McGOWAN
Program Administrators

Accounting Firm Mergers: Your Path to Success

Upward mergers (smaller to larger) in the accounting profession are becoming more and more common. It's no surprise either, with the increasing cost of crucial technology, a need to broaden advisory services, and the high demands of a shrinking professional pipeline.

Accounting firms use Mergers & Acquisitions (M&As) to grow. It allows them to broaden their services, remain competitive with other companies doing the same, and expand into new territories. Sales or mergers can be an excellent solution for complex business challenges. A **sale** occurs when one company purchases another company's tangible or intangible assets outright, including intellectual property or divisions. A **merger** occurs when two business entities combine into a single legal entity. The resulting entity retains the assets of each company.

Yet, accounting firm mergers are highly complex, with each new deal requiring its own unique approach. As a result, M&As often create anxiety for all parties involved, especially when there is no strategy in place to tackle issues as they come up. Read on to better understand the current mergers and acquisitions landscape and how your firm can prepare for an acquisition or sale.

What has caused the rise in accounting firm mergers?

One cause for the uptick in M&As is the issue of succession and available talent. As partners in a firm age, their valuable expertise must be replaced to keep the company afloat. Merging with larger, more developed, and experienced companies allows them to secure the talent they need and their own retirement.

Additionally, the profession has become far more complex for small firms in recent years. Organizations must provide an increasingly wide range of expertise to succeed in today's accounting landscape. This is especially true for smaller organizations, where clients demand more than tax returns and audits. Today, these accounting firms also have to advise on wealth management, cryptocurrency, consulting services, and global trade. As a result, smaller firms struggle to deliver everything at the right quality and cannot compete with larger firms that have the resources to meet their clients' needs.

For larger firms, acquiring niche practices that provide bespoke services is highly attractive. It allows them to expand their capabilities and creates unique selling points that put them above the competition. With the highly competitive nature of the profession, accounting firm mergers are an effective way to set yourself apart. Diversity is crucial to a firm's operational capacity. Expanding teams to include seasoned, effective talent from smaller firms is a fantastic way to close the skills gap affecting accounting and professional services.

What should sellers and buyers keep in mind?

A successful accounting firm merger is complicated, and there are many ways an M&A could fall apart before reaching the finish line.

A clear rule is that both parties should benefit from the merger. If the deal is too lopsided—meaning one party improves their situation at the cost of the other—tensions could rise, and negotiations could break down. This lopsidedness may be caused by pressure from the buyer on the seller to adapt, changing their way of working and making staffing changes. The result could be a disconnect within the seller, causing staff to leave and their clients to potentially go with them

Otherwise, negotiations for an accounting firm merger must also be entered for the right reasons. These include increasing a talent pool, accessing a new marketplace, expanding services and capabilities, or planning for succession. Problems arise when the reasoning is that more prominent firms are better. That is only true if the firms are set up to capitalize on the benefits of scaling up.

Ultimately, mergers must meet both parties' original strategic, professional, and financial objectives. To achieve this, everyone involved needs a strong understanding of the marketplace.

Is it a buyer's or seller's market?

While the market has long been understood to favor buyers, the coming period of economic downturn caused by global events could shift this power balance. By examining similar situations from the past (such as the 2008 recession), we can deduce that as organic growth slows, M&A activity increases.

This is due to M&As being the primary source of growth during times of economic strife. As a result, buyers actually want to merge, which means we may see an increasing seller's market. In any case, both buyers and sellers will have strong motivations to engage in accounting firm mergers, meaning we could see even more activity in the coming years.

How should buyers prepare?

To ensure buyers are meeting the needs of all stakeholders during an accounting firm merger, they need to keep four things in mind:

- **Their customers:** Customer satisfaction must remain the priority throughout a merger. Plans need to be in place for securing customer retention, ways to incorporate new services and talent to improve the customer experience, and effective communication of those changes and benefits to customers.
- **Their limits:** Mergers require evaluation of the knowledge and skills of a workforce. This analysis allows both parties to take necessary actions to retain or re-recruit personnel. As this happens, a plan needs to be in place to discuss these changes internally and put the broader team at ease.

- **Their culture:** A merger involves technology, personnel, and crucially, a mixing of two potentially very different working cultures. To do this effectively, both parties must first understand their culture. They need to be sure of their values and identify where potential clashes may occur while taking advantage of cultural overlaps.
- **Their transparency:** Questions are a natural part of accounting firm mergers. Buyers should prepare to answer them from all parties involved and be as transparent as possible. Left to their own devices, team members, stakeholders, and more will come up with their own answers, which may ultimately harm the merger. Be clear on how the M&A will impact the team, customers, and the company's future. Highlight the positives and be honest about the challenges along the way.

By understanding the pros and cons of a merger, buyers are put in the best position to put all stakeholders at ease. The M&A will likely be a stressful time for all, but open, honest communication can ensure a successful merger.

How can sellers best position themselves?

Sellers can put themselves in the most advantageous position by understanding what buyers are looking for. This is typically a talented team, loyal and well-paying clients, a clear record of past activity, and a solid commitment to quality.

However, a few other tips and tricks will make a seller more attractive.

- **Limit your must-haves.** For instance, don't make it a requirement for a buyer to take over your lease or keep your name. Similarly, buyers may not want to take on unprofitable clients, even if you have a good relationship with them. Every must-have makes it harder for buyers to bring their stakeholders on board.
- **Update your technology.** During a merger, efficiency is critical. Buyers will want to integrate your products and services at a pace, and having a modern tech infrastructure with cloud capabilities and remote-working technology can make the difference.
- **Ask questions.** This will help sellers anticipate a buyer's needs. Consider whether a buyer is interested in the seller's client base or if they want to know the specifications of the seller's office space. These will help the seller understand what is attractive about their firm and may even give them more negotiating power.

When does legal representation come in?

Accounting firm mergers are incredibly complex, dealing with many stakeholders, financing queries, and contracts.

Buyers and sellers should explore hiring a lawyer specializing in mergers as soon as possible. Having the right people in place to assist with appropriate financing while advising on the drafting, negotiation, and performance of contracts can ensure the success of a merger.

Mergers are among the most significant events in a firm's life, with positive and negative consequences that will last for years. All parties must have confidence in the merger, be adequately prepared, and communicate effectively with their teams to ensure a beneficial future for everyone involved.

Insurance coverage that protects your firm

McGowan Program Administrators has decades of experience providing highly specialized professional liability insurance policies. Our Accountants E&O Insurance policy is designed to provide you with extensive, affordable coverage—notably featuring tail coverage so that your firm doesn't have to worry about litigation in the months and years following the merger.

Contact us today to learn more about how comprehensive coverage will benefit you during a merger.

Contact us:

L Squared Insurance Agency LLC
2430 Camelot Ct Grand Rapids MI 49546

Lee E Norcross
Email: Lee@L2Ins.com | Phone: 616-726-7080 | f: 616-940-1196

www.L2InsuranceAgency.com