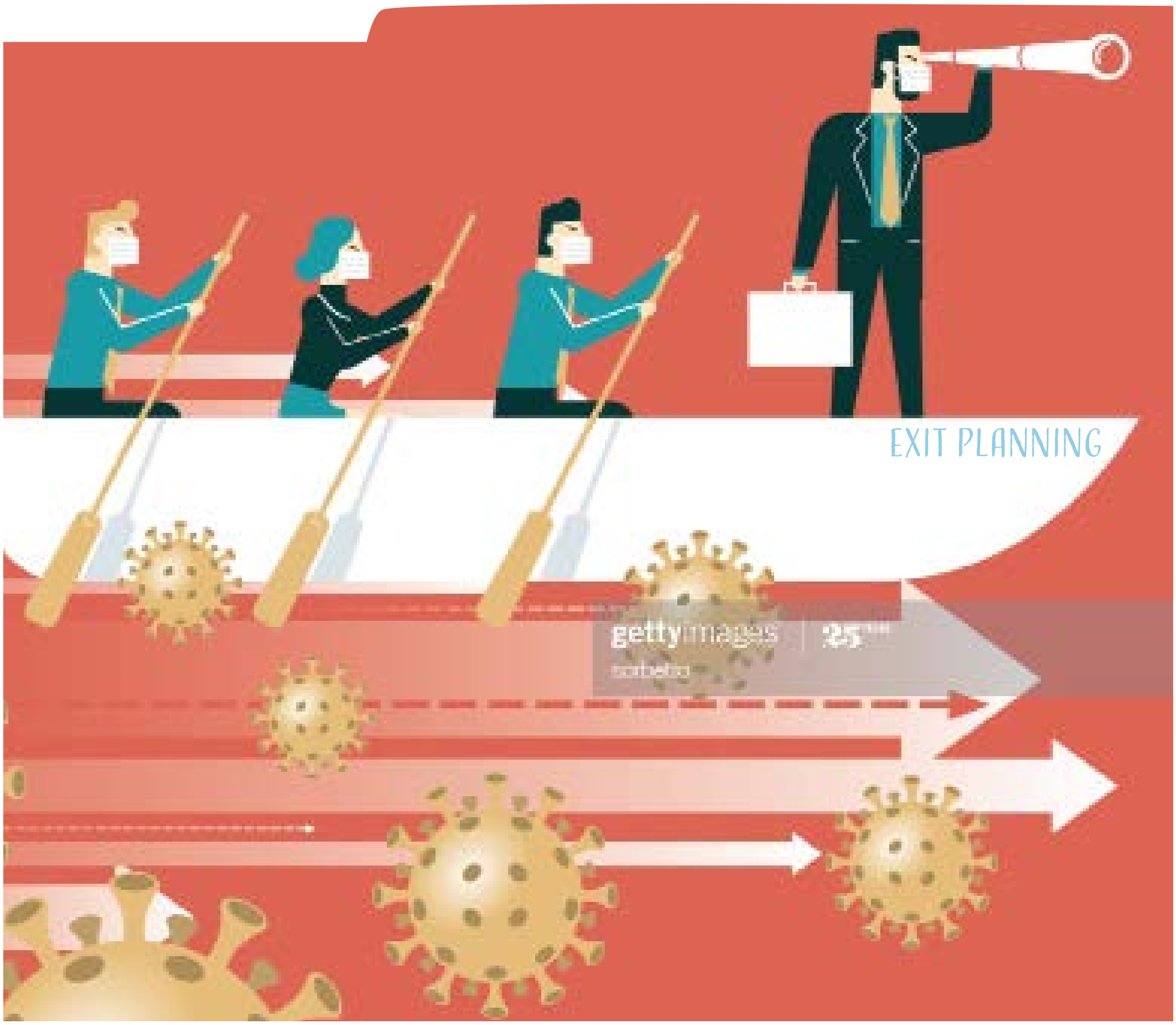


SUCCESSION'S SPEED

Is Covid-19 Motivating Firms to Accelerate Their Exit Planning?

