Private Equity -

A New Era for Accounting Firms

AGN Global Business Voice
Practice Management

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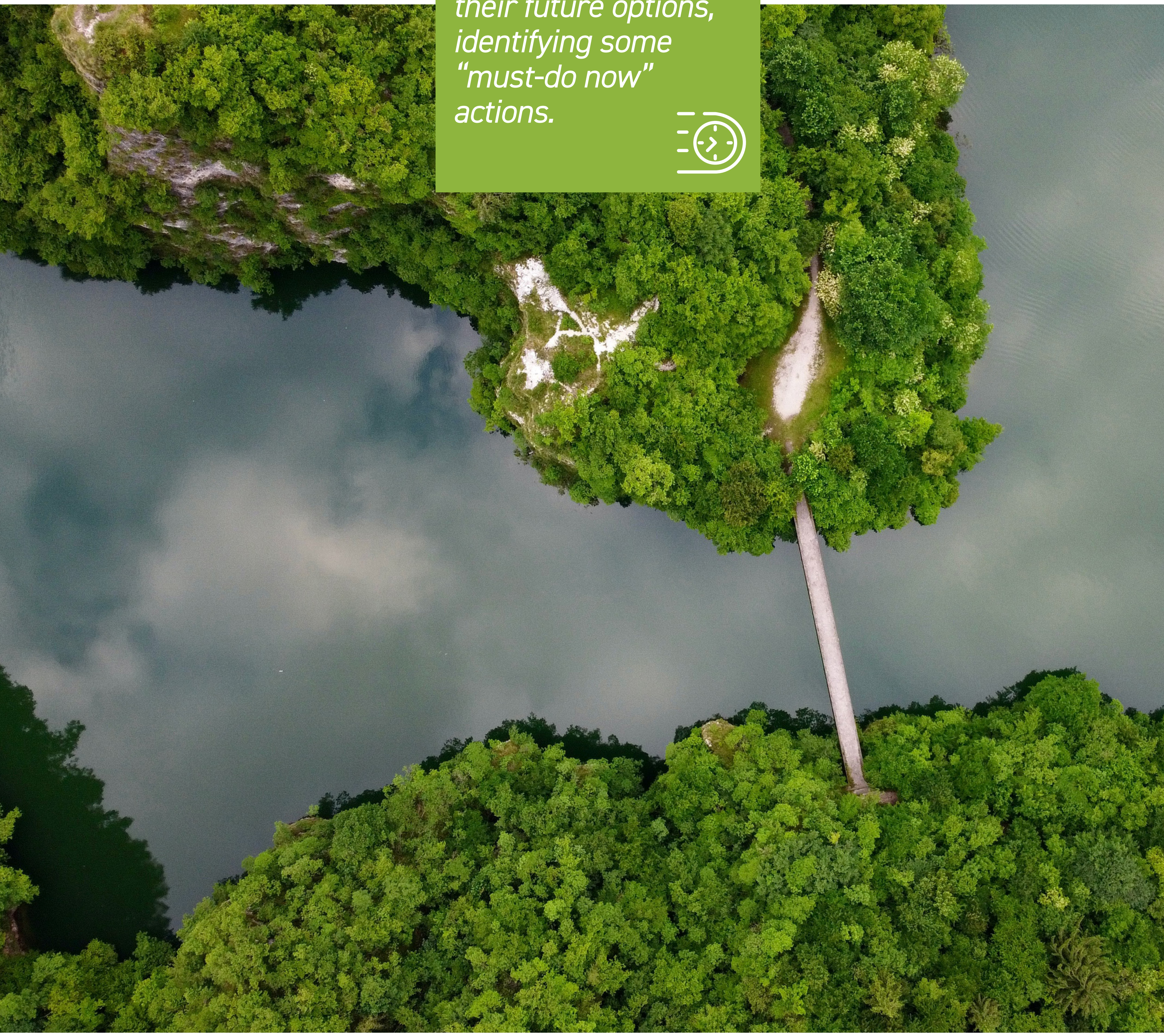
A New Era for Accounting Firms

Private equity (PE) is fundamentally reshaping the accounting industry, offering growth, expansion, and competitive positioning, while introducing complex strategic considerations for firms navigating this transformation.

