

# SUCCESSION PLANNING

## Solos and First-Generation Law Firms

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If you are the founder of a solo practice or small law firm, chances are you think about the long-term future of your firm on a regular basis, yet the day-to-day demands keep you from taking steps to address it in any proactive fashion. Developing a plan is not as hard as you may imagine, and the benefits from the effort spent are well worthwhile.

The goals of a succession plan should be (1) making sure your clients' ongoing needs are taken care of, (2) providing you the flexibility to enjoy some personally rewarding retirement years, and (3) maximizing the value you receive for the law practice you have built through years of hard work. It is only through a process of planning that begins well in advance of the firm founder's retirement that these goals can be achieved.

First-generation law firms are usually founded by lawyers who are both strong leaders and exceptional rainmakers. If the firm has grown over the years, the founder's focus in hiring additional lawyers has been for the purpose of servicing clients and performing legal work without succession in mind. As a result, the supporting lawyers frequently do not develop the skills necessary to generate business on their own and successfully lead the firm.

### FAST FACTS:

Succession planning is a process, not an event.

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There may be rewards from transitioning your practice to a successor. Don't give up that opportunity because of lack of planning.

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In this respect, every solo practitioner or small firm has a succession issue. Even those lawyers who say they love their work and have no plans to retire may be surprised to find that, over time, their feelings may change to "I want to work when I want to work." Sometimes this feeling can creep in unexpectedly. By the time most lawyers reach their sixth and seventh decades of life, they no longer want the demands of a full-time practice. In many cases, the future of their practice or small law firm ends dimly, forced by immediate events like illness, disability, or death.

Lack of any forethought in retirement planning results in some lawyers winding down their practices and closing the doors—an unfortunate finale to what could have been a lasting legacy.

Every founder of a solo practice or small firm must consider what he or she wants for a retirement plan and whether the alternatives include transitioning the law practice to a hand-picked successor. Making the decision may seem daunting, and implementing it may seem formidable; in many instances, this is the cause of inaction, but many who take the necessary steps say they wish they had done so sooner.

First, it must be recognized that succession planning is a process, not an event. If your firm has ever created a strategic or long-range plan, the approach and work involved are similar; the process should begin at least 5–10 years before the solo practitioner or founder of the firm intends to begin a transition. Identifying a successor and developing a step-by-step shift takes time. In most circumstances, if you are in your mid-50s, now is the time to set a plan in motion. Waiting until you reach 60 or 70 is too long.

## Elements of a Succession Plan

There are several aspects to a long-range succession plan, including:

### Generational Spread of Partners

Some aspects of succession planning are pretty simple. For example, as you grow your firm, make sure you hire from different generations. You might be surprised to learn how many small firms grow by adding lawyers from the same generation as the founder and end up with all the partners in the same age group.

### Leadership Requirements

Rarely do we see a successful firm without strong leadership, which therefore becomes a critical succession planning issue. Some believe leaders are born, not developed. Others embrace the concept of leadership training. We won't solve that debate, but the point to take away is that successful succession involves identifying or developing one or more effective leaders to succeed the founder.

### Management Responsibilities

Management is unlike leadership and involves different skills. Every law firm needs individuals who are organized and have the ability to carry out policies and effectively implement new plans. As firms grow, the majority of the management duties can be delegated to an office manager.

### Entrepreneurial Spirit

Lawyers who are founders of small firms have an entrepreneurial spirit. Without it, they would not have embarked on be-

coming business owners. Unless you focus on this factor in your recruiting process, you are likely to make hiring decisions that surround you with lawyers who are not and never will be entrepreneurial and therefore not the firm's successors.

### Transitioning Clients

Clients are not commodities easily transferred from one lawyer to another. The lawyer-client relationship is intensely personal. The successful transition of clients to successor lawyers takes more effort than most lawyers appreciate.

These elements need to be part of a comprehensive plan that includes recruiting, training, career development, and sharing of clients. For some, the effort may seem burdensome, but for those who can implement such a plan, the financial rewards and lifestyle benefits will be worth the effort.

## Alternative Approaches

Most small firms are unprepared when the founder wants to retire. At that point, what are the possibilities? Fortunately, there are still a number of approaches to take. For example:

### Recruit a Successor

Solos and small firms with no apparent successor may consider engaging in a process to hand pick a successor. The successor could be an experienced younger lawyer who can be groomed to become the owner of the business. There would likely be a fast track to partnership and an exit strategy with an appropriate compensation arrangement for the retiring lawyer. This succession approach covers a period of 5–10 years.

