

Considering a Merger? How's Your Ego?

CPAs planning for a successful future always consider and reconsider various growth opportunities, and never before in the history of the profession have there been so many of them available. One very popular method of expanding a firm is acquiring or merging with another CPA firm. Mergers and acquisitions, when successful, can, among other things, help your firm stay ahead of the technology curve, attract top-notch staff and, of course, expand your client base. If you are considering a merger, or if you are just interested in knowing what the options are, be sure you first understand the changes and the potential in your marketplace and, most important, find the perfect partner.

Adapting to the new environment

New technology has eliminated or altered many of the traditional accounting services. In the course of one generation, most traditional write-up functions provided by CPAs have disappeared—new cash registers compute sales tax and perform inventory control, and mass-merchandized software and outside service companies can do company payrolls. Pundits predict that most individuals will be doing their own tax returns on their PCs and filing them electronically by 2006. To help offset anticipated revenue loss, you should consider merging with practices or practitioners that will bring new niches and specialties to your firm.

Multi-discipline consolidation. Public and private companies have entered the marketplace to compete for accounting clients. Financial services corporations, such as American Express Small Business Services and HRB Business Services are buying up CPA firms and offering their customers one-stop shopping that includes accounting, tax preparation, financial planning, investment planning, business consulting and insurance. Banks and brokerage firms are readying themselves to enter the market as well.

Many CPA firms have decided to merge or associate with other firms to be able to compete with these newcomers. Others are merging simply to provide their client base with competitive services. Merging with practices, individuals and/or businesses

with expertise in the desired growth areas can be far faster and less expensive than attempting to train and develop your current staff.

Finding the best staff. The talent pool in public accounting is limited. Many CPAs have left public accounting to work for private companies offering alternative work arrangements and, sometimes, higher pay. Practitioners often merge their firms with other CPA firms to augment their staff and be able to offer talented young CPAs jobs at more competitive salaries. Others seek mergers to attract professionals with special accounting, tax and technology expertise. They want to increase the value of their practices by generating new revenues from existing clients. Many firms expect to retain talented staff members by affiliating themselves with other regional firms. Smaller firms may decide on a merger because they've "hit the wall" and no longer have the capacity to generate additional revenues.

Exit strategies. Some CPAs are considering mergers simply to fund their retirement. These firms often lack adequately funded retirement plans and senior partners may not feel their retirement income is assured, especially if younger staff members are not willing to accept the responsibility of being co-owners. Successful succession plans, however, must be designed early—considerable time is required to phase in a successor. This goal also can be accomplished by merging with a successor.

Finding the perfect match

Establishing the right merger partner is absolutely essential. First and foremost, there must be the right chemistry between the firms. The firm cultures and egos must be complementary in order for the partners to operate as a team. If the parties to a prospective merger don't feel comfortable with each other, the merger should be canceled.

Culture. All practices exhibit unique firm cultures that include how the firm does business, its personnel policies and its fundamental attitudes. Firm culture issues can include employee benefits, vacation policies, dress codes, recordkeeping, organization and how different departments and staff communicate and what they expect from each other. For example, staff at different levels may account for their hours differently—even lunch breaks may be handled in a different

way from one firm to another.

CPAs can ensure merging firms agree on culture issues by thorough candid dialogue early in the negotiation process. Review each other's employee handbook or guidelines and ask probing questions. The partners should have some of these preliminary meetings at the offices and during social engagements. Prior to the actual merger but after the numbers have been worked out, spend some time observing the day-to-day activities of each other's practices. You can do so on a per diem basis or as a consultant in the beginning to maintain confidentiality.

Ego. The egos of the partners play a significant role in any merger. They will have an impact on the name of the new firm, the titles, the order of names on the letterhead, compensation, office accommodations and, most important, control.

Retiring practitioners, in particular, will have some ego problems. Remember, for them, a merger is bound to be an emotional experience. The retiree may not believe the firm can retain his or her clients. However, in a proper transition, the client is more likely to stay with the firm, rather than start over with a complete stranger. Retiring practitioners, therefore, must get other partners involved with their clients. They will have to let go and pass the torch to others to ensure the firm is prepared for their retirement. Although this can be done gradually, the successful long-term retention of the client base depends on an efficient and tactful transition.

All succession plans should clearly express who the next managing partner will be. This typically is based on equity or on a vote from the board of directors or all remaining partners. Knowing who will be filling what role before the managing partner retires will help your transition plans. Also, never force your client to jump from one partner to another over a short period of time.

Match talents

Once good chemistry is established, the next step is to analyze the firms to judge how the various strengths and talents complement or bring added value to the merger. Such a review should include, for example, how the productivity, billing rates and earning power match.

What services do each of the firms offer in common and more important, what services provided by one firm are new to the other. Review not only how but where work gets done. For example, some firms work at the client's place of business or at his or her Home. How are billing and collections accomplished? What kind of growth rate is each firm enjoying? What is the retention rate for staff? These are but a few of the areas that require due diligence.

It is important to make certain that client satisfaction is equal for both firms. This can be determined by reviewing the client retention rate. Some firms take random telephone polls of their clients to verify the level of satisfaction with the firm's services. When communicating news of the merger to clients, CPAs should assure their clients that the firm will maintain its continuity.

Assuring continuity. It's a good idea to keep the merged offices geographically near the client, even if it requires, in some cases, maintaining a satellite office. The same fee structure should be used at first; necessary changes to satisfy the merger can be made slowly. Staff members with whom the client is most comfortable working should continue to be used. Finally, clients should be serviced in the manner to which they have become accustomed. For example, if a client is used to having a principal come to his or her office every quarter, that client will probably be upset if the new firm sends a junior to handle the business.

The "de-merger" clause

It is surprising to see how little time is devoted to negotiating "divorce clauses" for mergers. Parties spend a lot of time reviewing how a merger is to function when it is successful, but are rarely prepared when the merger is failing. This is a major mistake unless the primary purpose of the merger is to provide an exit strategy for one of the merging firms—an exiting partner does not generally need a de-merger clause.

De-merger clauses are usually very complicated—it is very difficult and tricky to be in the process of merging two firms, then stop in the middle and retransition the clients to yet another situation at a later date. De-merger clauses should include information on the division of staff, original clients, new clients developed post merger, equipment and how restrictive covenants, leases and the name of the firms will be treated.

Also, de-merger clauses must have a "back date" by which they must be utilized. A typical back date will be one to three years from the effective date of the merger. It is unreasonable and frequently impossible to "de-merge" after a certain period of time has elapsed. Once the back date has been exceeded, if a partner wishes to leave, he or she will have to be "bought out" in accordance with whatever provisions are in the partnership agreement.

Don't be overwhelmed by the merger process. Mergers and acquisitions that are properly thought out and structured are a viable way to accomplish many different personal and professional goals. Before you take the plunge, seek out a specialized consultant or an attorney who has experience with accounting practice mergers. You also should speak with your peers who have successfully merged with another firm.

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