INTERNAL SUCCESSION READINESS

Keys to help prepare your firm for a leadership transition

Internal Succession Readiness

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Introduction

The CPA profession is facing a significant issue over the next five-to-15 years. The vast majority of CPA firms in the United States are poorly prepared to manage the succession of their owners internally. There are many reasons for this.

The profession attracted a lot fewer new entrants in the late 1980s and through the 1990s than it had historically. During that time, we made it harder to enter the profession by converting to five-year degrees to obtain the CPA designation. Plus the profession did not offer competitive compensation compared to alternative careers in finance and technology. This led to a substantial shortage of labor in many markets during the late 1990s and first decade of the 21st century when the economy was strong and firms were growing. The effect on many firms today, as the economy has slowed, is a lack of available talent to provide succession for their owners.

The problem is exacerbated because CPA firms on the whole have done an inadequate job developing the talent they do have to the extent necessary for young people to be viable successors for the current owners. This is especially true in small and medium-sized firms.

And further adding to the problem is the fact that the majority of firms in the U.S. are owned by "Baby Boomers," those individuals born between 1946 and 1964. The concentration of ownership in this age group means many firms are simultaneously racing toward the need for succession due to pending owner retirements. There are more and more firms seeking the same resources and solutions within a limited pool of options.

Transition Advisors LLC specializes in working exclusively with CPA firms on ownership transition issues. Our principals have advised and helped thousands of firms over the past 20-plus years on mergers, succession strategies, owner agreements, and other matters strictly related to the transition of ownership in CPA firms.

The majority of firms we work with on succession planning initially have a strong desire to handle the transfer of ownership in their firms internally. An upstream merger or sale is often seen as the solution of last resort. We are often told firms have a preference to leave a

65% of all CPA firms in the U.S. indicate they will have succession challenges for their partners within the next 5 years.

38% of senior partners at firms indicate younger members of their firm are not ready to step into leadership positions.

2008 PCPS Succession Survey

legacy, for a smoother transition, for flexibility in the way the transition of ownership is managed, for retention of the firm's and owners' identities, and an inclination to continue to manage the firm's affairs and the owners' careers on their own terms. Like many entrepreneurs, a lot of CPA firm owners are control driven. They want to maintain control of their business affairs as much as possible.

This white paper is designed to help you understand what it will take to successfully execute an internal succession of your firm's ownership interests. You will gain the insight and tools you need to determine if you have the necessary talent on board to take over for your owners as they exit, how to obtain and develop more talent so your bench is properly positioned for that task, how your owner agreement needs to be structured to help you manage the transition successfully, and how to effectively transition the roles of the retiring owners so the firm remains at least as strong as it was prior to the exit of its most senior and experienced talent.

If, after reading this white paper, you have additional questions about your situation, feel free to call us at 866-279-8550. We will direct you to the Transition Advisors principal that can best help you.

"Like many entrepreneurs, a lot of CPA firm owners are control driven."

Principles of a Viable Internal Succession Plan

Assess the Timing of Partner Succession Needs

Before you undertake a strategy to develop succession in your firm you need to have a clear picture of what kind of succession team to have in place and when. Ideally, your firm will develop a system where the necessary young talent is developed continually to provide a steady flow of successors for your retiring partners. Unfortunately, many firms have not developed that type of culture, and as a result, their need can be significant and immediate.

This assessment consists of determining two things about your group of partners:

- When replacements for your partners are likely to be needed.
- What kind of replacement partners are going to be necessary to keep the ship sailing in the same direction.

The first step is to determine as best you can when each of your partners is likely to slow down or leave altogether. This should be based on conversations you have had with those reaching an age where it is appropriate to consider the timing of their retirement. A mandatory retirement age in your owner agreement helps make this type of planning easier and is a good reason to have such a provision. However, many agreements exclude that requirement so you may need to rely on uncertain plans each partner has for the end of their careers.

