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Succession and Transition Planning for the Solo & Small Firm Attorney: Start It Now, Or Regret It Later

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For most small firm attorneys, retiring or stepping away from the practice is like mortality. Most will avoid thinking about it until it is shoved into our faces.

For some the "shove" is a serious illness. For others, it's a crisis in the practice – the loss of a long-time pillar of the practice or a major, longtime client, perhaps an economic downturn that damages revenues (like the present one). Something happens, and they suddenly realize they don't have the drive, energy – or the know-how – to rebuild change or refocus. So they decide it's time to step out.

Unfortunately, by this time it's usually too late. The attorney is likely to lose hundreds of thousands of dollars in potential value, or even discover they can't attract anyone to buy or take over. And they simply have to close their doors and walk away.

When to Start Planning for Transition

So, when is a good time to start planning for a transition?

Now. Right now. It doesn't matter if you are 60 or 30. Because a happy transition isn't an accident, and can't be accomplished in a few months. The best transition starts as early as possible. An ideal time frame is 5-7 years, a possible time frame is 2-3, and a fire sale timeline is 12-18 months.

Just as too many small firms have no partner agreements, the typical attorney has no real plan for their retirement other than trying to save enough money to retire.

A well-planned and well executed plan yields the attorney literally hundreds of thousands of dollars that might have been lost without a plan. That makes it important enough to be approached with the same seriousness that one would lavish on a high-stakes litigation matter: with extensive research, study, planning, strategizing, and impeccable execution.

Even more important, a succession plan is a type of risk management. The solo attorney struck down by illness or death can leaves dozens of clients damaged, and the attorney's loved ones unprotected. A succession, where a second attorney is "understudying" the senior attorney, provides an important ability for the attorney to honor their obligations to clients even if they are no longer able to practice.

So, can a solo or small firm attorney actually create a successful, profitable transition plan that gives them what want – a healthy payout, and the ability to step back to a slower "of counsel" pace rather than retire completely?

There are three answers to the question. No, yes, and maybe.

Let's start with the no. No if you want to simply sell your practice but its revenues are less than $150,000. At this level, most buyers won't see any value beyond a token amount, or at most, may simply offer to take it over. At this revenue level the most you can hope for is some percentage of future revenues from existing clients and files.

But that "no" can become a "yes" if the attorney is willing to re-think and refocus, and spend 2-5 years to build a more attractive practice before attempting to execute a transition.

So What Makes a Firm Attractive and "Saleable?

So let's start by defining what the minimum requirements for a saleable/transitionable practice looks like:

1. Revenue of $250,000+, with a yield to the owner of approximately $125,000, or 50% of gross.
2. A clearly definable, quality operational structure including
   a. Forms, checklists, procedures for all phases of firm operations, from office management to basic legal processes and functions – knowledge that has been

"externalized" to facilitate efficient, consistent operation of and delivery of legal services, smooth addition or changes of staff, and therefore reduced dependence on "essential" staff.

   b. A knowledge base of standardized "boilerplate" documents, letters, etc. that create efficiency and assure quality

   c. At least one well-trained, quality staff member who facilitates and supports all firm operations, and serves as a "lieutenant" for all client and firm matters

   d. Technology that is adequate and fully functioning to accomplish firm work:

      i. A true network with server and backup

      ii. Internet access

      iii. Current (and legal) software

      iv. Functional contact & client management software, or in the case of a litigation practice, functional and correctly used case management software.

3. An active and clearly definable marketing program, consisting of

   a. A basic marketing plan and list of targeted organizations and activities

   b. A documented base of active referral sources

   c. An effective website and web presence

   d. A documented list of firm marketing activities and organizational involvement

In other words, the saleable firm has a definable and valuable "infrastructure" beyond the attorney's personal goodwill. It is a practice that can produce a significant amount of client value even when the attorney is not present, and has a very significant "operations plant."

If you're already here, congratulations, your answer to the question is a definite "yes" – you have a saleable practice, and you can skip the next section. But read on. You may find it valuable as well.

