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The Changing Face of M&A

Given the steady drumbeat of accounting firm mergers announced and completed over the past decade, and the way the pace of mergers and acquisitions has only seemed to increase, it's easy to assume that it will continue in much the same way. But that ignores the nature of the trends that set the recent great wave of mergers in motion - and risks missing the signs that those underlying trends are changing, with serious ramifications in the merger landscape.

To get the lay of the land for 2013, we convened a "virtual roundtable" of leaders in the area to give us their sense of where things are headed. Our panelists are all experts at creating and facilitating deals, having between them worked on literally thousands of transactions: Steven Berger, a shareholder at the law firm of Vedder Price; Allan Koltin, CEO of Koltin Consulting Group Inc.; Jay Nisberg, president of Jay Nisberg Associates; and Joel Sinkin, president of Transition Advisors.

Do you expect the merger & acquisition landscape for accounting firms to change in 2013?

Koltin: I believe the M&A frenzy that we saw in 2012 will continue to accelerate in 2013. If you look back over the last five years, every year there have been more mergers and acquisitions within our profession. Even more interesting is the fact that they have continued to be larger, and we're also beginning to see more mergers of equal-sized firms which, until a couple of years ago, was unthinkable. I also believe that 2013 will have another major landscape change in terms of M&A players and structure. Don't be surprised to see one or two significant private equity firms enter the accounting profession in a rather big way!

Berger: I believe that the M&A market will continue at the high levels of intense interest in pursuing deals. There are still more buyers than sellers, so there will be intense competition for the purchase of quality firms. Buyers, however, are looking more closely at expanding their range of services, so sellers with niche practices or a unique client base will be highly attractive.

Sinkin: Much of the potential changes in the marketplace, if any, will be based on the economy. If the economy does not improve greatly I see the marketplace being very similar in 2013 as 2012. That is to say, the M&A activity will remain off the charts. The same driving factors will be there: the aging of the Baby Boomers and the economy. When organic growth is challenging, M&A growth becomes more attractive. ... Values have reduced over recent years, a trend I would expect to continue.

Nisberg: I am anticipating the M&A landscape to change significantly in 2013. I am expecting it to dramatically tighten up with respect to more "due diligence" in both directions going forward. While there have been numerous amalgamations over the past three to five years, I'm seeing a number of firms - either the acquirer or the acquired - who, when asked if they would do the deal over after one or two years of experience, are saying "Not on your life." I also have seen some firms exercise their "divorce clauses," primarily due to their inability to integrate into a new environment. The bottom line is that I expect fewer mergers or acquisitions in 2013, but I also expect more introspection, due diligence and more careful decision-making.

This will produce far more successful combinations going forward. I think in the past firms were jumping at what appeared to be attractive situations, not realizing how much change would be involved.

Berger: Despite the pressure to grow, buyers are becoming more sensitive in their due diligence investigations regarding both the economics and the culture of the firm to be acquired. Sellers with continuing practices are looking for buyers with solid management track records and are seeking not just to be acquired but to become part of the management team of the combined firms.

How long do you expect the current M&A market to continue?

Nisberg: As I said, I believe that the current market trend for M&A will start to show signs of decline in 2013. Acquirers will be far more choosy and those with the ability to buy with cash will continue to be most desired; however, even these firms have been depleting their cash coffers and will be more careful how they spend money on cash deals going forward. So M&A will continue but not at the same rate; a slowdown will occur, while those aggressively acquiring will be far more picky.

Koltin: I guess, like all things, at some point there is a leveling off. From a national perspective, I believe the M&A market will continue to be hot, but in certain markets I am starting to see fewer quality firms available to merge up, especially where there's already been a lot of consolidation. Everyone always asks me if it's a buyer's or a seller's market, and the simple fact is that it's neither. Rather, it's a great opportunity for high-performing firms that are either buyers or sellers. Conversely, for low-performing firms, it will continue to be a tough marketplace in terms of opportunities as it relates to buyers and sellers.

Berger: The market should continue at least at the same pace, if not increasing its pace, in the next year or two. The pending changes in the tax laws will impose dual pressures: The search for solid tax practitioners will intensify, but those tax practitioners will be spending a significant amount of time in 2013 understanding the new tax laws and may not be able to focus on merger opportunities.

Sinkin: I don't see an end for at least five to seven years. The difference is that what has always traditionally been a sellers' market - assuming you are in a reasonably densely populated area that has many competitive accounting firms in it - will gradually become more of a buyer's marketplace, specifically for the larger firms.

Koltin: I would also add that, in the past couple of years, the landscape for M&A has changed. Historically it was 90 percent driven by succession-planning issues. Today I would guess at least one third of the mergers I see taking place are purely for strategic reasons, whereby the seller was a high-performing firm and could have stayed independent, but simply felt the upstream merger would put them in an even better position than they presently were.

Are the trends in M&A different for small versus large firms?

Sinkin: There are huge differences! For the small firm, say under $1 million: Again, if you are in an area of the country where there are many local accounting firms, here succession is not as great of an issue to overcome. Many firms can absorb a small practice into theirs with little to no incremental increases in overhead, and as long as the terms are right, that market is likely to remain strong for sellers. If you are in a remote area of the country and have few local accounting firms, supply and demand takes over and the buyer has more control.