BY MARK H. FOWLER, CPA (INACTIVE), CMC

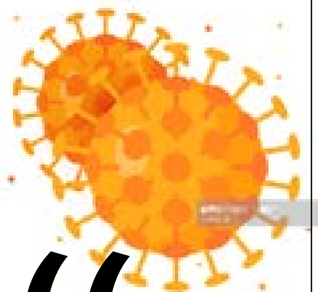
The environment plus overall posture and business models of CPA firms have been in change mode for more than 10 years, impacting all stakeholders. Those who have not adopted a program to raise the bar on diversity and quality of services, or to create a culture for career growth for team members, may find themselves concerned about their future.

Pressures to create a succession/exit plan for CPA firms have been growing. Many firms have merged up or merged together. Other firms, often smaller ones, have sold their practices and retired. In addition, the focus for many is to build a succession model from within, with team members taking on more and more strategic and operational duties.

Other factors and variables, some self-imposed, can exaggerate the situation. For your consideration:

- **Technologies are always a topic for attention:** Both a benefit and a risk, the increase of new technologies will require additional investments in dollars and time, requiring serious energy and interest to make them successful.
- **Client and market needs are ever-changing for specialty services:** Increased need for niche services is putting on the pressure (in both dollars and time) and additional work is necessary to find alliances and experienced talent—all of which, as above, require serious energy and commitment to achieve the status of an expert.
- **Business models must be geared to the evolving future:** It's easy, almost a knee-jerk reaction, to fall back on what we did yesterday, last year. Business models need attention. Reorganization of our firms is needed so that all areas of importance are interconnected, while bringing all stakeholders on the same page as well (see California CPA September 2019, "What Are You Doing for Your Future?")
- **Talent recruitment and training necessary to develop personnel so they can contribute to growth are always required for the profession:** The trickle-down recruiting from larger firms—national firms in particular—to smaller firms dried up more than a decade ago, if not longer. Again, it's the word "investment" that raises its head, this time for recruiting needed talent, and creating educational and career programs designed to grow leaders for the firm's future.
- **Partners and shareholders of a certain age may recognize the reality of needing to retire or step back:** The number of partners seeking, needing, wanting to retire grows, while team members with the ability to help with that transition are missing. Plus, the professional focus has changed more to a career/financial focus, including a quality of life component.

These factors have been in play for some time and will continue until serious change occurs in the profession or firms in a succession challenge make drastic changes.



"RULE OF THUMB: A SOLID SUCCESSION/EXIT PLAN CAN TAKE THREE TO FIVE YEARS TO ESTABLISH SUCCESSFULLY.

Enter COVID-19

The impact of COVID-19 has had its own influences. There's the worry whether a firm will exist at the end of the year. It's reassuring that the profession is an "essential business" and that the lockdown happened during tax season when firms had plenty of work on the books. But how long will there be enough business? Many businesses have had to close for an indefinite period and many have taken the opportunity to close their doors for good because it was time to move on, retire, etc. Where will business come from in 12 months?

These pressures—along with the compounded needs of helping clients navigate their businesses, securing loans and helping to assure personal financial well-being over and above tax needs—all have a stressful influence on firms and their operations. Many larger firms have resources and talents to adapt more effectively than smaller firms. This additional investment in new technical skills and experience, along with the clearly uncertain future, can be driving firms to be more seriously concerned about how they invest their resources, while creating or accelerating succession/exit plans.

"With COVID-19 in the world, CPA firms will be required to adjust to a 'new normal.' Teleworking is not likely to end as the crisis subsides. Firms will need to generate new practices and policies for working-at-home, as well as invest in technology to enhance data security for remote workers," says NewGate Law founder and managing partner R. Peter Fontaine, who provides legal counsel for professional services firms nationwide.

"It's clear that what clients expect from their accountants will be elevated. Clients will be asking whether their accountants are equipped to respond to and fully support urgent business needs. To retain clients and survive, firms may need to hire personnel with deep expertise to fill in gaps for known and anticipated experience and talents. Finally, firms may need to re-evaluate partner matters. Should retirement of older partners be accelerated to free up needed cash and make room for promotions? Should admission of new partners be accelerated to retain talent? Should partner buy-outs be reduced to generate more operating capital for the firm? These and other important management and structural issues have been brought into sharp focus by the COVID-19 pandemic."

We're seeing firms being more concerned about the future. Some that would not have been considering a transition for several years are now planning to make the change sooner, rather than later. Firms that have been actively entertaining changes (shopping around) are now more interested in advancing the process. Larger firms are reaching out in the middle of tax season, hoping to connect with firms that have had it with the pressure overall and need to move toward a merger or some other transition. Our experience is that merger projects that would normally slow during tax season are advancing forward, with owners/shareholders investing time to focus in the process for a potential merger.

