MERGER MANIA -- WHAT YOU NEED TO KNOW

It seems that you can’t pick up a newspaper today without reading about a merger of national, regional or local firms.

If you are a partner in a CPA firm that is contemplating a merger, you are about to enter into an extremely risky venture. This article will help you to lessen your risk and give you a better chance of having a successful merger.

“Does this make sense for me?”

Merging your practice or selling it to another firm is a major rite of passage. It is fraught with emotions that run from extreme excitement to deadly fear. A merger or acquisition makes sense only if you know what you want to achieve. No one else can answer the above question for you; only you can answer that question. Let’s look at some reasons why firms merge.

1. Increase size should improve the profitability of the combined practices. You may not see it the first year, but partner incomes should have the potential to increase because of economies of scale, new services or skills acquired through the merger, leverage of people, etc.
2. Need for special talent. From all indications, there will be a human resource shortage for some time to come. If you can’t find the talent you are looking for in the market place, then you might just have to go out and acquire it.
3. Entering new markets. There is no doubt that the easiest way to enter a new market is by acquiring a local practice. This is especially true for the small to mid-size firm since “client relationships” are the foundation and backbone of any practice. If you go into a market for the first time by yourself, it will take significant resources and time to develop those relationships. If you acquire a firm in a market, you are also acquiring the relationship provided that the partners and key staff of the acquired firm remain.
4. Gaining market share. There are two ways to acquire market share. One, you compete head on with your competition through marketing and client service. Two, you acquire your competitors and their corresponding market share. In many cases, the second approach is quicker and less expensive.
5. Succession planning. An acquisition or divestiture may be a way to achieve a smooth passage to the next generation of owners. Many firms have ignored the fact that sooner or later they will have to face the issue of succession. Since most firms have not funded future buyouts there exists a lot of fear about how this will
happen. Merging with a firm that has a substantial number of younger partners may be a solution to this problem.

6. Access to capital. A merger or a sale to a larger entity can bring the needed capital into the firm. With the ever-increasing cost of technology and training, having access to capital can often help the firm become more competitive in their market.

There are probably several other reasons to merge, but the above six seem to be predominant.

A word of warning: Before you start down the merger path make sure that the key partners in your firm are in agreement. Mergers do change the dynamics of any firm in many different ways and any change will be looked upon with some degree of fear and perhaps mistrust. It’s also a good idea to make sure that the partners agree upon the type of merger candidate. For example, if you are a $10 million firm, should you be spending time chasing a sole practitioner with $250,000 in volume?

Who do I want to merge with?

Get your pencil and paper out and start identifying the ideal merger candidate based on your primary reasons for seeking a merger. Here are some basic parameters you will want to identify:

1. Size. How large or how small of a firm should you be looking for? Firms that are too small may not have the same quality as your firm. Firms that are too large may be more interested in acquiring you.
2. Service Mix. This could be one of the major criterions. For example, are you looking to become stronger in your existing niches or are you trying to expand into new niche markets?
3. Client Type and Size. If you do no SEC work, will you feel comfortable with the added exposure if you acquire a firm that has a hand full of SEC clients? If your average fees per client is $10,000, how well will you firm with one that services clients with average fees of $3,000?
4. Billing Rates. There are times when you can acquire a firm that has lower billing rate than your firm has and move that billing rate up the ladder. However, be careful when you come across a firm that is similar in size and make up to yours but has substantially lower billing rates. It may make sense to do the merger, but just make sure you totally understand what is driving the differences.
5. Location. Will you want to have two locations or will you even need two? Is the firm in a location where you want to be or are they willing to relocate to your office? Do you have the capacity to absorb the new practice?
6. Client Service. Unless you and the candidate firm both have done client satisfaction surveys for the past few years, you may have difficulty determining the level of client service. You will want to make sure that the candidate firm has the same or similar client service philosophy that your firm has. If one firm operates like a revolving door and the other doesn’t, there will be some philosophical issues. Don’t be afraid to ask to talk with clients.
7. **Billings and Collection.** Nothing can cause more problems after an acquisition is completed than a discord in this area. It is critical that both firms have similar billing philosophies.

8. **Firm Culture.** Do you have a 9 to 5 culture and the acquired firm works form sunrise to sunset? Does your firm operate with an open door policy and the other firm with a closed-door policy? Just make sure that your values and their values are compatible.

9. **Profitability.** Last, but not least, make sure that the profitability of your target firm falls in an acceptable range. You may be able to improve the profitability of the acquired firm if you have the management talent. But remember that their clients are used to paying a certain amount and you won’t change that overnight.

**How do I know when I found the right candidate?**

Knowing that this is the firm you want to merge with consists of some science, some art and some gut feeling. Here are some traits you will want to find in your merger candidates.

1. **Client Service Handler.** In the long run the most successful firms are those that can hold on to their clients. The longer a client stays with a firm, the more profitable it usually becomes for the firm. You will want to determine how effective each partner is in keeping clients and expanding services to their client base. Always be cautious when you see a lot of client turnover.

2. **Business Development Skills.** Building an accounting practice is a skill that few possess. If you can find a candidate or firm that has business development skills, think twice before you decide this is not the firm for you. The key, of course, is that the new business is profitable business.

3. **Look for winners.** As you know there are winners and losers and sometimes the only difference between them is their perspective. For example, a loser sees a sand trap between each hole on the golf course, while the winner sees a hole between each sand trap. Winners inspire and motivate others; losers sap their energies. Finding winners for your firm can add the needed boost to your firm’s energy and vision.

4. **Value added services.** In today’s market clients are looking for the services that make them more profitable. The merger candidate that brings these types of services will bring an added value to your firm.

5. **Economics.** Unless the merger makes economic sense, you probably wouldn’t do it. Pro forma income statements on the combined practices will show what the new firm will be able to do top line and bottom. They will also identify areas of consolidation that will need to be agreed upon prior to completing any merger.

**Make the hard calls first**

Perhaps the biggest mistake that you can make is to wait until later in the process to make some hard decisions. The sooner you can address “deal breaker” issues the more
likely your merger will be successful. Let’s look at some of the “deal breaker” issues that are likely to arise.

1. Will all the partners come across in the merger? There is little doubt that you will find at least one partner who won’t fit into the new firm. It may be culture or it may be productivity. Whatever it is, make sure you identify and resolve it before the merger takes place. It may be hard to do, but it will be harder later on.

2. Will all the staff be hired? There will certainly be some duplication of positions. You won’t need two receptionists if you are consolidating into one office. Will you need two firm administrators, IT administrators, and so forth? The same decisions will have to be made with professional staff. Depending on the acquired firm’s utilization of their people, there may or may not be additional saves here.

3. What will happen to clients? Many firms worry about losing clients after a merger. Experience shows that this does not happen unless key members of the other firm do not come across. If you are acquiring the practice of a sole practitioner and the owner is planning to retire, you can expect to lose a significant number of clients. Why? Because the relationship is now gone and clients will be more open to talk with other accountants. The other factor that drives clients away after a merger is fees. If the fees will drastically increase (10% or more) you can expect to lose clients.

4. Compatibility. In other words will the partners get along? Bringing two firms together naturally calls for changes. What will the new firm be called? Who will be the managing partner? Which partners will be on the executive committee? How will compensation be determined? Is each group of partners willing to bend? A merger has to be a win-win event or it won’t stand the test of time.

If you take the time to think through these questions and know why you are looking for a merger candidate, you will greatly reduce the chance that the merger will not be successful.

If I can help you in your merger/acquisition needs, please feel free to call at 952-930-1295 or email at aaquila@aquilaadvisors.com.