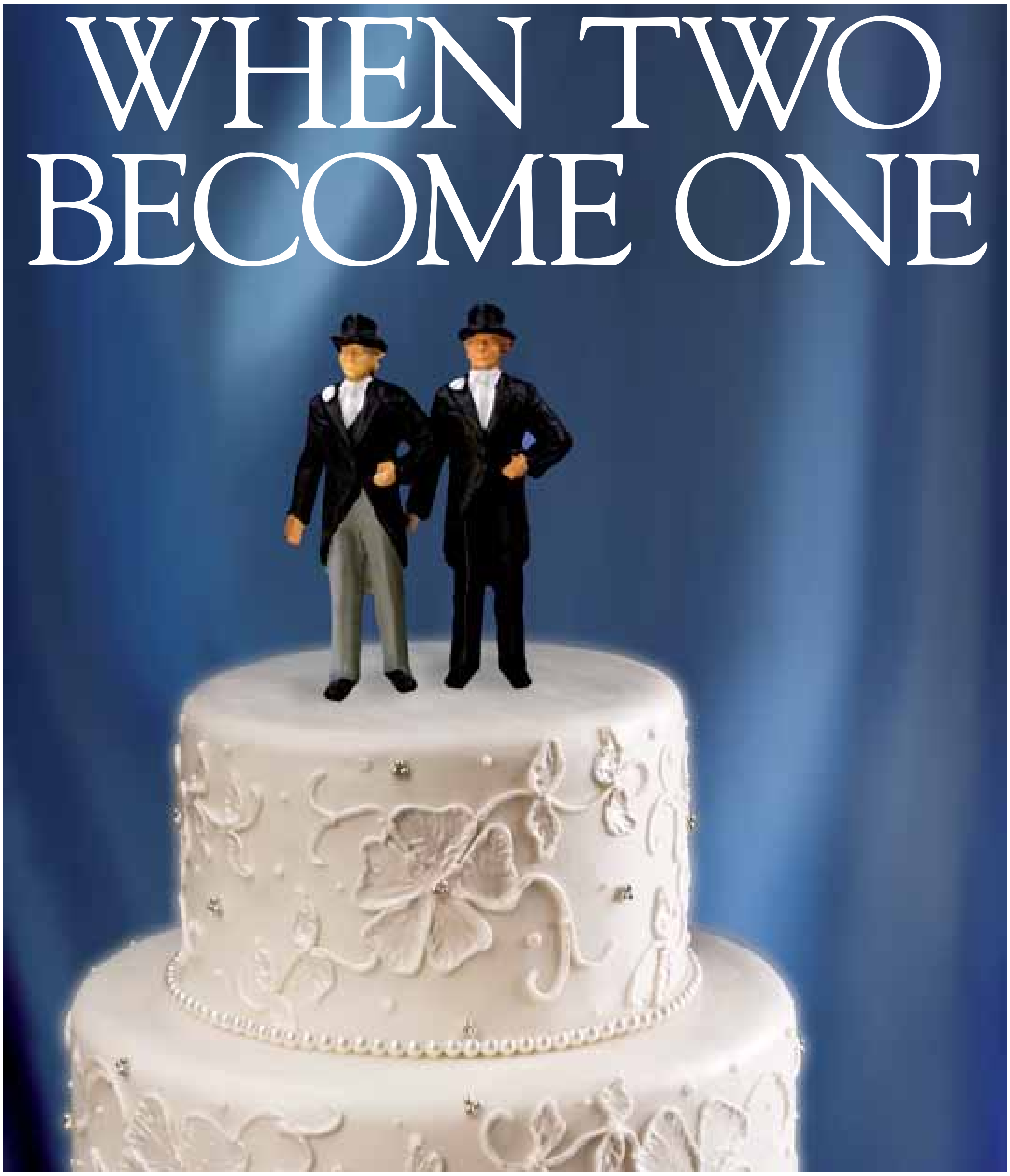
WHEN TWO BECOME ONE



WHAT SHOULD PARTNERSHIPS LOOKING TO MERGE CONSIDER BEFORE TAKING THE PLUNGE, ASKS SANTHIE GOUNDAR

There has been talk of increased merger activity in the UK accountancy sector over the coming years. Indeed, many smaller- and medium-sized firms see merging as one route for them to grow and thrive. But this is no easy route. So what should firms consider when they get the urge to merge?

Richard Turnor, partner at law firm Maurice Turnor Gardner LLP, says: 'For accountancy practices, the two entities merging are likely to be partnerships or LLPs. If they're both LLPs, then either one will transfer its business to the other, or both transfer to a new LLP that's been set up to receive and merge both businesses.

'In either case, all assets – including work-in-progress, bills delivered, equipment, staff, lease on building – will be transferred to the LLP they're joining, and the receiving LLP decides which liabilities it takes on.'

