

MERGER (column 2) – WHAT TO CONSIDER IN A POTENTIAL MERGER CANDIDATE

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In the first column, we looked at common reasons (excuses in some cases as you might recall) that people often consider for merging their CPA firms. And as we committed, in this column, we are going to continue our conversation about mergers and discuss some ideas to consider when looking for a potential merger candidate. Although we find that an internal ownership transition often can be your best bet, a merger makes sense in many cases. So, if this is the direction you are heading, we've highlighted some of the issues below that we think you ought to consider, with the first one being to really take a close and hard look at the compatibility of the organizations courting each other.

Who Is a Likely Candidate for a Merger?

If you are going to consider a merger, which firms would seemingly be a good fit for your practice—i.e., your clients and your employees and if, applicable, partners? The better the fit, the more likely you will be able to retain clients and employees, and the greater the chance for overall success of the merged firms.

The notion of “fit” encompasses a variety of factors you should consider, above and beyond the typical due diligence checklists you can use to work on details and verification of matters for a deal. While there is no question that the deal has to economically make sense, it is not the numbers that drive success. It really is about compatibility of the business models, staffing, client base, fee structure, practice style and firm culture. This investigation is all about you being able to answer the questions, “How well will my clients and people get along with this new firm?” and, “How do and will we do things around here?” Consider the compatibility of the practices in several, broad areas:

- Strategic perspective
- Owners' styles, goals and relationships
- General cultural match
- Client bases and services offered
- Performance management and pay systems
- Firm ownership and governance models
- Business processes and practices
- Succession management practices

You probably know enough to make an initial judgment in these areas about the most likely candidates in your marketplace, just from having competed against them, and from your contacts with them at professional functions. As you pursue discussions with any of them, you'll get a better feel for the fit between your practice and theirs.

Strategic Perspective

Strategic perspective refers to the role that strategy plays, if at all, in the management of each firm. It also refers to the general strategy being pursued at each firm and the relative compatibility between the two strategies.

The first question to consider is whether either firm has a truly shared direction or vision that explains what either practice will look like in three to five years. If you currently run your firm with any sort of long-

term strategy in mind, beware of joining up with a firm that doesn't operate this way. Instead of having some core philosophy and mutually agreed-upon targets for the future, you will have added partners who don't operate around strategy, and the ensuing chaos will feel like you have entered the twilight zone – a place where every idea looks like an equal opportunity. Firms that don't respect and follow strategy often create a business environment where decision-making is driven by the anxiety of the day and disconnects between various operating activities are common, while accountability is probably nonexistent.

But what if both firms have developed some sort of mission statement, core values and long-term direction or strategy — what are they? Does anyone pay attention to them? How compatible are they? For example, if one strategy is to grow through assurance service offerings, and the other firm has a strategy to grow through a combination of traditional services enhanced by becoming better “trusted advisors” to their clients, this could either be a great match or a train wreck. It could be a great match if the strengths fill the weaknesses of the other and vice-versa. The combination could also be a train wreck if either firm doesn't respect or see value in the philosophies or strengths of the other. So, take time to really explore this area in your initial discussions.

Owners' Styles, Goals and Relationships

How do the owners in each firm relate to one another? Are they very businesslike and formal in their dealings with one another, extremely informal, or somewhere in between? How much respect do they show for each other in casual interactions? Do they vociferously argue their points until a true, shared decision is made, or are discussions characterized by little discussion of opposing views?

What about conflict? Does it show up, and if so, what does it center on? Or are they passive-aggressive, seemingly agreeing to common goals, but never quite implementing them? This is an important area. We can't over-emphasize the need to really think about the questions we've raised here.

General Cultural Match

Culture is the major driver of “how we do things around here.” It's derived from explicit behaviors and physical trappings, as well as assumptions that are often unstated. You can begin to assess someone's cultural fit with your culture by looking at obvious physical characteristics of the practices:

- Locations — In what part of the community, and what type of office space (Class “A,” the upscale buildings, or class “C,” a more modest physical presence?)
- Office layout and design — Sizes of offices, use of cubicles vs. private offices, etc.
- Furnishings and decorations— Again, there could be a wide spread between the tangible trappings of the firms, from low-end to functional, high-end, upscale pieces.
- Technology – Does the firm use technology to support various functions or is it so technology integrated that everyone has to be computer-savvy just to be able to work there?

When we refer to behaviors and underlying assumptions, we're referring to even more factors that you should be able to observe or at least infer from your observations. Things to consider in comparing cultures include:

- **Level of formality** — When you call the other firm's office, do they refer to the owner(s) as Mr. or Mrs., or by their first names? How are you addressed at your office? When you see the owners

and any of their staff out and about during the work week, do they seem to dress as you and your people do, or does their look typify “pinstripe,” while yours screams “business casual?”

- **Displays of influence** — Do you and your key people all drive European sports cars (think Porsche, “Beemers,” sporty Mercedes models, for example), while the acquiring firm owners drive conservative American models? Or do they all wear Rolex or Patek Philippe watches while you and your people wear Timex and Citizen timepieces? Here again, these things may be indicative of different cultures (and likely billing rates).
- **“Old school” or more up-to-date view of work/life balance** — If you are one of the increasing number of firms that expects people to have something approaching a “normal” life outside of work, with limited overtime requirements, the merger of your practice with a firm where all of the leaders work 2,600 hours or more a year will not bode well for retention of your key people by the acquiring firm.
- **Always serious vs. relaxed and fun** – Is your office environment one of work hard/play hard, or is everyone serious at work? Does your office tend to have firm outings with people socializing after work hours vs. a firm that everyone considers just a place of work?

