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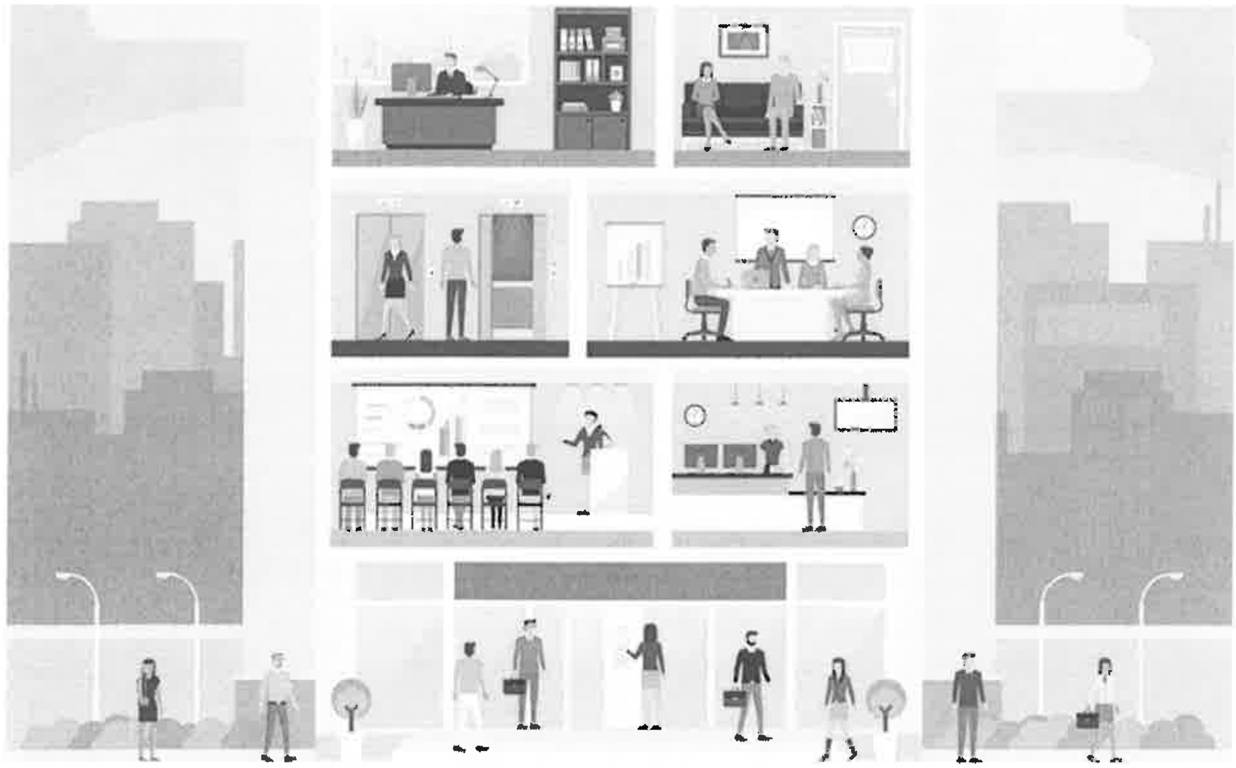
EXPLORING THE ISSUES THAT SHAPE TODAY'S BUSINESS WORLD.

Does Your Firm Have Curb Appeal?

Nine signs you're not acquisition ready.

By Carolyn Kmet | Winter 2016/17



It used to be that a retiring partner from a small to midized CPA firm would groom a successor to take over. This straightforward approach ensured a smooth transition from one partner to another—specifically, someone already familiar with the firm's staff, clients and processes.

Today, however, there's a growing trend towards seeking out mergers and acquisitions instead. In fact, the 2016 Accounting Firm Operations and Technology Survey found that 51 percent of respondents are considering a merger or acquisition in 2017, a 13-percent jump over 2015.

"We've seen an increase in accounting firm M&A activity for at least the last five years; over that period, it has been robust and consistent," says Russell Shapiro, a member of Chicago-based legal firm Levenfeld Pearlstein, LLC, which provides legal representation to many accounting firms in the process of selling, buying or merging.
What gives?