Whether your firm has been working the succession/exit planning process or not, this is going to be on the minds of a lot of accountants. Challenges like COVID-19 can push the envelope and set firms moving down the road quickly to resolve uncertainty through a merger. Advancing the process may be the right thing; moving forward quickly also might be appropriate. Rush you may, but do your homework! Doing so with the proper evaluation is mandatory, along with experienced professional advice and good legal counsel; this includes due diligence (which starts even before the first meeting), option identification, culture review, after-transaction business plan, etc. Virtually all professional services firms need help with this evaluation.

Some Guiding Principles to a More Successful Merger/Acquisition Experience

- Firms are looking for people—good professionals who can grow into leaders or are already career-focused and successful. If you can upscale your talent and initiate training programs to help your team members to expand their capabilities—technical and business-oriented—it will benefit all parties.
- Be prepared to say no to a deal that doesn't seem right. Be able to create options and, if necessary, stay the course.
- Upgrade your client services, especially with the COVID-19 needs; your clients need to follow you for you to be truly successful. Clients are more inclined to support your needs if you're attentive to theirs.

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- Being pro-active on all fronts is essential. The competition is out there. Remember this statistic: 72 percent of small-business owners have changed their CPA or accounting firms because the firm "did not give proactive advice, only reactive service" (Accountex, July 2017, The Sleeter Group).
- Do your due diligence in all aspects of what drives an accounting firm: culture, financial well-being, succession/exit planning, previous mergers (talk to the people who came into the firm), firm staff, essentials in human resources and training policies/procedures, business plan review (make sure there is a place for you and yours) and client base (profitability, life cycle, niche services). Our experience is that, in mergers and acquisitions, the profession seems to slide on due diligence at the highest level possible. "We will take care of that later," is death to the seller mostly and, also, to the buyer.
- Compare and create options to understand dynamics of the deal and of the future living/working conditions with its rules and regulations. Most transaction options are not "apples to apples" and a great deal of analytics must be prepared to ensure you understand which works best for you and all stakeholders.
- Rule of thumb: a solid succession/exit plan can take three to five years to establish successfully. Rushing forward because you may feel the need to do so is not an excuse to put a plan in motion. Do your homework and put something solid in place.
- An inappropriate behavior of a seller is to take suggestions of the buyer that indicates, if they do this, then "we have a deal." Recommendations can be expensive and doing so can distract the seller from marching forward on other opportunities and/or changes they are already making for themselves. They can also be a benefit, but only on your terms and the needs of your situation.
- Clean up your act. No buyer really wants to solve your problems. If you have talent that's not readily serving the firm or is not being well served in your organization, it's best to help them find a more appropriate place.
- Take some time to understand the valuation process. Get your mind around the fact that each situation is different. "Willing Buyer/Willing Seller" is still the cardinal rule. For instance, the 1.2 to 1.3 times revenue purchase is one-dimensional because, in many of these arrangements with a smaller transaction, the seller is not involved going forward. In another situation, the purchase price might be 1.0 times gross or less, but owners/sellers stay on to earn more and transition in a more orderly, gracious manner.
- Take care of yourself. One anomaly we've found is that many sellers have reached a point of no return and are ready to escape and can't wait to get out the door! This desperation is often healed after the first year of a merger, just as the seller's one-year transition contract is ending. Now, the seller is refreshed and ready to go, yet there is no place to move forward, except to find a new path. Understand that things can get very positive when merged if, of course, you have chosen wisely.
- Conversations and interconnection are at the core of success. It doesn't matter whether it's dealing with buyers, team members, clients or other associates, your ability to better understand others and come alongside them to create dialogues helps everyone win.

Conclusion

Whether the global pandemic (with its unintended consequences) is urging you on, or whether at some time in the next few years you will be transitioning the firm or your senior partners, starting your succession and exit planning now is an excellent idea. It takes time, it requires learning and growing and it has its costs. These investments of time and money will make all the difference in your future success.

Remember: it's not only you, the owners, who are merging. All in the firm are advancing and adapting their lives. Start early to pull it together to create the team that will make your merger partners or buyer proud.

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