Keeping It Together

Plan the transition to retain staff and clients

(Part 2 of 2)

by Joel Sinkin and Terrence Putney

Retirement, health issues for an owner, the desire to grow—all of these are reasons firms engage in mergers or acquisitions. Most firms decide to merge or acquire only after considerable analysis of financial and professional outcomes. Last month we gave general advice for ensuring a merger or acquisition goes smoothly. But a firm's ability to make a successful deal depends not only on deal structure and due diligence but also on the successor firm's ability to retain clients and staff. Unfortunately, an agreement between the partners of two firms to combine has nothing to do with whether staff and clients stay or leave.

This article looks at the challenge of retaining clients and staff immediately after the merger. Retention should be addressed through a properly designed and executed transition plan, which should be divided into two retention sections: clients and staff.

Client Retention

A client generally selects a firm based on chemistry between the client and the accountant, location of the firm's office, cost and perceived value of services, professional expertise, and trust. The announcement of the merger/acquisition deal may force clients to deal with the broad concern, "Will my relationship with the firm change?" More specifically, their worries relate to the reasons they selected the firm:

- "Will the partner I have been dealing with still be there?"
- "Will my fees increase?"

■ "Will the staff I am used to dealing with and procedures I am accustomed to working with remain the same?"

■ "Will the firm's location still be convenient?"

Addressing these concerns is critical to client retention. The message you deliver in the merger/acquisition announcement must speak to the issues—and at the same time reinforce the reasons clients initially chose your firm over others. Whenever possible, when you inform clients about the transaction, reassure them that the things they depend on will not change; emphasize continuity regardless of what is changing; focus on things that are not changing; and stress what the client is gaining rather than losing.

Your client transition plan should list action steps in these areas:

1. ***Timing of the announcement.*** Decide when various clients should be told of the transaction. Generally, all clients should receive a formal announcement fairly close to when the news becomes public to assure they are given the information they need so they will support the deal. How and when you make the announcement, however, depends on the importance of the client to the firm and the amount and timing of interactions with the client.

Your best clients (usually measured by size of annual fees, or importance to the firm in other ways such as a referral source or stature in the community) may be told about the pending combination before it is consummated. If your firm has a number of annual clients (such as individual tax clients), consider waiting to tell them about the deal until close to the time of their annual visit to the firm (for example, when tax organizers are sent out). This approach minimizes the time during which clients may make assumptions about what the combination means to them and consider an alternative to their current service provider. This technique works best when the business combination will not likely become generally well-known for these clients.

2. ***The message.*** Whether you communicate with clients in person, by letter, or by phone, make sure you send a consistent, positive message about the transaction (for sample letters, see the online version of this article at **www.journalofaccountancy.com**; enter code 20081182 in the search box). To assure consistency, some firms draft scripts for staff to use as they talk to clients.

Focus the message on how the merger/acquisition benefits the client. The initial announcement might say: "We are merging with Smith and Jones to provide our clients with new areas of expertise and access to more resources." Promote the new or specialized services the acquired firm offers. Additionally, include in the announcement reassurances of things that will *not* change—especially staff, fee structure and client services, which are all key concerns.

How and when you address the concerns of both clients and employees affect a merger's success.

Focus on Continuity of Service

Continuity of service is critical to retaining clients. Make the transition transparent by:

■ ***Retaining contact information.*** Keep phone and fax numbers, domain names and e-mail addresses for at least a year. Answer the acquired firm's phone number on a dedicated line with a custom greeting that uses both firms' names.

■ ***Maintaining service and billing methods.*** Don't immediately change work processes and billing systems. Wait until clients are comfortable with the new firm.

Is the combination deal a merger/acquisition, or is it a purchase? In your communications with clients, the press and staff, avoid the term "purchase." Clients do not like to think they have been "sold." Even if the firm is purchased from an estate of a deceased practitioner, call the transaction a merger or an affiliation.

3. ***Deciding how to deliver the message.*** The importance of the client will dictate how the announcement is made as well as when it is made. For example, a personal visit by the partner in charge of the account is the best way to convey the information to important clients. If that is not possible, the partner should at least make a phone call. This allows the messenger to respond to questions immediately and reinforces the client's importance to the firm.

Clients who are scheduled to be seen in the near future can be told in person

EXECUTIVE SUMMARY

■ **When a merger or acquisition takes place,** clients are chiefly concerned about who their accountant will be, if their fees will change, and if the office location will be convenient.

■ **Top staff worries include job security,** changes in compensation and benefits, and restrictive employee agreements.

■ **A smooth transition that results in** retained clients and staff carefully addresses all concerns.

■ **In the initial stages of the transition,** care should be taken to make changes slowly so clients and staff can become acclimated to the new firm's operations.

