I have always asserted that Small & Medium-sized Practising (SMP) firms need to either merge and/or be strategically affiliated; otherwise, in the very near future, they could be wiped out. The question one begs to ask is this: “Is the auditing profession a sunset industry?”

It cannot be denied that globalisation and trade liberalisation have had a significant impact on the accounting profession, and some SMP firms have prepared themselves to face this onslaught, which brought about the pressure of stiffer competition and higher stakeholder expectations. Those SMP firms which took steps to strengthen their competitive edge either via merger and/or strategic affiliation are now stronger and able to face yet another wave of changes – the introduction of small audit exemption, limited liability partnership (LLP) among others.

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NEVERTHELESS, IT’S NEVER TOO LATE TO TAKE ACTION

To start with, we can acknowledge that we need to be realistic about the challenges facing our very own local service providers, especially as a result of the globalisation and trade liberalisation process affecting the professional services sector, particularly the accounting sector. Naturally, the “adverse” impact of the liberalisation of trade in the services sector is not only confined to local accountancy service providers but also to relevant government agencies, education institutions and consumers, which have a cascading effect.

Amid the continuing widespread corporate scandals and sweeping reforms (with more and more international financial standards being introduced and implemented, especially the full convergence on 1 January 2012), the urge to either merge and/or strategically affiliate these SMP firms has long been registered on the radar screens of practicing accountants. Nevertheless, accountants being accountants have been procrastinating.

Now, with stiff global challenges ahead, many firms will be forced to consider either mergers and/or strategic affiliations with the view to competing more effectively, at least in the Malaysian professional accounting arena. Generally speaking, most firms are motivated to either merge and/or be strategically affiliated by the desire to achieve sustainable growth and to take advantage of leveraging synergies and/or to defend or strengthen a market position.

To begin with, let’s separate the two components – mergers and/or strategic affiliation although one may argue that strategic affiliation is also a form of merger but dressed up in a different context.

WHAT’S A MERGER?

“A merger is more than merely an agglomeration of two or more firms!” It is similar to that of a marriage between a husband and a wife with the exception that there is no gender involved and that there may be more than two parties. Naturally, there are many factors involved. Together with the many pros, there are cons too.
WHAT ARE THE MYTHS OF A MERGER?

Indeed, there are as many myths surrounding a merger as there are illusions. One may perceive that in a merger the partners in the merged firm will be spending less hours at work or indeed enjoy lighter workloads in view of the synergetic effect. Other myths include immediate higher income (wishful thinking!) and better lifestyles.

Certainly, all these benefits can be attained, perhaps not immediately but in the longer run. However, one nagging fear of a merger is the possible loss of management control of one’s own practice.

As a practitioner, I would have thought that the main objective in a merged entity is to face the many challenges both locally and globally and to achieve ongoing sustained growth – this must be the key priority!

In view of the many high failures of mergers, the next best alternate option for many of these SMP firms is to consider strategic affiliation, which can take the form of either:

LOCAL STRATEGIC AFFILIATION

OR INTERNATIONAL STRATEGIC AFFILIATION

It must be highlighted that any strategic affiliation must be on an affirmative basis where all participating firms are fully committed to one another, just like a merger. The key word is commitment!

Nevertheless, SMP firms need to consider either option in order to build capacity and pool resources to cope with the many challenges arising from the ever-changing landscape of the accounting profession. There are innumerable threats to SMP firms such as the possibility of the exemption of small audits, whereby many SMP firms are still very much reliant on this source of income. Equally, SMP firms are also consistently finding it difficult to recruit talent in view of their smaller size and also the unearthy long hours of hard work, which are another deterrent. Pressure on SMP firms to raise their quality of professional services is already straining their existing tight human resources, especially since the International Standards on Quality Control 1 (ISQC 1), which prescribes certain structures for practising firms offering audit assurance services was adopted. Adding to this pressure is the Accounting Oversight Board (AOB), under the purview of the Securities Commission, which further imposes various restrictions and quality controls for the audits of public interest entities.

On the whole, SMP firms are not only facing more and more stiff compliance requirements, but also rising compliance costs. Bearing in mind that accounting standards are ever-changing at an alarming rate and to rub salt into the wound, many of these new accounting standards following implementation are again undergoing reform. Instead of convergence, it would seem that accounting standards are going for divergence at least as far as accounting and taxation profits are concerned. This is placing undue pressure on all practitioners, more so on the SMP firms.

