CPA Firm Mergers: Is it a Buyers' or a Sellers' Marketplace?

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Like most scenarios that include a buyer and a seller, the marketability of CPA firms adheres to the eternal law of supply and demand.

The demand for a practice is heavily based on the size of a firm (in gross revenues) and the location.

Depending on demographics and geography, some areas of the U.S. are definitely skewed toward the buyer, while others favor the seller.

Location, Location, Location

If your practice, for example, is situated in a densely populated part of the country such as New York, Chicago or Philadelphia, the supply of available accounting firms obviously increases. In more remote areas, not only would there be fewer buyers in the field of potential suitors, but many potential acquirers would perceive that with a dearth of competition, the remaining firms would more than likely inherit some if not all of a practice's clients should a practitioner walk away from his or her firm. So why should they go through the elaborate and often time-consuming process of a merger or acquisition? In other words, it will not likely be very seller-friendly.

Conversely, if your practice is in a market populated with literally hundreds of CPA firms, there's a high likelihood there would be a number of competitors bidding to become your successor firm.

Couple that with a still-uncertain economy that has made both organic growth and billings collection ongoing challenges. The larger your marketplace, the more likely the scenario becomes a seller's market.

Size Does Matter

Sorry for the cliché, but in determining whether you are in a buyer's or a seller's market, size is a key criterion.

Consider this scenario: You operate a small CPA firm in a densely populated metro area. That works to your advantage because in a crowded and competitive market, there are undoubtedly a number of larger firms that can absorb your smaller practice and incur little or no increases in overhead. Also, remember that aside from the Top 100 and the larger regional firms, there are an overwhelming number of one-to-two-partner firms in the country, so there's an excellent chance they will generate a great deal of interest from their somewhat larger counterparts as they become available.

The larger firms in the country face greater logistical challenges in the M&A arena because the available pool of successor firms is far more restrictive. For example, in a metropolitan market with a high population, like New York, there may be dozens of firms generating between $5 million and $35 million in revenues, versus several hundred if not thousands of smaller firms whose billings range between a floor of $200,000 and a ceiling of $2 million. It would not likely result in a high cost factor for one of the larger practices to absorb those smaller firms interested in merging. There will always be an ongoing interest in those smaller firms in metro markets, thus creating the "demand" portion of the equation.

A larger firm or even a smaller regional practice looking to merge therefore may face the prospect of having just a handful of firms who are large enough and have sufficient resources to become their successor firm. Unless you're a top 100 or super-regional entity, few firms could realistically absorb a practice generating roughly $10 million in revenue without a substantial increase to their costs and infrastructure.

Always Exceptions

As with any rule of thumb, there are always exceptions. Examples of practices that would not necessarily fit into the aforementioned supply-demand criteria are:

• **Niche practices:** In this age of specialization, well-established or even new and prosperous client service lines attract the interest of firms not only in the same market, but often in outside regions as well. In my 20-plus years of being involved with M&A and succession strategies, I've seen a countless number of niche firms merge with firms in outside markets they previously were not in.

• **Exceptional clients, fees and firm metrics:** Who wouldn't be interested in a firm with that trio of exceptional quantitative and qualitative measures? Impressive firm and client metrics will easily attract a number of potential successor firms from different geographic markets as well as their next-door neighbors and heighten the demand factor (and usually the valuation) for that firm

• **Firms with excellent young talent:** As many firms see their partners from the Baby Boomer generation aging, the value of bringing in young talent increases so a firm can build a stronger internal succession team. The AICPA recently reported that 75 percent of its membership will be eligible to retire by 2020, so the development of younger staff is essential for succession.

• **Some practices in remote areas:** Firms located in a remote geographic area can sometimes attract larger firms that may be seeking to gain a foothold in a new marketplace, even those in less penetrated territories than their current markets. If you review many of the top 100 mergers over the past 12 months, you will discover that many of them involved larger firms merging in smaller firms²many with client services or specialty niches the successor firm did not have²and often in a market or location where previously they did not have a presence.

• **Technology:** Firms with superior and sophisticated technologies and higher IT spending per FTE (full-time equivalent) employee have been able to effectively operate multiple locations and have often established top-level technology consulting or reselling practices that make them appealing M&A candidates. A firm with a strong technology niche also serves as an enticing recruiting tool for younger professionals and, as a result, will be in high demand should it decide to explore merger opportunities.

And there you have it. Whether it's a buyer's or seller's market largely depends on many of the criteria listed above, but there are also exceptions. Perhaps most importantly, remember that whether you're a buyer or seller, the best deals are those in which all parties²sellers, buyers and clients²prosper after the ink has dried.

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