The next step is to determine what type of role replacement you are going to require for each individual partner. There are generally two types:

- Role reallocation.
- Role succession.

Role reallocation refers to reallocating the duties a partner has to other partners and staff without the need to actually have in place

"Develop a system where the necessary young talent is developed continually to provide a steady flow of successors for your retiring partners."

a new partner. This occurs typically when a partner that is retiring does not have special expertise, nor unique skills, and the firm has the existing capacity to reassign the partner's duties to existing high-level personnel. Usually the firm will need to replace the "productive capacity" of such a partner, but that may be all.

Role succession refers to having to replace a retiring partner with a new partner. The new partner is often someone that was promoted to that position prior to the retirement and has capacity to take over the duties of a partner. There may still be the need for reallocating more complex clients or high-level management duties to other partners. The key issue is if the firm had five partners prior to the retirement, it believes it will need at least five partners following the retirement. Often this is due to capacity concerns, but it can also be due to special expertise and skills. If a retiring partner was concentrating on a niche service, it may be the case that a partner needs to continue emphasis in the niche for the firm to maintain its competitive advantage.

Once you have determined the timing and type of replacement necessary for retiring partners, you have an idea of what you need in the way of bench strength and when you will need it. If you have a need for a role succession replacement in two years and you don't have a person on your bench ready to step up, you have a critical issue that needs to be addressed aggressively. Conversely, if you won't have the need for role succession for a longer period of time, you have more options for how to acquire and develop the necessary talent you will need for replacement partner-level resources.

"The new partner is often someone that was promoted to that position prior to the retirement."

The Four Steps to Executing Internal Succession

There are four primary objectives every CPA firm needs to achieve in order to have a viable internal succession plan. Those are:

- Acquire the necessary talent to create internal successors.
- Develop that talent into a strong internal succession bench.
- Have in place the right financial arrangement to manage the admission of new owners and the buyout/retirement of existing owners.
- Develop a transition plan that will allow the firm to transfer the

duties of owners that leave without diminishing the value of the firm.

Acquire the necessary talent

Define success: Acquiring the necessary talent starts with knowing what you are looking for. This may sound overly fundamental. But if the next person you hire is not someone you can picture becoming an owner in your firm, how can you expect them to become that person? How many of these type people can you afford to hire? In order to fill short-term needs, most firms settle for far less talent than they need in the long term to build an internal succession team. Some reasons for this approach to recruiting staff include:

- The hiring process is laborious and not something most CPAs enjoy doing.
- Often, staff are hired exactly when they are needed because someone left; this creates a sense of urgency to hire a replacement as fast as possible to fill an immediate opening.
- New staff often have the attributes the firm needs in the short term, but not the skills that will allow them to become the firm's future leaders; this shortcoming is tolerated because those long-term skills are not necessary now.
- The firm has never formally defined what skills are required to be an owner in the firm; therefore, the firm has no benchmark to evaluate candidates for long-term success.

Acquiring the necessary talent to create a strong bench of future owners requires a commitment to constantly be searching for strong talent, making calculated decisions as often as you can about a candidate's long term potential, as well as short-term skill set, and building a virtual profile of the skills necessary to become an owner in your firm as an evaluation tool for candidates.

Alternative means of locating talent: The manner in which you find talent can be varied. Certainly, traditional recruiting of inexperienced talent is one approach. Firms that are committed to obtaining talent typically rely on this tactic. They often feel they don't have to purge the cultural training experienced staff bring with them.

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The downside, especially for smaller firms, is their inability to compete with larger firms for the best talent and the inherent risk that comes with candidates that are 10 or more years from maturing into owner status. These firms feel they can't risk inexperienced staff who won't stay with the firm long enough for a variety of reasons that may have nothing to do with the firm's ability to provide a long-term career opportunity.