The whole process is a huge undertaking, requiring lots of agreements, legal form filling and detailed negotiations on many issues. 'Partners usually become partners of the new entity, but staff are usually dealt with under the Transfer of Undertaking rules. Some staff may be made redundant, but not always. Liabilities are often a huge issue for the merged firms. If, say, clients are suing a firm that ceases to exist after the merger, the other firm may not be prepared to take on historic problems.'

SHARING PROFITS

Turnor adds: 'For example, a small firm might say a larger firm should treat their historic problems as the continuing problem of the new firm, but if the larger firm will not take on these liabilities, the old LLP will have to be kept in being and an insurance policy must be maintained.'

Governance arrangements of the new entity have to be agreed, says Turnor, as well as how profits will be shared. Banks and landlords will also have to be dealt with, to ensure there is no default of banking covenants or on the terms of the lease. Tax issues will also need to be considered, especially around partnership cessation rules, so cash reserves may be needed. And sometimes the terms of the merger may be more favourable to one firm than the other.

'Where firms merge as equals, they might re-negotiate the LLP agreements,' Turnor says. 'But often when a small firm joins with a bigger firm they sign up to the bigger firm's agreement and just "slot in".

'Normally the bigger firm survives and the smaller firm disappears. It's often more of a takeover than a merger.'

CHANGE MANAGEMENT

Ron Goldsmith, partner at Goldsmith Practice Services LLP, a specialist in accountancy practice sales, observes that while most of his firm's deals have been reasonably successful, 'there is always an issue when handing over responsibility for a practice to someone else – the fear of change is a major item'.

'Synergy remains the key word in terms of mergers and acquisitions,' he says. 'The most successful acquisitions have been where practices are acquired and brought in to work with the acquiring practice, so that they adopt the working processes and share the same building. Acquisitions that have been separated have been successful but it's more difficult purely because of culture issues. The acquiring practice may have a different culture, and it's very difficult to impose that on to another practice if it is 50 miles away. People tend to continue doing what they did before, and often do not take kindly to change.'

Goldsmith says a big driver behind practice sales is that, with retiring partners, younger partners cannot (or will not) raise the substantial funds often required to buy the goodwill from them to continue.

In these cases, he says, 'a successful transition to a larger firm then lies in the willingness of the younger partners in the firm being acquired, to be able to work with the partners in a new firm. Some work, some don't. Some are more successful than others, and it's not unusual to find at some point one or more partners in the acquired firm may well leave, and even take some fees with them by mutual agreement.'

But it is not just the partners and staff within the firm that must be considered, adds Goldsmith. 'In all the discussions with regard to the merger and acquisition of accountancy practices, one thing must remain paramount – the clients need to be happy with any changes that take place,' he says.

'Losing the partner looking after them, or even a change of premises, can result in clients seeking alternative accountants. This would not be good news for either seller or buyer.'

'At some point one or more partners in the acquired firm may well leave, and even take some fees with them by mutual agreement'

A STRATEGIC PLAN

Medium-sized firm Hillier Hopkins LLP announced its merger with BFS Accountants Ltd towards the end of 2010. Colin Howe, partner at Hillier Hopkins, said his firm has had a number of mergers and acquisitions in recent years as part of its strategic plan; some introduced by merger agents and some by direct approach from his firm. 'We specifically targeted one- and two-partner practices where we knew the owners were approaching retirement and likely to have succession issues,' Howe says.

'We wrote a short letter expressing an interest and suggesting an initial meeting to explore opportunities. Out of approximately 50 letters sent, four meetings were generated, of which one completed to merger. The meetings were primarily designed to ascertain if there was a cultural and personality fit, to assess the quality of the client base and to describe in outline how a deal could be structured.

'From the meeting, outline heads of terms were agreed, leading on to some basic due diligence on the practice and its client base. Legal and employment due diligence followed, with appointment of lawyers and construction of the various legal agreements to capture the agreed terms in final form.'

There are upsides and downsides to mergers, Howe explains; and while the upsides include immediate cashflow increase, benefits from knowledge sharing, job security and a 'painless and profitable exit for the merging partner,' the major downside is the time commitment to deal with the legal issues and ensuring effective integration on IT and training systems, as well as the effort needed to make sure staff integrate and feel part of the team. And then there's the everyday stuff.

'It's usually the external factors that cause most difficulty, for example getting telecoms suppliers lined up for switchover on merger day, and dealing with landlords and PII [professional indemnity insurance] cover. A detailed "map" of everything that needs to be done, with assigned tasks, really helps. It also helps to have a very efficient facilities manager, like ours,' Howe says.

Howe warns, however, that firms thinking of merging should not do so lightly – no one should underestimate the time and costs involved, and certainly mergers should not be undertaken for growth alone; there should be a strategic reason to do so, he says.

'If you are paying cash for goodwill, consider doing the deal through a limited company to qualify for corporation tax relief on the goodwill amortisation,' Howe adds.

'Be very concerned about the potential loss of clients and goodwill post-merger and ensure any deal is structured with either an earn-out or claw-back based on client retention."

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