At this crossroads, M&A options offer a solution as SMP firms can optimally achieve economies of scale with combined resources to eliminate inefficiencies. Given all these challenges and higher stakeholder expectations within the accounting profession, SMP firms must now seriously take drastic steps to strengthen their competitive edge either via merger and/or strategic affiliation. Both options offer synergistic benefits. Certainly, when SMP firms either merge and/or affiliate strategically, they automatically comply with part B, Section 520 of the Malaysian Institute of Accountants (MIA) By-Laws on “Incapacity or death of a sole practitioner.” Approximately 80% of the accounting firms in Malaysia (and other neighbouring countries too) are sole proprietor practices. Hopefully, M&A arrangements will reduce the concentration of sole practitioner firms which are often plagued with practice continuity issues.
M&A – THE BENEFITS
Although some SMP firms would have encountered past failures and obstacles in either a merger and/or strategic affiliation, many too have attained success. The many benefits that can be reaped from M&A arrangements are as follows:

OPPORTUNITY FOR CAPACITY BUILDING BY POOLING OF RESOURCES
The pooling of staff would generally lead to better staff retention as a result of a larger staff force and this allows for expertise to be shared, which ultimately provides an opportunity for specialisation. Such capacity building also offers greater and better sharing of technical information which in turn enables better training programmes to be undertaken within the SMP firms.

With combined capacity building, this also gives rise to opportunity for expansion to other related professional arrangements, such as a Multi-Disciplinary practice arrangement with like-minded disciplines.

By the same token, practitioners can now place better focus on practice management and development with better career development and advancement for both staff and management. This capacity building in turn prepares the SMP firms to offer more personalised development programmes and training for both clients and staff.

WIDER SCOPE FOR EXPANDING THE RANGE OF PROFESSIONAL SERVICES
Other than the traditional professional services, namely assurance audit, tax, accounting and secretarial, the range of other related professional services can also be expanded with various experts and specialised managers and partners joining forces leading to the greater and better ability to fulfill the expectations of clients. In most instances, this expanded range of professional services leads to better quality and cost efficiency, which results in higher quality assurance and a greater degree of compliance.

The expanded range of professional services also enables the SMP firms to provide value-add to their clients in terms of related services which would not otherwise have been possible.

GEOGRAPHICAL COVERAGE
M&A offers SMP firms a wider geographical coverage, both locally and globally, with the mitigation of resource constraints. There is certainly a greater ability to support clients’ business expansion needs in different geographical locations, hence leading to better services for the clients which also leads to better client retention.

Wider geographical coverage also enables SMP firms to tap into the various economic corridors that the government is continuously launching each year; with the most recent being the “Economic Transformation Programme” which are planned to boost economic activities outside the Klang Valley.

BRANDING OF A BIGGER FIRM
M&A usually offers SMP firms a better and improved image as a result of a bigger merged size due to combined capability. Certainly, with a bigger firm size and wider geographical coverage, the name of the SMP firms is generally better known and the public at large is usually more receptive to a bigger player hence leading to better branding.

PRACTICE CONTINUITY
To reinforce what was mentioned earlier, M&A arrangements will enable these SMP firms to continue even with the exit of a partner or if there is a change in ownership. Likewise, admission of additional partners is easier since the partnership structure is already in place. Given that practice continuity is in place, clients naturally feel more at ease since they are no longer dependent on one practitioner but a group of practitioners with possibly different expertise.

RETIREMENT PLANNING
As in practice continuity, M&A offers an avenue for an exit opportunity should the retiring partner wish to do so, without jeopardising the future of the practice and thereby creating a value for the retiring partner.

GREATER FINANCIAL SECURITY
Generally, M&A offers a bigger financial investment which ultimately leads to better financial security. This enables more efficient management systems to be put in place in view of the higher financial investment commitment in more advanced technological and computerised systems. The benefit is generally the reward of better financial returns for partners.

M&A – THE FEARS
Despite all the above benefits of M&A arrangements, there are also possible pitfalls. The common traps shared by some practitioners are:

• Lack of planning and the failure to obtain full support and commitment from all participating firms;
• Unsuitable candidates, the short-sight edness of participating firms and personality clashes;
• Differing viewpoints, concepts and corporate cultures;
• Distorted and unclear visions and missions of participating firms’ objectives;
• Valuation of financial asset worth and disputed goodwill valuation of individual firms;
• Nepotism and favouritism – a common phenomenon in our Malaysian culture;
• Financial constraints – the other extreme angle;
• Non-audit services – failure to expand the range of professional services;
• Autonomy and autonomy; and
• Failure to deliver the ultimate “promise” i.e. synergy attainment.

Naturally, a successful M&A arrangement goes beyond merely understanding the above pointers. Most importantly, participating SMP firms need to make a concerted and ongoing effort to ensure that the M&A arrangement works rather than taking it for granted.

However, one may ask: “What’s the significant difference between a merger and a strategic affiliation?”
Unlike a merger, strategic affiliation generally goes beyond borders. Commonly, a merger is more of a linear expansionary “marriage” while a strategic affiliation can be exponential or explosive in nature since the latter takes the local firm to a global platform.

