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Voices Evaluating culture in M&A

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In our experience, the parties to most mergers & acquisitions between accounting firms focus a lot of attention initially on clients, service mix, and billing rates during the initial stages of the process. Then the attention almost always shifts to the deal terms. However, most of the time when we hear a deal failed, the reason given is a clash of cultures. The firms just weren't a good fit culturally. Clearly, more attention needs to be paid up front on assessing culture to assure the success of the deal.

The classic definition of culture is the behaviors and beliefs characteristic of a particular group — an accounting firm in this case. OK, sounds logical — but what can you do with that? Normally we can develop a level of comfort with a person or firm when we first are exposed to them. We often say that if you can't imagine having lunch on a regular basis with the person across the table from you, walk away from doing a deal with them. Our gut feeling is an important gauge of cultural fit and should not be ignored. Unfortunately, that is as far as the assessment of culture goes in too many cases. When that happens, whether or not the firms turn out to be good fit is based on dumb luck.

Instead, start your evaluation of culture by asking three questions about your firm and the firm you are considering combining with:

- What is it like to be a partner/owner in these firms?
- What is it like to be staff in these firms?
- What is it like to be a client in these firms?

You'll find a wealth of information about the culture a firm wants to create in their owner agreement and partner compensation system. Both should define what the firm believes is critical to its success and how the firm wants the partners to execute that strategy.

A good example of this is how much emphasis the firm places on managed books of business in determining compensation and partner retirement valuations. Firms that operate in a book-of-business culture tend to create a lot of certainty in the way a partner is paid based on a simple operating metric. However, this system also tends to promote protecting one's book versus making decisions about managing clients for the good of the firm as a whole. The frequent result is silos and "partner-loyal" clients. Make no mistake: Firms managed with strong emphasis on books of business can be very successful and profitable. However, firms that operate in a one-firm culture tend to create "brand-loyal" clients. Combining firms with this disparate approach to client relationships can be difficult.

Range of compensation between partners can be another clue to culture. Firms that have little variation in compensation from top to bottom may indicate a culture that values collegiality, which can be very effective. However, such a culture can also be an indication that the firm is unwilling to call out performance, both good and bad, and tie compensation to the evaluations. A firm with a strong partner performance evaluation system may be a difficult match for a firm with a collegial partner culture.

Technology is increasingly a differentiator between firms. The gap between firms that are on the cutting edge and those that have not upgraded technology is becoming wider. Technology now tends to define the overall operating culture a firm operates in. At the very least, the partners of a firm with outdated technology merging into a firm with a robust up-to-date technology platform have to be willing to embrace the change that will be required. In some cases, merger opportunities are being rejected over just this issue due to the probable extent of cultural shift that will be required of the merging partners and staff.

Other examples of cultural characteristics that should be explored are governance, partner accountability, range of equity owned, and adherence to firm policies and procedures by partners.

Staff culture

Nowadays, the quality and retention of staff are almost as important as the clients in many mergers. A clash of cultures in matters that pertain to staff can have a detrimental impact on the short-term success of a deal and in some cases be hard to overcome long-term. Adjustments that will avoid staff being required to accept a reduction in compensation, other than in extreme cases, is an obvious must-have. If the benefits package, such as treatment of paid time-off, is substantially different in the two firms, the gap can often be overcome with an adjustment in cash compensation. However, other differences are harder to overcome.

Of course, any time you will be taking something away from staff when they join the new firm, you are putting retention at risk. Make sure you look at the intangibles that define the culture for staff. Examples include:

- Number of hours staff are required to work, especially during busy season;
- Amount of travel with overnight stays required of staff;
- Office infrastructure — for example, private offices versus cubicles or shared space;
- Availability of flex time and flex space;
- Remote access; and,
- Autonomy in client service and other day-to-day decisions.

Differences in the pace and availability of advancement is a key especially when the staff in question has a lot of experience. The current trend in the profession is towards specialization. Many small firms still operate in a generalist culture. The shift required of staff to more specialization can be daunting.

The progressive firms in the profession are creating a culture designed to appeal to millennials, many of whom are very focused on lifestyle as opposed to just compensation as the determining factor of where they remain employed. You might assume the benefits to merging staff of a culture like this will be a plus for them, but sometimes the change can be uncomfortable and hard to accept, especially for the merging firm partners.

Client culture

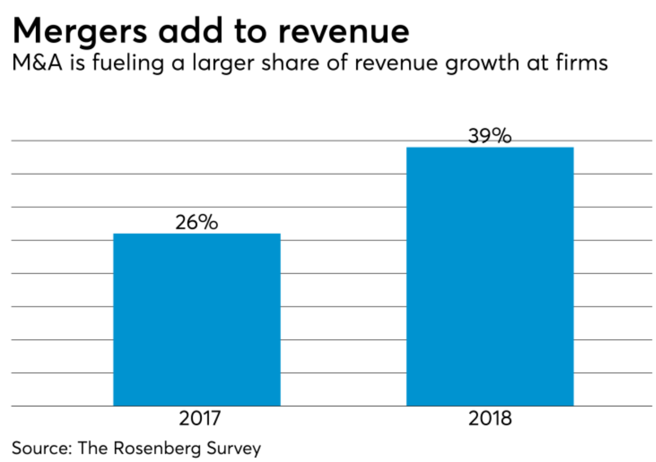
Most of the time we see evaluations of fit between firms in mergers include a good assessment of the kinds of clients a firm has, the services it provides, and the fees charged. However, often this evaluation falls short of considering the entire client experience.

The key things to address include:

- How is the service provided? In the office? In the client's offices? Virtually through portals and email?
- What is the standard operating procedure for billing? For collection? A firm that bills clients once per year even for service provided throughout the year or is lax on collections will change the client experience dramatically when merging into a firm that aggressively progress-bills and is intolerant of past due balances.

Clients of firms with low staff to partner leverage will likely be accustomed to a lot of direct service from partners. Merging into a firm with high staff to partner leverage may cause some clients to experience less direct partner involvement in their relationship with the firm, which may be perceived as unacceptable.

Many progressive firms are promoting a shift from primarily providing compliance services to a lot more advisory/consulting services. Generally, in a merger the assumption is clients will embrace the greater amount of attention and higher-value service provided to them as a result of this shift. This is often where firms see the opportunity for revenue-based synergy. However, the change in client experience could be disruptive if cross-selling is introduced too quickly and aggressively.



Conclusion

When it comes to evaluating cultural fit, look and feel is an important guide. Look beyond that into the specifics about how a firm operates for a better view of how well the integration into a common culture is likely to go. Metrics remain a critical aspect of any merger or acquisition, but you must move beyond just the numbers.

Very few mergers and acquisitions will be considered successful without very good client and staff retention post-closing. Key considerations are either cultures in both firms that align, or a serious commitment from the partners of the merging firm to accept the culture of the successor firm.

Ask yourself this: Will the clients and staff of the merging firm perceive this combination as the gain of what the new firm brings or a loss of what they were accustomed to in the old firm? Compatible cultures will go a long way in making it the gain of the new firm.

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