So what about the "maybe" answer. Maybe, if the attorney doesn't yet have this in place, but is willing to build a plan and completely focus on good execution.

So, let's put it on the table. The above description sounds very different than the traditional practice. It sounds more like a business – which it is. And let's make no mistake about it: the sale or succession will be based largely on the issue of "is this a viable business worth buying into, joining, taking over?"

To build a great transition plan requires that you have a *successful legal business*, which most small firm attorneys never achieve.

Out in the non-lawyer world, every successful business transforms itself every few years in its continuing quest for growth. It has to, if it really wants to grow. The leaders recognize that how they did business as two or three guys with a truck doesn't work when their client base has grown from a dozen to a hundred, and cannot work if their goal is a thousand, or ten thousand. So they seek advice from outside, and evolve their operations in light of both their present status and their future goals. As a result, how their business operates today is dramatically different from the "two guys and a truck" stage.

Why Attorneys Don't Build Businesses

The biggest obstacle for attorneys in planning the end of their legal careers was placed in their path decades ago, when law school told attorneys "you're not a business person – you're a professional." They inferred that a "business" was somehow slightly dirty and inferior to the professional firm, and stunted your thinking about how to grow your practice. So most solo/small firm attorneys spend their careers working in "non-businesses." They treat it like a job - come in, work hard, go home. They don't plan for growth and change. They don't plan for attracting new business – after all, law school taught them the only thing they need to know about attracting business – the "better mousetrap" theory – just do good work and clients will come. And hiring staff is resisted, and usually done only as a desperation measure, with reluctance, and with resentment of the additional expense.

The reason why so many practices stay small is that they never evolved how they operate. When the attorney gets more business they just work more hours. And when they're working as hard as they can, both marketing and the quality of client care declines. And the practice finds its level and stays there.

Michael Gerber, in his book "The E-Myth," talks about how to turn a job into a successful business. He says that, as long as the owner does all the work and is the center of everything, it is only a job. Because when the owner isn't there, there is no business.

So, in order to have a truly great practice – even before planning for a great transition – the attorney must build a great legal business. Without this foundation the attorney cannot deliver the level of client care they aspire to, and cannot create the income they dream of. They hit a ceiling of time and energy. They get stuck in, as Gerber calls it, the "doing it, doing it, doing it," and never take time to stand up on top of the enterprise and ask the critical questions: "How is the business doing? How can it do better? How can it serve more clients better, faster, more profitably?"

Where Is Your Firm on the Job – Business Scale?

The attorney seeking to sell or transition their practice for the maximum return must step back and analyze it the way a business appraiser might. (And yes, there are many experts who appraise law firms and professional businesses.)

- Does it have an infrastructure – the forms, procedures, checklists, document files, technology and team – that would make it worth buying?
- Does it have an institutional presence – is it visible and viable in the community – or is its value purely in the personality of the owner?
- Can the "goodwill value" –its single most valuable asset – be transitioned to the new attorney successfully – and is the seller willing to do it?
- Does it have an established marketing program, with web presence, advertising, marketing statistics, list of key contacts and referral sources?
- Does it have a positive reputation that creates and sustains growth?
- Does it generate enough income to justify some amount of sale value?

Beyond the Business Structure – Will Your Practice Area Remain Viable?

And there is a relatively new issue that today's appraiser will examine -- the future viability of the specific practice areas the firm engages in.

Some years ago my colleague Bill Cobb, a law firm advisor in Texas, asserted that the products law firms deliver essentially fall into four categories: commodity, "brand name," "high expertise," and "nuclear event."

The "commodity" firm delivers a product in which the buyer doesn't perceive a significant value to the attorney, such as real estate closings, simple wills and uncontested divorces, traffic, etc. These firms are facing dramatically increased competition, first non-attorneys such as financial planners and title companies, next from the thousands of attorneys pouring out of law school who are trolling for any business and undercutting prices, and finally from technology, both the canned and the web version, such as:

- Forms and information found for free on the web, such as freeadvice.com, lawhelp.com, and nolo.com
- Low-cost software, such as Willmaker, Quicken Family Lawyer, etc.
- Internet-based services such as LegalZoom, DirectLaw, Rocket Lawyer, etc.