The beauty of a strategic affiliation is that such an arrangement attains all the benefits of a merger and more. First and foremost, in terms of say, geographical coverage, with a local strategic affiliation, the firm is now seen as having branch offices in different locations within the country. With an international strategic affiliation, the local firm is now part of a global network. Just imagine that one local firm in the Klang Valley has been operating for many years. When its clients expand their businesses overseas, it is likely that the local firm may lose those clients to bigger players. Despite having painfully nurtured these clients, the firm is now losing them when the benefits of higher fees are within reach. However, when this firm gains entry as a strategic affiliation to a global network, the door is now wide open because that local firm is now being seen as having an international presence. From a business perspective, clients would perceive such a strategic affiliation as the firm widening its geographic coverage beyond local shores in order to provide better support for client expansion, hence leading to value-add and better services for the clients.

From local to international, such strategic affiliation generally gives a positive vibe with a better image as a result of a bigger entity due to the combined capability, which ultimately leads to better branding. But then one may ask: “What does branding have to do with an accounting firm?” In response, I would say, branding creates an emphasis on the firm’s difference for quality and through targeted communications, further enhances a more meaningful way to describe the firm’s services i.e. product/service differentiation.

Given that strategic affiliation enjoys all the benefits of a merger, such an arrangement also overcomes many of the pitfalls faced by a merger. The one biggest myth is the loss of proprietary management control which is now eliminated under strategic affiliation. The firm will continue as it has been operating before, other than being seen as being part of a bigger group or global network of practising firms. There is no risk of a “divorce” and incurring huge legal and related costs especially where there is a break-up, as in a merger.

Another added benefit is that strategic affiliation is also an avenue to expand clients’ base via referrals from other member firms, both locally and internationally. Such strategic affiliation generally involves referrals of clients from one to the other member firms as a whole, and this arrangement creates and expands the client base of the practising firms within the group or global network of practising firms.

At this juncture, one may ask: “What are the drivers for a merger and/or strategic affiliation?”

To me, the main drivers or at least the priorities for a merger and/or strategic affiliation may be the following:

- International branding
- Better client retention
- Continuity and/or succession planning

M&A – THE SELECTION PROCESS

Now that we have examined both mergers and/or strategic affiliation, we also need to understand the selection process and its various formalities.

TO BEGIN WITH, WE NEED TO: IDENTIFY POTENTIAL PARTNER(S)

One needs to identify the potential “partner(s)” firm or international network for strategic affiliation. Like a courtship, one needs to identify like-minded practising firms which ideally share the same vision and mission as well as the “values” of your own practice firm. Identify the form of relationship that is to take place – be it formal or informal, especially in a strategic affiliation arrangement. In the past, many firms would be seen as “affiliated” to an international network which is generally a non-committal arrangement whilst of late, affiliated firms are now assuming the name of the international network and this is more of an affirmative arrangement – a commitment!

TERMS AND CONDITIONS OF AGREEMENTS

Upon acceptance by both parties to go on an affirmative strategic affiliation arrange-
ment, the terms of agreements must be agreed upon at the forefront to avoid any misunderstanding such as the following:

• Payment of an agreed annual fee for the strategic affiliation arrangement;
• Payment of a licence/royalty fee for the use of the strategic “affiliation name” and “affiliation logo” including the global website among the use of standard quality programmes;
• Defining the rights and benefits of the global strategic affiliation membership;
• Defining the territorial rights;
• Terms and conditions for the admission of new members to the strategically affiliated global network;
• Where possible, identify the “Leader” of the strategically affiliated firm in each country or region;
• Define regional and practice management to include any financial arrangements and related commitment;
• Marketing obligations and related commitments;
• Professional insurable liabilities in line with the By-Laws of each country, bearing in mind the professional independence and Anti-Money Laundering Act; and
• Finally, terms and conditions for the exit or termination of membership to include expulsion of member firms.

CONCLUSION

It’s timely to take stock of where you are now. Both mergers and/or strategic affiliation arrangements are viable options and you need to weigh your own personal firm’s requirements. Both options offer you many benefits although you need to weigh the consequences in the unfortunate event of a “divorce” – be it a merger and/or strategic affiliation.

In the case of a merger, the legal and related costs can be exorbitant, not forgetting the many other complications; whilst for strategic affiliation, the costs are probably only the membership and related fees together with a notice period for exit.

At the end of the day, we must not let fear rule us in this ever-changing landscape of the accounting profession since fear can and will always cloud us to the many benefits of successful M&As. To those practitioners who have had failed in M&As, remember: “Appreciate second chances because once you lose it, you will never get back what you let go!” So, let’s take the bull by the horns and view M&As as the way forward.

The Mergers & Acquisitions Working Group of MIA has created a special portal for member firms to register for the above options. The MIA website link is at www.mia.org.my/e-merger

For those practitioners who wish to discuss these options, please feel free to contact or email the writer, Dato’ Raymond Liew at raymondliew@mcmillanwoods.com