This AGN Global Business Voice brings the thinking up-to-date and invites AGN members to think widely about their future options, identifying some "must-do now" actions.

So, are we seeing a New Era? The traditional partnership model has long been the backbone of professional services. Definitions are unclear, but there are likely between 20 and 50 active PE-funded consolidators in each of the US and UK markets. Globally, the PE phenomenon is moving into other jurisdictions like Canada, Australia, and some other European and emerging markets.



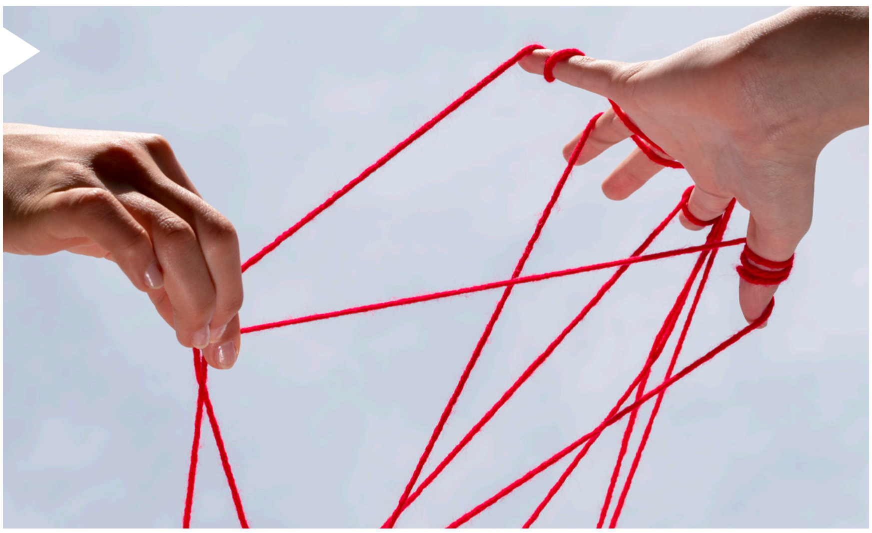
External investment is presenting unprecedented opportunities and challenges. PE-backed business models offer significant growth potential, enabling firms to scale, adopt cutting-edge technologies, and enhance service capabilities.

As with any fundamental business structure shift, PE investment also introduces strategic considerations and potential risks. Firms should maintain a balanced perspective, recognising both opportunities and challenges.

The Private Equity Panacea

PE investment offers solutions to several macro-industry trends in professional services. Addressing these business issues whilst selling equity at double historic valuations is tempting for a generation of current equity owners considering exit and retirement. And it can be equally exciting for management teams who believe they can generate high growth and premium returns by leveraging:

- **Capital for Expansion:** PE provides firms with financial backing to expand into new markets, invest in technology, and acquire complementary services. This generates mass to leverage scalable technologies and processes.
- **Talent Retention and Development:** Whilst traditional equity partnership may not be an option, PE-backed firms can offer compelling career progression and participation incentives to attract and retain top professionals.
- **Operational Efficiencies and Digital Transformation:** PE investment enables firms to implement advanced scalable technologies, automate processes, and improve profitability while enhancing client service delivery.
- **International Expansion:** PE-backed firms can leverage their investment to establish a stronger international presence, ensuring they remain competitive in a globalised marketplace.



Positioning For The New Era - What To Do Now

1. Evaluate Alternative Ownership Models

Firms should explore various ownership structures beyond full PE buyouts, such as hybrid models, Employee Stock Ownership Plans (ESOPs), or minority investor arrangements.

2. Drive Long-Term Growth and Modernisation

To remain competitive—whether pursuing PE investment or staying independent—firms must focus on sustainable growth strategies. This includes investing in digital transformation, strengthening talent acquisition & retention, and the evolution of their service offering in light of AI and technological impacts. It will be important to preserve and build an inclusive entrepreneurial culture.

3. Prepare for Regulatory and Structural Changes

As PE reshapes firm ownership, accounting firms must stay ahead of evolving regulations and industry oversight. Understanding compliance risks and governance changes will be critical for maintaining trust and credibility.

4. Assess Financial Risks, Including Debt Burden

PE-backed firms often take on significant debt through leveraged buyouts. Traditional firms should carefully analyse the financial implications of PE investment and ensure they do not compromise long-term stability for short-term gains.