Firms that are looking for more immediate solutions to talent often will seek out talented professionals with significant experience who are close to owner status. A manager at a large regional firm is a good example. This person might be looking for a better opportunity or a different environment. In order to make this strategy work, you need to be prepared to: 1) make an attractive offer including a clear path to ownership (though not necessarily guaranteed), and 2) potentially invest in the candidate while they grow into a role that is adding value to the firm. Often, to be competitive in recruiting top talent, you have to be willing to pay top-level compensation. The required compensation may be out of the norm for your firm and hard to justify because you don't currently have the client volume necessary to maintain your current profit margin. If the person is actually as good as they need to be to qualify as a key part of your succession team, they will soon create enough value to more than pay for themselves. But at the time you are making the decision to go forward, this decision may feel like a significant investment.

"Seek out talented professionals with significant experience who are close to owner status."

Using mergers to find talent: A third strategy we have helped many firms execute is to acquire or merge in a firm that has young talent that can strengthen their succession bench. Sometimes, young staff you find in a merged-in firm are effectively diamonds in the rough due to being undervalued by the owners of their current firm. Or possibly the firm being acquired doesn't have enough time for these younger staff to mature into the succession role the firm needs immediately even though they're recognized as having long-term potential. Another version of this approach is to merge in a younger practitioner with an existing book of business that you believe is capable of taking over for partners down the road. Think of it as a merge-in to a buy-out.

Developing talent

There are three forms of training that need to be a part of every professional's development. This applies to everyone in the firm, but is especially important for future owner candidates. These forms of

training are:

- Generic Competency Training.
- Firm Culture Specific Training.
- Mentoring.

CPE: Generic competency training is what we often refer to as Continuing Professional Education. The courses we take to maintain a CPA license, often in classroom settings, are examples of this type of training. This training takes the form of technical training, personal development (such as writing skills, time-management skills, and IT skills to name a few), and leadership training. Leadership training is often directed at future owner candidates and includes project management, supervision, and practice-development training. In order to develop future owners properly, it may be necessary to increase the budget you allocate for their generic competency training. As candidates develop you may want to consider using some specialized training to develop the skills that are unique to owners of CPA firms. You should consider expanding your continuing education plan beyond technical training to include personal development training.

There are several consulting firms in the U.S. that offer partner development programs. Most accounting associations offer access to this type of continuing education. You can find programs that address specific parts of comprehensive development programs in most CPE curriculum catalogs.

On-the-job-training: Firm culture specific training is also known as on-the-job-training. However, the term more specifically identifies the objective as being not just how you do something, but how we do it and what it takes to be successful in our firm. As a candidate approaches the date when you hope they are ready to be admitted as an owner, ideally it becomes a foregone conclusion they will be able to handle their new responsibilities. The best way to know that is to observe them managing those tasks in advance of that date. For example, a key responsibility for an owner in a CPA firm is managing all aspects of client relationships both for the benefit of the client and for the benefit of the firm. An example of firm culture specific training is to assign full client management responsibility to managers including handling all aspects of a billing run (with appropriate oversight). Let them learn how to balance the needs of the client, maintain quality

> "As candidates develop you may want to consider using some specialized training to develop the skills."

control, manage firm resources, and achieve the firm's goals for profitability. The key to a strong firm culture specific training program is often to stretch your expectations of what staff can do to include what you want them to learn how to do.

Non-Equity Partners: Many firms are now using Non-Equity Partner status (also known as Income Partner) as the final polishing needed for future owners. Often the financial commitment to a Non-Equity Partner is not nearly as significant as to an Equity Owner. There may be a much lower obligation for retirement/buyout, if there is one at all. The Non-Equity Partner normally does not sign onto the firm's ownership agreement. Compensation is often managed completely separate from Equity Owners. Of course, in a sale or merger a Non-Equity Partner is usually not a party to those proceeds. It is usually easier to terminate or demote a Non-Equity Partner.

However, the benefit of Non-Equity Partner status is the professional is usually given the same day-to-day responsibilities and influence with clients and staff as an Equity Owner. Therefore, you can observe their ability to handle those duties without committing long term to the perks and benefits of Equity Owner status.