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Case Study: A Successful Long-Distance Transition

Larry, age 62, intended to sell his practice in three years, but his wife's health precipitated an early move across the country to Arizona. He wondered how he could sell his $300,000 personal tax-return practice when he couldn't personally serve his clients. Good planning salvaged the situation and retained his clients.

Larry merged his practice with Michael's firm, which was very similar in operational style and expertise. They created a new entity with both their names in the firm name.

Larry sent out a merger announcement letter emphasizing Michael's expertise and explaining that Larry would brief Michael on each client's needs. Michael would interview clients to find ways to reduce taxes; they would both review the return. Fees would not change, and Larry would remain the lead partner on the account.

Larry called each client from Arizona and scheduled the meeting. Michael completed the returns and sent them to Larry to review. Larry called each client to review the return. If a client called Michael with questions for Larry, Michael called Larry. Larry called back the client, listened to the questions, then responded, "Let me discuss this with Michael and get back to you with our joint opinion; Michael will call with the answer."

With this process, clients became used to working with a new accountant, and the result was almost 100% client retention.

Case Study: Transitioning Over Time

Each of two equal partners in a $1.7 million firm had sights on retiring—David in two years, Martha in four. The firm, which employed two CPAs, one paraprofessional, and one clerical person, had a profit margin of 40%. The firm reached an agreement with a successor firm that had excess staff and office capacity and a similar operating style. Client retention was high because of the way the transition was managed.

An initial announcement letter was sent to the clients emphasizing the gain the clients would experience from the talent of the new firm and the continuity the combined firm would offer.

David and Martha would each receive compensation equal to 20% of the collections from all of their original clients, consistent with their current profitability (including the cost of perks and benefits). If they needed labor in addition to what was used in the past, they would pay the successor firm 67% of the normal billing rate for the excess labor.

At the end of the second year, David would retire and start to receive his share of the payout over the subsequent five years. At the end of the fourth year, Martha would retire and start to receive her share of the payout over the subsequent five years.

This transition allowed clients to acclimate gradually to the successor firm. Starting immediately for David and in the final two years for Martha, clients were seen in person on an alternating basis by the original partner alone and then by the original partner and the successor partner jointly. By the time David and then Martha retired, clients were comfortable with the successor. No further announcement was required. The transition was completed fully, and the client-retention risk of the buyout was effectively eliminated.

as those meetings occur. Send a letter or an e-mail to clients who are less critical to the firm's success. Do this, however, prior to a public announcement made through a press release.

4. ***Introduction of the successor.*** A personal introduction of the successor to the client helps assure an effective transition. It also helps prevent the client from praising the merger but warning that the existing partner must remain in charge. (A client is unlikely to say to your successor, "Nice to meet you, but don't come back.")

If the business combination is occurring for reasons other than succession, it is not critical to take along or otherwise introduce the client to anyone in the new firm. However, if the plan is for the partner in charge to phase out (even over the next few years), that process is best started with the announcement meeting. You can introduce a successor as "backup" or additional support if the transition will be occurring over time.

In addition to introducing the successor, defer to him or her whenever possible. For example, a client may call you (the partner who is transitioning) with a question or problem. Instead of responding as usual, yield to your successor. Allow him or her to return the call. This action supports the transition and shows that the successor is taking a sincere interest in the client. If you continue to answer every question, the relationship will not transition, and client retention will remain at risk.

5. ***Involvement of both firms in the communication process.*** Little things can make a difference in perception. For example, mailing the announcement letter in the predecessor's envelope but writing it on the successor firm's letterhead ensures the letter will be opened and sends a powerful but subtle message about the transition.

6. ***Time commitment of the seller to the transition.*** Sellers seeking to leave soon after the acquisition understand their presence is necessary for a successful transition, but they wonder how long they will have to continue working.

It is not the number of hours spent

Case Study: A Merger Resulting in Lost Clients

In this case a $2.7 million firm with three equity partners was merged into a regional firm. Two partners intended to remain in the successor firm long term. The third, John, was to stay for three years and then be bought out. In this case, 20% of clients were lost when John retired.

The firms in this case did not have a plan to transition clients. During the three years he remained on the job, John handled all his clients as usual, answered all their questions himself, and never actively got the successor firm involved with the clients.

