

Having the Right Firm Merger Mindset

A leading consultant explains how to take maximum advantage of current trends. **By Robert Fligel**

Although their dynamics are changing, demographics, recruitment, and retention are still the biggest factors affecting firm mergers and acquisitions. With regard to the demographics of partners, the upward age spiral continues. Recent statistics indicate more than 60 percent are over the age of 50 and close to 10 percent of all partners will retire in the next two to three years. Compounding this is the difficulty firms are having attracting and retaining quality staff. This alarming trend is why many firms consider merging up or selling. The first question that potential acquirers ask me is: "What level of staff is maintained by the target firm?" and, in multi-partner firms: "What is the partner age distribution?"

Continuing to Work

Many aging CPA firm partners and sole practitioners hope to remain active in their practices well into their sixties and even beyond, health permitting. There may be some truth to the pop slogan that 60 is the new 50, and so on. It may be fair to assume that a number of retirement-aged CPAs don't have significant outside interests to justify not wanting to keep working. Since they are working longer, many of the most desirable merger and acquisition deals reflect a willingness of the acquiring firm to allow productive partners to continue well past a normal retirement age.

Not Just Retirement-Minded

Years ago, the motivation of the vast majority of firm mergers related closely to the age and succession issues of the smaller firm. However, more firms now are considering an upstream merger as a means to grow better and faster. These tend to be multi-partner firms with an acceptable dispersion of ages within the partner ranks. Some of the perceived drivers are improved ability to recruit in a larger firm; pace and status of technology investment; regulatory demands of the profession; a desire to provide a broader range of client services; and the ability to achieve meaningful economies of scale.

The firms that will become long-term players are having these types of discussions at their partner meetings and asking the question: "Should we consider merging up or embark on an acquisition strategy?"



Boom Times End

All CPA firms that I know are generating the most revenue that their capacity will allow. Most could earn considerably more if they had more staff. Many say that they don't have time to offer other services that their competitors provide and that their clients might want. These boom times can be attributed to a long-lasting

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robust economy, increased need for services based on regulatory issues like those raised by Sarbanes-Oxley, trickle down work, and the ability of CPAs to roll out new services such as personal financial planning and investment management. I suspect that valuations will be going down eventually as more firms realize they have to sell or merge.

Many Don't Close

In most cases, merger discussions either shouldn't have commenced in earnest or should have terminated earlier because of deal breakers. These can include: incompatibility of professional practice philosophies; lack of personal chemistry among the partners; significantly different compensation models and/or profitability; and inflexibility on key issues such as equity, compensation, or management.

Merger and acquisition meetings are incredibly time consuming and can be

emotionally draining. There is also the concern of word "getting out." The point to consider is that with a little more upfront discussion and an earlier focus on deal breaker issues, the process can become much more productive. It would also be wise to consider a managed approach in the correct order with the help of an experienced intermediary to arrive at the right decision sooner.

Don't Focus on Multiple

It becomes all too easy to focus on the price of the deal as a percentage of the most recent revenues. As almost every CPA knows, except in the rarest of circumstances, the agreed-upon price isn't the final price.

The multiple, or percentage of revenues, is a subjective number based on such factors as the profitability of the transaction to the buyer; the degree of synergy between the firms; the terms of the deal as the longer the payout period; the lower the

price or multiple; client or industry concentrations; and recurrence of revenues.

The most successful deals are those which exhibit a compelling synergy between the two firms. In those cases, the seller typically ends up receiving much more than the nominal negotiated price of the transaction because of additional services offered to the seller's clients and higher seller profitability due to leveraging lower-level staff post merger.

The Real Obstacles

There can be significant pitfalls that should be of concern. The first is lack of personal chemistry. Notwithstanding the appeal of the combination on paper and in the wallet, a good merger can't happen without chemistry. If you have concerns about the idea of a day-to-day relationship, walk away.

It is also easy to get caught up in emotional issues. It may be great to double in size or add a new location or spe-

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cialty, but does that by itself really make for a good merger? Work hard to separate fact from emotion.

Then there is the problem of incompatible philosophies. If you're not on the same page regarding client service issues, approach to tax, other technical issues, or business ethics, forget about it.

A merger focusing only on dollars or succession won't last. A mutual interest in location, industry, growth strategies, and other areas is necessary. There must be an ability to provide added value for staff and clients. They need to feel something special.

From an execution standpoint, an obstacle can be the lack of an agreement on merger details before the attorney starts drafting. I advise executing a signed letter of

intent before bringing in the attorneys. This will save much time, money and frustration. Finally, lack of a detailed transition plan can also adversely affect a merger.

The Unspoken Concerns

Many avoid firm succession planning. They don't want to give up control, and be "managed." This is a very valid concern. Someone is going to be the new firm leader and that simply has to be accepted. The right merger partner will be very good at smoothing the transition.

There also is a belief that the right fit won't be found. Most likely that's a smokescreen indicating a lack of preparation or motivation as is the claim of not enough time. Although more money might be made in the short-term by not selling, what often happens is a crisis like death or disability results in an unfavorable disposal of the practice. Ultimately, the fear of change may be the number one deterrent.

Living With Status Quo

These are great times for the public accounting profession. The need for existing and new services is strong. Public respect is solid for the "trusted advisor." However, this is also when a significant number of firms should be actively considering whether to merge, sell, or grow via acquisition. Forward-thinking firms will survive and thrive. Firms operating at the status-quo level will begin to shrink, experience significant partner and staff attrition, and ultimately will sell at a reduced price or cease to exist.

Which firm is yours? **PA**

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➤ For related material, see "Tried and True Blueprint for a Firm Merger" in the November 2006 issue of Practical Accountant at practicalaccountant.com. See also "Your Firm" channel at webcpa.com.

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