Administrative Office
6901 Shawnee Mission Parkway
Suite 110
Overland Park, Kansas 66202

transitionadvisors LLC
Leading CPAs Through Transition With Succession and M & A Strategies

National Headquarters
2 Galleine Drive
Commack, New York 11725

tel 866.279.8550 fax 913.262.8700
www.transitionadvisors.com

Exit Strategies: What's the Right One for Me?

For many owners of CPA firms, succession is often treated as the elephant in the room – they know it's there but too often they try their best to ignore it.
Unfortunately, succession planning or in many cases, a lack thereof, doesn't simply fade away – if anything, it increases exponentially in importance as practitioners inch closer to retirement age. If it's not addressed in advance and efficiently, then your succession and transition options narrow rapidly. Regardless, with the average age of equity owners in firms being just under 54, it's almost certain that either you or one of your partners will be slowing down or exiting altogether within a 5-10-year time frame.

<u>What Our Clients are Telling Us</u>

While many of our clients have begun the begun the process of passing the ownership torch, invariably the next question that we get is "what is the best avenue to take with regard to an exit strategy?" Some opt for an internal succession plan which for many may alleviate the fear of a loss of control associated with a merger. But if they haven't developed their "bench" to a point where they can easily transition the ownership reins, we advise them that their succession solution lies externally via a merger.
Below we will explore two of the most common strategies: internal succession and merging upstream.

<u>Internal Succession</u>

In many cases, firms ranging from sole practitioners to firms generating up to $15 million in revenue have a decided preference to look internally for a succession solution. They envision maintaining control of the practice while getting paid for their buyout. Firms that have been forward-looking enough to have developed their "succession bench" obviously hold a distinct advantage to prepare for an internal succession. Firms that haven't done so, but prefer the internal transition will often have to look outside for key hires – including what we like to call the "Holy Grail" a young CPA with a book of business, currently the most in-demand commodity in the profession. To transition the reins of the firm internally there are two critical requirements: correctly transitioning the owner's responsibilities and, of course, their clients, to the chosen internal successor, and, a deal structure that makes sense.
When a partner or owner retires, you must make sure that the firm can effectively pick up that person's workload. Thus you need to have both the capacity to replace the retiring partner and the skill set. Don't make the critical mistake of assuming that you can "spread it around" to the remaining owners – as they are often at maximum capacity themselves. Also, make sure you replace the role – not just a body. If, for example, the retiring owner was the firm's "rainmaker"

you can't expect to insert the quality control partner and expect the same results. Ditto if that exiting stakeholder owns specialized credentials or licensing. From a financial viewpoint, you must make sure the debt obligation to the retiring owner is self-funding and not met as a result of having to reduce the compensation of the remaining owners. A key point to remember is that nobody will be willing to perform the same work for less money.
Nor should they.

<u>Merging Upstream</u>

If your succession exit strategy does not lie internally, then you must look elsewhere for a solution. An upstream merger into a larger firm holds a number of advantages for partners exiting within five years or less, including greater resources, a wider platform of services, more cross-selling opportunities and freedom from managerial tasks such as administration and billing. Once extricated from those routine obligations, it will allow more time to concentrate on new business development which will often be rewarded with an incentive program. Under the Two-Stage deal structure, it allows the seller firm owner to maintain reasonable control of the practice and income level during the length of the transition period. For multi-partner firms where some owners are seeking near-term succession while others seek long term financial and professional growth, an upstream merger with the "right" firm allows partners with different sunsets and goals to work out customized deals for each partner. Merging upstream is a practical succession solution with one big caveat – when the partners of the acquired firm are at least five years or longer from succession. It would be counter-productive to bring new equity partners on board for a short-term solution.

We always welcome the opportunity to chat with you about what's on your mind regarding your strategic plans. Look for our next monthly issue which will focus on the how and why accounting firm multiples are in decline.