Mentoring: The third component of training is mentoring. One of the reasons mentoring is so important is, if done properly, it is two-way communication. Not only does the mentor have the opportunity to tailor advice to the specific needs of the mentee, but the mentee also has the opportunity to participate in identifying what their needs and goals are. In our experience, too often we have found when we inquire of a firm's management about the potential for a specific candidate becoming a future owner that no one even knows if that person desires to become an owner. Mentoring gives you the chance to assess the true long-term goals of candidates, as well as the opportunity to convey to candidates the opportunity the firm offers candidates. It is an important opportunity to build on the insights candidates gain from their observations of how the owners in the firm operate and manage their careers. The very best candidates will find a way to succeed on their own. Mentoring gives you the opportunity to make sure: 1) those candidates end up succeeding in your firm instead of somewhere else, and 2) the candidates that need some extra help receive it. An internal succession plan is hard to make work if it depends on finding super stars that might come along once every 10 years, if ever.

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Using mergers for leadership development: Mergers can play a role in leadership development as well. Many smaller firms find themselves with the right people at the wrong time. The firm isn't growing fast enough to provide an opportunity for advancement to owner status when that "right" person's maturation is complete. Existing owners may be reluctant to dilute their profits and value by splitting the same-sized pie into more pieces. This is especially the case with the uncertain economy we have been experiencing recently. A merger can help the firm create an opportunity for younger talent to take over for the older practitioners acquired in the merger as they transition out of the firm.

Here is an example of how this works. Assume the firm has three partners. They manage on average $1,000,000 in business each. They have a talented young professional, Sally, that should be considered for owner status as soon as possible. Sally has brought in about $100,000 of new business over the past several years. Sally's clients would naturally be a good start to her managed book of business. However, the owners are reluctant to promote Sally with only $100,000 in clients to manage. They are also reluctant to carve out much of their existing books of business to seed Sally's book of business. They have located a practitioner with a $500,000 practice that wants to retire in three years. Using a Two Stage Deal they merge the practitioner in. (For additional information on this topic refer to our article, Two Stage Deals, on our website, www.transitionadvisors.com, under Resources, Articles, Succession Planning.) Sally is promoted to partner and over the next three years, the practitioner's clients for the most part are transitioned to Sally. At the end of the three-year process, Sally is managing a $600,000 book of business and the firm's succession team is one person stronger.

"... Having the wrong financial arrangement is the next most critical reason firms fail to successfully execute internal succession."

The right financial arrangement

What we are primarily referring to here is the owner agreement. That could be a partnership agreement, operating agreement, or shareholder agreement. It is the agreement that manages the financial aspects of admitting new owners and paying off owners that leave for whatever reason. Second to not having the right people in place to take over for owners that are leaving the firm, having the wrong financial arrangement is the next most critical reason firms fail to successfully execute internal succession.

Objectives for your owner agreement: There are two primary goals for your ownership agreement to make sure it is the "right" one.

- It has to make financial sense to both sides of the transaction. "Both sides" means: 1) the firm and its existing owners, and 2) the person that is either being admitted or the owner that is leaving.

- The agreement should create an incentive for the firm and transitioning owner to execute the business plan that is the basis for the transition.

This concept can be expressed by this tried and true rule — people do not normally enter into a financial transaction to lose money. In a CPA firm, losing money usually means the owners making less compensation. A buyout arrangement for a retiring owner that is going to result in the remaining owners either: 1) investing more capital, or 2) receiving reduced compensation, has a poor chance of being viable. In the same vein, an owner admission arrangement where the new owner is going to be taking a step back in compensation, net of the cost of buying in, is not a very compelling offer.

Structuring owner buy-outs: The key financial objective of a buyout arrangement is that it be self-funding. Use this rule of thumb. The capital available for the buyout or retirement payments is the compensation the retiring owner is leaving behind. There are three things that capital has to be used for: 1) paying off the retiring owner, 2) replacing that owner with new resources, and 3) creating some upside for the remaining owners to motivate them to assume the risk and responsibilities of the buyout; in many cases their workload will increase.