### Merger

Solos and small firms can consider merging with another small law firm. This type of arrangement usually involves a two- or three-year period to execute. Often, the retiring lawyer is provided an of-counsel arrangement with appropriate compensation and benefits. The duties of the of counsel may vary, but a critical component is continued involvement with the clients as matters are transitioned to one or more other lawyers. Experience has shown that some continuing involvement of the retiring lawyer is critical for the new firm to retain clients.

### Acquisition by a Large Firm

Solo practitioners and small boutique firms with a highly specialized practice, strong revenues, and a solid client base can be attractive to some large firms. There have been numerous instances in which large firms have brought in successful solo practitioners and offered them a mutually advantageous exit strategy. It must be noted, however, that only a few solos have practices that would produce the revenue necessary to be attractive to a large firm.

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### Sale of a Law Practice

Rule 1.17 of the Michigan Rules of Professional Conduct allows for the sale of a law practice, provided certain conditions are met. The rule is of recent origin, so we have limited experience on which to evaluate the effectiveness of a sale of a law practice. But for most solos, an abrupt sale to a third party is fraught with problems, including client retention issues. As a result, the better course for a solo is entering a process of bringing in a successor and planning a transition over a comfortable period.

These approaches involve an analysis of the marketplace and identifying the most appropriate candidates for confidential inquiry. This process can identify firms that may have an interest but, like so many lawyers, they are caught up in day-to-day business and haven't found the time to focus on what may be good ideas.

### Advantages of Two-Tier Partnerships

The advent of two-tier partnerships came in the 1980s, at a time when many large firms found themselves partner heavy and therefore needed to slow the growth of partnership ranks. In recent years, more small firms have begun to adopt two-tier partnerships for different reasons. The primary advantage for small firms is that it allows for a gradual transition into partnership, with the founder more easily maintaining control of the most critical decisions for a longer period. The time also allows for development of younger partners.

Under a two-tier partnership, the second tier is made up of nonequity partners (sometimes called income partners) who are salaried, not responsible for firm debt, not required to buy in, and have no opportunity to share in the profits with the exception of an employee-like merit bonus. While the more significant decisions are reserved for equity partners, the firm can be structured so nonequity partners participate in practice management issues and other routine decisions. It represents an internal distinction; to the community and client base, they are partners. The

nonequity status provides time to groom lawyers and prepare them for the responsibilities of ownership.

### Compensation Issues

A proper succession plan requires that the successful senior lawyer transition clients to younger lawyers three to five years before an anticipated retirement. For this to work, the firm's compensation system needs to be structured so the senior partner is rewarded, not penalized, for sharing his or her clients with the next generation of lawyers. While compensation is a major hurdle, there are a number of techniques that innovative firms have employed to protect the compensation of senior partners during such a transition. For example, some firms with formula-based compensation systems have adjusted their systems to incentivize transitioning of clients from seniors approaching retirement to the next generation of lawyers. Firms with substantive-based compensation systems have set transitioning goals for senior partners and held them accountable in the compensation process.

### Exit Plans

When it comes to structuring the exit plan, of-counsel arrangements or consulting agreements are excellent vehicles for providing the retiring partner with a reduced role and appropriate compensation based on a variety of factors that may include the value of the business being transitioned. Lawyers structuring such an arrangement have great flexibility. Financial considerations are always in the picture. Understanding the value of the law firm for the purpose of selling an ownership interest to the next generation of lawyers is an important part of the process. Beyond merely knowing the value, it's beneficial to understand the key drivers that impact the value. Only lack of planning will stand in the way of developing an innovative approach for succession from one generation to the next and creating a beneficial wind-down to retirement.

## Conclusion

Succession planning involves several specific considerations, which every firm should address:

- Make sure the ages of the firm's lawyers are balanced across more than one generation.
- Make hiring decisions on the basis of the eventual future need for leaders and rainmakers.
- Educate all lawyers in the business of law; that is, how the financial model works and what is necessary to attract clients and lead to financial success and stability.
- Look for opportunities to involve all lawyers in some aspect of management to evaluate whether they have the skills to become future leaders of the firm.
- Make sure the evaluation of the firm's lawyers includes contribution to the culture of the firm and its shared values to reinforce the importance of those qualities in the future leaders of the firm.
- Have a valuation process to set a realistic value on the firm for purposes of supporting the transfer of ownership interests in connection with the plan for succession.
- Develop a client transition plan that involves the next generation of lawyers participating with the firm's most important clients while protecting the more senior lawyers on issues of compensation and status.

The critical point is that small firms and solos must plan for the future. Make decisions about growing the firm, move beyond hiring for the short term, and create a firm identity and an institutional approach. Address succession planning and have an exit strategy that will allow clients to continue to be well represented and, at the same time, permit the founder or other senior lawyers to retire gracefully, achieving rewards for the value of the firm they have created. ■



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