Industry Trends

# Best Practices on Succession Planning

*By Allan D. Koltin*

What are the main challenges and obstacles that are facing most firms?

**Q: Can you share with our readers some statistics that would illustrate the succession planning dilemma that is facing the profession and address why it has become such a big issue?**

**A:** Most small- and mid-sized firms completely ignore succession planning. A recent AICPA survey on succession found that only 35 percent of firms had a documented succession plan in place; yet, over 60 percent of the firms had owners in the 55-to-62 age bracket. I believe the reasons most firms don't do succession planning is that they either believe they will "deal with it when they have to" or they see their retirement as so far in the future that they don't feel it is important to plan for today. Clearly, neither answer is an acceptable approach to planning for the future.

**Q: Why has this emerged as such a big issue today vs. in the 1980s or 1990s?**

**A:** I believe the problem exists today because of what didn't take place during the 1990s. In the early 1990s, 2 percent of college graduates received their accounting degree. By the end of the decade, the calculation had dropped to 1 percent of college graduates. This simple statistic is playing out today because that potential labor pool of future partners in CPA firms is virtually nonexistent. This is not to say that good, young, future partners do not exist. It is just that when firms are trying to find future talent, it is more of a needle in a haystack.

**Q: What caused the drop of enrollment in accounting programs in the 1990s, and was that a temporary or permanent drop?**

**A:** Many factors contributed to the drop in enrollment in the 1990s, but many would point to the five-year accounting curriculum as a negative, along with the fascination of going to work for a dot-com or financial services-type company. Clearly, that generation carried the flag for a much greater work-life balance and, unfortunately, our profession was a bit slow to reinvent itself in terms of truly becoming a "best place to work" or "employer of choice" firm. I also believe that, as firms have become much more profitable, we have become a much more attractive alternative to best-in-breed talent, who now realize they can have a healthy work-life balance and still enjoy significant earnings over their careers.

**Q: Are there early indicators you can pinpoint as to whether a firm will have a succession planning crisis or not?**

**A:** There absolutely are! I believe partners and firms (and firm leadership) often have a fork in the road and the path they take will ultimately determine if there will be a succession planning issue or not. One path would be where the partners view each staff member as essentially fungible goods and merely someone to get their work done. With this attitude, staff members often experience low job satisfaction, rarely take ownership of the clients, and truly don't grow professionally as individuals, and hence, into the future leaders of the firm. The other pathway would be one in which the partners bring in the business and, for the most part, quickly challenge the staff members to not only handle the clients, but ultimately take over the responsibility for the clients. The mantra in these firms might be, "The most valuable thing a partner can do is bring in business and feed someone else, and if you too want to become a partner, these are some of the skills you will need to embrace."

**Q: Are there any other factors that firms need to consider along the way?**

**A:** Yes. Firms need to have an investment philosophy that is geared toward "asset building" vs. "asset milking." In an asset-building firm, reinvestments are continuously made in recruiting, developing, and growing talent, along with supporting investments in technology, marketing, training, new product development, and leadership. Asset-milking firms are much more "me" oriented in their approach and will cut whatever corners they can to not spend money and invest in talent. I often see it when I talk to partners about continuing professional education (CPE). In asset-milking firms, CPE is seen as a necessary evil, and they will do whatever they can just to get the minimum hours in. In an asset-building firm, there is a strategy for growth, both for the firm and the individual. In these firms, CPE is viewed as an opportunity to continue to grow professionally and become more valuable to the clients and to the firm.

**Q: What is the biggest benefit of succession planning, outside of continuing the firm?**

**A:** I think one of the biggest benefits of succession planning goes to the retiring partners, in that if they properly transition their clients to other younger partners within the firm, they will receive some type of compensation or goodwill payment for essentially passing on the "legacy" of the firm. In firms where there is no financial benefit at retirement, partners will oftentimes continue to hoard clients because there is no economic benefit to transitioning their practice to others within the firm.

**Q: What are the issues/challenges that can come up in succession planning?**

**A:** The biggest challenge is first defining what, if any, mandatory retirement date the partners within the firm should have. If there is no mandatory retirement date (or at least a designated date to sell your shares or equity interest), partners will continue working as long as they want to. Unfortunately, more often than not, the older partners can also be blindsided by a younger partner's sudden decision to leave the firm. Recently, I worked with a firm where all three senior partners indicated the same manager would be the one to take over their practice. Unfortunately, three weeks later that manager resigned to pursue a job in another industry. The other big challenge that typically arises is when partners attempt to transition their book of business to younger partners and fail at doing this. Sometimes it could be the fault of the firm, in that it doesn't have adequate service providers to take over the partner's book of business. More frequently, the retiring partner has the mindset that no one else can service the client as well as he or she can, and it becomes a self-fulfilling prophecy. As I have always said to retirement-minded practitioners, "If you got hit by a car or won the state lottery tomorrow, I guarantee you that someone in the firm (or outside the firm) could step up and service the client." Bottom line—we are all replaceable!

