FREE Report

Nine Strategies for Multi-Partner Firms Considering a Merger or Acquisition

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Leading CPAs Through Transition With Succession and M & A Strategies

A firm with multiple partners should consider several vitally important items when developing an expansion plan that involves mergers or acquisitions of accounting practices. Below are nine key things to initially keep in mind.

1. Identify and Document Your Objectives

Many firms are persistently in search of firms to acquire or merge in. Often the managing partner is assigned or assumes the task of executing this strategy. Even if the firm's objectives for this strategy have been clearly articulated at the senior management level, the rationale for this type of expansion may not have been communicated to all the partners in the firm. Proper execution of an expansion plan is difficult unless all the persons involved in the merger or acquisition and those responsible for managing the post-acquisition business plan know what the firm's objectives are.

You can create better outcomes if you document the firm's objectives and circulate the documentation amongst key management personnel. Normally the distribution list should include all the partners in the firm and other key management personnel.

There can be several reasons why you might pursue expansion through mergers and acquisitions. The most common are:

- Acquire or expand niche services offerings
- Enter new geographic markets or expand the firm's presence into additional offices in an existing geographic market
- Create momentum to spur organic growth
- Absorb excess capacity or create fixed overhead cost synergies
- Expand the overall client base to create a larger demand market for specialized service offerings
- Improve the firm's brand through an increase in market share
- Increase profitability by taking advantage of the return on investment that is normally built into most acquisition transactions
- Address concerns for the internal succession needs through the acquisition of potential new leadership

For example, let's say your objective is to create or improve niche service offerings. If you have clearly articulated that objective to both the leaders of the firm you are targeting and your existing partners:

- Your due diligence will be more on-point
- Benchmarks you are using to evaluate the opportunity will be appropriate
- Post acquisition execution of the business plan has a better chance of succeeding

Developing an expansion strategy in a collaborative manner that includes a complete analysis of your firm's goals and objectives gives you a better chance to capture alternative opportunities.

2. Make a Thorough Analysis of Target Firms in the Market

Many firms believe they are aware of all the firms that meet their criteria and they rely on this inside knowledge to develop target firm databases. The larger the market you are targeting, the more likely there will be firms that are below your radar screen that maybe worth investigating. No external database is 100% accurate and the data you need to

make the evaluation against your benchmarks, such as revenues and employees can be faulty. It is normally best to use several sources and tactics to establish market intelligence.

If a firm has a poor reputation in your market or one that is inconsistent with your values, no amount of additional information can overcome those perceptions. However, assumptions about other information such as types of clients and services you have developed without direct investigation can lead to erroneous conclusions. You should consider going through with interviews and other means to validate criteria used to evaluate candidates.

3. Due Diligence Should Cover Business As Well As Financial Risk

Typical due diligence procedures usually are designed to assess financial risks and standard accounting industry performance benchmarks. Aspects of performance such as quality and productivity obviously should be reviewed.
There are two areas of risk that are often overlooked in due diligence: key assumptions in the business plan and operational elements of specialized service lines.

Unless the merger or acquisition is a standard one that will not materially affect your existing operations, you should prepare a financial model that analyzes the business case supporting the plan. There is always risk that key assumptions will not materialize. Due diligence should address the key assumptions you are making in the business plan.

Operational risk is much greater than normal when your firm is acquiring a specialized service line that it does not have prior experience with. You should have a complete understanding of the new target markets, competition, and key operational success factors. Consider obtaining outside expertise to assist in the due diligence process. Otherwise, you may be relying on the acquisition candidate firm for that expertise.

4. Manage Risk Through Incentives in the Deal

You cannot buy and sell people. You also cannot assure a person or a group will behave the way you assumed they would when you prepared the assumptions that supported the business case for the merger or acquisition. This applies to the clients of the firm you acquire, the partners that remain after the transaction, and other personnel. The terms of the deal should normally include incentives for the people of the firm you acquire that have responsibility for execution of key aspects of the business plan. Normally these incentives will apply to the acquired firm's partners. Sometimes non-owners are key to the success of the business plan and need to be recognized in the incentives as well.

