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Key Strategies to Build Value & 'Stage' Your CPA Firm for Sale or Merger

Viewers of home-improvement television shows are familiar with the concept of "staging" a house to make it look more attractive to potential buyers. A similar process (though far less superficial) can be undertaken to improve the value and operations of CPA firms. The process can not only bring a higher price for the firm, but it may improve the firm to the point that the next generation will be eager to take over the firm without having to seek an outside buyer.

The suggestions offered by consultant Bill Reeb of the Succession Institute at the AICPA Practitioners Symposium in Las Vegas can help firms that want to position themselves for sale, as well as those in the market to acquire, by understanding where real value lies in today's CPA firms.

While Reeb's suggestions can help you improve your firm's operations and value, you may also find that the process of improving the firm could become a process of preparing it for internal transfer rather than outside sale. But firms will find that a lot more than a new coat of paint is likely to be needed to enhance their firms' value, unlike home staging.

Reasons to sell. Reeb described some of the common reasons that a CPA firm may be headed for the sales block:

- More retirement benefits can be obtained for partners by merging than by retiring from the existing firm. Expect this to impact the firm's value, since "anyone buying expects to make more from the firm"

than the current owners have been able to do.

- Owners don't believe the remaining partners have the leadership skills to run the firm long enough to pay off retiring owners.

- Partners don't believe the firm will stay together after the retiring partners leave. The belief is that the remaining partners don't get along, don't trust each other, and don't share a common vision for the firm.

- Some partners refuse to be held accountable and function as a partnership—so you need to sell and let someone else deal with them.

- There's not enough talent to take over the firm. This is a sign of a firm that has failed to invest in training and development.

- Financial results are not good, and the owners want to join a firm that can help improve them. Better fees and billing rates are the answer to this issue, Reeb said.

- The niche specialty and talent pool need a bigger client base than you have access to. This is a legitimate reason to seek a merger, Reeb said, although he asks why the current owners can't build the practice themselves.

- Business processes and practices are somewhat out of date, and the current partners want to avoid investing in them. These are an important part of your firm's value, Reeb said. Cutting back on technology, marketing, training, and develop-

ment will cut the price you can get for your firm, he warned.

Almost all of the reasons cited above tend to indicate problems with firm structure, operations, and management, Reeb observed. The broader issue that underlies many of these reasons is a failure to have a succession plan. Firms are still lagging on this, although many owners are approaching retirement age (see the sidebar).

Preparing a firm for sale (or for succession).

The steps presented below are not overnight developments. They are strategic initiatives that are the heart of practice management that results in a firm that is positioned to be profitable and grow sensibly.

- **Create a strategy.** You'll get more from an internal sale than from a sale to an outsider, Reeb maintained. "Your partners will still pay a lot more for the ability to continue to do what they're doing." There is less risk and change from this kind of sale, and the existing owners already know the business.

For those who say there is no interest in purchasing the firm by the next generation, Reeb counters that developing a firm worth acquiring is the key. You want to "build the business so that someone could work 45 hours a week, not 60—and you'll have a lot of staff."

He adds, "Sell them a business that they can run and that they can see. Then they'll be interested. But a loss of irreplaceable talent and partners who have not created the proper structure? That business won't make sense to them, and they won't see anything to buy."

- **Charge clients a fair fee.** Raise fees to where they should be, Reeb urged. Look at your competition to see what others are charging. Worried about clients leaving because of raised fees? You'd be likely to lose those clients anyway, Reeb said.

A trained staff is worth more in fees, Reeb reminded the audience. "Give them a raise—you'll still make more."

The Scary State of CPA Firm Succession Planning

New data from the AICPA's 2008 Succession Survey indicates that CPA firms still have a lot of work to do in succession planning—even though retirement is drawing nearer for increasing numbers of partners.

"We're still so much like a cottage industry," said consultant Bill Reeb in discussing some of the findings during his AICPA Practitioners Symposium presentation on preparing firms for sale. "Many firms have not gone through a first owner transition."

The numbers demand the attention of partners and other firm leaders: 63 percent of firms will have partners retiring in the next five years, and 32 percent will see two to five partners retiring in that time span.

Despite these numbers, just nine percent of multi-owner firms said they have drafted a plan but have not had it formally approved, 35 percent have started a plan and will complete it soon, and another 32 percent report they will start the process in the next year or two. A very disturbing number of firms—10 percent—say they do not feel the need to have a succession plan. Perhaps not surprisingly, 29 percent identified various merger or sale scenarios when the senior owners retire.

IOMA's research into this issue reveals some similar trends, although more respondents to our research say they have a formal, written plan that is part of the firm's partnership agreement or incorporation documents: 26.7 percent. Another 14.9 percent are moving informal plans into formal and written plans now, and 6.9 percent are revising their formal, written plans now. Another 21.8 percent indicated that no plan exists, but the owners were going to work on one this year. And—as disturbing as the AICPA results—nearly a quarter (23.8 percent) told us that they have no succession plan and do not plan to develop one.

