insight

The Hand of Private Equity in Accounting Firms

Private equity is reaching into the accounting world, but why—and what's the trade-off for CPA firms?

By Natalie Rooney | Spring 2022

Mergers and acquisitions are nothing new to the accounting profession, but 2021 brought a fresh face to the negotiating table: private equity (PE) firms.

In August, TowerBrook Capital Partners purchased an ownership interest in EisnerAmper LLP. In September, Lightyear Capital bought into Schellman & Co. LLC. October brought an investment by New Mountain Capital (NMC) in Citrin Cooperman and Company LLP. And in January, Parthenon Capital entered into an agreement to acquire RSM US Wealth Management LLC from RSM US LLP.

"This is transformation happening right before our eyes," says Allan Koltin, CPA, CGMA, CEO of Koltin Consulting Group in Chicago. He consulted with both EisnerAmper LLP and Citrin Cooperman during their negotiations with PE firms. "These deals are strategic investments in the future," he says. "Investment from PE is about having a strategic and capital partner." When PE firms first expressed interest in accounting firms, Koltin says about a half dozen “mega PE firms” were solely interested in the top 20 to 25 accounting firms. Now, he’s getting calls from PE firms about accounting firms as small as $10 million in revenue to as large as $1 billion.

What's in It for Accounting Firms?

Koltin says one way PE firms have created a brilliant business plan is by showing how their investments help recruit, retain, and grow accounting firms’ young talent—always a top concern of firm leaders.

Koltin describes PE’s investment in an accounting firm as offering associates three bites from the apple: at closing, three to five years later, and then when the PE firm eventually sells the firm to a bigger group. These “three bites” give young talent rollover equity in the new company, something they’d normally wait decades to unlock.

“Today’s young leaders are much more astute from a financial and business perspective,” Koltin says. “They know if they do things the old-fashioned way, they’re going to sit at the firm for 30 years until they vest. Then, if the firm is still there, they’ll get 2 times their compensation spread out over the next 10 years. In today’s dollars, that’s nothing, and they know it. PE is exposing this unfunded chain letter for what it is and showing that there’s a newer, better model entering the profession.”

Even though 2021 marked the closure of the first official deals between accounting firms and PE firms, the first discussions began back in 2007 before being scuttled by the Great Recession.

Then audit and tax began using technology solutions like artificial intelligence and bots and lower-level compliance work was moved offshore. Now, there’s the added stress of a war for talent as firms’ young stars push back and say they won’t do mundane work anymore. “This talent war comes back to how technology transformed the accounting business literally overnight,” Koltin says. “Today, talent has so many other options. A young tax senior told me, ‘I only have to prepare a tax return 15 times to know how to do it. I don’t need to do it 15,000 times.’ That was an ‘aha’ moment for me. If your model is about recruiting, building, and retaining your stars, you need to give them challenging work.”

Koltin sees accounting firms using PE capital in four ways:

1. To buy out or retire the firm’s deferred compensation or retirement obligation.
2. To acquire like-minded accounting firms. “Firms will merge up if they get substantial cash,” Koltin says. “Remember, the unfunded chain letter model doesn’t appeal much anymore.”
3. To add nontraditional accounting services, such as consulting, advisory, outsourcing, or wealth management. “To buy those businesses, you’re competing against cash buyers that are primarily PE firms,” Koltin explains.
4. To invest in the fourth industrial revolution: the build-out of technology, AI, new ways of getting work done—whether that means outsourcing to India or stepping into the war for talent. On talent, Koltin says, “It’s about having the gunpowder to compete for superstar talent sitting at competing firms and being able to offer lucrative packages that encourage great talent to leave where they are.”

Koltin says these four buckets didn't really exist when PE firms originally tried to enter the accounting realm. "Until 2012, the profession pretty much ran itself. It was a low capital outlay. But in the last decade, this has become a whole new world. It was just a matter of time before firms would thirst for capital," he says.

What's in It for PE Firms?

Accounting is attractive to PE firms for several reasons, but they've historically been on the outside looking in, says Christopher Geier, CEO and managing partner of Sikich LLP in Chicago. "That's partly because of the traditional accounting firm partnership structure and the fact that accounting firms doing attest work have to be majority-owned—or even entirely owned—by CPAs and can't have outside investors."

