The Impact of Technology on Firm M&A

Technology has emerged as one of the biggest issues surrounding the mergers and acquisitions of CPA firms. Not only is it a key concern when assessing the future success of firm affiliations, it is also increasingly driving firms to seek mergers. One of today's key criteria in determining a good "fit" when evaluating a potential M&A partner is their technology culture. The IT cultures of both the buyer and seller firms can and will heavily influence the success of a deal.

<u>What Our Clients Are Telling Us</u>

As an example, if a seller firm's staff and owners are using cloud technology, the staff will likely be accustomed to working remotely at least part of the time. If the buyer firm remains constrained with an outdated IT platform and resistant to embrace such 21st century strategies such as multiple screens and client portals, the post-merger integration process will likely suffer as a result. Very few mergers will be considered successful if most of the acquired firm's clients aren't retained. Drastic changes in the client experience can have significant impact on retention unless they are introduced gradually. Recently, we were working with a Top100 firm who was in the process of deciding which of two candidates with similar revenues would make a better merger partner. Firm A had impressive metrics – i.e. good client retention, realization rates and high net income per partner. Firm B had average metrics but had a robust IT platform and made significant investments in technology. The owner of the buyer firm chose Firm B because he knew that the metrics could be improved, but the effort to convince the owners of Firm A to make the required investment in time learning the new technology and convert to a paperless culture would not be worth the effort. He said "I can make them more profitable but can't make them throw out the paper!"

The IT Impact on Metrics and Profit

When optimized properly technology tends to lead to higher productivity and often to higher revenue per partner. Billing rates can be increased because of the higher productivity of the staff. However, in many cases the profit margins may be lower due not only to the technology investment, but also the higher leverage. However, a lower profit margin doesn't necessarily mean lower profitability. As with most highly leveraged firms, even though the margin is lower, it is applied to higher revenue per partner which should result in a higher net income per partner. If a target merger firm is willing to embrace a move to a richer technology environment, the potential for improved profitability can be significant. As cited in the example above, we have often witnessed acquiring firms retreat from potential candidates who are lagging in technology due to the sizeable upfront investment often required to get them up to speed.

Impetus to Pursue a Merger

In todays' M&A landscape, technology serves as a two-fold M&A driver – first for the growth potential to a firm offering IT consulting and the other to address the future impact that technology advances such as blockchain and artificial intelligence will have on the way CPA firms operate. Experts have predicted that emerging technologies not only will automate operations such as audits, but will force firms to move away from what is known as Type A work to evolve to more of a consulting role – i.e. becoming proactive as opposed to reactive with regard to client services.

We are now seeing firms that have historically considered themselves in a strong competitive position rethink if they will be able to compete with their larger peers down the road due to their inability to make what may become a necessary investment in technology. Many are considering combining forces with larger firms to overcome this threat. For smaller firms, the need to invest in new technology as the owners near retirement has always been motivation to seek a merger as way to avoid that cost.

At the same time we are increasingly seeing firms specifically target practices for M&A that offer specialized IT consulting such as cybersecurity, stress audits, forensics and disaster recovery services.

Making Your Firm More Attractive

A common question we're often asked is "what can I do to make my firm more attractive as a merger candidate?"

The common wisdom is that your house never looks better than before you decide to put it on the market. The same can apply to CPA firms. While there are myriad ways of sprucing up a firm cosmetically (i.e. bright and cheery décor, clean carpets and cubicles), many times it's the internal component that sells firms and one major point of differentiation is technology. Does your firm have a 21st century IT culture, or are there literal skyscrapers of papers piled up with your staff still working off one screen? Do your current applications allow staff to work remotely? Because with the changing workforce demographic, younger workers will expect this option and not view it as an employee perk.