The Four Exit Ramps for Your Career

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The end of your professional career is something you will eventually face. How will you manage that? This article discusses the four options you have for your eventual retirement from public accounting.

1. TURN OUT THE LIGHTS

Another way to describe this approach is "do nothing" and let nature take over. Surveys tell us between 15% and 20% of sole practitioners have no plans to retire and will one day just walk away. A multi-partner firm with no owner agreement, or an agreement without a mandatory retirement age provision, can effectively have partners in the same situation. Often the practice gradually loses clients and staff over time to attrition. Sometimes the practitioner changes their mind so late in the game that it is hard to find a firm interested in acquiring what they have left.

The primary advantage of taking this approach is you stay in control of how the end of your professional career will play out. While the tradeoff is the practice will have little or no residual value, you keep all the profits until the end. Practitioners considering an offer to sell often say, "If I just work in the practice three or four more years, I'll make the same as selling." They are usually mathematically correct. The difference is, of course, when you sell you get paid for not working.

Challenges include keeping up with technology and the lack of back up and support when you need it. Furthermore, you will be leaving your family, staff, clients, and maybe partners in the dark as to how and when this will end. Sole proprietors will have no protection from a temporary disability. There is some benefit to putting in place a practice continuation agreement (PCA) and that should be considered if this is your plan. However, a PCA is not a succession plan. It is more like an insurance policy for your practice.

2. SELLING

A common succession solution primarily for smaller firms—especially sole proprietors—is to sell. The larger your firm is, and the more partners your firm has, the more likely you will merge upstream. In some cases, it may be a combination of some partners selling and some merging as we discuss below.

A common mistake many practitioners make is treating the sale of their practice like the sale of a car. They plan to work in the practice until the last minute, find a buyer, and essentially turn over the keys and ride off into the sunset. The value of a CPA practice is totally based on a seller's ability to transition client relationships to a buyer, so the buyer has a very good chance of keeping those relationships long term.

When planning your succession always start with how many more years you plan on working full time before substantially reducing your time commitment to the practice. Technology has made client relationships less personal these days. In the past, accountants visited many of their business clients regularly in person. Not so much these days. A strong personal relationship with clients can actually be a key advantage when transitioning the relationship to a successor. In many practices, a partner/owner sees a majority of clients in person no more often than once per year. Retiring in three years may sound like a long time period, but for most clients the result is only three more times you will see your clients in person. This gives you only three opportunities to personally manage the relationship transition to a successor.

If you have already decided to substantially slow down, you are likely seeking an immediate sale. In order to achieve the best outcome, try to remain in an "of counsel" role with the successor firm to promote client retention. However, if you are one to five years from slowing down, a two-stage deal may be for you.

Here is a link to an article that explores this concept in greater depth:
https://www.transitionadvisors.com/files/content/ATwoStageSolutiontoSuccessionProcrastinationJOAOctober2013.pdf

Clients don't like to be sold to someone else. It disrespects the relationship. Instead, in a two stage deal you combine your practice with a successor firm and continue to manage the practice within the successor firm's infrastructure. The combination is held out to the clients as a merger. You remain involved full time. In most cases you'll be considered an income or contract partner in the successor firm. So long as you maintain similar hours and collections from your clients remain steady, your compensation should be kept whole. That initial period of mostly full-time involvement is called stage one. This approach promotes a gradual transition of the relationships and client retention should be very high. Stage two is the buyout. Because it isn't realistic to keep your compensation intact while simultaneously being paid for the purchase of your practice, and it isn't compelling to continue to work full time for less compensation, financially this structure makes sense to both parties.

However, if your career horizon is more than five years out, a full merger may be a better option.

3. UPSTREAM MERGER

The terms "merger" and "acquisition" are often used interchangeably. In a sale, the practice owner does not retain ownership in the successor firm. In a merger, the owner exchanges their practice ownership for ownership in the successor firm. You will be signing onto the successor firm's owner agreement.