It doesn’t matter which of these best describe your firm. They all work and we know examples of all of them, both successful and marginal, in each version of each category. So, this is not about right or wrong...but rather, about finding similar cultures.

Client Bases and Services Offered

Rules of thumb in this area deal with compatibility as to size and nature of clients, industries served, offerings provided, service policies and practices, rates, and locations:

- **Industries served** — Do you service clients in industries in which the acquiring firm has expertise? If not, how will this niche fit into the overall strategy and operations after the merger, and can you expect the technical support you need for retention of those clients by the merger firm?
- **Nature of clients served** — Do both firms have similar client bases — similar in size of client, sophistication of clients, and nature of industries, for example? Or does one firm service more sophisticated organizations that have CPAs in roles as CFOs, while the other has more clients with less well-trained bookkeepers in key financial compliance roles?
- **Service offerings** — What about services offered? Does one firm offer mostly tax, some compilation and business advisory services, while the other offers mostly audits and some reviews, with significant transactional tax planning? This could be viewed as synergy and a good thing. But this diversity could also be a huge disconnect because the firm could struggle in trying to maintain the skills and expertise to deliver these services.
- **Service policies and procedures** — Does one firm see itself as the Tiffany of local firms, charging high prices for apparent value added through its high level of service, service quality and marketing, while the other firm provides essentially similar quality of technical work at a no-frills price with services that reflect the pricing?
- **Charge rates and fee structure** — How closely aligned are the fee structures of the two firms? Is one charging clients significantly less than the other for comparable work? In particular, if your effective rates are less than those of the merger firm, you will have problems.

- **Geographic locations and related differences** — Different parts of the country, of a state, or of a region within a state, have different subcultures and potentially unique economic conditions that can create some interesting issues for you to consider. The point is that just because two offices might only be within 50 miles of each other, don't assume that client sharing and service synergy will be a slam dunk.

Performance Management and Pay Systems

What gets measured and monitored for the purposes of compensation, and how do people get paid at the two firms? Is one firm more focused on individual productivity of partners, while the other is focused on cross-selling and paying partners to implement strategy? What do partners' perks include at each firm? What about staff performance management, pay and benefits? How much effort is going into helping staff with their professional development and careers?

Firm Ownership and Governance Models

Does either firm have formal policies governing admission to partnership? Would any of the existing personnel be considered a partner candidate in the merged firm (because there may have been commitments made to key personnel by the mergee owner years before the merging of the two firms)? How is ownership spread out among current partners? How are key issues decided at voting time — by equity ownership percentage, one partner/one vote, majority vote, unanimous vote, or some other variation? Do either of the firms have standard operating procedures in place that discuss these issues, roles of partners, etc.?

What form of governance and management is used: every partner does whatever they want in the name of client service; weak board with a strong managing partner/CEO; weak board, strong executive committee, weak CEO/MP; strong board, strong MP/CEO; or any one of 20 other different scenarios? Find out what the REAL structure is (not the structure they sell to the public, but the one that actually exists). And what about ownership agreements? Is there one (and only one) signed agreement in place or are their multiple versions of the general agreement with many partners also having an additional side-agreement?

Business Processes and Practices

What formal and informal communication processes are in place at each? What about other policies and procedures — standard operating procedures, for example — how does each firm deal with practice development and client acceptance, billing and collection, etc.? What about staffing and leverage of partners' time? What are the organizational structures at each firm, and is one or both top-heavy?

How standardized are the procedures at each firm? Do owners each run their area of the business differently, or do they follow standard procedures for documenting work, filing workpapers, reviewing the work, and so on? If neither one has much in the way of standardized procedures, how will you determine which to use?

Personnel Development

How are people developed within the two firms? Are there clear competencies that each level in the firm is measured? Do the firms have an "only the strong survive" mentality of development, or is it based on investment of time and money in logical development processes? Does everyone report to someone specific who is in charge of his/her career development, or does everyone simply report to everyone above them? Do people who supervise others get compensated for the achievement of those who report to them,

or are they only compensated for their own personal production? Are the people who can make others around them better, faster and stronger perceived as exceptionally valuable, or does the firm look for superstars and promote them first? The answers to these questions will definitely give you insight into potential culture clashes.

Succession Management Practices

If you're merging your practice into another firm for long-term security and protection of your ultimate buyout, consider the long-term viability of the firms you are looking at as merger partners. What is the acquiring firm doing about succession management? What do the pending retirements look like for the senior owners — how many will be retiring over the next few years, and at what cost to the firm? How much ownership percentage in the acquiring firm will be changing hands, and who will end up with what relative ownership percentages there? When do partners have to sell their ownership, or can they remain as owners until they are run off or forced to retire? What about written agreements that specify clearly what these senior owners will get, and under what terms and requirements and when? And what's the likelihood that the acquiring firm will end up being sold or merged upstream itself?

These are common issues we focus on when looking at potential merger candidates. Lack of similarity or the existence of variations in any area does not mean you have a deal breaker. It simply means the two firms need to hash out those differences and arrive at an agreed-to go-forward strategy before the deal is done. Change creates anxiety. And there is nothing that creates more anxiety for the people within the merging firms than unaddressed or ignored blatant incompatibility and conflict in direction.

In our next column, we will be responding to a number of questions that have been submitted to us on this topic. So, we are going to do what we do best, which is ruffle a few feathers, as we address some differences in what younger versus more senior partners might be looking for out of a merger and how these two views -- often vastly different -- can come together into a single solution. We look forward to continuing this dialogue next time.