1. Key Considerations for AGN Members

Traditionally, accounting firms have been structured as partnerships, offering long-term career paths culminating in equity ownership for high-performing professionals. The introduction of PE into the sector has begun to change this model:

- The **pool of future firm owners may narrow**, as equity is increasingly concentrated among institutional investors rather than senior professionals who have worked their way up through the firm.
- This could lead to **talent retention challenges**, as ambitious professionals may not have the equity participation opportunities they had expected.
- Some firms are exploring hybrid models that **preserve elements of partnership structures** alongside PE investment to maintain leadership incentives. Given the relaxed regulatory environment, there is scope here for imaginative solutions – Employee Stock Ownership Plans (ESOPs), Bank Funding etc, (See Appendix A).
- It will be important to build and maintain an **inclusive and entrepreneurial culture**, attractive to top professionals.

2. "The First Flip": Still an Open Question

PE investment is cyclical, with firms typically undergoing a 'flip' to new investors after a few years. While the first wave of PE-backed firms in the accounting sector appears to be achieving initial return targets, it remains to be seen how sustainable these models will be over multiple investment cycles.

- The **long-term value of PE-backed accounting firms** will depend on their ability to generate sustained growth beyond the initial expansion phase.
- Investors will need to balance **short-term financial targets with long-term client and talent retention strategies** to avoid market instability.
- Close monitoring of **the outcomes of early PE-backed firms** will provide valuable insights into the sustainability of these investment models.

3. The Debt Burden Factor

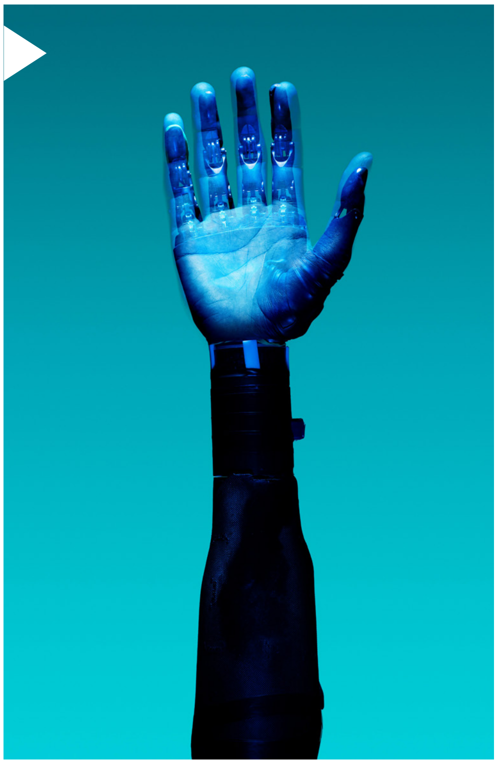
One of the core mechanisms of PE investment is the use of leveraged buyouts ("LBOs"), where external funding is used to finance the acquisition of firms. While this approach can accelerate growth, it also introduces new financial risks:

- Some successful accounting firms that were previously self-sustaining are now **carrying significant debt loads** as a result of PE transactions.
- Is there a risk that this added **financial burden may pressure firms to prioritise short-term Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) growth over long-term client service and professional development?**
- Firms considering PE investment must carefully evaluate their ability to **manage debt obligations while maintaining financial stability.**

4. Evolving Markets, Talent & Technology

By bringing in top specialists and investment muscle, PE-funded businesses are leveraging technology and new expertise to drive efficiency, attract talented professionals, and provide great service and rewarding careers. We should anticipate notable successes as they drive high-quality, repeatable, and scalable approaches, such as technology driven auditing.

The PE phenomenon presents opportunities for conventionally funded firms: PE-backed firms' technologies and expertise could become commercialised and more accessible, affordable, and common. Additionally, bespoke, high-touch, premium offerings like specialised tax services or sector-specific expertise may prefer other service models. Already, some conventionally funded firms are reporting an influx of recruits from the PE-backed environments — potentially the early stages of professionals opting for alternatives to professional life in the PE-backed models?