If the buyout is not self-funding, the result is that for as many as 10 years, or even more, the remaining owners are faced with either reduced compensation or borrowing funds. No one knows of course what the future will look like exactly. However, the prospect that this might be the outcome can sometimes lead to younger owners "opting out" by leaving or pushing for an external solution to succession through a merger or sale. Even a perceived lack of commitment to the plan by the younger partners can lead to the senior partners seeking an external solution such as a sale or merger because they don't have confidence they will be paid under the retirement arrangement they created.

"... Perceived lack of commitment to the plan by the younger partners can lead to the senior partners seeking an external solution ..."

A common reason we see firms seeking upstream mergers is a lack of confidence in the firm's ability to pay the retirement of the senior owners.

Admitting new owners: The same concepts apply to the terms for admitting a new owner. If the new owner is going be required to borrow a lot of money or will be paying off debt from the compensation he earns for a long period, he might conclude this isn't such a good deal after all and opt out.

On the other hand, how can the retiring or selling owners justify giving away an asset that represents years of their sweat equity? Often the problem can be solved not by reducing the total payout or liability, but by timing the payments so they don't create negative cash flow. Deferring the buy-in dollars for a new owner until later, or even to the day when an owner leaves, can allow a new owner to be admitted, realize upside currently, and not require the firm or its owners to "give away" the value.

Planning and Paying for Partner Retirements: There are many ways to tackle these issues in agreements. The key is to keep the concept of finding a win-win outcome in mind as you consider alternatives. (For additional information on this topic refer to our article, Planning and Paying for Partner Retirements, on our website, www.transitionadvisors.com, under Resources, Articles, Ownership Agreements.)

Tying the Agreement to Transition: When it comes to executing the business plan that supports the transition of a retiring owner's role, overall you want to keep the ship sailing in the same direction without losing ground. Your goal should be to keep the clients the owner managed, the staff that worked with the owner, and maintain the momentum the firm had prior to an owner leaving. The plan for how to do this depends on each firm's and owner's situation. But think about what it is going to take (see the following section, Transition plan). Then make sure the agreement creates an incentive to execute the plan or has penalties for failing to execute the plan. One key thing is the notification required for an owner to leave and receive full benefits. We recommend that most agreements require at least two years' notice of intent-to-leave if the payments will be fixed at the date of termination. A failure to provide adequate notice could subject the payments to adjustment for lost business or some other form of adjustment.

"Keep the concept of finding a win-win outcome in mind as you consider alternatives."

For example, one way to promote the two-year notice is to calculate a pro-rata adjustment to the retirement payments of an owner failing to provide adequate notice to client retention in that owner's book of business for the two years following the date of retirement. You directly relate the penalty for the failure to the actual impact of that failure.

Tying retirement to retention: A more drastic approach to manage the financial risk of a transition is to tie the retirement payments to the retention of clients following the retirement. This is less becoming the norm in the profession as firms move away from the "eat-what-you-kill" structure. And even in firms that directly tie compensation to books of business, there is still a big disadvantage to tying retirement payments strictly to retained books of business. This approach fails to create an incentive for the firm to create and execute a transition plan prior to the retirement of its owners. The tendency is to not worry about it until the time arrives because the firm has no risk. The result is often a poor transition. However, an owner nearing retirement often senses the significant risk of a poor transition, and therefore, fears he won't be paid. This can lead that owner to look for external alternatives seeking a better outcome. So instead of the firm maintaining its volume, the firm is contracting. This can become a vicious cycle leading to the demise of the firm.

Transition plan

Everything up to this point has been based on the assumption that your firm identifies the steps necessary to transition the duties of a retiring owner. Now you need to make sure you effectively execute the transition.

