STEPS FOR BUILDING A SUCCESSION PLAN

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Step 1: Assess Your Need for a Succession Plan

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

1.You already have a plan in place to sell your practice. Some financial advisers may have already developed a succession plan or may have taken care of succession planning in their operating agreement. Still, because of the possibility that a number of important issues may not have been addressed, you may want to do some additional research and consult with relevant professional advisers to ensure that you have covered all your bases.

2. You want to gradually wind down your practice, preserving your relationships with clients while referring them to other financial advisers in your area. While this option typically does not allow you to realize the full value of your practice, sole practitioners sometimes opt to simply phase out of the business rather than go through a sale process.

3. 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 still may 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 to do so.

4. Your planned retirement is more than five years away and it does not make sense to single out a successor (or successors) and a specific plan so early on. Just as it makes little sense to try to enact a succession plan at the eleventh hour, nor does it seem reasonable to try to initiate a succession plan when your practice still has so much time to grow and change, bringing with it new staff, partners, opportunities and challenges that could cause you to alter your plans for transition radically.

For a simplified checklist of how each of these considerations indicates your preferences toward an internal or external sale, see the chart below:

Step 2: Decide Which Transition Is Best

If your firm does not fall into any of the aforementioned categories in Step 1, then you should seriously consider pursuing a succession plan for your firm. There are two broad paths that your plan can take: an internal succession plan or external succession plan. In order to determine which path represents the best transition option for you and your firm, you must evaluate your preferences with regard to 1) total deal proceeds to you; 2) deal structure; 3) your involvement with the successor(s); and 4) your working relationship with the firm during and after the transition. These key factors and considerations include the following:

1. Total deal proceeds. In an external sale, the seller can often keep much more of the equity and run a competitive process to push the selling price higher. For an internal sale, the seller often has to give up much more equity to internal players before the deal. The seller then often sells the remaining equity at a 10% to 30% discount in recognition of who the buyer is and what they offer. The dynamics of the discount are similar to selling a house or car to family or friends.

2. Length of time in which 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 their 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 their shares.

3. How hard you want to continue 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 completed, the seller may not be working for the firm in any capacity. Over the course of an internal transition, you may continue to work often and harder and for a longer period of time, particularly as you endeavor to 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 with the day-to-day duties of running your business.

4. Where you would like the focus of your work to be. If you want the focus of your work to be somewhere 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, if you choose.

5. Length of time you want to dedicate to a successor's training. In an external sale, you likely will dedicate six to 12 months to the training of your successor by handing off the clients first, then by educating them on the firm's methods. In an internal sale, the training and mentoring might take two to five years. In this case, the focus is much more on the development of the successor's skills than on their orientation to the firm's clients and processes.

6. Length of a payment schedule. External sales typically have shorter payment schedules (three to five years) with more cash upfront, while internal sales have longer payout timelines with less cash upfront. If it is more important to you to have more cash upfront with less risk for you to assume, 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, then you should consider an internal sale.

7. Length of time you want to continue working. If an external firm buys a wealth management firm, the exiting owner tends to be pushed out the door more quickly — not only for logistical and financial reasons, but because an uncomfortable situation is created when a former owner becomes 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.

For a simplified checklist of how each of these considerations indicates your preferences toward an internal or external sale, see the chart below.

Step 3: Evaluate Your Options

Each succession path leads into multiple options that your firm might take. If pursuing an internal plan, you can:

► Merge with another firm to obtain a successor and sell equity to them

► Sell equity to existing internal partners

► Give or grant equity to family members

► Recruit or hire an external successor and sell equity to them

If an external succession plan appears to be a better fit, then you have two primary options, which are as follows:

► Sell to a third party and exit your firm in one to two years

► Sell to a third party and exit your firm in two or more years

The process of determining which transition option is right for you and your firm represents the first key step in developing and implementing a succession plan. With the appropriate forethought and preparation, you can put yourself on the path toward 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 accomplished for more than 220 years.

About ECHELON Partners

ECHELON Partners (ECHELON) was formed in 2001 to offer investment banking and consulting to a subset of the financial services industry known as "investment product developers and distributors" (IPDADs). Since that time, ECHELON's professionals have helped hundreds of senior executives envision, initiate, and execute a multitude of complex business strategies and transactions. ECHELON's business is making companies more valuable through delivering advice and orchestrating transactions. Accordingly, ECHELON measures its success in the enterprise value it creates for its clients. Companies that strive to outperform their peers choose to work with ECHELON because we are as passionate about their results as they are.

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