"While the trend originally started because of succession planning issues, an estimated one-in-three firms today is pursuing mergers and acquisitions as a way to achieve strategic growth opportunities for their practice and their clients," explains Allan D. Koltin, CPA, CGMA and CEO of Chicago-based Koltin Consulting Group, Inc., specialists in professional and financial services firm mergers and acquisitions.

"I believe the biggest reason the merger mania has continued is because the vast majority of mergers that have taken place in our profession have proven to be successful," he adds, noting that if that wasn't the case, we would see a "rapid downward spiral" in terms of the number of mergers taking place.

But would you recognize the signs if your firm wasn't, in fact, M&A ready? These nine factors will tell you everything you need to know.

1. Technology isn't king

Technology is unquestionably driving M&A activity in the accounting industry. As more and more CPA firms look to capitalize on cloud computing and paperless workflow systems—and more—mergers and acquisitions offer an efficient way to acquire tech savvy talent.

"The most successful transactions are with firms helmed by visionary leaders who understand the increasing convergence of technology and accounting, and recognize the long-term benefits in scale, value-added service offerings and geographic expansion to meet client needs," says Jim Sikich, CEO and managing partner of Sikich LLP, a professional services firm.

2. No leaders? No way

Sikich has taken a strategic and aggressive approach to acquiring successful firms with forward-thinking leaders to support his organization's ambitious national growth goals. Not all the firms he encounters, however, are well-positioned for acquisition.

"Some firms come to us to discuss a potential acquisition, and it's obvious they did little to lay the necessary groundwork. Instead, the leaders waited until they were ready to sell and retire to begin the process," Sikich explains. "An accounting firm is not well-positioned to be acquired if it has aging staff, most of its partners are nearing retirement, and it has failed to address succession."

3. You're a cultural mismatch

Company culture is another important acquisition consideration. "Many times, companies will have a culture that emphasizes maximizing short-term profits at the expense of creating long-term value and sustainability. As a result, there is little investment in personnel, which hinders recruitment, development and retention," says Sikich. And that means you're at a disadvantage as an acquisition target.

4. Underwhelming performance

CPA firms seeking a merger or acquisition must demonstrate strong financial performance and positive historical growth, and must have a game plan for profitable future growth. "If a firm has poor financial performance and unrealistic expectations relative to its value, it will not be appealing to a potential buyer," Sikich emphasizes.

5. Top talent? Maybe not

A strong staff that provides continuity for clients following a merger or acquisition, and a cohesive partner group, also can contribute to a successful merger or acquisition.

"For larger firms, buying a firm that has excellent staff is almost always an absolute must. High-quality people are often more difficult to attract and develop than great clients," says Brannon Poe, CPA, founder of Poe Group Advisors, a brokerage firm that assists with the purchase and sale of accounting practices.

6. No objectivity, no buyer

A good rule of thumb is to evaluate both your M&A attractiveness and readiness every couple of years. Regardless of whether firm partners ultimately decide to proceed with an M&A strategy, the evaluation process itself is an important exercise.

"The firm needs to look at the opportunity as objectively as possible from a prospective buyer's point of view," says Poe, further suggesting that firms conduct a SWOT analysis to document their strengths, weaknesses, opportunities and threats. He adds an additional factor—timing—into the mix. Firms will need adequate time to implement changes and improvements that arise out of the SWOT analysis, such as changes in billing or pricing, or the need to prune underperforming clients, service lines or staff.

7. Cash isn't flowing

Let's not forget that cash flow is a top priority. Firms trying to position themselves for acquisition and attract buyers might maximize cash flow by dropping underperforming service lines, raising prices, or letting go of unnecessary staff positions—all of which a SWOT analysis could reveal.

8. You're on the fence

In Poe's experience, if the buyer senses that the seller isn't really ready to sell, then they might stall negotiations or just walk away. "No one wants to invest the time and energy required to do a deal, only to have the seller take the practice off the market due to a change of heart," he explains.

9. Niche? What niche?

Developing clientele within a specific niche or specialty practice also may help firms increase their attractiveness. "From the buyer's perspective, acquisitions are made to expand and strengthen geographic reach, add or enhance certain expertise, and to leverage infrastructure," Shapiro explains.

While it takes significant time and investment to properly position a firm for acquisition, it's all in the name of increasing that "curb appeal."