Risk should be addressed in the value of the deal. There are two ways to do this. One approach is to discount the deal to recognize unusual risk. If there is a sizable concentration of clients in a volatile industry segment, there is normally additional risk that the business will not be retained. Because a valuation should reflect future cash flow, a discount is normally appropriate compared to a more stable client segment. The other approach is to use contingent terms such as earn out or collection deals. This is the basis for variable terms using future client retention as the means for determining value.

Contingent transaction terms have the advantage of creating incentives and mitigating risk. Usually the acquired firm's partners are in the best position to mitigate operational risk such as client and employee retention. The potential value of the contingent portion of the deal can provide the currency for the incentives as well as protect the acquiring firm's investment. This concept can apply to a merger as well as an acquisition. A look-back provision in a merger that adjusts the relative valuation of the acquired firm due to post merger performance problems can be an effective tool to mitigate risk.

5. Time Kills All Deals

If all the parties are aware of the goal and purpose of the affiliation, it should not take more than four to eight weeks to come to an oral agreement in an acquisition, or a merger of unequals, and shortly thereafter have all the documentation completed as well. The longer the negotiations the more likely bad things can happen:

• Staff and or clients may find out what is going on and feel nervous about their security and start making plans to leave the firm.

• The longer two firms negotiate the more adversarial it can get. It is very hard to consummate a deal with an adversary. If it does become contentious and the deal still closes, it can have negative ramifications later.

A merger of equals will often be more drawn out because the resulting business plan is more complicated to work out. Often new agreements such as partner compensation and partner retirement have to be addressed in a merger of equals whereas the dominant firm's policies and agreements frequently are used in a merger of unequals.

6. Reach a Complete Agreement Before You Close the Deal

You cannot and should not work out all the minute operational details of the post-acquisition business plan during negotiations. However, all key operational assumptions need to be addressed. If an item does come up and you have difficulty reaching a resolution, do not fall into the trap of agreeing to agree later. It will not be easier to resolve it after the transaction. An inability to reach an agreement may be an indication the deal shouldn't be done.

Key operational assumptions fall into two categories. Those are:

• The items the parties need to know to understand the risks they are assuming. These normally include any contingent or formula-based transaction terms such as collection of accounts receivable, treatment of WIP, and assumption of liabilities.

• The things the individuals need to know to do their jobs in accordance with the business plan. These include job descriptions, compensation methods, brand names, facilities, transitional strategies for staff and clients, and modifications in client service and management.

The best agreements are in writing. Your merger or acquisition agreement will obviously be written. Put other important business plan items and commitments in writing as well to avoid future misunderstandings.

7. Create a Proper Transition Strategy

You and the other firm will agree that you have merged your client lists and that your employees will work for the successor firm. However, the clients and staff have to decide to stay in order to make this work. Experience tells us they will stay if the proper transition plan is implemented. It starts with how the change is communicated.

Clearly, the clients liked the way they have been serviced by their original firm. They have come to expect certain procedures, fee schedules, staff and many other items they grew accustomed to. The staff likes where they are working, their firm's policies and procedures, and culture. There isn't any reason that their experience with the successor firm should be less gratifying than their previous experience. If it will be, you may be merging with the wrong firm because your cultures may be too dissimilar.

Do not assume the clients and staff will automatically determine that the new environment will be as good or better without specific information. It is more likely they will have reservations than excitement. It is important to be very clear about new policies and procedures and not leave people to fill in the blanks for themselves. The key to a proper transition plan is emphasizing what the clients and staff will gain with the new successor firm, not what they might perceive they will lose of the old.

The outcome of a transition plan can hinge on the minutest details. Which firm's envelope is used to send the letter notifying clients of the change can make a difference in ensuring the clients open it. The appropriate transitional strategies will help make the deal work for clients and staff which is the foundation of a successful merger.

