What is Succession Planning?

'Succession' has been a buzzword at the forefront of the industry for quite some time now. But what exactly does it mean to you and how is it applicable to running the day-to-day of your business? I find many Advisors think they don't need to worry about succession planning because they have no intention of leaving their business any time soon. The sobering fact is this though – ***every*** business will transition at some point; it's as unavoidable as death and taxes. A lack of planning for it, however, jeopardizes the sustainability, viability, and stability of your business **TODAY**.

I argue that succession planning should begin the day you first start your business. It's not an event, but rather a process – the process of deciding when and how you would like the business to be managed or transitioned. Succession planning is not just about planning your retirement either. It also protects against unforeseen events such as premature death and permanent disability, and it considers who you would ultimately want to leave or sell the business to, and how to fund the transfer or sale.

Let's begin by taking a realistic look at the state of the industry[1]:

- The average owner's age is 57
- 84% of firms have no formal interim continuity plan (in case of an unforeseen event)
- Of those with an interim plan, only approximately 40% (or 6.4% of advisors overall) address disability
- 52% lack a written operating agreement—and 89% lack an ***effective*** operating agreement covering profit distributions, losses, and capital contributions, as well as exit provisions
- 73% lack employee retention mechanisms (employment agreement, non-compete/non-solicit)
- Only 13% have seriously begun planning for a long-term transition (i.e., next generation)

These statistics emphasize a need for holistic corporate planning – one that incorporates your growth plan with your transition plan. Keep in mind too that not having a plan is a plan of sorts, though it's usually a plan for disaster. Look at these scary facts:

- More than 1 in 4 businesses never re-open their doors after an unforeseen event[2]
- For those that do re-open, 29% fail within 2 years[2]
- Revenues drop 60% when an owner dies[3]
- 4 years after an owner's death, most businesses still show no sign of recovery[3]

So how does an owner face the challenge of perpetuating their business and decide what to do? This article addresses where to start and will discuss the top ten things you can do today to begin navigating the decisions surrounding succession planning.

1. **Determine what you want.** Take some time to sit down with a pencil and paper and write out what your dream transition strategy would look like. It doesn't need to be perfect or even realistic, but it will get you thinking about what you would ultimately want to have happen. Also think about what retirement means to you. When would you want to retire? What will you do with your days after

retirement? Lastly, consider what you would like to achieve from the business. Is there a certain dollar amount that you would need to comfortably be able to retire? What legacy do you want to leave behind?