- **Stop discounting your work to keep people busy.** "We're the only profession that can't find enough staff but still gives away work." He expressed concern that, despite the avalanche of Sarbanes-Oxley work, firms are starting once again to discount audits!

- **Take steps to convert "D" clients to "C" clients—or let them go.** You know who the D clients are—the ones who don't spend much and have no prospect of added future work, complain about what they are charged, and drive your staff crazy. The concept of letting go of even these terrible clients is one that many partners just can't bring themselves to accept. But Reeb says you must do it to create a practice that has value (and, not coincidentally, one in which the work is more profitable and interesting).

Classify your clients periodically so you understand who the high-value, "A" clients are (the ones who provide most of your revenues) and the "B" clients (good though

under-served clients with potential to bring more revenue to the firm). The precise definition of each level will vary by your firm's individual strategy, skills, and future plans. For instance, a firm may have an entire firm of C-level clients (steady revenues, though not much growth potential). As long as this is, in fact, your firm's strategy, and you are meeting your goals, it's fine.

- **Verify that your services make sense.**

Consider the synergy of the services you offer—and who provides the expertise within the firm. Don't support services that don't fit with the firm. Eliminate what Reeb called "island" services: the ones that are not supported by more than one person. Although these may be lucrative, there is no future in them, since there is no one to do the work when that single-service provider retires. A service with five to eight people is fine, Reeb said, since someone else can take over when the lead person leaves.

- **Improve your business development process.** Firms need to emphasize the growth of current clients, something most firms neglect. Most growth comes from either existing clients or referrals from those clients, he noted.

Be mindful about the growth that your firm is pursuing. While some firms believe that any growth is good growth, Reeb advocates growth that is both reasonable and profitable. Uncontrolled growth can result in bad service, untrained staff, late delivery of products—and the loss of your firm's good reputation. He recommends aiming for 90 percent capacity for the best staff management, not the typical 110 percent used by most CPA firms.

- **Stop operating like multiple individual firms.** Systematic marketing is best and avoids the syndrome of rainmakers "holding other partners hostage" and firm splits that can otherwise develop.

Firms need to understand which operational model they fall under and then consider whether they need to change it to allow for more growth opportunities. Here are the two models identified by Reeb:

— **Eat what you kill (EWYK).** As a general rule, EWYK is the model used by all solo practitioners and start-up firms with fees up to about \$4 million to \$5 million. This classic entrepreneurial model works at these levels since the owner or owners have a hand in everything.

Eventually, though, the firm cannot continue to grow and flourish beyond a certain point without the development of staff to take on more responsibility, freeing owners to "hunt" exclusively for new and expanded work.

— **Build a village model (BAV).** This is a variation on the one-firm model and requires owners to focus on building talent and specialization so the firm can continue to grow. "It's about leveraging people," Reeb explained. The BAV model trains, builds processes and methodology, and expands infrastructure.

Being aware of growth from EWYK into a BAV firm is important, Reeb says, because it brings the ultimate goal: to "build something that someone else can run."

The expanding firm must also work to expand partner book of business, support growth, and feed the expansion of staff skills. As the firm grows, partners should focus on client relationship management. This is the most important part of an owner's job, Reeb pointed out.

To illustrate, Reeb said that in a small firm, \$750,000 is about all a partner can work. Realization is low because the partner is essentially doing everything, there is little staff or client development, and no excess capacity to allow for the addition of more work. This is not a saleable firm, in Reeb's view.

Large-book partners can go one of two ways. They can delegate work, spend more time on client development, train staff, and let more senior staff and young partners take on real responsibility. Or they can hoard the work, refuse to delegate, not train and develop staff, and limit their growth potential. It is delegation and development that will help the book of business grow, Reeb said.

Workload balance is a part of making this suc-

ceed. It isn't easy to hand over a client to another partner, Reeb concedes, but it is necessary to make sure there are balance, service, and growth potential.

- **Improve firm management.** By this, Reeb means develop your staff and make sure work is "pushed down" so that expertise is developed at lower levels and managers become involved in training younger staff. Establish a pay system that rewards people for doing what you want them to do. And invest in your infrastructure: technology, training and development, and so forth.

The sales process. Shopping around, due diligence, contract negotiations—these are all important parts of the process. What's changing is the price and what is assessed and valued, as noted in Reeb's observations above.

When it comes to offering a firm for sale, Reeb said, too many owners start by asking, what can I get for it? Focus instead on the value you are offering. Be aware that some purchasers of firms

are now looking at firm profitability (rather than actual book), so the scene is changing.

In general, in a purchase transaction, most firms are still seeing dollar for dollar of revenue, usually capped at the previous year's revenue per client or in total, at no interest, and generally paid out over four years, depending on the size of the firm.

In a merger in which at least some owners will continue to work for the merged entity, retirement for the incoming partners is included. Terms generally are a fixed price, a multiple of salary, ownership percentage, or book size times an adjustment to net revenues. Payouts tend to be over five to 10 years, and deferred compensation is usually at no interest. Capital is often paid back over a shorter time with interest. There is usually a cash flow cap to extend the payment period if cash flow is tight. There may also be premiums or discounts that add or take away from the standard retirement benefits.

For more information:

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