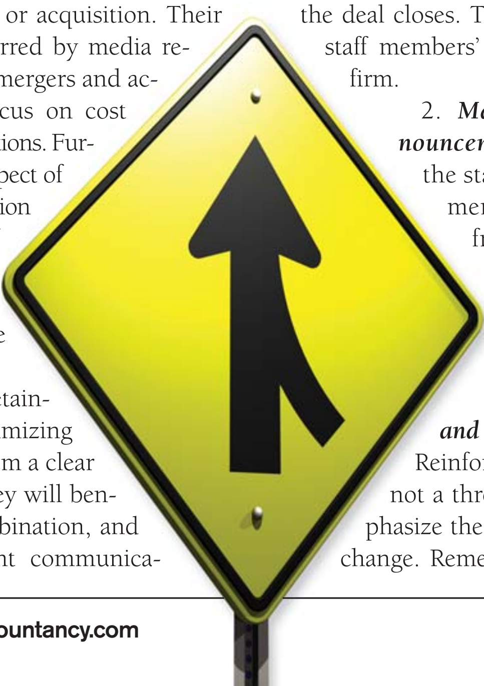
The substantial loss of clients affected John's buyout payments as well as the firm's profitability because his buyout was tied to client retention during the first two years following his retirement.

with clients but the message sent to them that matters the most. For example, if you are a retiring practitioner, consider the amount of time you physically spend in front of clients. Often, it is no more than 200 to 300 hours per year, with the remaining "client service" time spent behind the scenes preparing, reviewing and supervising work.

Therefore, if you spend the same time seeing clients and remaining available for consultation via phone and e-mail, the clients may perceive no difference in the relationship. Planning an appropriate amount of "face time" allows for the transition of most of that practitioner's client service responsibilities.

Staff Retention

Most staff members have never been through a merger or acquisition. Their perspective is blurred by media reports about large mergers and acquisitions that focus on cost cuts and staff reductions. Furthermore, the prospect of a merger or acquisition holds the specter of significant change, and many people are uncomfortable with change.



The keys to retaining staff are minimizing change, giving them a clear picture of why they will benefit from the combination, and providing constant communication. Effective staff-retention strategies address upfront concerns about job security, compensation and benefits, and employee agreements.

No simple solutions can eliminate all of these fears, but one of the most effective actions is clear and frequent two-way communication in which you share your firm's vision and ask for (and listen to) their opinions. These actions create an environment in which staff feels someone is listening, they have input, and their opinion counts.

Plan and execute your staff-retention plan carefully. Address basic concerns by taking these steps:

1. ***Inform the most senior staff members first.*** When it is possible to do so (considering the risk involved), announce the pending business deal to them before the deal closes. This reinforces these staff members' importance to the firm.

2. ***Make firsthand announcements.*** Do not let the staff find out about a merger or acquisition from an announcement meant for clients and the public. Tell them in person.

3. ***Send an upbeat and positive message.*** Reinforce that the deal is not a threat to staff and emphasize the things that will *not* change. Remember that the topmost question of staff members is, "Will I have a job after the merger?" If you have no intention of reducing staff, reassure them with the simple message—sent to both sides in the deal—"You are welcome and coveted."

4. ***Tackle the issue of compensation and benefits.*** Another concern staff members have is the deal's effect on compensation. The merging companies will almost certainly have different compensation programs. As your firms become one company, try to keep compensation at historical levels, even if existing levels at one company are not totally in sync with targets.

Forcing pay cuts to bring people into line is a surefire way to run them off. A better approach to bringing salaries in line is to freeze compensation at existing levels and let natural attrition and time gradually bridge the gap.

The same applies to benefit plans. If the acquiring firm's plans, such as health insurance cost sharing or paid time off, are not as generous as those provided by the old firm, one method to bridge the gap is to compensate for the loss of these benefits with a cash adjustment. The cost of attrition often far outweighs the minimal cost of keeping people whole (which actually costs nothing compared to the predecessor's historical cost structure). Also indicate how the transaction will affect perks.

5. ***Address employment agreements.*** New employment agreements are often a necessary part of a transition. But staff may view the restrictive covenants in these agreements as a negative. Present the agreements as a way to promote security and certainty. This focus will help retain staff and still protect the business.

6. ***Clarify reporting relationships.*** Describe what the transaction means to staff in terms of their roles, the management structure (and how they fit into it), and office facilities.

7. ***Talk about career opportunities.*** The firm's most motivated staff, the people who count on long-term career growth, may assume the transaction will limit their opportunities. If the deal presents a good

opportunity for their careers, be clear about how growth can occur.

8. ***Orient new employees.*** Remember that employees of the acquired firm are new. Distribute employee handbooks; obtain signed agreements; conduct training on all major systems such as time and billing and tax prep software; and consider holding a get-acquainted event for the employees of both firms.

