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The State of the M&A Market

The deals just keep coming

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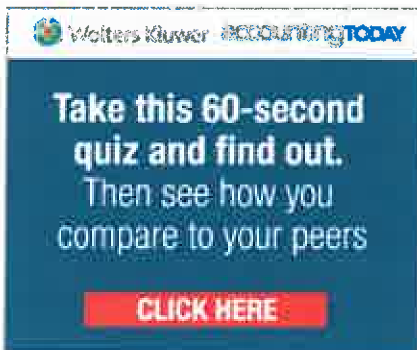
Each year for the past decade, the appetite for mergers and acquisitions in the accounting space has outpaced the previous year – and 2015 was no exception. What's more, the market continues to shift in unexpected ways, as the supply of buyers and sellers changes, along with what they hope to accomplish in individual deals.

To help map out the M&A landscape for the year ahead, we asked a number of experts in the field to share their thoughts on what 2016 will hold for firms looking to combine. Our "virtual roundtable" included Steven Berger, a shareholder at law firm Vedder Price; Allan Koltin, CEO of Koltin Consulting Group; Ronald Loberfeld, managing partner of Abrams Little-Gill Loberfeld; Jay Nisberg, of Jay Nisberg & Associates; Russell Shapiro, a member of the Corporate & Securities Group at law firm Levenfeld Pearlstein LLC; and Joel Sinkin, president of Transition Advisors.



How would you characterize the M&A market?

Shapiro: The market continues to be robust. Acquirers want to keep growing and expanding into new markets to leverage their infrastructure. Smaller and local firms continue to view merging as a way to fund retirement benefits, gain ability to service larger clients and gain access to better technology platforms. The pickings are getting slimmer, however, and while I do not see any ebbing in merger activity for the time being, I wonder how much longer it will last. Many larger firms are willing to absorb smaller firms with smaller clients than in the past. It is an open question in my mind as to whether the smaller clients will be retained. There may be more activity among the Top 100 Firms.

Sinkin: The market is very active and will remain so for the foreseeable future. There are many reasons for this activity but the main ones include: succession; large firms seeking to enter new marketplaces; large firms who recently did enter a new marketplace now looking into tuck-ins; talent grabs; and establishing cross-selling opportunities by merging in niches and the like including nontraditional accounting and tax firms

Accounting M&A keeps going strong, continuing the trend of the past several years. Firms who are "buyers" are always looking for acquisitions to fill practice area or geographic niches. The desire for geographic expansion is somewhat paradoxical. Geographic reach is important as the ease of electronic communication makes geographic borders (whether local, state, national or international) less meaningful. At the same time, buyers are looking for "boots on the ground" in desirable markets to improve marketing opportunities and visibility. So, city firms are looking for suburban offices, and national firms are looking for offices in smaller cities where, in the past, you would not expect to find national firms.

At the same time, the smaller firms are continuing to age and most do not have viable succession plans. Either the contractual retirement packages for the founding partners are not sustainable economically or there is a lack of an agreement on how the succession should take place. The retiring partners seek guarantees of their retirement. In addition, as the larger, more national firms make forays into markets where previously only smaller firms dominated, those smaller firms are facing increasing competition from more widely recognized names. Finally, the practice of accounting has become more complex and requires more significant investment in technology in order to remain competitive.

Loberfeld: Crazy. Every day you read online about another firm who has merged or been acquired. Many firms who would not ordinarily be looking to merge are doing so now because no one seems to want to miss an opportunity. Succession planning and the aging Boomers are primarily driving the M&A activity. In the background you have many firms who are also using M&A activity as part of their marketing plan for growth. Size of firm doesn't matter. The smaller firms are becoming part of medium-sized firms. Large firms are becoming parts of giant firms. It's hitting all sectors. The big question is, when will this all slow down? For the time being we may continue to see activity like this for the next several years.

Nisberg: The M&A market is changing, chaotic and confusing. The last three to five years, there were two dominant reasons for merging or being merged: to obtain quality clients to grow the top line, and to obtain quality people. Today most deals I'm involved in are mostly driven by succession planning, or to obtain services sophisticated clients want and need but that the firm can't seem to create or afford. Interestingly, every merger you read about, the reasons are always client-centered, people-centered or resource-centered. That makes perfect sense since no one being acquired wants to admit that they had little or no confidence in younger partners being able to retire or buying out the senior and controlling partners. This raises an entirely valid argument for funding partner buyouts. The biggest change I'm seeing is that more acquirers seem to have more cash or "creative cash" available to do acquisitions, either by guaranteeing retirement benefits or through cash incentives. It is also clear to me that many acquirers have picked over the premier market and are now looking at firms they may have passed on earlier in the merger/acquisition strategy process. The chaos seems to be a result of firms being acquired misjudging their negotiation position and in many cases believing their firms have greater value than reality would suggest. I'm also seeing the old adage of "firms being worth one times gross fees" being ignored more often. Acquirers seem more willing to pay a bit more to meet changing demands or geographic objectives.