**Q: How do most firms best deal with those challenges/issues?**

**A:** The best way to deal with these challenges is to create a document on succession planning that specifically defines things, such as the mandatory retirement age and the date for giving notice. Then, each year, the partners should update their projected retirement dates, with the knowledge that there should be a two- to three-year transition period before the partner officially retires. In Year 1, the retirement-minded partner should identify who will be succeeding him or her and allow that individual to shadow the partner on the accounts. In Year 2, it should be a joint effort between the retirement-minded partner and younger partner in terms of servicing the client. In Year 3, the younger partner would actually take over the account, but would have the retirement-minded partner available should there be any big issues that arise that would require his or her assistance.

**Q: What advice do you have about grooming one's replacement?**

**A:** I find there are usually three types of partners: (1) those who are exceptional at bringing business in; (2) those who are exceptional at handling client relationships; and (3) those that we (said in jest) want to lock up in a back room and have high chargeable time with limited human contact! It's the client relationship piece that is the most critical piece during a transition. Let's face it, a lot of partners in CPA firms can produce a financial statement or tax return, but the true "gift" is the partner who can be seen by clients as their most valuable trusted advisor (and go-to person on business and personal issues). This is what I refer to as the "glue" that keeps clients coming back for more. When we lose this piece of the service, clients often become vulnerable and switch firms.

**Q: What advice do you have about merging with another firm as a way to solve a succession planning problem?**

**A:** The truth is that an upstream merger is probably the number-one solution for many smaller firms that have a succession planning challenge. There is an old adage, "The way you make your bed is the way you sleep in it." I find all too often when I meet with firms that the way they have run their practices has caused many of the succession planning issues that they are experiencing today. As I previously said, issues like not investing in younger talent, not growing as a firm, and not passing on clients to younger individuals are the factors that frequently result in a lack of talented staff members who are capable of stepping up as the future leaders of the firm.

**Q: What do you see as the top critical mistakes that are made in the succession planning process?**

**A:** I see three top critical mistakes:

1. *There is no accountability for partners to do what they say they will do to successfully transition clients.* I am seeing more firms put a clause in their succession planning document that would penalize retiring partners for not "doing their part" to successfully transition clients and keep them at the firm. Clearly, attaching some dollars to succession (whether it is current or future compensation) will go a long way to getting a partner's attention.
2. *Retiring partners are not always candid and honest about what their true intentions are.* As I mentioned before, the document might say "65 and out," but truth be told, the partner believes that he/she needs to work until 70 to have enough money to retire on. The conflict takes place when the retiring partner claims that the firm has failed in providing adequate support to transition the business, when in reality the partner simply wants to extend his or her working years until age 70.
3. *There are too many older partners who are getting close to retirement and a limited number of younger partners to handle the books of business.* It is not atypical that I find a five-partner firm at which three to four partners are ages 58 to 65, with the youngest partner in his or her 40s. There is no way that the firm can support the retirement payments to a couple of partners at the same time, let alone maintain and transition the retiring partners' books of business.

**Q: What is the risk/disadvantage when you don't have proper succession planning?**

**A:** I'd like to tell you that the risk is that you'll have to merge up, but I will tell you that sophisticated buyers (or acquirers of firms) want to only merge-in or acquire firms that are as successful (or more successful) than they are. What typically happens to a firm with major succession planning issues is that it will die a slow death, with the last person standing "turning out the lights" on the last day of the firm's existence. Having said that, some firms realize that phenomenon will occur at some point, but simply don't care, as they would rather continue to work and make more money in the present, even if it means sacrificing future goodwill/deferred compensation payments.

**Q: Are there any other big demographic changes that you observe today that might not have existed in prior decades relative to succession planning?**

**A:** I think the biggest issue today is probably that age 65 is really like 55, which would suggest why partners in CPA firms have the will and desire to work well beyond age 65. I've seen many talented partners in their late 60s or even early 70s who are as productive as some of the young Turks in the firm. I think it is critical that the firm retain the right, *via* the partnership agreement, to determine on a case-by-case basis who can continue to work at the firm past age 65. However, under no circumstances do I believe that these partners should maintain an equity interest and/or significant say in the future direction of the firm.

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