Succession Planning: **What Are the Roadblocks in Most Mergers? Is Anything "Easy"?**

By Joel Sinkin and Terrence Putney

After being involved with hundreds of mergers and acquisitions of accounting firms over the past 20 years, we have found a trend: the bumps in the road are the same whether the mergers are between firms of equals or a smaller firm is merging into a larger one. Conversely, some surprising things are not as hard to overcome as one might think.

Financial terms

When asked, most firms indicate they expect the greatest difficulty in merger negotiations is finding acceptable financial terms for both parties. In reality, we have found the financial aspects of the deal structure are often one of the easiest things to deal with. This is not to say coming to the financial terms in the deal structure is not without its challenges. We can usually find satisfactory outcomes using this basic win-win concept: no one does a deal to lose money. The acquiring firm is usually not going to invest a substantial amount of its capital or ask its partners to accept lower income to do a merger or acquisition. In the same vein, most firms seeking to merge upstream are not going to be interested in making less income while doing essentially the same things after the merger that they did prior. Similarly, sellers that will continue working full time for a while prior to slowing down or retiring feel the same way. Fortunately, we hardly ever see a situation where both sides' needs can't be satisfied.

Deal structure also becomes easier if both sides are willing to be flexible. Often, the acquiring firm addresses partner retirements/buyouts in a certain way. If one or more partners in the acquired firm seek succession in less than five years, a customized approach to their buyouts is often a way around the problems a preset agreement can pose. However, for those partners that have more than a five-year horizon, usually adopting the agreement in place in the firm they are merging into is the best ap-

proach and necessary. In these cases, because there is a long-term relationship anticipated, it is important to become part of the partner team without conditions as soon as possible.

It also helps to look at compensation as a package. For instance, if one firm's partners have auto allowances and the acquiring firm's partners don't, the problem can be overcome by recognizing this "perk" for what it is, part of the compensation package. The solution is usually in not forcing that kind of benefit to continue in the merged firm and recognizing the partners merging in should expect a bump in compensation or benefits somewhere else in the package.

Equity

A major problem we run into is the treatment of equity for minority equity partners of the smaller merging firm. In a recent deal in the Midwest, we arranged a merger of a three-partner $3 million firm and a $15 million ten-partner firm. The $3 million firm had one partner who owned 45 percent of the equity, one that owned 40 percent and the third owned 15 percent. So in effect, the 15-percent partner was being attributed with a $450,000 of "value" in the deal. That wasn't enough to justify him being a partner in the larger firm. However, the 45-percent partner would be leaving in three years. We worked out a deal so that the 45-percent partner sold (in a separate transaction) the 15-percent partner 15 percent more equity and merged in the remaining 30 percent. He then would be compensated upon retirement for only 30 percent by the acquiring firm, and all three came in as equity partners.

The trend in the profession is the actual amount of equity a partner has is less and less important. However, an equity partner going to nonequity status after a merger is very complicated and problematic (except in the case of partners nearing retirement). This can be a very difficult issue to overcome. It brings to the surface many questions, including valuation buyouts of equity owned in the prior firm by partners not granted that status post-merger, what role nonequity partners will have and the impact nonequity status will have on their compensation.

Firm name

We know of firms and consultants that fear this issue so much they try to resolve it in the very first meeting with a prospective merger candidate. The reality is that we have never been told a firm we worked with lost clients because the name of the firm changed after a merger. Clients actually don't care what the name of a firm is. What clients care about is how they will be served and who will be providing that service. If the message of what a merger means and doesn't mean to a client is delivered properly, the clients will go along with the deal.

So, why is this such a big issue and hard to overcome? Because of egos. Named partners sometimes fear a loss of identity and legacy. Even partners who are not named partners fear they will be viewed as second class in the successor firm if their firm's name doesn't survive. This issue is almost always totally emotional—and those are the types of problems that can be the hardest to overcome.

The most effective way of appealing to the parties is by helping them understand this is a business decision: it is merely one involving branding. For the future success of the firm, the name is far less important than communicating with clients directly about what the merger means to them. As long as clients are assured that they will be receiving the same or a higher level of service and quality, their fees won't increase and they will be dealing with the same partner(s) and staff, the name of the successor firm will be almost irrelevant.