Transitioning client relationships: For most firms, the key owner duty that needs to be transitioned is management of client relationships. Most firms depend on owners to be personally involved in the relationship the firm has with clients, especially the largest and most important ones. However, it is also logical that the more dependent the firm is on an owner's relationship with clients, the more at risk the firm is when the owner leaves. An owner leaving can be a traumatic experience for clients due to the uncertainty it creates.

Many clients have back-up relationships with other firms due to a relative or acquaintance, or a firm that has been recently soliciting their business. Studies have shown that up to a third of all clients

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in a typical CPA firm are considering moving to another firm at any one time. The key to a good transition is to make the day an owner leaves the firm into a non-event for the clients. The way to do that is to completely transition the relationships before the owner leaves.

Make sure you have considered available capacity: Anybody that is worthy of becoming a successor to a retiring partner is already completely booked to capacity. A well-run firm is not going to have good people waiting for more to do. This is where a lot of succession plans break down. A firm can have the right people in place. It can have the right financial arrangement. Then when it comes time to shift duties from a transitioning owner to someone else, no one has the capacity to take on the new duties. As a result, clients begin to receive less attention than they did from the transitioning owner. The transitioning owner senses this and abruptly stops the transition because he is afraid to lose clients and fears a poor transition reflects on him.

In most cases you can't just pile more work on one other partner in the firm. You also can't expect a newly promoted, and usually inexperienced partner, to effectively manage the most complex client relationships of a transitioning owner. The best approach is to consider a shift of duties for several of the owners. This is a good time to reposition client books for several partners and key managers. Most partners have clients they are overqualified to manage. These can possibly be shifted to a less experienced partner or even a non-partner. Clients might be better served by a partner that has better expertise or skills than the one they have worked with from the time they became clients.

"Put the internal successor in place while the retiring owner can participate in the process."

Also keep in mind that you will need to replace at a minimum the productive capacity of a transitioning owner to maintain your revenues. If an owner is producing 1,200 billable hours at $250 per hour, that is $300,000 in production that either is absorbed by the existing personnel or you have to hire additional personnel. Failure to address this can lead to a loss of revenue.

Use a minimum two-year transition period: This is why we recommend a two-year notice period. Use those two years to put the internal successor in place while the retiring owner can participate in the process. Just like the client has relied on their retiring owner's advice for many years regarding their financial matters, they will follow his lead through the transition process. The process can be

handled in a gradual manner. By the end of the transition period, the client should have accepted the internal successor as the go-to person for them.

Of course, depending on the person that is retiring, there may be other duties that have to be transitioned as well. Someone has to take over for a managing partner that is retiring. Many firms believe the transition for that role should take longer than two years. It is not unusual for the successor to be identified far in advance of the expected retirement date and to work alongside the managing partner for several years in that role.

Case Study

MNO Accountants and Consultants, LLC (the name has been changed to maintain confidentiality) was a four-owner firm in a mid-sized East Coast market that sought our assistance with internal succession. The managing partner was concerned because:

- He was about three years from wanting to slow down substantially at which time he was slated to begin his buyout.
- His other three partners were expressing concern that they did not believe they could take on his responsibilities without bringing in at least one new owner.
- The other three partners also were concerned they could not afford his buyout.
- Although they had a young person they believed had the talent to become a new owner, they had never admitted a new owner internally and did not know how to do that and be fair to both sides; they were certain the person they had in mind could not afford to make a substantial investment, but they were also reluctant to just give the ownership away.
- The firm was reluctant to seek an upstream merger even though that increasingly seemed to be a foregone conclusion to solve their succession problem.

“It is not unusual for the successor to be identified far in advance of the expected retirement date ...”