Koltin: As we know, whether we refer to the current state of M&A as a frenzy or trend, we know at some point both frenzies and trends come to an end. The M&A frenzy in the accounting profession is now in Year 9 and, while it's hard to imagine that the pace can continue, every indicator suggests there will be more mergers in 2016 than there were in 2015. Interestingly, this is a trend that has essentially continued over the past decade, even through the Great Recession. Obviously one of the big changes going on is that the acquirers have essentially expanded from the Top 100 Firms to include the Top 500 firms (firms with revenues of $7 million or greater).

What M&A-related issues or opportunities should small firms bear in mind for 2016?

Loberfeld: Firms of all sizes should bear these points in mind:

- Be sure you have a smart reason to merge. Just to merge because so many others are doing it is not a good reason.
- Selecting the right firm to merge with can be very complicated and tricky. Be sure to engage a consultant/specialist with M&A experience to guide you. The money will be well spent.
- Culture is huge. A comprehensive analysis of the firm and how both firms would operate as one requires a lot of homework and due diligence.
- Location, name, governance are just a few items that can break apart a deal. This all needs to be fleshed out early on.
- Both current and deferred partner compensation factors must fit well, both for today and for the future.
- Your clients need to fit well in a new environment, both from a service and fee perspective.
- The transaction needs to be good for your staff and leadership teams.
- The smaller firm needs to be receptive to "losing control." This must be dealt with, including open conversation of the new service and leadership roles.

Nisberg: Depending on one's definition of "small," the biggest pitfall is that owners of smaller firms inevitably believe their firms are either worth more than they are being offered or they are in such great demand the acquirer needs them more than the reverse. Small firms must keep in mind what they are and what their relevance is to the firm merging them in. Be careful of what I call the "GM Syndrome."

Shapiro: For small and midsized firms, if you want to merge, don't wait too long. You will want to merge while your client base and staff base are still robust and while you still have an internal succession option. If you try to milk everything out of the business, your prospective merger partners will not be as strong and/or you will not get as good of a deal. If you want to remain independent, you will have opportunities with people who do not fit into the larger firms, but you will have to work hard and keep investing (especially in talent).

Sinkin: If your reason for executing a merger is you are seeking succession, start sooner than later. Not only does transitioning partner-loyal clients take more time than most devote to it, but values are shrinking and will continue to do so. Also, the amount of firms with the capacity and skill set to replace retiring partners is limited but the amount of Baby Boomers who will be seeking succession solutions increases geometrically almost daily. And if your succession plan is based on finding young talent you will groom to be your internal replacement, start thinking differently as this is becoming closer to a pipe dream then a succession plan.

Koltin: Smaller firms are becoming much more active in M&A and understand now that this is an excellent way for them to grow their firms. That being said, smaller firms always need to be careful that they have the resources to properly transition the seller's client base. Oftentimes, smaller firms are at full capacity in terms of their existing talent and are well-intentioned to take over the seller's client base, only to find out no one has the time or the capacity to make that a reality. It has been refreshing to see smaller firms attacking the sole practitioner market, as there are many wonderful firms and client bases within that segment of the practice.

Berger: Smaller firms should be looking for M&A opportunities as either buyer or seller. Smaller firms face issues in today's market of the lack of qualified staff, the high costs of technology, the complexity of regulatory compliance and encroaching competition from other markets. Sometimes, these issues (especially staffing) can be eased by acquiring even smaller practices that would not disrupt the general atmosphere of such a firm, or by luring individuals from larger firms who seek a more appropriate platform to grow their individual practices. While outsourcing certain services and cloud computing services have enabled the smaller firms to compete technologically, those solutions are not perfect and pose risks of reliability, confidentiality and security. Internal disputes among partners nearing retirement may not be solvable with methods that previously worked. Succession planning in smaller firms sometimes can be solved by bringing in additional partners to change the dynamic, and hence the small firm might want to be a buyer; at the same, though, the smaller firm may want to solve the intrinsic problems by finding a larger firm to override these underlying issues. The smaller firm should be careful, though, because when acting as a seller, the interpersonal issues among partners of the seller will arise and need to be addressed in the negotiation of the partnership/employment relationships with the new firm.

What M&A-related issues or opportunities should midsized firms bear in mind for 2016?

