

# **CPA FIRM MERGERS: YOUR COMPLETE GUIDE**

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# 1

## Introduction

As a generation of aging Baby Boomer partners marches towards retirement, thousands of firms are seeking the only exit strategy available to them – merge into another firm. Thus has a voracious appetite for mergers been created at all size levels, particularly:

- Sellers who are sole practitioners (remember, 30,000 of the U.S.'s 45,000 CPA firms are solos and a huge percentage of those are at an advanced age) and multi-partner firms under \$2M.
- Buyers with annual revenues of \$3M and larger.

### Do mergers work?

Ask a partner from a smaller firm that merged upward whether the match has proven successful, and the likelihood is you'll get a less-than-enthusiastic response. Why isn't this partner jumping for joy? Is it because the merger didn't work? Usually not.

Albert Einstein famously said "If only I had could think of the right *questions* (i.e., not the right *answers*)."

Well, that's what doing a merger successfully is all about – asking the “right” questions.

Look at the reasons why the merger was done in the first place and see if those goals were met. Good examples of the “right” questions:

1. Did you firm up your buyout?
2. Did your clients react well to the merger and were they retained?
3. Did the firm you merged with provide you with younger partners and bright young staff that you didn't have before the merger?
4. Has being part of a larger firm given you more ways to satisfy your clients and attract new ones?
5. Will the merger get you closer to achieving your growth objective?
6. Are you making more money?

Here are some other reasons we've heard over the years why firms are reluctant to pursue upward mergers:

**Reason #1: We fear a loss of control.** Response: What do you fear? Name one thing. I have yet to talk to a “hesitant” firm that can name even one specific, valid fear. The loss of control issue is more a mindset or fear of the unknown that dissipates once the merger takes place. However, if you fear being held accountable for things you know you *should* be held accountable for (like collecting your receivables, billing your WIP, getting your timesheet in on time), then the fear may be valid.

**Reason #2: We feel like we've failed the firm by merging out of existence.** Response: What's the alternative – dying in your chair? Seeing the firm deteriorate to a shadow of itself while the partners hang on in their dotage? By merging, the partners are being proactive about preserving their clients, providing jobs for their staff and giving themselves a way to retire gracefully. There's no shame in merging up – my research on the life of CPA firms shows that as many as 80% of all firms never survive the first generation.

**Reason #3: We hear a lot from other firms that mergers don't work.**

Response: My experience is that mergers do work...if you do them right. Doing mergers “right” means:

1. Carefully assessing the extent to which the reasons for doing the merger will be realized.
2. Examining the fit of the two firms' personalities and cultures.
3. Doing your due diligence.
4. Getting crystal clarity on what will be expected of you at the new firm.
5. Understanding what your role will be at the new firm.

When a smaller firm merges up, that poignant “end of an era” feeling is to be expected. It's a natural emotional response. But merging with another firm is no reason for remorse. When done right, it's a courageous step forward.

But when mergers are done wrong, just like any decision made poorly, you are bound to be unhappy with the result

## This book addresses ALL types of mergers

It's designed to assist firms of all sizes in negotiating a merger, regardless of the merger type:

- Smaller firm merging into a larger firm (upward merger)
- Larger firm merging *in* a smaller firm (downward merger)
- Mergers of equals or close to equals:
  - Two firms close in size merging together (sideways merger or merger of equals).
  - Two firms of different sizes merging together, but the gap in size is small enough that the smaller firm is able to freely negotiate terms.

Though there are obvious differences between the mergers above, there are many similarities as well. As you read the monograph, we encourage you to avoid skipping sections that you feel don't apply to your situation because there is bound to be information that will be useful to you. Besides, a fundamental tactic of negotiations is to put yourself in the shoes of the other side. This gives you a better understanding of what's important to your merger partner.

## The term "negotiation"

"Negotiation" can take on two different meanings in the realm of CPA firm mergers:

1. "Negotiation" in the true sense of the word: Most or many of the aspects of the merger are open for discussion. Neither firm enters the negotiations with the intent to stubbornly impose or force the other firm to "do it their way."

Examples of issues commonly open to negotiation in the true sense of the word include:

- Name of the firm.
- Partner income allocation method.

- Partner agreement including partner buyout plan.
- How the firm will be managed.
- Tax software that will be used.
- Format of client financial statements.

Negotiations of these types are the least common scenario and occur primarily in mergers of equals.

2. "Negotiation" where the smaller firm knows it won't have much influence on the terms. The partners of the smaller firm are under no illusion that they will be able to get the larger firm to change its policies and practices on issues such as those listed above. Instead, the smaller firm goes through a process of learning what the larger firm's practices are and assesses whether they can live with them. It's possible that a few, minor items could be compromised on.

This is the most common negotiation scenario.

#### Important terms used in this monograph

As is the case with most professions, certain terms are often used interchangeably with others. Technically, the terms may have different definitions, but in common usage, they are virtually synonymous. For this merger monograph, here are those terms:

#### **Merger vs. acquisition.**

- A **merger** is a transaction where two companies join forces to form a new company. Cash is rarely paid to the owners of either firm.
- **An acquisition** occurs when one firm purchases a smaller firm for cash, with payments commencing on the effective date of the sale. The owners of the seller phase out after a relatively short transition period.

**In reality, the vast majority of "mergers" are really acquisitions** in substance, though not necessarily in form. In these "mergers," there is no doubt that the larger firm is the "surviving" firm and the smaller firm will cease to exist.

In conversation, the terms **buyer and seller** are often used: The larger firm is considered the “buyer” and the smaller firm is considered the “seller” even though legally there is no sale or acquisition and it’s unlikely that cash payments will be made by the buyer to the seller at the onset of the merger.

**Partner.** There are two kinds of partners at CPA firms: Equity and non-equity partners. Some firms prefer the term “income partner” instead of non-equity partner, but the two terms are synonymous. Equity partners literally are owners in the firm where as non-equity partners are partner in name only and rarely have an ownership interest in the firm. Unless stated otherwise, whenever we use the term “partner,” we refer to equity partners only.

#### How to use this book

This book was written by a consultant with over 20 years of CPA firm merger experience. It’s easy for novices at mergers to feel overwhelmed with everything the monograph suggests you do and beware of.

**Instead of trying to do everything we suggest, try to take away several morsels that resonate the most with you.** Use this book as a guide to augment your good business sense of what to do and what not to do, rather than as a roadmap to making every step, large and small, throughout the merger process.