MERGERS – Look beneath the surface!

First-hand experience has taught me that firms do not spend enough time really getting to know the merger or acquisition candidate and are over confident in their estimation of the planned synergies and integration effort and process. As accountants are often prone to do, they focus on and devote their energies to the financial aspects of the merger, sometimes forgetting that there are several phases in a successful merger transaction.

Phase 1

Preplanning. Before you contact the first candidate make sure that you know what is important to your firm and why you are considering a merger. Firms merge either to acquire talent and/or new services, expand into new geographic markets, or to acquire revenue and corresponding profits. Remember that in every merger things will change – not only for the merger candidate but also for the acquiring firm. You can be 100% sure that life will not go on as before. Therefore, know what is negotiable and non-negotiable. Mergers give you an opportunity to carefully look at your own firm as well as the other. If there are personnel, systems or procedures that you want to change, you should consider making those changes as part of the merger process. Don't wait until after the merger is done!

Phase 2

Researching the target firm. A targeted search is much better than a shotgun approach. What does your ideal firm look like in terms of revenue, profitability, average fees per client, average fees per partner, partner ages, range of services, and so on. In identifying your ideal firm you also need to give some thought to cultural characteristics. They should be the same ones that identify your firm's culture – physical facilities, patterns of behavior, values, and so forth. Once you have these items clearly outlined you can begin the search. Determine if the search should be open or closed. If open, you will promote it in the local CPA journal. If closed, you will send a limited number of letters to your key targets.

Phase 3

Information gathering. You can never gather enough information about the merger candidate. Every firm has some skeletons. Just make sure there are none that will come back to haunt you. Here is a list of the basic information you want to have – financial statements for the last 3 years, current year financials and budget, staff/partner information (salary, bonus, and benefits), ownership, partner/shareholder agreement, computer systems information, liability insurance coverage and claims history, etc. It's best to give the merger candidate a checklist of all the items you want. If you are talking with multiple firms you will then have the same information in the same order. It makes it easier to compare firms.

Phase 4

Meeting the players. Love may be wonderful, but what about the next day. Firms love to court each other and talk about all the great things they will do together. Reality is that often what is promised is not delivered. Interview each and every partner since they may soon be your partners. Examine the client list carefully. How do they compare with your existing clients? Look at the physical setting and layout. If the walls have not been repainted or new carpet installed and things look shabby, maybe the partners are more interested in their own well-being rather than investing in the firm. What's the firm's work ethic – 9 to 5 or 5 to 9? What's the firm's management style? What is their value system? Commitment to client service? Profitability? Tolerance for risk? Where are the personnel problems and how will they be addressed? Once you have answers to these and a lot more questions, then you can move onto the next step.

Phase 5

Negotiating a transaction. Negotiating can be a very emotional event, especially when it comes to determining the firm's new name, leadership roles, partner compensation and the like. There is seldom a merger of equals, so don't fall in the trap of thinking that two people will share power. It just doesn't work. Negotiate from a forecast of what you believe the two firms will produce together. Agree upon and put into writing partners' duties, the compensation plan, billings and collection policy, work hours, etc. Make sure you determine each partner's new compensation, ownership position in the new entity, capital requirements and retirement benefits. Don't forget to determine if you will have a de-merger agreement or not.

Make sure you articulate how you do things, who will be coming across as partners, what staff and administrative people will you accept. There should be no uncertainty in the acquired firm as to what will happen. Everything should be put into a letter of understanding between the two firms.

Phase 6

Due Diligence. Before you decide to sign on the dotted line, you will want to verify the financial information the acquired firm has given you. If you don't have tax returns for the last few years, now is the time to ask for them. Obtain a detailed equipment and depreciation schedule, aging on accounts receivable, copies of real estate leases, copies of all benefit plans, payroll information, and peer review reports, etc. You will also want to randomly examine work papers for audit, tax and consulting engagements for quality.

Phase 7

Post -Merger Issues. This normally makes or breaks most mergers. Either the acquiring firm does not lay out a detailed plan to accomplish all the changes that will be needed, or the acquired firm does not believe that things will have to change. Since the two firms will be physically working together come Monday morning, you need a plan to make the integration go smoothly. This plan should come out of the negotiation and due diligence phases. There is a tremendous cost of confusion – both in profits as well as in human capital costs. A transition plan will reduce the rumor mill, provide people a go-to resource to get questions answered, and insure that clients continue to be served and productivity does not falter.

Don't think of the transition as just affecting staff. Partners too will be going through much of the same emotional and psychological trauma. If you do anything during the post-merger period, make sure you talk with each person, new and old, in the firm. Everyone will be concerned about what the merger means to them. If you are reducing staff, do it before the merger happens. Take as much of the unknown away so that everyone is dealing with facts not fiction.

Set up transition teams to cover the major areas – benefits, compensation, systems, scheduling, etc. The better your internal communications, the smoother the post-merger phase will go.

A final word of caution

A merger will never solve an existing problem in your firm. It is not a solution to partner problems. Make sure you have your own house in order before inviting someone in.