For the one-to-eight partner firms, succession continues to drive many of the deals. Remember, too, that as firms increase in size, the amount of local firms large enough to be their successor dwindles. Thus as firms grow in size, their marketplace and value shrink, and the reality is it becomes more of a buyer's marketplace.

Larger regional and national firms will continue to seek market share, adding niches to penetrate their clients with additional services and add to their bench.

Koltin: I don't know if the trends are different, but clearly some of the cultural and operational issues are different. In smaller firms, most practitioners are generalists and many perform both accounting and tax services. Obviously when you merge into a larger firm it is much more departmentalized and structured, which represents a change that is sometimes difficult for smaller firms and practitioners to make. Also, not always, but most of the time, smaller firms have partners that have books of business wrapped very tightly around them, whereas larger firms are much more leveraged and have many touch points as it relates to the client base. This also represents a cultural challenge for smaller firms coming into larger firms.

Nisberg: The trends are very different. Small firms will be more easily amalgamated and the trend will increase. These firms, commonly referred to as "tuck-ins," are easier to accomplish, there are more of them and they are often acquired for skills and services, rather than volume. The larger firms are far more difficult to accomplish, it is a longer dating process with far more complexity in the decision-making process. I also believe the due diligence needs increase as the size of firm increases. One other consideration is that many of the high-quality, highly desirable firms have been in mergers over the past few years, and the pickings are getting slim. Those firms of a larger size are becoming more competitive in this space. It only makes sense that the best players get sought after first and those great larger local or regional practices being pursued will command a larger price and more accommodations.

Berger: Large firms, as buyers, seem to be seeking niche practices or new geographic areas to expand the range and scope of their overall services. Small firms as buyers are focused on solidifying their position in existing markets.

Koltin: It should also be noted that a majority of smaller firms don't have mandatory retirement provisions at age 62 or 65, whereas many of the larger firms they would be merging into have such requirements. I have seen this be a major stumbling block when larger firms are talking to smaller firms, as many small-firm sellers want to work until age 67 or 70 while still being treated as an equity partner during this time. Safe to say, there are some major differences in smaller and larger firms in terms of how they approach M&A.

What do you think are the biggest misperceptions accounting firms have about M&A? Or the biggest mistakes they make in approaching it?

Berger: Both buyers and sellers typically underestimate the amount of time and effort it takes to integrate the two firms to reap the benefits from the merger. Clients are more adaptable to change than firms generally believe, as long as the change in firms is communicated in a timely and complete fashion. Despite extensive due diligence, there is often culture shock when two firms combine, and the practical realities of effecting a true combination are that it takes longer and requires more funding than anyone ever anticipates. The more realistic firms are in exchanging information about their respective cultures and the pluses and minuses of their own firms before the merger takes place, the smoother the transition will be.

Sinkin: One of the biggest mistakes that firms make in approaching M&A is thinking that you can transition your clients over a short period of time. If your clients are brand-loyal, this is likely true. But for smaller firms, clients are traditionally partner-loyal. And with the cloud, e-mail, and staff picking up work, the frequency of client in-person contact has reduced dramatically, to the point where most clients are only seen in person once a year. Thus when someone says, "I am seeking to slow down in three years; I have plenty of time," it is only three visits. Therefore the biggest misconception is that they can transition clients faster, and as a result not enough firms commence their succession plan early enough.

Koltin: Without a doubt, the biggest misconception that smaller firms have about merging into larger firms is that the larger firm will absorb the client base and then get rid of the people. Nothing could be further from the truth. Some years ago I heard a quote from the CEO of a Top 100 Firm who said his idea of a perfect merger would be one with 50 staff and partners and no clients. I believe the major mindset change in M&A for larger firms has been to focus on the talent and specialized expertise that they would get from the merger. It's almost the belief that if you get the talent, the clients will follow. This is oftentimes a major disconnect when buyers and sellers come together to talk about M&A.

I think the biggest single mistake that firms make in M&A is the refusal to talk and meet with other firms. When we had our CPA firm back in the 1990s, we were fiercely independent, but always met with every competitor coming into our market or who was already active in our market so we could learn about their strategy and maybe a couple of best practices along the way. ... The big mistake I see is firms forming an entire perception of another firm based on one encounter or hearsay. Let's face it - all of us have an ex-employee or ex-client out there who has a great need to justify (sometimes negatively!) why they left the firm.

Nisberg: I have been giving this great thought and I am convinced the biggest misconception is that "culture" is the most important criteria in finding a merger candidate. It is not. Culture has long been used as the reason to do a merger or not to do a merger. It is a very convenient excuse. My logic is that there is no one "culture" in firms. CPA firms have many cultures within them. Audit and tax departments have different cultures. I can show you culture clash from one corner of a firm to another, from one floor to another and from one office to another. What I truly believe is that decision-makers have been using culture as a convenient explanation for failed mergers - or successful ones for that matter - but I tell you it is absolutely not the case. The most important criteria or characteristic trait for successful mergers or acquisitions is values. It's all about values. ... I think the reason so many of my mergers are successful is

because I specifically look for a commonality of values more than anything else. One can't ignore culture, but it is far less relevant than one might expect.

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