Developing Your Succession Plan

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This is the second in a series of articles to assist practitioners in establishing their exit strategy. The first article, raised some of the concepts and issues related to succession. The purpose of this article is to discuss the elements of succession plans (exit strategies) for both sole practitioners and partnerships.

When is your anticipated retirement date? Is it in two, five, ten, or 15? At that time, will you be tacking off the coast of the Queen Charlotte Islands, golfing in Arizona, fishing in the Interior or sitting at your desk wondering where all the time has gone? Simply stated, your succession plan needs to be established as soon as possible to ensure that you have the structure in place long before your desire to retire sets in.

Many of the elements of succession plans are similar for both sole proprietors and partners but the timeline and execution can be somewhat different. As a partner, you may have a partnership agreement that outlines when and how each partner will transition out of the practice. Then again, you may not.

Practice Evaluation

Whether you are a sole proprietor or partner, determining the approximate value of your practice is the first step. The value of your practice, or portion of the partnership, consists of both quantitative and qualitative factors, both of which contribute to its marketability. The calculation of the quantitative value of your practice is often very easy for practitioners. What are the annual billings? What is the breakdown of your practice between audit, review, compilation, tax and consulting work? How much of your personal tax and/or on-going consulting services relate to corporate clients? Practices that have a balance between audit, review, compilation, tax and consulting work attract a better sale price than a compilation and T1 practice.

The qualitative issues of valuing your practice are very critical to attracting a successor. For example, the intellectual property and client continuity of your staff is valuable to your successor. If your staff is looking to retire or leave, this would definitely impact the transition and value of your practice. Also, the purchase price may also be affected based on the quality of the technology and systems used to operate the practice. Practices that are focused on a specific niche may command a higher price but may limit the number of potential purchasers.

A word of caution before you set your mind on a particular valuation figure, please note that this is merely a starting point. There are many factors involved in the potential sale price of your practice that will determine the final selling price. For example, the demand for practices in your area, your length of time to retirement, whether you plan to relinquish partial control and provide existing employees with an equity share of the practice will impact the final selling price.

Your Successor

How does one attract a successor? It is always wise to put yourself in the shoes of the potential successor. If you have purchased a practice in the past, you can appreciate the motivation of the person who will be your successor. What was important or motivated you when you purchased your practice? Perhaps you simply wanted a fair price for a solid client base that would provide you with challenging work and a healthy income stream.

You wanted an easy transition – your new clients to accept you, recognize your professionalism and trust your advice. You wanted a smooth change with your new staff – a preservation of their intellectual capital, knowledge of the clients, trust and loyalty. You wanted to temporarily retain your predecessor to assist you in the retention of the clients. You also wanted your predecessor to fade out of the practice gracefully at the end of the transition period.

More to the point, you never wanted your predecessor to cause conflict between you and your new clients or staff. Although time has passed, the issues are still the same. Why would your successor expect or need any less from you and your practice?

A potential successor will need to do their due diligence by reviewing your files, firm's financial statements, systems, technology, etc., to ensure that they have an accurate picture of what they are buying. You may want to have potential successors sign a confidentiality agreement to preserve the value of the practice.

If your potential successor is an existing employee you could have a complete role reversal with your employee eventually becoming your employer. One practitioner told me that he better be careful how he treats his staff. He may be working for one of them in the next five years. Many practitioners find that being an employee, subcontractor or consultant in their old practice has advantages. It allows you to transition yourself out of your practice, assists with cash flow and protects the client retention and facilitates the payout stream of income.

Partnerships may find it easier to provide a breadth of services that may be more attractive to a successor; therefore, the period of time to attract a successor may be minimized. It also may be more difficult to find a successor as the firm must not only attract a successor who best fits the client base but best fits the personality of the existing partners, as well. The necessary buy-in from your partner(s) could slow the process.

Transfer of Trust

The transfer of the client base can be the most emotional and challenging aspect of succession. Conflict can easily occur. A properly structured succession will result in smooth transition for the successor, the predecessor and the clients for the optimum retention of the client base.

Anticipate that your clients may feel uncomfortable with the transition, especially if the successor is not an individual that they have had any interaction with. It is your responsibility to ease their concerns. Have both you and your successor meet with the client to assure them that they are in the best possible hands. To assist in the transfer of trust, unless previously agreed to, do not return calls or meet with your previous clients without the successor present. This will assist in establishing the trust between the client and the successor.

In conclusion, the elements of succession plans are as unique as each practice. Your needs, as well as the needs of your successor, will determine how your succession plan is executed.