

## Nothing succeeds like succession (RIBA Journal)

*In the first of two articles, Jim Kay discusses the need for succession planning for a successful professional services practice*

Our Research Studio has just carried out a review of succession planning within design practices. The results show a growing problem. Many practices are not getting exit strategies for aging owners properly resolved. Of 70 architectural firms reviewed, more than half did not have formal solutions in place. The same was true for 65 structural engineering practices surveyed.

The upshot of this surprising lack of strategic action by some key firms currently active in the marketplace is likely to be significant if not meaningfully addressed soon. More than 50% of the firms surveyed remained either fully or substantially owned by original founders, most aged well over 50 and therefore 'getting on a bit'. Fitting the parts of our research findings together, it looks to us like a sizeable proportion of today's consultancies might not be around in the same form in five to 10 years' time. Some practices may be so inextricably linked to their founder's name and culture, or procrastinate on succession so long, that when it comes to the crunch - perhaps the death of the big-draw name, or the expensive buy-out that is the expected precursor to the retirement of founding partners - the ensuing leadership team struggles to find a viable solution. More enlightened and pragmatic organisations that bite on the succession bullet early on are much more likely to survive and thrive.

The phenomenon of 'exit strategy optioneering', or succession planning, has become particularly relevant with recent fall outs and top level moves from some leading firms in the industry. The impact on succession in these circumstances can be radical and sudden, driven more by expediency than rationale. We don't perceive reckless drivers afoot in practices that are ignoring the inevitable; rather it's more likely that the continuous day-to-day pressures of running a business in a challenging market mean there are always more pressing issues to be dealt with. In addition, the long-term personal toll of growing/maintaining a business is not conducive to thinking about actions to be taken for a life after the current, all-consuming work situation.

The predicament does not only impact on incumbent owners. The ramifications for having a non-disclosed or non-existent succession policy can cut straight through a practice, from top to bottom. For example, senior staff, highly mobile and in much demand by the competition, will be growing ever more impatient for career progression. With the realisation that retirement timescales for existing owners/leaders may be going back in time, the decision to seek greener pastures and the desired career opportunity, becomes easier and more likely. Certainly, for management one notch below the ownership strata, it is the desire for equity participation or partnership status that is the single, key factor behind changing employers.

For owners that care about the sustainability of their businesses, it's not just a case of 'take the money and run' when it comes to retirement.

Indeed, so closely are many owner/founders linked to their organisations' sustainability (through name, culture, contacts etc) that if they removed themselves completely overnight, there may not be any worth left in the business. The next generation of owners and their funders know this and can be guaranteed to want to 'lock' the selling owner into the business for a fixed period after the sale is agreed. It's not uncommon for the remuneration to be linked to the financial performance of the business during the earn-out period.

The value of consideration to be paid for the equity being sold is governed by many factors, including tax efficiency and the preferred payment method. Purchasers come in numerous forms too, ranging from an MBO (management buy out), to venture capitalist or competitor acquisition. Those contemplating succession must recognise that value calculated today, as the retirement fund to be collected some time in the future, is highly likely to vary. Worth will almost inevitably be calculated by a formula that includes a multiplier of EBITDA (earnings before interest, tax depreciation & amortisation ie a standard way of defining 'profit'. Multipliers today are substantially lower than they were a few years ago and EBITDA can vary for a whole variety of reasons, not all of which are within a business's control. So timing is everything!

Succession planning is a complex affair, dealing with many issues, some of which can be mutually exclusive. Although intended to be logically driven by business management, it's not unusual for a plan to be dominated by an owner/founder with an unspoken personal agenda eg leaving a dynasty behind, what-else-to-do fears, uncertainty of the motives or capabilities of subordinates. The best succession planning solutions, therefore, respect subliminal as well as obvious drivers, unique to each organisation, particularly with regard to future changes.

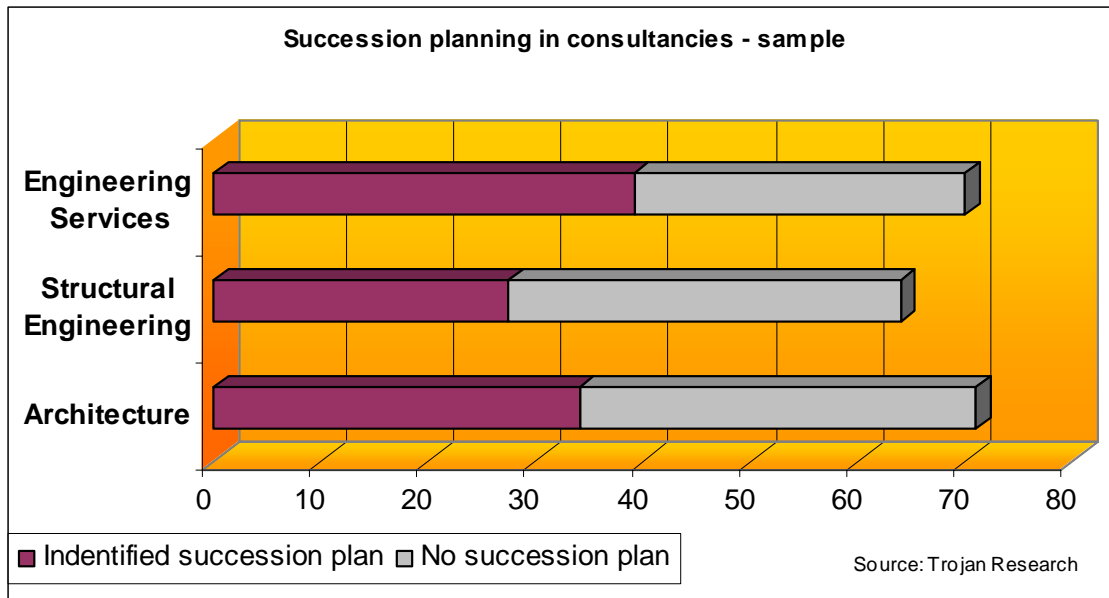
The longer the period over which the succession plan is formulated, refined and introduced, the better. A decade before an owner/founder departs could be considered a sensible minimum. However, it's not uncommon for founding owners to leave it to the last minute, if not beyond, to think seriously about their organisation's future after they have gone. By this time, options are likely to be limited and more of a knee jerk reaction, perhaps to a specific event eg a sudden health scare.