Here is a link to an article that discusses why so many firms are seeking upstream mergers these days:
https://www.transitionadvisors.com/files/content/WhatsDrivingUpstreamMergers_June_2019.pdf

How a merger will benefit you financially as an owner in the successor firm is defined by the successor firm's owner agreement and partner compensation system. Key provisions to review are governance, retirement benefits, and capital requirements. Most owner agreements do not include specifics about partner compensation. So, make sure you review that as well. Many agreements in larger firms place little or no value on relative ownership levels. However, in some firms, equity ownership can be the most important factor determining the allocation of value, compensation, and governance. It is common to provide a conditional guarantee to the owners of the merging firm to keep their compensation steady for up to two years so long as practice revenues and partner chargeable hours remain somewhat steady. It is, therefore, important to understand how compensation will be determined after the first two years.

Practitioners of small firms often struggle with the level of accountability a larger firm will normally place on its partners. So, they will sometimes seek a merger with a firm of similar size assuming the cultures of the two firms will mirror each other. There are two problems with this. First, size is rarely a proxy for culture. And second, what are you really accomplishing by merging into another small firm that is likely facing the same challenges your firm is addressing by merging?

4. INTERNAL SUCCESSION

We find CPA firm owners often prefer to deal with partner/owner succession through an internal solution. It offers the least amount of change and the most control. Unfortunately, due to a lack of adequate talent on the bench, many firms ultimately conclude this is not an option. For those firms fortunate enough to have a strong bench, the other keys to making an internal solution work are an owner agreement with the right terms for buying out retiring partners and a process for admitting new partners.

In addition to a lack of adequate talent on the bench, we see many firms shoot themselves in the foot by not creating the capacity partner candidates need to develop and execute the transition of a retiring partner's relationships. Your best candidates are usually the ones partners depend on the most. In order to execute the plan, you have to create succession for your partner candidates within the firm as well as for the retiring partners. It is becoming more and more challenging to recruit partner-ready talent as a shortcut to an internal team. You need to be in a constant mode of hiring and developing with an eye toward long-term potential. You can only hire so many new staff that you can't envision as a future partner before you have nothing to work with.

The terms for paying for partner retirement have to make sense. Run this test for a typical partner in your firm. Start with their compensation. Subtract what it would cost to replace their productivity (e.g., 40% of their billable time). That's your net capital available. Then calculate the annual cost of their retirement including payback of capital beyond cash basis. If the annual cost exceeds 50% of the net capital available, the terms may be too rich. You can adjust the terms through extending the term of payment and/or lowering the valuation multiple.

When addressing new partner buy-ins, consider two things. Will your new partners be making more compensation net of their buy-in? Will they earn value over time through their sweat equity as they help the firm grow? If not, your arrangement may not be compelling enough.

Here is a link to an article that addresses a unique approach to admitting new partners:
https://www.transitionadvisors.com/files/content/HowToAdmitNewPartnersJoA_Dec2015.pdf

Alternative deal structures: In many multi-partner firms, the partners are frequently in different stages of their professional careers. For example, one partner may be seeking to retire immediately, one partner may be 3 years from retiring, and yet another may have a long runway left. This firm might merge and structure the first partner's deal like an immediate sale, the second partner like a two-stage deal, and the third partner as a merger.

THE FOUR C'S

Choosing the "right" successor firm, regardless of deal structure, should start with the four C's.

Chemistry: If you can't imagine eating lunch with the partners of a firm you are considering merging with, don't go any further. You have your clients and staff because they are comfortable with you. If you are not comfortable with your successor, why would your clients and staff be?

Capacity: Consider if the successor firm has the capacity and skill set to replace partners and team members retiring in the near future.

Culture: Culture is a concept that could take pages to define. Ask yourself three questions to assess culture in your firm and a target firm: What's it like to be a partner in the firm, a staff member, and a client?

Continuity**:** Will you be able to position to your clients the combination of firms as a gain of the successor firm's capabilities and not so much the loss of what your firm has meant to them? Will there need to be significant changes that will make client retention suffer?

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