



AIA Best Practices: Key decisions to start a successful ownership transition

Contributed by Peter Piven, FAIA, with William Mandel, Esq. Excerpted from Architect's Essentials of Ownership Transition

Summary

If you're considering an ownership transition for your firm there are critical decisions you will need to make in order to know what you're ready to offer your prospective candidate(s). This best practices article lists key points to consider before transferring firm ownership.

Establish the framework of your offer

Once the decision has been made to transfer ownership to others in the firm, the current owners must make several critical "business" decisions in order to form a comprehensive understanding about what they wish to offer (the "deal"), and then communicate that offer to the prospective candidate(s). Without a clearly delineated deal, it is highly likely that the owners will offer something that they later determine they cannot deliver. Current owners can use the following questions to establish the framework for the offer they will make to prospective candidates.

Objectives of ownership. Will the firm be structured: (a) as a vehicle through which the owners can practice their professions while retaining primary responsibility for their personal financial goals (e.g., use the high current income approach as used in law firms, medical practices, etc.); or (b) as a collective vehicle that endeavors to build common equity for all (e.g., an institutional/corporate approach)?

Control. Will all (new) owners have an equal voice in firm affairs, or will there be a difference between a "control" group and a "participation" group (i.e., those who control the destiny of the firm and make its critical decisions versus those who simply participate in the firm's profits)?

Participants. Who will be invited into ownership, and in what increments? If there is one candidate that the current owners have identified, this question is readily resolved. Otherwise, the options include: (a) inviting only the most deserving into the control group, excluding all others; (b) inviting some into the control group and others into a group of participating, but not controlling, owners; and (c) inviting all as participating, but not controlling, owners.

Valuation. What do the current owners consider a fair value for their interest in the firm?

Payout methods for sellers. Do the sellers want payment immediately, or would they prefer that payment be deferred to a later date, or to retirement?

Buy-in methods. How will the buyers pay for their interests in the firm? It is rare for new owners to have sufficient financial resources to pay in cash. Sellers can offer assistance by accepting a cash down payment and a note for the balance to be paid annually, hopefully out of profits. If the sellers require cash, the firm can guarantee a bank loan. This is rarely done and other mechanisms may be used.

Vesting. When will buyers be considered “vested” in their share of the profits or losses, and in their share of the firm’s capital if they die or withdraw before their interest is fully paid?

Decision-making. After ownership has been transferred to new owners, how will the new owners make decisions for the firm?

Compensation. What will be the policy regarding the base salaries of owners and the distribution of firm profits? Who will determine the policy? One successful solution is to create a ratio between the salaries of current and new owners such that the average salary of new owners will be less than the average salary of the current owners.

Benefits. Will there be special benefits or “perks” for new owners? Owners in professional firms can receive compensation that is not tied to their salary by providing or accepting various benefits in addition to or in lieu of salary. It is important to be crystal clear about benefit entitlements.

Withdrawal. How will the firm deal with death, permanent disability, and retirement, and at what ages? How will the firm handle early-withdrawal requests?

Involuntary separation. Which mechanism will make it possible to ask an owner to withdraw, and how will such an owner be compensated? The shares of an owner who is asked to withdraw are normally redeemed at full value.

Additional owners. Which mechanism will be employed to invite new owners into ownership or to expand the interests of minority owners?

Qualification of owners. What legal or other criteria must be met for people to be considered for ownership in the firm? What are the expectations for owners’ time commitments, performance, and behavior?

Other. What other conditions, if any, should apply to the matter of ownership? Should the name of the firm or its form of organization change? This question should prompt the current owners to think about issues that perhaps have seemed natural and have not been addressed but that now require direct attention.

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