9. ***Maintain an open dialogue.*** Give staff a way to ask questions and explore what the merger or acquisition means for them after the deal is consummated. Provide opportunities for one-on-one conversations by assigning a "go-to" person with whom staff can work. Small firms may designate one individual as a go-to person. Larger firms may consider assigning the role to several individuals—one for each category of employees, such as managers, senior staff and junior staff. ❖

AICPA RESOURCES

JofA articles

- "Mergers & Acquisitions of CPA Firms," March 09, page 58
- "Securing Succession Success," Dec. 07, page 34
- "Two-Stage Deals," March 06, page 43
- "Price Equals Value Plus Terms," Dec. 04, page 67

CPE

- *Mergers, Acquisitions and Sales of Closely Held Businesses: Advanced Case Analysis*, a CPE self-study course (#732863)
- *What You Need to Know About Accounting for Business Combinations*, a CPE self-study course (#182000)

Publications

- *Adviser's Guide to Mergers, Acquisitions, and Sales of Closely Held Businesses* (#091027)
- *Compensation as a Strategic Asset* (#090493)
- *Securing the Future: Building a Succession Plan for Your Firm* (#090486)

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THE NEXT GENERATION

SUCCESSION PLANNING: WHERE DO YOU STAND? *By Joel Sinkin*

CPAs help clients to plan their retirements and exit strategies many years in advance, but many fail to take their own advice and wait too long to start the process of succession planning. By considering the answers to a couple of questions, practitioners can gain a better perspective on what steps they need to take to ensure a smooth transition.

When do you start to plan your exit strategy? If you expect to sell your practice one day, there are interim steps that you can take to maximize the value of your firm. Many professionals want to gradually reduce their time commitment to the practice and ultimately sell, but may not wish to walk away completely. How will that transition work? The first thing a practitioner must do is try and envision how many more years — or tax seasons — they want to work full-time. Most smaller accounting practices have a significant number of personal and business clients they deal with only annually. Some other clients may have contact with the office or staff throughout the year, but see the owner only once a year.

If you are five years from seeking to reduce your role, that may seem like an eternity, but in reality it adds up to just five visits for many clients. That's important because, in most cases, if clients were able to perform the work we do for them, they would not have hired us. Thus, they really aren't equipped to judge whether we are great, adequate or inept at what we do for them. So, why do they choose your firm?

The answer in most cases is because the client likes and trusts you! Of course, fees, location, service procedures and other elements all are critical as well. But if the client was not comfortable with you, in most cases they likely would choose another alternative.

With that in mind, it's important to remember that the key to any firm acquisition is client retention. That's why it's important to start the process by reviewing any how much longer the owners will have client contact. In a perfect world, we should affiliate with our ultimate successors well enough in advance to give the clients an opportunity to gain a comfort level with them. There are methods of affiliating that enable the retirement-minded members of a firm to maintain control and income while gradually acclimating their clients and successor to each other. For more information on to this process, see the *Journal of Accountancy* article, "Two-Stage Deals" (http://www.aicpa.org/pubs/jofa/mar2006/sinkin.htm).

What are your firm needs and commitments? Besides years until retirement, there are other variables that can affect succession. If you are about to relocate, make a major investment in technology, add staff or institute another significant change, this may be the time to review your succession plan. Before you act, consider whether there is another firm or practitioner with whom you can affiliate that will participate in the investment. Or, perhaps the affiliation itself may satisfy your need because of the other firm's resources. If you need additional staff capacity or technology to enhance your practice but you are thinking of reducing your role in the next five years or so, an affiliation now with another firm that has that technology or excess capacity can possibly achieve all your goals.

Lease terminations also can play a significant role in the timing of your succession plan. If you are fewer than five years from reducing your time commitment to your firm, then now's not the time to enter into a long lease for your space. If you have a lease, you will limit your potential audience of successor firms to ones that can live with another location or do not currently have one. Firms that take on leases at this stage likely will reduce the size of the offers they receive by this additional cost factor. Enabling a successor firm to move your practice into their infrastructure makes a more profitable deal for the successor firm, which means they can afford to pay you more for your firm.

Taking Action Now

Your practice has its greatest value while it is running at top efficiency. By creating your succession plan in advance when the practice is peaking, you can structure the most lucrative deal. Remember, it takes time to transition the relationships that took years for you to establish and nurture. This action agenda will help you begin the process:

1. Decide how many years you have until retirement or a reduction of hours.

2. Review your exit strategy options. If you expect to sell your firm, assess the following:

- Is our current staffing sufficient?
- Will we need more staff in the near future?
- Is our technology adequate as is? Will it need to be updated soon?
- Will we need to relocate in the near future? If not, how long is our current lease? When does it expire?

3. Given the answers to questions 2, what steps should be taken to make the firm more attractive to a prospective buyer? Would an affiliation with another firm satisfy our staffing/technology/space or other needs? Would any commitments or investments made now limit the offers from prospective buyers in the future? ■

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