Getting the time to think strategically and tactically about succession planning isn't easy for partners/directors/owners nowadays. Their focus is inevitably on the essential day-to-day management issues - always guaranteed to take precedence over delving into the less palatable side of dealing with leaders' life expectancy and the hereafter. However, succession planning is a critical part of running every business and should form a seamless element of all organisations' culture, brand, management regime and business model. The more difficult the succession plan is to produce and agree as a team, the more likely it is that the organisation is run in an autocratic style.

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Images:

Data source: private research into the construction industry undertaken by Trojan Research Studio.



## 2<sup>nd</sup> piece

### Setting up a successful succession plan

*In the second of two articles, Jim Kay discusses how to set up an effective succession plan*

The worth of an architectural consultancy, and how it's calculated, is market driven and therefore ever changing. This means that it's vital for owners or partners to review regularly their succession plan, as the value intended to be generated on exit may change. It's not uncommon for plans to be adjusted during this process. Planning for this possibility mitigates potential future shock, giving the best chance of avoiding that last minute reaction when the inevitable suddenly dawns.

A trait of some successful consultancies is for their highly talented owners/founders to surround themselves with support teams that can be relied upon to deliver. These management teams, although essential, were not necessarily chosen for their future leadership strength. Understanding these aspects is crucially important for any team contemplating an MBO (management buy out). Their combined strengths and weaknesses, together with each individual's ambitions, need to be built in to the model for the new business.

It's not uncommon for their actual ability to be different to perceived ability or for their personal aspirations not to be fully aligned. The result, either before, during or after the MBO, can be unnecessarily complicated internal politics, resentment and frustration; possibly even the fragmentation of an otherwise excellent organisation.

Complications can also arise when new executives are employed, with the intent of becoming leaders/future owners, late in the succession plan. This can cause disenchantment in the existing management team by what it sees as new, senior embers thrust upon it. These new arrivals are relatively easily ring-fenced by the incumbents, effectively starving them of nutrition and ultimately causing the failure of the succession plan.

The options available to owners wanting to fund their exit are manifold. They range from staying on in post (possibly part-time) and management buy-out to trade sale or venture capitalist intervention. There is also a variety of means by which the consideration can be paid eg a cheque at date of sale, payments over a fixed 'earn-out' period, share swap. Each solution will enjoy differing benefits, disadvantages and risks, the blend of which should be orchestrated to suit each situation's particular circumstances. However, some options can, in effect, end up being a 'tax' on the new owners and not, therefore, giving the reshaped firm the best start in life. Take, for example, a solution that fixes an amount per month to be paid to the selling owner, regardless of how well or otherwise the new business is trading.

A more recent option, selective acquisition, may suit some succession plans. This enables the predetermined blend of risk and reward, together with sustainability, to form the basis of the exit strategy. It can avoid many of the pitfalls that traditionally beset corporate acquisitions but it is dependent on all relevant issues being formalised by the owner and management team from the onset. With this solution the criteria for an acquiring suitor is established and then the market is researched to find that perfect fit. Target suitors are approached discreetly and bespoke business models developed with those that are interested in growing by acquisition or merger. In this way the selling practice avoids broadcasting itself on the 'for sale' circuit, mitigating the impact on trading and staff uncertainty, among other things.

So whatever form of succession planning is being considered, holding on to the prime asset, the staff, is essential. Talent has never been in shorter supply and employers are becoming ever more aggressive in how they attract and retain high performing human capital. Sensing a problem with morale, motivation or leadership in a competitor can often encourage companies to appoint headhunters to take advantage of the situation. Hence, avoiding the staff discontent or confusion that so often ensues from poor or non-existent succession planning, is essential in mitigating the risk of losing key individuals or teams.

There has never been more opportunity for businesses to thrive or grow. A lack of clarity about sustainability, caused by silence on an approaching ownership/leadership vacuum, should not limit this potential.

Sorting out the optimum exit strategy and putting it in place, including communication with the staff, is becoming a more burning issue for a greater number of practices every day. Whether remaining stand-alone or merging or being acquired, the right succession plan will ultimately depend on the quality of relative decisions taken early in the process and the sincerity with which it is implemented.

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