Culture

One topic that should always be discussed at the first meeting is culture. Culture defines everything about how a firm operates. How a firm treats staff and partners is cultural. How partners are paid, how clients are billed is cultural, the way people dress at the office, the manner in which new business is developed and the amount staff and partners are expected to work are cultural. The reason cultural issues are hard to overcome is because they define the very essence of a firm in most cases. You are who you are. When there are cultural differences between

firms, they can usually be overcome if one of the firms aspires to adopt the culture of the other firm to become better.

As an example, we recently worked with two firms on a merger where there was a stark difference in partner billable hours. The larger firm expected at least 1,300 hours from each partner. We introduced them to a firm that averaged 850 hours per partner and the firm seemed loathe to the idea of partners being accountable for their chargeability. However, it turned out the real issue was with the two senior partners of the smaller firm who would be leaving soon anyway. The younger partners in that firm looked forward to a system where their willingness to produce a lot more billable hours would be rewarded and lead to a more profitable firm. Often, though, this kind of cultural difference can be hard to overcome.

Unnecessary must-haves

We worked on a potential deal recently where the owner of a smaller firm was seeking succession. This firm had an "office manager" making $85,000, who had been with him for 31 years. The seller's loyalty, while admirable, got in the way of making a reasonable deal and he required a successor to guarantee long-term employment for this person. The office manager had very little chargeable time and was totally expendable by all successor firms we introduced the seller to. If the decision about how to handle this person was made nonemotionally, a satisfactory answer could have been found. In all probability, a severance package amounting to as little as $25,000 would have done the trick, and that would have been insignificant to the overall package. However, we couldn't get the seller to think rationally about the issue and weren't able to make the deal happen.

Leases

If a firm has a long-term lease remaining that can not be cancelled or reasonably sublet and no room for expansion, finding a deal can sometimes be hard. Their options are limited to firms that see that space as is as perfect for their business plan. If the successor firm already has a presence in the same marketplace, many times they cannot gain enough synergy unless they can combine both firms into one office. Many firms also believe it is important to operate under one roof to integrate cultures and clients, create cross-selling opportunities and take advantage of operational efficiencies.

However, just like with firm names and other must-haves, some firms seeking a merger will give too much priority to retention of their space even when the circumstances don't warrant that. They like their offices, they like living five minutes from the office or they unreasonably fear loss of clients if they move (even though most firms rely on meetings with their clients in their offices for very little of their business). Conversely, some successor firms are unreasonable in their expectations of how to resolve the tail end of leases for acquired firms. They expect the acquired firm to eat the final one to two years of the lease in an effort to squeeze as much profit as they can out of the early years, ignoring the long-term benefits that will overwhelm that short-term delay in cost savings. Remember, there is hardly ever a cost associated with maintaining the status quo. The cost is an opportunity only to improve profitability and that will be realized in many cases soon enough.

Not having all partners on board

We too often see senior partners purport to represent the firm, when, in fact, they have not even told their partners they are in negotiations. This was a common problem during the consolidation craze in the late 1990s and early 2000s, as there was a lot of money being thrown at deals. A managing partner going to his other partners with a surprise "guess what I got for us?" almost never works unless the other partners are partners in name only. It is very difficult to resurrect a deal that has blown up due to a lack of transparency within either firm's partner group.

In summary

The common denominator in all of the above issues that make deals hard to do is a lack of awareness or consideration for what the other party's per-

spective and reasonable needs are. When both parties take the time to see the issue from the standpoint of the other party and try to find solutions that are win-win, almost any obstacle can be overcome.

About the authors: Joel Sinkin (*jsinkin@transitionadvisors.com*) and Terrence Putney, CPA (*tputney@transitionadvisors.com*), are partners in Accounting Transition Advisors, LLC, which exclusively consults on the merger & acquisition of accounting practices. They travel cross-country to teach CPE for state and national accounting associations, have consulted on over 1,000 accounting firm closings and succession plans, and published books and articles on the topic. They can be reached at 866-279-8550 or at *www.transitionadvisors.com*. ✦

This article is reprinted with the publisher's permission from the CPA Practice Management Forum, a monthly journal published by CCH, a Wolters Kluwer business. Copying or distribution without the publisher's permission is prohibited. To subscribe to the CPA Practice Management Forum or other CCH Journals please call 800-449-8114 or visit www.tax.cchgroup.com. All views expressed in the articles and columns are those of the author and not necessarily those of CCH or any other person.