TRANSFER OF POWER

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One of the crowning achievements of American democracy is the peaceful and orderly transfer of power from one leader to the next. When one leader's term is over, another is waiting in the wings to accept the same responsibilities and to carry on the business of the office. This time-honored tradition did not just happen; it was the product of the thought and deliberation of our forefathers and was rigorously defined and protected by the Constitution.

With many advisors approaching retirement age, it is clear that their own terms as practice owners may be coming to an end and that someone else may have to take the reins from them soon. But, with less than 10% of these owners having developed formal succession plans, not many advisors have taken the time to develop and implement their own "Constitution" to facilitate this transfer of equity and control, while also ensuring their financial futures.

Without a dedicated succession plan, your firm could face anything from a tumultuous handoff to your successor to a significant drop in value. However, if you do adopt a succession plan to prepare for your exit, you will not only realize a better value for your practice, but you will also provide for the long-term stewardship of your firm, including your employees and clients.

Before you anoint your successor and begin drafting your exit letter to clients, you should ensure that your firm really needs a succession plan at this time. If your firm would benefit from a plan, you should then consider whether an internal sale to employees or partners, or an external sale to a third party fits into that plan. The steps below will help you decide which transition option might be best for you.

DO YOU NEED A PLAN?

Unlike its close relatives, continuity planning and disaster recovery planning, which are both short-term imperatives, succession planning is something that only some firms need to work on now. Following is a list of reasons why your firm might not need a succession plan at this time:

* *You already have a plan in place to sell your practice.* Some advisors may have already developed a succession plan or may have taken care of succession planning in their operating agreement. Still, you may want to do some additional research and consult with relevant professionals to ensure that you have covered all your bases.

* *You want to wind down your practice gradually,* preserving your relationships with clients while referring them to other advisors in your area. While this option does not maximize the value of a practice, the owners of small, sole practitioner practices sometimes opt to phase out of the business rather than sell.

* *You plan to retire in less than five years and only have time for certain aspects of a succession plan or an external sale*. If you plan to retire in less than five years, you may still have time to enact a succession plan, but your options dwindle with every year that you get closer to your planned exit. For instance, you may not be

able to dedicate as much time to training and developing an internal successor, or there may be value enhancements that you cannot make to your firm because you do not have the time or resources.

* *Your planned retirement is more than five years away, and it does not make sense to single out a successor and make a specific plan so early.* Just as it makes little sense to try to enact a succession plan at the eleventh hour, so is it unreasonable to try to initiate a succession plan when your practice still has so much time to grow and change. New staff, partners, opportunities and challenges all could cause you to alter your plans for transition.

WHICH PLAN IS BEST?

If your firm does not fall into any of the categories mentioned above, then you should seriously consider pursuing a succession plan. There are two broad paths that your plan can take-internal succession or external succession.

In order to determine which path represents the best transition option for you and your firm, you must evaluate your preferences regarding several key factors. Here are several questions to focus your decision-making process:

* *What are the total deal proceeds?* An external sale may allow the seller to keep more of the equity and run a competitive bidding process to push the selling price higher. In an internal sale, the seller often has to give up more equity to internal players before the deal takes place. Often the seller then sells the remaining equity at a 10% to 30% discount. The dynamics of the discount are similar to selling a house or car to a family member or a friend.

* *How long will you hold equity?* In an external sale, most sellers are completely out of the equity in their firm three years after close. In some cases, sellers retain a piece of the firm's equity or the equity of the buyer. In an internal sale, it is more common for the seller to retain a piece of the firm for many years, enjoying both a dividend and steady increase in the value of his or her shares.

* *How hard do you want to work?* After an external sale, the selling partner's role in the firm's operations is often significantly reduced. By the time the transition is complete, the seller may not be working for the firm in any capacity. During an internal transition, you may work often, harder and for a longer period of time, particularly as you train and mentor your successors. On the positive side, an internal transition can provide an opportunity for you to focus on a more specific and less stressful area of the business without being preoccupied by the day-to-day duties of running the show.

* *What will be the focus of your work?* If you want the focus of your work to be outside the firm, or you do not want to work at all after the transition, then you may lean toward an external sale. If you want to refine the focus of your work to be more in line with your passions and interests, such as focusing chiefly on portfolio management, then an internal sale will provide a greater opportunity for you to do that in your own firm.

* *How long do you want to spend training your successor?* In an external sale, you will likely dedicate six to 12 months to training your successor, as you hand off clients and explain your operations. In an internal sale, the

training and mentoring might take two to five years. In this case, the focus is more on developing the successor's skills.

* *How long should the payment schedule be?* External sales typically have shorter payment schedules (three to five years) with more cash up front, while internal sales have longer payout timelines with less cash up front. If it is more important to you to have more cash up front with less risk, then your preferences are more in line with an external sale. If you would rather have a longer payment stream, enjoying some interest and possible capital appreciation, consider an internal sale.

* *How long do you want to keep working?* If an external firm buys a wealth management practice, the exiting owner is often pushed out the door quickly, not only for logistical and financial reasons, but also because it is uncomfortable for a former owner to become an employee. On the other hand, an internal sale allows sellers to continue working in the firm for a longer period of time, depending on the terms of the deal and transition.

The process of determining which transition option is right for you and your firm is the first step in developing and implementing a succession plan. With the appropriate forethought and preparation, you can put yourself on the path to realizing the business value you have created, while allowing your firm to enjoy the same kind of seamless transition from one executive to the next as our nation's leaders have done for more than 220 years.

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