5. Regulatory Implications: Returns vs Quality?

The accounting sector has undergone a dramatic shift in ownership structures over the last 30 years, moving from unlimited liability partnerships of technical experts to corporate ownership of external investors. The latest shift catalysed by private equity has yet to be fully tested by regulatory bodies:

- Historically, **partners bore direct responsibility for audit compliance** and faced unlimited personal liability for their work. More recently, whilst most jurisdictions have had forms of limited liability for some time, ownership remained primarily with those working in the business.
- Under PE ownership, **the legal and financial risk shifts further away from the individual professionals doing the work.** At some point this may likely raise concerns about accountability.
- **Regulatory responses remain uncertain**, as audit oversight bodies adapt to a new landscape where ownership and compliance responsibilities are increasingly separated.
- The **potential for future regulatory scrutiny** is high, particularly as the sector grapples with maintaining audit integrity under a profit-driven ownership structure.

Action for AGN Members

As firms navigate this evolving landscape, the key to success lies in strategic positioning and informed decision-making. Firms should:

1. **Assess Long-Term Value Creation:** Whether seeking PE investment or one of the alternative models, firms should focus on building a business that attracts investment while safeguarding long-term sustainability. Alongside, an emphasis on building an attractive entrepreneurial culture will be important.
2. **Remain Agile in Decision-Making**: Whatever funding and ownership model is chosen for the future, PE will impact significantly the competitive landscape. Firms must actively evaluate the role that PE could play in their future, whether through a minority investment, full buyout, or strategic partnership.
3. **Understand the PE Investment Cycle:** Firms should conduct rigorous due diligence on potential investors and ensure alignment between their long-term strategy and investor expectations.
4. **Monitor Regulatory Developments:** Understanding how regulatory bodies respond to changes in firm ownership will be critical in ensuring compliance and maintaining public trust.

Essentially firms have an opportunity to pursue active modernisation and investment strategies - this attracts the PE community. And in more than the short term, whether with PE or other means, firms will need to adapt their strategies to remain competitive.

Conclusion: Embracing Change While Maintaining Integrity

Private equity represents neither a demolisher nor a panacea for accounting firms. But it undoubtedly represents a significant structural and competitive shift in the industry. If navigated effectively, it can drive both substantial growth and innovation, and significant opportunities for those choosing PE-backed models, or indeed the various alternative models that exist.

As AGN supports its members through these changes, we focus on equipping firms with insights and frameworks to thrive in this evolving landscape. PE is a transformative strategic tool that requires careful management. The choice for firms is not **simply "PE or you lose";** rather, it is about **how to adapt, grow, and create sustainable value** while navigating the opportunities and challenges of PE investment where it is applied.

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Appendix 1:

Other Ownership Models Are Available....

1. Employee Stock Ownership Plans (ESOPs)

- Employees acquire ownership over time, creating a vested interest in firm success.
- Potential tax advantages, including deferred capital gains tax for selling owners.
- Used successfully by accounting firms to maintain independence while offering succession solutions.

2. Hybrid Partnership-PE Model

- Maintains a core group of equity partners while selling a minority stake to PE investors.
- Balances external capital for growth while retaining traditional partnership governance.
- Helps existing teams maintain control and cultural integrity.

3. Cooperative Ownership Model

- Shared ownership between employees, partners, and even clients or industry stakeholders.
- Encourages long-term decision-making and aligns incentives across all stakeholders.
- Rare but viable in professional services where sustainability and independence are priorities.

4. Strategic Alliances with Shared Ownership Pools

- Instead of full mergers, firms create equity pools across multiple firms.
- Used to create economies of scale, share tech investments, and enable joint market expansion.
- Could work well within international associations like AGN to build integrated service offerings without ceding full PE control.

5. Minority Investor + Employee Option Pool

- External investors take a minority stake while employees get share options.
- Reduces challenge of cultural shift compared to full PE ownership.
- Provides liquidity while keeping leadership incentives aligned.

6. Public Listing via Alternative Investment Markets

- Some accountancy firms (e.g., in Australia and the UK) have explored IPOs or public listings on secondary markets.
- Offers access to capital while allowing the option of M&A with some element of consideration in marketable securities.
- Creates complexities in governance but can be a strong alternative for high-growth firms.

7. Private Family Office "Evergreen" Investment Model

- Long-term capital investment from a family office instead of PE firms.
- More patient capital, focused on steady growth rather than fast exits.
- Allows firms to remain independent while securing funds for development.

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