Koltin: There has also been a significant uptick in midsized firms' participation in M&A. Midsized firms have the luxury of having a deeper bench than smaller firms and oftentimes are better able to deal with the transition of the seller's client base. If I was to offer up one suggestion to midsized firms it would be to supplement M&A with a strategic plan for bringing in lateral talent, preferably with a specific industry or service-line specialization. Midsized firms need to be very careful as they grow that they also continue to focus on building out their product and service lines. Some midsized firms have fallen into the trap of getting big, but then not having the necessary industry expertise and depth to compete with other larger firms.

Berger: Midsized firms, like smaller firms, should be constantly looking for opportunities as either buyer or seller. They face the same issues of increased competition from the larger firms expanding into their markets, technology issues and a lack of sufficient qualified staff. Midsized firms may, however, have a more established firm structure that provides for internal dispute resolution, and may have a governance structure that facilitates the implementation of a succession plan. If a midsized firm does not have such infrastructure, then it might be more likely to be a seller rather than a buyer. Midsized firms also face issues of exponential technology costs they must bear in order to meet the competition, and possibly to attract staff. If a midsized firm is going to become the local office of a larger regional or national firm, before entering the transaction, the midsized firm should be closely examining issues of governance (how autonomous will they be in the local market, role in total firm governance), synergies with other offices of the larger firm (joint client development efforts, expansion of service offerings to existing clients), and compensation (are there significant overhead costs to be borne by the local firm). Midsized firms should always be looking for opportunities as buyers as well, especially to find synergistic additions to the existing practice, or even geographic expansion within the local market (i.e., expansion to other immediate localities to enhance visibility).

Nisberg: These folks are suffering with the "Middle Child Syndrome." They don't know if they should beat up the younger sibling or if they are going to be beaten up by the older sibling. No one is going to beat them up. These firms are struggling with giving up power and control or exercising the power and control. The big decision here is merging up or merging in. It is very difficult to get all partners on the same page here.

Sinkin: Midsized firms have the exciting opportunity to meet with smaller multi-partner firms that have both young and older partners. These firms typically lack the capacity to replace all of the retirement-minded partners internally, so this means the midsized firm can scoop some up, replace the retiring partners and make more money and have the younger partners join and be part of the ongoing firm. Just be wary that you have the capacity, the ability to leverage and the skill set required to replace these retiring partners, and a culture match that enables the young partners, the clients and staff to feel comfortable in the successor firm.

What M&A-related issues or opportunities should large firms bear in mind for 2016?

Berger: Larger firms are more likely to be buyers than sellers in the coming year. Larger firms seeking to expand geographic reach or the menu of service offerings for clients will be looking for high-quality firms or practice groups to create synergies. Like all buying firms, the large firm buyers should devote significant time and effort to a full due diligence examination of the target firm or practice groups. This is especially true in the attest area, to make sure that no significant independence impairments, on either side, will adversely affect the economics of the transaction. If the larger firm is looking to expand, it needs to make sure that the target fits in with its strategy and is not buying just for the sake of buying. Quality control due diligence is extremely important, and the larger firm should test the proposition that the target firm will conform to the QC requirements from the perspectives of client intake, internal reviews and procedures, and staffing. Billing rate compatibility is important as well; imposing high billing rates on an acquired smaller firm may result in a loss of clients by the acquired firm.

Nisberg: Don't overwhelm smaller firms being acquired. Be careful not to strip them of their self-worth and make acquired firms feel like you're doing them a favor by bringing them in to your culture. I call this the "Big Dog Syndrome." On the converse, don't lose sight of who the surviving entity is, but be willing to borrow attributes from those you acquire.

Sinkin: All mergers should never forget to focus on the Four Cs: Chemistry: if you don't want to eat lunch with someone, don't merge with them; Capacity to take on the work load; especially when the mergee has partners and high-level staff heading to retirement in the short term. Culture: is there one word with more importance, more meaning and more influence over the success of any merger? Continuity: most partners, professional staff and clients have many choices of firms to work with. When merging in a firm, we should realize the parties are comfortable with the way this ship is sailing now. The work environment and compensation for staff, the fee structure and manner that clients are serviced ... if you are going to have to make wholesale changes to the firm you are acquiring/merging in, be sure these changes will be perceived as a gain, not a loss or be prepared for some challenges.

