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# Merger Momentum Continues as accountancy firms contemplate their next move

**By Phil Shohet and Andrew Jenner**

Practitioners know that, in the accountancy sector, size matters. The news pages in this magazine over the last couple of years bear testament to the number of smaller practices that have chosen to grow through merger and the trend looks set to continue.

In the August 2007 edition of Accountancy Ireland we looked at the issues driving the merger and acquisition market and the matters that any firm considering a merger needed to address. Since then the market has shown no signs of slowing down on either side of the Irish Sea. Indeed, in late 2007 the British Chancellor, Alastair Darling managed to provide his own impetus by altering the Capital Gains Tax arrangements so many firms sought (and succeeded) in selling out before the tax threshold was crossed.

Then, of course, there is the 'me too' effect. Many independent practices have seen their rivals growing exponentially and becoming ever more aggressive in the marketplace. They feel that unless they too jump on the M&A bandwagon they simply will not be able to compete. Size matters, and although many smaller businesses prefer the personal touch of an independent practice, they still want all the bells and whistles in terms of added value services that the large firms can provide.

What has changed, however, is that many firms are now are now contemplating their second, or even third merger. With some experience under their belts they are now much more knowledgeable about the process and results are therefore more likely to be successful. Of course, there is another side to this coin. For the firm entering the market for the first time it is even more a case of either 'caveat emptor' or 'you only sell your business once'. Where one party to the deal has knowledge and experience on their side, the other needs to keep their wits about them.

Another lesson that seems to emerging from all this experience is that a well constructed deal does not have to follow conventional lines if all the parties involved are to benefit, regardless of the size of the firm involved. A certain amount of nipping and tucking can improve the outcome of the deal provided the basic rule is never forgotten:

|   |   |
|---|---|
|   | Vision |
| + | Strategic fit |
| + | Efective leadership & management |
| = | Enhanced and sustainable profitability |

## Means to an end

A successful merger is not an end in itself, it is a means to an end and the parties involved must never lose sight of that end. On a business level, the partners need to be sure that the merger will help them win and service more and better quality work from existing clients and new work from potential clients that neither firm could hope to win individually. On a personal level the partners need to be sure that the merger will help them achieve their personal ambitions – whatever they may be.

## Partner perspective

Taking account of the partners' personal views is absolutely vital as they are probably the biggest prospective deal breakers in any merger. No matter how closely they agree on the business aspects of the deal, when it comes to their own aspirations and expectations there is a huge potential for conflict.

Simply agreeing the name for the merged firm can cause a falling-out between two firms of similar sizes. Adopting a common policy for profit sharing arrangements, agreeing retirement plans (and in particular the issue of goodwill), the 'hierarchy' of the partners within the merged practice; even the management of debt and the control of working capital are all issues that can rapidly become contentious.

## Managing the merged business

The vision for the future also needs to take account of the more mundane aspects of managing the merged business, in particular the financial

management which will almost certainly mean amalgamating two different styles and systems. A financial evaluation covering the first two years based on realistic and prudent assumptions needs to be carried out in advance of the merger.

## Common stumbling blocks: examples

So what are the most common stumbling blocks to a successful deal? They are many and various, but here are just a few examples: all of them are real situations that have occurred within the last few months.

### Five-partner practice

First is a five partner practice with a turnover of @ £3m. They needed to fund succession and protect their upper end clients. Although there was some expectation of goodwill for the older partners they were still a very attractive proposition for their target market of independent, medium sized firms. Indeed, several suitable firms were very interested in pursuing a deal, but there was an insurmountable problem. The senior partner insisted on a 'management position' within the merged firm in order to retain his status and credibility. Even though he was due to retire in a couple of years none of the interested parties was prepared to accede to this demand: status was just as important to them! The result was that the firm eventually merged (on an extremely unequal basis of course) with a multi-office practice. The senior partner got his title, but no real power to go with it and the firm lost their independence.

### Larger practice

Our second example is a larger firm billing £6m annually with office space to spare. They were simply looking for more turnover, so the sole practitioner with two compatible business sectors who was looking to retire in 2/3 years seemed the perfect acquisition. The partners paid 80% of GRF in instalments based on billings over a period. Although the people fit was good, within a very short time it was painfully obvious that the due diligence process had been woefully inadequate regarding the examination of the sole practitioner's client base. The result was a significant level of bad debts, a reduction in fees and a consequent reduction in both goodwill payments and profits earned. Nobody gained anything.

### Well established 2-partner practice

Finally, a very well established and extremely successful two partner practice billing over £3m. The partners (aged 64 and 55) had been together for over 30 years, but age and ill health was forcing the oldest into retirement. They found a good quality medium-sized firm where an acquisition would be a good fit. Agreement was reached on every aspect of the deal and they were poised to complete when the younger partner suddenly got cold feet. Psychologically he was being dragged out of his comfort zone and thirty years of 'the family firm' was about to be swept away. Fortunately the acquiring firm understood the potential effects of cultural change and, rather than walking away from the table as many would, they were prepared to take the time and trouble to reassure him and ensure that he would be eased comfortably into his new environment. The deal was saved at the 11th hour and the outcome has been an extremely happy, not to say profitable one for all concerned.

## Conclusion

Most firms that have been through a merger – even those with successful outcomes - would agree that, if they had the chance to do it over again, there are things they would do differently. However, in general the results of today's mergers are far more beneficial to all concerned than those of a few years ago. Providing they remember never to take anything for granted, to look at the opportunities critically and to leave no stone unturned in the due diligence process there is no reason why every firm, whether buying or selling, whether the larger or the smaller unit in the transaction, should not achieve exactly the result they desire.

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