Develop a plan for governance of the merged firm that is fair but also effective. Make sure you aren't creating an environment that will lead to gridlock. You should have a specific governance system spelled out in the merger document, including naming people to specific positions. You should also have identified a means for modifying the leadership team if it isn't effective.

8. Plan for a Worst Case Scenario

Make sure you have a pre-nuptial agreement or de-merger clause (unless your deal is for a short term succession of all the owners). Most firms spend all their time figuring out how the merger will work based on the single premise it WILL work. What if 6 months later the merger is a failure? Have a way of de-merging spelled out in advance. In the event there is a need to dissolve a merger, there are enough difficulties without having to come up with a plan to de-merge. Draft in advance and be sure to include things relating to each firm's original clients, new clients that come in after the merger, clients who insist on staying with the other firm, staff, facilities, and technology.

Make sure your plan is realistic. Both firms will have made significant investments in the combined operations. Unless the successor firm is still operating in the original facilities of both firms with essentially all the same staff and clients as before, the break up can be expensive (although necessary if it truly isn't working).

9. Find Expert and Experienced Help

In acquiring an accounting practice, there are a voluminous amount of things to be worked out including valuing the practice, structuring the deal, what to review in due diligence, and documentation of the deal. Even if your firm has undertaken many mergers or acquisitions in the past, using a professional who has years of experience specific to accounting practice mergers and acquisitions, can be very helpful. The advantages of outside expertise include:

• Assisting in developing and documenting an expansion strategy using mergers and acquisitions

• Providing data regarding target markets

• Communicating with target firms anonymously in the initial solicitation

• Identifying practices that fall below the traditional radar screen

• Assistance in the structure and terms of the transaction by providing insights into the other party's motivations

• Assistance with the design of due diligence programs

• Insights into transition strategies

Should you have any questions or comments, please feel free to call us directly (866–279–8550 toll free) or e-mail us at one of the addresses below.

If you want to find out more about how to start or execute the merger and acquisition process for your firm, we will provide a free consultation.

Go to our Web site www.transitionadvisors.com and view articles for more information on buying, selling, and merging accounting firms.

Since 1990, Joel L. Sinkin has exclusively provided merger, acquisition, and succession plan consulting to accountants nationwide. He has personally been involved in closing over 650 such transactions. He is the co-author of *Guide to Buying and Merging CPA Firms* published by Practitioners Publishing Company. He is a frequent speaker at national accounting conferences and has been an instructor in dozens of CPE courses. He has been

published in *Sum News* (Massachusetts Society of CPAs), *The New York State CPA Journal, Insight* (Illinois CPA Society), and *TAXPRO Quarterly,* the AICPA's *The Practicing CPA,* and he is frequently quoted in local and national mediums. His article, *Price Equals Value Plus Terms,* is featured in the December, 2004 issue of the *Journal of Accountancy.*

Joel believes that the needs of the parties in every merger and acquisition are unique and successful execution requires a thorough understanding of each party's objectives. The chemistry between the partners in the two firms is a key component to making the deal work. "A good deal is a fair deal. I also believe it's beneficial to both parties for retiring practitioners to transition at a pace that meets their clients' needs and is consistent with their personal plans. The best deals are win-win propositions."

Terrence E. Putney CPA has over 25 years' experience in the CPA profession. For six years, he was Managing Director-Mergers and Acquisitions for RSM McGladrey, the fifth largest accounting firm nationally, and held several executive positions with its corporate parent. He structured and negotiated many transactions resulting in the acquisition of accounting and consulting firms ranging in size from $200,000 to $30 million. Prior to joining McGladrey, Terry was the Managing Partner of Donnelly Meiners Jordan Kline, a 60-person CPA firm in Kansas City.

Terry thinks it is imperative that practitioners have a clear understanding of their objectives when pursuing a sale of their practice or the merger with or acquisition of another practice. "I've seen deals not work or not materialize because one of the parties to the succession plan had not thought through what they really wanted to accomplish. Accounting Transition Advisors will make sure the approach to executing your plan will meet your objectives. Because we are consultants and not brokers, we can be much more flexible in helping a firm succeed with its transition plan."

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