2. **Define your attributes.** What makes your business unique? Your vision/strategy, culture, platform/infrastructure, capital, and story are all important components of your business. Get really clear on what these are and be able to articulate your attributes. This will become important as you begin deciding who is the best fit to transition your business to. Having a compelling story – the who, what, why, and how of starting and running your business – helps you become clear on your value proposition and will assist in determining and vetting your options for the future.
3. **Know your value.** I've talked before about owners having an unrealistic valuation expectation. Sadly, the gap between expectation and actual offer/sale price are more often than not realized in the 11th hour – as owners are in the midst of planning a transition. Performing regular valuations throughout the lifecycle of the business allows you to plan ahead. Given enough time, you can make incremental changes to your business (via KPIs) to increase value leading up to the transition ***(Extra:** Ask me when it's the best time to sell/transition your business – it's not when you think!).* Also, just because you need $x from your business to retire, doesn't mean it's actually worth that!
4. **Review firm structure and operations.** Many <$100mm AUM Advisors are ***managing*** a book of business rather than ***operating*** a business. Oftentimes Advisors don't realize that a Sole Proprietorship is a disregarded entity and cannot be transitioned to another individual. That means that while your Client accounts can be transferred to another person, your actual "business" cannot. In considering what you want, review your structure and talk with professionals to determine if it might make more sense to create an entity such as an LLC to facilitate the transition of your business (it also adds a layer of liability protect). All of your operations/infrastructure play an important role as well – they can either make or break your succession success. By all means, it is best to create processes and a structure around your book of business that allow it to function as an actual business.
5. **Assess client demographics and stability.** Let's face it, the financial advisory industry is a relationship business. That's why a large part of deal structures are considered personal goodwill (anywhere from 70-90%). And if you're the only Advisor working with your Clients, how are those assets going to be "sticky" if something happens to you? This simple fact needs to play heavily into your transition plan. It's also important to look at the other key performance indicators around your Client base. For example, location, average age, account size, and tenure are all going to be critical factors for the individual who will succeed you. Take the steps now to make your Client base as attractive and stable as possible so that you can realize top value when it comes time to transition.
6. **Evaluate potential successors.** It's never too early to start thinking about who could replace you long-term (hint – it can be more than one person). Perhaps you have a child or other young relative who is new to or entering the industry. Or maybe you already have a younger Advisor on your team. Even if retirement is 15-20 years away, start taking a hard look at those around you to determine if they could potentially be a successor. Remember that being a good successor goes well beyond being a good Advisor. You'll ideally want someone that shares your culture and vision, and will make a good business leader. More importantly, you'll want to start grooming and mentoring this individual as soon as you have an inkling that they might be the right fit. This training process will also assist in making the right decision as you begin to see how well you work together.
7. **Utilize employee retention mechanisms.** As your business grows and you add staff around you, particularly a potential successor, it's important to put the correct employee retention mechanisms in place. Employment Agreements (executed upon hire) are never a bad idea for staff members and should contain both a non-compete and non-solicitation clause. Additionally, client purchase provisions can help protect against a younger advisor that might leave the business and have clients follow him or her. Finally, bonus compensation plans and stock ownership programs go even one step further to retain, motivate, and incentivize your team.
8. **Remember death & disability.** Unfortunately, even the best laid plans can become derailed. While succession planning is generally geared toward a long-term strategy, we cannot neglect to plan for the "what ifs". Sudden death and disability simply cannot be ignored! And if you think, "It can't happen to me," think again. According to actuarial tables, in a business with two partners both 35 years of age, the probability that one of them will die before age 65 is a whooping 47 percent! For partners who are both age 50, the probability drops only slightly to 40 percent[4]. In my 9 year career in this industry so far, I have been involved in 5 cases where an owner unexpectedly passed away and 8 instances where an owner faced a disabling event (timeframes were anywhere from 6 to 24 months). It is imperative that contingency plans are put in place, whether it be via a Buy-Sell

Agreement or Practice Continuity Agreement. Remember too that both death and disability transitions can be funded with insurance.

9. **Prepare your strategy.** The succession planning decisions that you make now (or elect not to make) will be a major factor in deciding the future of your business. Just as important, you need to plan for issues that may not be apparent now, but could affect the business going forward. Once you have gained some clarity on the above points, begin to prepare your strategy. Keep in mind, this won't necessarily be the final roadmap – you'll need to continue to revisit your strategy (I recommend annually) as your business grows and evolves. But having some type of plan is better than nothing.

10. **Allow yourself enough time.** Remember that succession planning is a process. It's not something where you wake up one morning and decide you want to retire by the end of the week. Defining your plan takes time, both now and in the future. Your goal is to facilitate a smooth transition while making the business more valuable and desirable. Additionally, your plan may be to turn the business over to a family member on the most favorable terms to you, with the lowest tax consequences legally possible – this all takes careful planning. Finally, now that you have begun to construct an exit strategy, work each day to make the decisions that will position your business to reach your goal. In doing this, you'll likely find that running your business is a much more rewarding and fulfilling experience.

Developing both a long-term and emergency succession plan is an Advisor's fundamental responsibility, and one that should be addressed on a regular basis – long before it is ever actually needed. The stakes are much too high to make succession planning anything less than a top priority. After all, shouldn't we be planning as much for ourselves as we do for our Clients?

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[1] *Advisor Succession and Transition; What to Do; What to Avoid*, ThinkAdvisor, June 20, 2016

[2] *Will Your Business Recover from Disaster*, Forbes, September 4, 2014

[3] *Many Firms Don't Survive After Owners Die*, Forbes, February 26, 2013

[4] *Uncertain Death in Business*, Michael Jacobs