

Roles Of Partners, Equity And Compensation Stand Among The Top Considerations When Mergers Serve As Succession Solution

Succession planning is one of the most urgent issues facing accounting firms today. While firms often look for internal solutions to succession, mergers and acquisitions are alternative solutions. Terrence Putney and Joel Sinkin, senior partners at Accounting Transition Advisors, have advised on more than 700 accounting firm mergers and acquisitions. Here they answer some of the most frequently asked questions about mergers as a succession solution.

Expert Q&A

Q: When should a firm consider a merger to accomplish succession?

A: When firms can't replace the production or role of retiring partners internally, the need to seek an external solution becomes clear. External solutions include:

- Merging with smaller or similar size firms to strengthen the partner team and position long-term internal succession options;
- Merging with a larger firm to provide senior partners with the means to retire and younger partners with more long-term career options;
- Selling to another firm as an immediate solution. This option becomes more limited as a firm's size and number of partners increases.

Q: What are the keys things to consider in evaluating a firm to merge into?

A: Consider all of the following:

- *Ability to provide the resources needed by the firm seeking a succession solution.* Does the successor firm have the capacity and specialties required to replace



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the retiring partners? Does it have the expertise clients need? Does it offer the services existing clients require? Can it find necessary staff? Is leadership for the firm in place?

- *Chemistry between the partner groups.* If you don't want to eat lunch with someone, don't merge with them. Many partners invest more time with their co-workers and partners than their spouses. Mergers that fail frequently are the result of chemistry problems rather than business issues. Chemistry also affects client and staff retention.



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- *Partner compensation.* Rarely will the remaining partners of the "selling firm" be willing to take pay cuts, and firms often don't want to merge in a practice where the new partners make considerably more than the successor firm's partners. The key is whether the merger will improve profitability for everyone and make the successor firm stronger. Everyone may be willing to bite the bullet on compensation differences to increase long-term profitability.

- *Operational plan and partner roles.* Address the basics of the operational plan early in discussions. Stumbling blocks include location, billing rates, name of the combined firm, and approaches to client service. Partner roles should be specifically defined. Determine each firm's expectations for productive hours and duties by individual partner (or type of partner in mergers involving larger firms).

Q: What equity and compensation factors should we consider?

A: Creative options for partner compensation and equity are un-limited. Keep the following in mind when addressing these issues in a merger:

- *Significant differences in partner pay may indicate that the firms may not make a good fit as merger partners.* Don't be afraid to investigate the underlying reason for the difference. Performance-based systems can often be used to allocate ongoing differences.

- *Don't expect either side to take a pay cut.* Leveling compensation so the partners get along better is not a sustainable long-term solution.

- *Opt for simplicity and predictability in compensation for partners who are merged in.* Subjective criteria to determine compensation allocations depend on trust. There is not a sufficient basis for that trust with new partners.

- *Buying out a retiring partner should coincide with an adjustment in compensation.* Consider delaying the buy-out of retiring partners who want to continue to work if an appropriate adjustment in their compensation is not acceptable.

- *Avoid compensation formulas that maintain the identity between merging groups.* Compensation based on post-merger performance should be based on individual performance metrics to avoid perpetuating silos.

- *Include representation from both legacy firms on compensation committees.*

Q: What should a firm do to protect itself in case a merger doesn't work out?

A: Merger agreements should contain de-merger clauses. No matter how much "dating" two firms do or how exhaustive the due diligence is, you never know how well a deal works until people are in the trenches together. Triggering a de-merger option should be a worst-case scenario, and the agreement should discourage either party from being too hasty. But if the combination is not sustainable, there should be ways to limit the damage. Important components of a de-merger clause are:

- *Who keeps the clients?* Which firm is entitled to clients acquired after the merger? What if a client insists on staying with the firm that didn't originate the business? Use penalties to discourage proactive attempts to keep the other side's clients.

- *Space and resources.* How will space and resources be divided in a divorce? What are the time frames and cost allocations?

- *Staffing.* Use penalties for swiping the other firm's staff, perhaps based on a typical recruitment fee, which runs 15% to 25% of annual compensation.

Q: What are the keys to successfully using mergers for succession?

A: The most successful deals have the following characteristics:

- *Continuity.* Staff and clients have a comfort level with their firm. Change is scary. Make sure that perceptible changes are gradual and explained well to ensure maximum retention. Assure staff and clients that the ship is sailing in the same direction. Deals should emphasize the gain of the successor firm, not the loss of the predecessor.

- *Communication:* Communicate with clients, staff, partners and former partners of each firm. Former partners are important ambassadors for the combined firm. It is also important for any retiring partners to remember that they are no longer the primary decisionmakers. They should provide advice and support, not demands.

- *Planning in advance.* Too many firms merge and then create a transition plan. Prior to merging, a complete plan should be created. Who gets a phone call, a visit, a letter? What should the announcement letter say? Some retiring partners have trouble letting go. Make sure the transition plan is specific and complete to help retiring partners mentally prepare and overcome one of the most difficult aspects of creating a successful transition plan.

Accounting Transition Advisors consults exclusively on the merger and acquisition of accounting practices. Terrence Putney and Joel Sinkin can be reached at 866-279-8550; jsinkin@transitionadvisors.com, or visit www.transitionadvisors.com. ■