

Voices What's driving upstream mergers?

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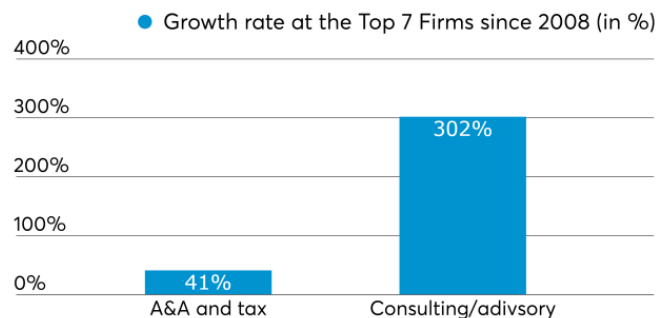
Traditionally, an overwhelming number of firms seeking to merge upstream have done so to address partner succession. However, due to a shift in the market among firms that seek mergers for growth, there are new reasons to consider an upstream merger to provide accelerated growth for your partners and deal with the pending seismic shifts in the profession.

Large CPA firms seeking to grow through M&A that have historically been willing to take on partner succession issues in a merger are losing interest in acquiring practices where most senior partners are retiring. Also, firms that previously pursued mergers to expand their geographic footprint have, for the most part, executed that strategy. We have been told by many of the most active firms in M&A that their primary objective now is to acquire both specialized niche services and young talent.

Futurists have predicted quantum changes in the profession within five years due to technology. The Big Four firms have spent hundreds of millions on artificial intelligence capabilities that are fundamentally changing the way they deliver services. Blockchain may possibly alter the manner in which attest services are delivered and, in some cases, eliminate the need for those services. The hours required to provide attest and tax compliance services may drop by as much as 40 percent due to the automation. It's hard to imagine that such a change in billable hours won't eventually drive down fees as well.

Non-compliance advisory services will clearly be driving future growth in the profession. According to the annual Accounting Today Top 100 Firms survey, A&A and tax services provided by the largest seven firms have grown by 41 percent since 2008. Meanwhile, consulting and other advisory services offered by these firms have grown by 302 over that same period. Firms that don't offer services beyond traditional compliance are going to find it harder to compete for new business and even retain what they already have.

Outstripping traditional services



Source: Accounting Today Top 100 Firms surveys

The case for your firm to consider an upstream merger should include strengthening your ability to compete in an environment that requires significant new technologies and a much wider array of service offerings.

Managing the future

We have consulted with many firms in recent years who have pondered the question that almost all firms will, or already are, asking: “How will our firm manage the costs and expertise required in order to get on the technology platforms necessary to remain competitive going forward?” When it comes to technology, many firms essentially don’t know what they don’t know – especially when it comes to determining the “right” technology platform.

Not only can the technology investment be significant -- the training of professional staff can be just as daunting. As AI eliminates the tasks that used to be performed by less-experienced staff, the challenges in recruiting may also be exacerbated. Here is an example of how important technology has become in the delivery of services: We work with firms that will automatically discard the technology platforms of the firms they merge in and invest as much as \$12,000 per full-time employee for replacements. They can’t afford to wait for attrition to do the job and the payback makes the investment well worthwhile.

Rather than trying to reinvent the technology wheel, we are seeing an increasing number of firms merge up to avoid what could be an overwhelming investment in new technology. We know of examples where this issue has even driven mergers between some of the larger Top 100 firms.

Growth

Advisory services are the other strong driver for mergers in today’s market. Firms that offer either niche services or industry concentrations are in high demand by acquiring firms. If the opportunity arises for a merger with a firm that has these services is compelling enough, we have seen very lucrative offers made by acquiring firms. This is despite an M&A marketplace that, overall, has shifted to favor the buyer.

However, even if your firm doesn’t offer niche advisory services, you probably know you should in order to remain relevant to your best clients. When you are competing for a new client, the old promise -- “We provide a personal touch and remain extraordinarily responsive to our clients” -- doesn’t cut it when your competitor is offering deep expertise in the prospect’s industry and can assist with cybersecurity threats and human resources management. Our firm has been consulting with many of our clients on acquisitions of specialized consulting services to either acquire that expertise or strengthen existing offerings because they know they can’t survive offering strictly traditional services. About one-third of the acquisitions completed by the Top 100 Firms last year were with non-CPA consulting firms.

Acquiring the expertise of a cybersecurity firm is way beyond the reach of most firms. However, we are seeing an increasing number of firms consider an upstream merger into a firm with these capabilities in order to improve the level of service they can offer their clients and prospects. We have seen examples of firms that double their fees to their existing client base in two or three years because of the wider range of services they can offer following a merger into a firm that has those capabilities.

Conclusion

For many years, the American Institute of CPAs has encouraged firms to pursue a path to become their clients' most trusted advisor. This strategy has never been more important than now. There are three ways for you to deal with the significant changes that will impact the accounting profession -- ignore the threat, acknowledge it but fail to act, or use the changes to your advantage. No one is predicting the demise of the profession. It is just going to be different. Eventually, many of the services CPA firms offer and the means of delivering them will go the way of 14 columnar paper. We still do spreadsheets - just not with paper and pencil.

If your firm has a significant near-term need for partner succession and the only solution is an upstream merger, just know the number of potential merger partners that will be interested has been narrowed. This trend will likely only continue. Even if you find a firm interested in taking on that problem for you, they will likely drive a harder bargain on terms than just a few years ago -- but in such a case, that may be your only option.

However, if you don't have that issue and are seeking to take advantage of the opportunities the future of the profession will offer, you may find you can jumpstart your growth and avoid some pain by merging with a firm that is ahead of the curve.

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