We evaluated the firm's operating agreement and determined the following key points:

- The managing partner owned 45% of the firm's equity.
- Under the agreement, he would be paid all of his capital account on the day he retired and his retirement payments over 4 years. His capital account was $325,000 and his buyout (which was based on one times fees, times his equity percent) would be $1,600,000, or $400,000 per year.
- The managing partner's compensation was $450,000 per year.
- With our assistance, the firm determined the cost to replace the managing partner's productive capacity was a minimum of approximately $150,000 per year. Plus if the young person they believed had the talent to become a new owner was promoted to Non-Equity Partner status (a new position we assisted this firm in establishing), a $25,000 per year increase in compensation would be warranted.

The conclusion from our analysis was the firm's capital from the managing partner's foregone compensation, net of replacement cost available to finance the buyout, would be $275,000 per year ($450,000 less $175,000). The firm's negative cash flow in the first year would be $450,000, and for each of the next three years the negative cash flow would be $125,000. This was not a surprise to the ownership group. The only options they had were: 1) to borrow the negative cash flow, or 2) for the remaining ownership group to accept substantially lower compensation for those four years.

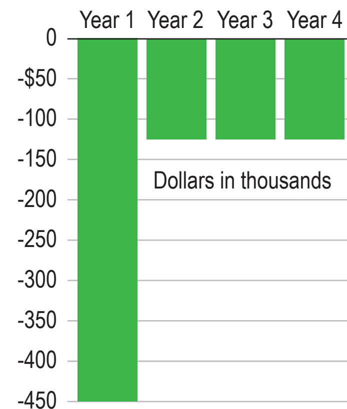
We helped the ownership group reach the conclusion that their objectives should be to:

- Maintain the total value of the managing partner's retirement (and eventually all partner retirement), but also.
- Avoid requiring the remaining partners borrowing or taking a step back in compensation during the buyout.

We first helped the ownership group establish that the goal of keeping the managing partner whole could be accomplished by recognizing

Before

Payout under current operating agreement would have a four year negative cash flow.



the important outcome was to pay him the total $1.925 million liability rather than worry so much when it was paid. With that in mind we were able to adopt a buyout arrangement that stretched the payments for the capital and retirement over 10 years at approximately $192,500 per year. This left approximately $85,000 per year of capital that was created from the managing partner's foregone compensation. The firm could use this as a cushion and for upside for the remaining partners.

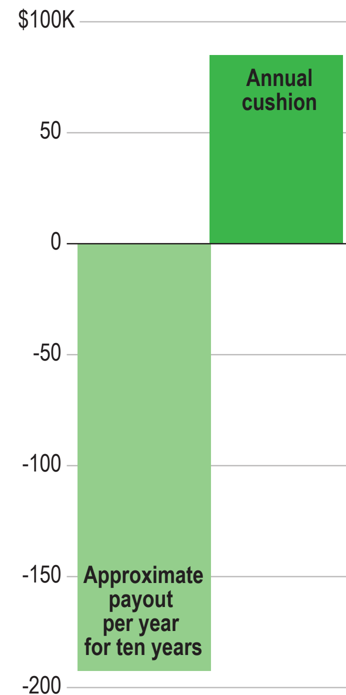
A compensation plan was adopted allowing the managing partner to stay on in a part-time role following the commencement of his buyout. He will be paid 35% of his billable time and $100 per hour for any administrative tasks the firm asks him to undertake.

We next approached the buy-in for the new owner by recognizing the goal should be to admit this person as an owner as soon as possible so he can participate in the transition of the managing partner's duties. An interim stage of Non-Equity Partner status was established to allow the firm to make sure its decision to promote this person was sound. The goal was for the Non-Equity status to last two years. Then we helped the firm conclude that how much this person invested upfront when promoted to equity status was not important, as long as they delayed the eventual investment he would have to make to a later date. This person could share in any growth he helped create and also benefit from the reallocation of the managing partner's equity as he helped pay for it by participating in managing the firm. We restructured the operating agreement to use a unit approach to equity. We did not allocate any equity units up front to the new owner. Units would be allocated to him from: 1) future growth (which would create new units), and 2) the reallocation of the managing partner's units he helped reacquire as that occurred. We asked the new owner to pay over time, from future compensation, for a fair share of the firm's tangible equity at book value which was a manageable obligation.