Koltin: Large firms need to continue to be opportunistic when strategic M&A opportunities arise. This could be in a market where they strategically didn't plan to be today, but rather in a couple of years, and need to take advantage of that opportunity today because it may not exist in a couple of years. In addition, I've seen larger firms move somewhat away from the acquisition of pure accounting firms and having a much greater reach into specialty and consulting practices, such as outsourcing, wealth management, and industry-specific practices. I believe that's a great strategy and will continue to differentiate them for years to come. Lastly, as it relates to larger firms, oftentimes larger firms are competing with other larger firms for the same acquiree. The one that wins is the one that essentially was willing to give an "outsider" a better deal than a "insider." Firms need to be willing to pay premiums and sometimes this means breaking the mold in terms of giving the acquiree a better deal than existing partners of the acquirer are getting today. Firms need to be not only strategic in doing deals, but also willing to sacrifice some short-term dollars for long-term success. I'm always reminded of a transaction that took place in Chicago about 10 years ago in which one firm was perceived as overpaying for the deal. Today, that practice has grown five-fold and the firm that finished second is still watching from the sidelines and has yet to successfully enter that market.

What are the biggest obstacles to making an accounting firm merger work?

Sinkin: While it is a challenge to reduce the roadblocks to one main one, I would likely start with the greatest challenge: change. Very few people are comfortable with change. This includes partners, staff and clients. The key is, can these changes be viewed as a gain with the new firm or will it be more focused on the loss of the old? Included in change is an increase in accountability. For many smaller firms merging into larger ones, the loss of control and the increase in their accountability is a daunting change. The best advice I can share is to remember that these mergers and acquisitions, especially for small and midsized firms, traditionally are much harder to manage on the emotional side then the financial side. When you look at mergers that didn't work well, while some it could be due to financial issues, in most cases it wasn't financial but issues relating to emotions, to change of culture, accountability issues, etc.

The numbers aren't hard to work most of the time; it is dealing with two firms becoming one on an emotional basis which can be the toughest obstacle to overcome but one of the most important to address.

Nisberg: The biggest questions to successful mergers remain what the name will be and who is running the show. Once these hurdles are crossed the next issue is the lawyers. They manage to screw things up. Often after the principle tenets of a deal are established, lawyers always seem to muddy the water. I think they like to renegotiate deals on behalf of their clients after the deals are done. Partners must harness their lawyer's creative energy and be sure they protect and memorialize the deal the parties want. Rarely do I see lawyers controlled by their clients and they recreate the entire negotiated process. CPA firm partners must control these people in this effort.

Koltin: I believe the biggest obstacle is getting all the partners of the acquiree firm on board and preferably doing most of it in Year 1. That being said, firms need to be careful, from an integration standpoint, that they don't have a one-size-fits-all approach to onboarding firms. Because of their client base or service offering, some practices truly might need to take longer to integrate, especially when there are major succession issues at play and clients are at risk.

Shapiro: With respect to the transaction itself (where, as the transactional attorney, I am most often involved), the hurdles are almost always personality related. Assuming the deal otherwise makes sense, if the main partners in each organization develop a rapport, the transaction can usually get done.

Berger: An accounting firm merger will work only if there is buy-in from the partners of both buyer and seller, and if the terms of the transaction are structure to facilitate the synergistic growth anticipated by the merger. Selling firms that enter a transaction because they were dragged by the largest rainmaker are likely to risk the early departure of significant personnel. Partners of the selling firm need to be motivated by the economic terms of the deal to make it

work, that they will be better off in the new structure than they would have been maintaining the status quo. Buying firms need to be assured that they are receiving what they think was promised. If the transaction costs too much without tangible results, then the partners of the buyer will be disheartened by the failed transaction.

Both buyers and sellers need to be realistic as to what to expect in the early months and years following the closing. Integrating the two firms takes time and costs money. Cost savings are not realized immediately, and both firms need to understand that going in. The "tone at the top" is important. Leadership has to embrace the merger.

Egos need to be left at the door. This problem usually manifests itself in the choice of a firm name (if the transaction is a merger of equals) and in governance. The name issue should be addressed on two levels -- legal and marketing. People often confuse the two. The firms can handle the press and the marketing to show the transaction. What clients care about is that they are still interfacing with the people they know and they are receiving the same or better services. For the acquired firm, there should be some role for their partner(s) in the leadership of the resultant firm. That shows the partners and staff of the acquired firm that there is someone who knows them and will look out for their interests.

Shapiro: With respect to the transaction itself (where, as the transactional attorney, I am most often involved), the hurdles are almost always personality related. Assuming the deal otherwise makes sense, if the main partners in each organization develop a rapport, the transaction can usually get done.
Koltin: The other big obstacle that I think occurs is with partners in the acquirer firm. They see this as something that "corporate" is doing and don't spend individual time with the acquiree, meeting with them and talking about common growth opportunities where both groups can work together. In essence, the two firms merge, but the reality is nothing has truly changed post-merger from what the relationship was pre-merger. We need to remind ourselves that the whole reason we do mergers is to grow together, share relationships and develop additional revenue from the combined client base.

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