



The Key Question: When Should Succession Planning Begin?

Over more than the quarter-century we have been facilitating CPA firm mergers, inarguably the most frequent question we get regarding succession planning is “when should it start?”

Ideally, succession planning should begin the day a firm opens its doors for business – but seldom, if ever, do firms get that proactive.

While you can never begin proper succession planning too soon, a harsher reality within the profession is that many firm owners begin too late and have sadly procrastinated to the point where they're faced with two of the most unfavorable transition options: among them, a hastily arranged merger, or, in a worst-case scenario, simply turning out the lights and locking the doors for good.

What our clients are telling us

Recently we were working with a small \$1 million sole practitioner in the New York area. He had no one on his “bench” to which to pass the ownership reins. He had been putting off succession planning and told us he wanted to wait until after the next tax season in which to begin. In the interim, a key employee resigned, he lost a large client and his aging IT infrastructure needed a costly upgrade. Now, instead of having the luxury of selecting a potential successor firm where the cultures and chemistry mesh, have a gradual transition, he is in a position where he's forced to accept deals with lower than market terms.

Some Sobering Succession Statistics

To further underscore just how far the profession is lagging in the succession planning arena consider the following:

- Less than half of multi-owner firms in an AICPA/PCPS poll said they have a formal succession plan in place, and for firms with 15 full-time employees or less, more than 70 percent do not.
- For sole practitioners, the news is no more encouraging as less than 6 percent have a practice continuation agreement in place in case of death or disability.

The concern over succession planning and its eventual effect on firms won't ebb anytime soon however, as 80 percent of the firms in another AICPA poll expect succession planning to remain front and center as one of the most significant issues impacting both their business and valuation over the next decade.

Getting Started – Internally or Externally?

While it's never early to begin mapping out a formal plan, as a partner or owner your ultimate objective should be to successfully transition your current client relationships and monetize the books of business - either to an internal successor, or to an outside firm via the external merger route.

Internally: If your goal is to create an internal succession strategy, step one will require you to complete a thorough evaluation of your in-house talent.

Do you have adequate “bench strength,” or high-performing potentials who you and the current owners feel can be nurtured and eventually assume the mantle of partner?

If you do, then crafting a formal succession plan will be somewhat less challenging but it would require creating achievable benchmarks and time frames. When looking at internal candidates, it's critical to do



a deep drill down on their past performance. Did they learn your systems quickly? Have they demonstrated an ability not only to develop new clients, but to retain them? Many firms may first decide to place them in a stepping stone-type post to see how they perform, and that means often giving them a non-equity or income partner role at first. And subsequently letting them know how to get from non-equity to equity should also be laid out.

But a critical caveat: *never* consider promoting a long-tenured employee to full partner just because he/she has been with the firm for a long time. Longevity should never be a consideration toward succession planning.

Externally: As a succession planning solution, M&A has emerged as one of the predominant trends within the profession as scores of major unions have been announced over the past several years with hundreds more that have occurred under the radar. The first order of business if you're an owner is to determine how many more years you want to work full time prior to slowing down.

If, say, you decide you want to slow down in three years, for most firms, by and large that's a total of just three in-person client visits as roughly 85 percent of CPA firms report that most of the annual tax and business clients are seen in their offices just once a year. So how do you locate your successor? We always advise our clients to concentrate on potential suitors who demonstrate the Four Cs – culture, chemistry continuity and capacity. Let's examine each facet in more detail.

Chemistry: Our company often recites a simple caveat to our clients: if you don't want to have lunch with someone, don't do a deal with them. If your partners are uncomfortable with a potential successor, why would you think your clients would be?

Culture: This can range from a basic, what's it like to work here? To more in-depth queries of what's it like to be a client or partner here? Does the staff seem busy and happy?

Continuity: Most firms have their clients because the clients feel comfortable with their people and services and have grown accustomed to a certain degree of handholding. How long have their clients been clients? How long have their partners been partners? Do they have a high staff turnover?

Capacity: Determine how many chargeable hours the retiring partner(s) currently log – can some of that that be replaced by lower-level professionals in the successor firm? Smaller firms need to be cognizant of the time an owner spends handholding clients and determine whether that can be transition to a staff member of the successor firm or does it have to remain under the purview of an owner or partner?

Summary

Whether your succession solution lies within your firm or with an external suitor, the time to begin succession planning is now. Firms that continue to postpone this critical strategy face the very real prospect of watching the value of their practices and years of sweat equity diminish as the number of firms seeking M&A as a succession planning solution begins to soar leaving an uneven playing field regarding supply and demand.

Clients are typically partner loyal at most firms. It takes time to perform a proper transition. It can't start too soon, but often can start too late.