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Considerations When Acquirers Come Courting

By JJ McKinney

In the second of our juxtaposed articles about the pros and cons of TPA business acquisitions and consolidations, J.J. McKinney looks at using this trend as a means of efficiency and business succession. All businesses face succession eventually. The more control the owner has in the succession plan the better for all parties involved. The succession plan needs to include the possibility of a future sale, potential unforeseen events, scenarios directed towards the associates within the firm or family members, and any other potential outcomes. This article includes some questions that need to be answered when putting together a business succession plan.

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Business owners in every industry dream of building valuable businesses and growing them to serve clients, create jobs, and increase profitability. The business becomes part of the owner and often indistinguishable from the owner. Businesspeople may focus on maintaining tight ties to the enterprise while others focus on establishing a company that stands on its own aside from the owner.

Retirement plan administration firms, commonly known as Third-Party Administrators (TPAs), are no different. A company of several talented individuals may be referred to on the street simply as the owners' name(s)—a classic example of an owner who spends more time working in the business than on the business.

Profitable firms that effectively run themselves without the owners stepping into every facet of the operation become attractive to investment firms growing a portfolio of like firms, industry peers looking to expand, and other potential buyers. A seller in this scenario may negotiate more favorable terms in the agreement and can earn a higher valuation for their business than counterparts. An owner tied too closely to the business's operation may struggle with profitability and operational efficiency, due to working in the day-to-day functions they should pay talented people to do.

Differentiation

As my former business partner, Kasey Price, used to quip, "If you have met one TPA, you have met one TPA." The statement speaks truth both to external relationships and internal operations. On one end of the spectrum, each client receives tailor-made pricing, design, and service. On the other end of the spectrum, technology runs most functions end-to-end with little personal touch. The high-touch model is more typical of the local TPA and builds lasting relationships that weather the years together. The high-efficiency model generally sells high volume and serves plan sponsors who can either do much of the work themselves or do not place significant importance on customization and relationships with their service providers.

At the extremes, at one end lies the tailoring TPA, devoted to making each individual experience unique, appearing to operate on the principal that what the client wants drives the business. On the other end of the spectrum, the high-efficiency model first attracts those who want little human touch. Over time, the low-touch approach places heavier burdens on the plan sponsor, often resulting in client turnover when their plan falls outside of the efficiency box.

In the end, the more successful TPAs rest somewhere in between the extremes. The middle ground seeks and finds efficiencies where it can without losing the personal touch the clients want, promotes the value of professionals so the clients know where the expertise lies, and invests in their people to be the culture that the owner presents both to prospective clients and career candidates. In the middle, a potential buyer finds a class of company that retains clients and continues to gain new relationships when changes inevitably come, even big changes like mergers and acquisitions.

Succession Plan

Eventually, all businesses face succession, whether succession is thrust upon it due to an unforeseen event or the business plan drafts a road map for a future with someone else at the helm. The more control the owner has in the succession plan due to proper evaluation and planning, the better for all parties involved. Even if the owner has no desire to sell the business, the succession plan needs to include the possibility of a future sale, potential unforeseen events, scenarios directed towards the associates within the firm or family members, and any other potential outcomes. Preparing a thorough succession plan is outside the scope of this article; however, business owners should seek advice to develop a path ahead from those who have sold their practices, companies in acquisition mode, and legal counsel specializing in mergers and acquisitions.

Mapping out the future keeps the balance of power in the hands of the business owner. On the other hand, reacting to an unfortunate or unforeseen event places pressure to take action that may not be in the best interest of the owner, employees, referral sources, and clients. How does an independent evaluator value the business? What is the ideal culture if an acquisition takes place? How does the succession plan fit within the scope of the business plan? What opportunities do current employees and associates seek in a growth and change-oriented environment? What answers do I want to hear from those who have taken this step before? Answer all of these questions and more to prepare a plan and priority list. Be as specific as possible. Ask the buyer every question you can imagine and consult with previous acquirees about the questions they forgot to ask, no matter how off the wall or offensive the questions seem. Make sure the answers sufficiently and completely address the questions asked.

Acquiring Minds Want to Know

Whether the owner remains in production post-acquisition or goes off into the sunset depends heavily on the mechanisms in place for running the business. When the owner in the eyes of the outside world is seen as "the business," an acquisition could send red flags flying among referral sources and clients.

Although we experience constant change, many still do not favor the big and abrupt changes that often follow acquisitions. When and how you notify internal associates and external partners plays a critical role in everyone's comfort level when announcements and press releases explode in the media. No matter how smoothly current merger and acquisition efforts have been for the buyer, many of your colleagues will recall previous negative experiences immediately. Spend proper time and energy laying a firm foundation with expectations.

The larger the organization, the shorter the term for the viability of responses to questions. During the pre-acquisition process, no matter who answers the questions, they likely do not know how the organization will look in six, nine, twelve, or more months. This is not dishonest practice; acquisitions fall through and pop-up constantly, and each new acquisition potentially changes the trajectory of the whole organization. The newly acquired company brings its own strengths, weaknesses, products, and services. The buyer may employ strengths to reorganize processes and procedures previously thought to be settled, whereas weaknesses may shift to gain support from other teams within the organization to make improvements. Better products and services often usurp the previous in-house expertise. The goal of building a better organization lies beneath the newness and change, ultimately driving toward a positive outcome. The acquired, even if they offer many best practices that carry forward, ultimately integrate into the whole over an undetermined time frame with previous and upcoming acquisitions.

Leadership roles often shift with new acquisitions and unexecuted "promises" make room for the savvier business owners who stamp their desired role into their own agreements. Owners in many cases fit very well into sales roles, as they serve in the primary sales function or face to the outside in their own firms. Evaluate and discern carefully whether sales consulting is the right path. Yes, the former owner has an important task in keeping partners, clients, and referral sources happy through transition and integration into the buyer's way; however, owners previously involved in all, or multiple facets of their firms may find longer term satisfaction by claiming a leadership role in management or operations. Sales consulting allows the former owner to manage certain relationships, but may not allow the time needed to focus on best practices that could help the broader firm as it grows and changes. A national firm may narrow the business owner's sales footprint due to other acquisitions based on crossover territories or in the exact same market space.

Conclusion

Although a TPA serves a noble purpose for retirement, it is first a business and must follow effective business practices for operations and viability today and into the unforeseen future. Buyers will continue make offers or other scenarios may come along that have a sale as the best solution. The current owner has the power before offers come to draft the desired destiny more completely through careful and meticulous planning both for the business and personally. ■