The plan was accepted by the ownership group and the manager was admitted as a new member. The managing partner's successor has been identified from one of the other partners and the managing partner's duties are being transitioned to the remaining partners in anticipation of his moving to part-time, semi-retired status.

After

Buyout arrangement for managing partner over a ten year period would create a cushion of $85,000 per year.



Next Steps for You to Consider

Our team of experienced professionals is available to assist you with an in-depth analysis of your specific situation and with direct hands-on assistance with planning and implementation to address your succession needs. Following a thorough evaluation of your specific situation and your owner agreement, we would be able to provide you recommendations for the development and execution of a succession plan and a new owner agreement, if warranted. Some of things that could be included in this analysis include:

- The viability of your “bench” to become your internal succession team.
- Means to strengthen your bench if that is needed.
- Assessing the effectiveness of your owner agreement to buy out retiring owners and admit new ones.
- Evaluating how your owner agreement addresses:
    - Death, disability, and other forms of partner termination.
    - Covenants restricting competition from terminated partners that are receiving post-termination benefits.
    - Governance.
    - Owner compensation both for existing owners and newly admitted ones.
    - Cash flow safety nets to help assure the firm remain solvent as the result of owner retirements and are able to meet its obligations to its partners.
- Identifying alternative approaches to determining equity value which could especially be helpful with respect to new partners, such as the unit approach.
- Identifying a transition plan for retiring owners that will keep the ship sailing in the same direction it is now.

“... We would be able to provide you recommendations for the development and execution of a succession plan and a new owner agreement ...”

You may also conclude at some point that you are unable or unwilling to build and execute a stronger internal succession plan for your partners. We are available to discuss alternative approaches to owner succession such as a merger or sale. We can help you understand what opportunities are available in the market, how your firm would be valued, what kinds of firms might be interested in talking to you, and what your partners could expect to gain from such an affiliation. We can also conduct a search for suitable firms to affiliate with your firm and assist in all aspects of the subsequent negotiations, deal structure, and transition of a merger or sale.

Other types of ownership transition consulting services we offer include:

Acquisition Readiness Evaluation: Determines what your firm needs to do to be ready to pursue mergers for growth.

M&A Transaction Support: Provides the tools you need to close an M&A transaction where you have found a firm on your own with whom you are considering a combination.

Merger Readiness Evaluation: Helps you understand what you can expect in the event of a merger with another firm, including techniques to increase the probability of a favorable outcome for your firm and its partners.

Owner Agreement Evaluation and Design: A complete evaluation of your owner agreement and recommendations for improvement to assure it meets your firm's strategic needs and those of your partners.

Partner Admission Support: Recommendations for the financial and transitional aspects of admitting new partners including buy-in terms and compensation plans which are specifically tailored to your firm and its near-partner candidates.

Partner Retirement and Exit Planning: Identifying the terms and transition plans necessary to properly buy out or retire partners in your firm, all customized to your situation and needs.

Partner Retreat Facilitation: Gives you access to our 20-plus years of expertise for your firm and/or partner retreats, and helps you focus on ownership transition issues.

"If you are unable or unwilling to build and execute a stronger internal succession plan for your partners, we are available to discuss other options."

Search Services: Helps locate potential M&A candidates that meet the specific objectives you have for a transaction.

We would be pleased to discuss these services with you at your convenience if any are of interest to you.

For more information you may contact us at:
www.transitionadvisors.com
info@transitionadvisors.com
866-279-8550

"Transition Advisors can help you focus on a number of ownership transition issues."

DEAL FACILITATION

Searches
Introductions
Negotiations

TRANSACTION SUPPORT

Contract Design/Review
Due Diligence Support
Deal Structure
Valuations

PRACTICE MANAGEMENT

Succession
Transition Planning/Implementation
Growth Strategy
Niche Development
Partner Agreements