Now, with a PE investment, the resulting spinoff company operates under an alternative practice structure, breaking the business into a legal entity for attest and audit on one side while the other side becomes the advisory business that doesn't have the same restrictions for ownership. This structure allows PE firms to invest in these professional services businesses, which Geier says they like for a couple reasons: First, accounting revenue is recurring, and PE firms prefer recurring revenue streams. Second, with the amount of consolidation happening in the accounting industry, there's a need for capital and the ability to put that capital to work by partnering with strong management teams that have solid M&A strategies. Accounting has all of that.

"Much of the work we do across all of our service lines is recession-proof," Geier says. "If you have established client relationships, you can deliver value to them through a variety of services. That's an intriguing thing for PE firms, as well. When you separate attest from advisory and talk about the advisory services, it's a huge, relatively untapped market—both sides of the equation make it a good time and opportunity for PE investments. That's what we're seeing, and what we'll continue to see."

The end game comes after five to seven years when the PE firm exits its investment by selling the firm or spinning it off into a public market offering.

Is PE Money Right for You?

If you're wondering if a PE investment is right for your firm, Koltin suggests taking the time to understand it first. "This is new, and it's different," he says. "Understand that the accounting business is changing and ask if this is a better way to achieve your goals."

Of course, finding the right fit is also key. Both Citrin Cooperman and Company LLP and EisnerAmper LLP walked away from initial deals that weren't right for them.

Joel Cooperman, former chief executive and current executive chairman of Citrin Cooperman Advisors LLC, says Citrin Cooperman was originally negotiating a deal with another PE firm in early 2021 but ultimately didn't feel like it was the right fit. He was put back in touch with NMC, an alternative investment management company he first met with in 2012. Collegial negotiations took place over five months before closing their deal on September 30.

Cooperman describes their capital infusion as providing "dry powder" Citrin Cooperman will now use to acquire accounting firms and other advisory businesses in technology and consulting. "Before the investment, we were successful and had significant capital, but nothing close to what New Mountain has made available. There's a much greater opportunity to grow our business," he says.

Cooperman also says the firm can now give deserving staff an interest in the firm's profits and growth, which is particularly important in a world where "people are quitting every five minutes. There are liquidity events for those ages 25 and up that were never available in a traditional model until partners retired," he explains.

At Eisner Advisory Group LLC, CEO Charly Weinstein says the PE investment received is an opportunity to accelerate the growth of the firm. Leaders had been discussing PE as an option since 2012, but a proposed structure at that time just wasn't right. "At a 2016 partner meeting, we really began to think about how we could raise capital to compete on a long-term, sustainable basis," Weinstein says. "We asked how we would get ahead of disruption and be a disruptor ourselves."

After unsolicited conversations with three different PE firms, EisnerAmper narrowed the choice to TowerBrook Capital Partners and then spent a year structuring the investment. Weinstein describes TowerBrook as a great cultural fit: "They truly understand the professional responsibility side, the alternative practice structure, the value of technology and innovation, the opportunities to accelerate growth in the profession, and the importance of creating opportunities for the next generation."

But Weinstein also notes that it's a long and challenging process. "You really have to be committed to seeing the benefits if you're going to go down this path," he advises. "It may not be right for every firm, but if you're a forward-thinking, highly successful firm that's comfortable with change, it's a great option. Every firm must figure out for themselves how to be sustainable, relevant, and important. Not everyone in the profession is on board, and that's OK."

But even with its challenges, Koltin predicts that at least two or three more top 100 firms will receive PE investments by the end of 2022—and the trend will likely continue.

A Strategic Investment in the Future

At the end of the day, Koltin says all roads lead to increased profitability: "The partnership model is flawed for all professions. We struggle to make decisions because everyone has a seat at the table. Decisions are watered down."

Consider Goldman Sachs and other investment banks that used to be partnerships. "They went public, growth and profitability soared, and they never looked back," Koltin says. "Moving and unlocking allowed them to achieve growth and profitability beyond the partnership model. PE offers a more corporate model. It's not for all, but it is for some."

In addition, Koltin emphasizes that clients aren't going to pay higher fees for compliance, but they will for consulting and value-added services. "Transformation is taking place," he says. "But we need the capital to succeed."

For his part, Cooperman says after founding his firm and serving as CEO for more than 40 years, to be able to provide this opportunity to his partners, retired partners, and staff not only creates a legacy for him, but is a tremendous event for the individuals, many of whom received significant money, rollover equity, and management incentives: “I’m very proud to have been involved. We have a great partner in NMC, and I’m looking toward the future of working collaboratively and building a much better business.”

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