Developing a business plan

A statement of practice direction has a likely timescale of three to five years at least. A business plan suggests the steps to be taken to realise that strategy and provides a basis against which to evaluate progress. A business plan is a more formal document of immediate goals to be taken in pursuit of the practice direction and may be required by lenders if a practice is seeking finance. It may also set out agreed plans, responsibilities and targets shared, or owned, by particular partners. There is no single format, although most banks now offer templates for the financial aspects of a plan. This section examines the common components likely to be found in a business plan, the basic budgetary and people requirements, and the monitoring process.

Common components

Common components of a business plan are likely to include:

- good accounting practices in respect of management control
- division of the business into components, by either service type or client segment (it is advisable to consider both, since success with one service for a particular client can often generate openings for other profit centres in a practice)
- measure of the current performance and profitability of each component
- financial performance target derived from practice direction
- identification of any investment requirements
- indication of allocated staff resource
- assessment of how sensitive the plans are to changes in the main forces that might affect those plans. This not only implies being ready for business not materialising, but also suggests planning for circumstances of greater than expected demand.

Good plans are also likely to be compatible with the structure of the firm. Some questions to aid in good planning are as follows:

- Do equity partner numbers ensure sufficient work procurement, department management, quality control and equity funding, while also ensuring sufficient returns for individual equity partners?
- Does the departmental/profit centre structure best reflect the product line/client/resourcing mix of the practice, thus maximising fee earning potential and optimising practice costs?
- Does the fee-earner structure best reflect the job requirements of each department/profit centre, optimising fee income against employment costs?
- Is the firm sufficiently supported by non-fee earning central functions, such as marketing and finance? Is the provision cost effective, inadequate or excessively costly?
- Are fee-earners sufficiently supported by direct support staff to enable their full effectiveness? Is the level of direct support inadequate or excessively costly?
- Are buildings and equipment owned, leased or rented? Would changing this mix improve practice value, operating profit or funding requirement?
- What is the mix of funding by partners' equity, retained profit or long/short term debt? In the current business environment, is the mix optimal in terms of risk, the tying up of partners' funds and debt costs?

Budgeting basics

Cash is the lifeblood of a practice, and numbers are the language in which a business plan proves or disproves itself. Until a business plan, for the next quarter, year or longer, is expressed as a budget it has not been completely tested for its feasibility. In other words, unless you are monitoring your expenditure and income against some form of budget, you will not know how well the practice is performing, or where and how management efforts should be directed. A budget is also the basic document where the sensitivity of the business to changed market conditions can be measured.

At its simplest the practice budget has only four components. The first component is the amount of resources available. This includes the mount of hours of potentially productive work that are available from the fee-earning staff or any associates in the firm. Then there is the cost of maintaining those resources, including a real or notional salary paid to partners, and the fees needed to be earned to cover those resources. Finally, the resulting margin or loss, if the fees expected are not generated, is considered. Whether the expected reward justifies the possible losses if the firm does not generate the income expected is an essential consideration of the budget plan.

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A normal budget is also expanded beyond these basic components so that managers can see how sensitive their profit and loss is to particular assumptions. It also considers the options managers have to reduce costs or increase financing when reality refuses to match their assumptions, and how much or little particular jobs or clients are contributing to the business.

The structure of a budget stays much the same and is shown in table 1. It starts with a forecast of earnings for the period concerned and the direct costs estimated to be incurred in realising those earnings. The resulting gross profit (which may be summed over several business lines) must also be sufficient to cover the overheads of the business to yield a net profit.

The people side of planning

In making your plans, you should consider the skills you are expecting, their development and the engagement of staff. This then assists partners in delivering the plan, which in turn promotes their involvement and effort. Their safety or exposure to hazards of various kinds must also be addressed, as should the manner in which measures will be perceived, keeping Goodhart's law in mind. Formulated in 1974 by the then chief economic advisor to the Bank of England, Charles Goodhart, it states that if an indicator is used to influence policy, its value as an indicator drops. Essentially, performance measures can often have unforeseen side effects.

Monitoring performance

Monitoring performance has two components: measuring present performance and improving for the future. 'What gets measured gets managed' may not be a slogan to everyone's taste, but the fact is that measuring focuses the mind. If you are not setting some targets to measure yourself against, how do you know how well you are doing? Some performance measures will focus people on the immediate term, and others on the longer term. No one has yet found a perfect blend of strategic and tactical performance indicators. One very useful balanced scorecard of performance assessment was created by David Maister, often cited as the guru of professional firm management, and is summarised by the acronym 'RULES'. This has become an industry standard for professional firms and is explained in-depth in the factsheet on Practice finance.

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Table 1: Structure of a budget

Item	£	Comments
Forecast earnings	**A**	May be a forecast professional time available multiplied by billing rate, or may be a projection based on an assessment of trading conditions
Direct expenses – Professional salaries – Associate fees – Other direct costs and expenses	**B**	May also need to be broken down by job type, client, office or area of the practice – Notional salary for partners – Fees payable on a per job basis – Other expenses only incurred if jobs are won and then charged directly to the particular job
Gross profit	**C = [A – B]**	
Overheads – Non-chargeable staff costs – Premises – Facilities services – Office equipment – Marketing – Telecommunications – Stationery, printing, etc. – Professional fees – Vehicles – Insurances – Practice development	**D**	How these are broken down depends in part on the practice; major items are shown – Excluding capital invested, if vehicles are owned – Training, quality assurance, improvement and any investment made out of operating budgets
Operating profit	**E = [C – D]**	
Finance – Finance costs – Depreciation – Interest – Dividends – Taxation	**F**	2.5 months
Net profit	**G = [E – F]**	**If partners' notional salaries have been included in direct costs to indicate the trading health of the firm, the notional figure should be added back in at this stage**