Because of the massive competition for this work, the commodity practice seldom has significant sale value, unless it is a very sophisticated, high-tech, high leverage firm based on high volume, high technology, and extensive marketing. And that type of "firm" seldom looks much like a law firm.

The "brand name" firm is one which has invested heavily in advertising, and has developed high consumer recognition simply because it is constantly seen on billboards, television, magazines, Yellow Pages, web searches and sites, and bus benches. Such firms rely on huge marketing budgets to attract a high volume of prospects, and often either decline a high percentage and cherry-pick, or refer large amounts of lesser business to other firms. This type of marketing is seldom available for the small firm or sole practitioner.

The "value" firm is one which focuses fewer matters with more complex work. Value firms generate business almost exclusively from personal referrals. There is an active network of individuals who think highly of the attorney and send their clients and contacts to them, meaning that marketing costs are low, and it delivers the best type of clients. Referred prospects see the value attorney as better than others because the referral source says so, and consequently they usually expect (and are willing) to pay a bit more for that firm's services. This type of firm is one of the most viable and valuable, because it provides an important service not readily available from other sources.

The value firm has the most sale value, yet they are more complex to transition. The transitioning-out attorney must commit to an extended period – a minimum of 12-24 months of "relationship transfer," to make sure all those referral sources come to know and trust the incoming attorney as they do the transitioning out attorney. And often this requires the long-term commitment for the transitioning-out attorney to stay involved with the practice for an extended period after the formal transition – not for heavy lifting, but in an advisory role to maintain the credibility of the referral sources and protect the firm's income stream. Exactly the role most attorneys would choose if they had the option.

The last type of practice is the "nuclear event" practice which is the value practice on steroids. This is the attorney that clients seek out when they have a life, career or business-threatening event. In these matters cost is essentially no object. This is the "fix it or I'll die" attorney. This practice requires an extended period of transition – even more so than the value practice. And it's even more important that the transitioning-out attorney stays connected to the practice.

Choreographing the Successful Transition Plan

To assure the best result from their succession plan, the attorney must undertake a carefully choreographed process. With careful planning, they can pass a viable and bountiful practice to a successor, cash out their full value, step back gradually over time, and remain in practice with the firm for an extended period, gaining additional income for years, and being able to connected and involved with their profession.

A successful transition is centered around several key elements which must be planned for and consistently addressed over an extended period:

1. Development of a timeline for attorney transition

Failure to develop a clear picture, and a clear timeline, for all significant elements of the transition will result in failure to achieve the transition successfully. Without a clear picture, a potential successor will be extremely difficult to attract.

Remember, the best candidates will have more options than others, so the picture has to be attractive, and the incoming attorney has to trust that the outgoing attorney is fully committed to a clearly designed process. The potential successor must see that there is a very specific timeline for them to achieve full ownership. They need to be able to “fully understand the game,” so to speak.

The timeline has to have two parallel tracks: one for the transitioning-in, and one for the transitioning-out. The successor has to also see the long-term commitment of the transitioning attorney to support the firm during the entire transition, with revenue targets and marketing activity levels for both. What can sew up a “sale” is the purchaser’s clear understanding that they will receive full support from the transitioning-out attorney over the buy-out period, and won’t be left to fend for themselves and with a big debt partway through the process.

Parenthetically, the outgoing attorney should commit to assuring that the incoming attorney continues successfully – and is able to finish paying any long-term payout. Too many owners have sold their businesses on a long-term payout only to watch the buyer crash and burn the business without paying their buyout price in full.

Inside this timeline is one of the hidden values of a well-planned transition. To facilitate obtaining a successor, the firm should only seem to have an attractive practice, but even a bargain price.

The secret is in the sauce, as they say. Because in the wisely planned transition, the purchase price is only a part of the outgoing attorney’s compensation.

One part of the plan is to increase the firm’s revenues significantly as the succeeding attorney enters the practice, not only to pay for both, but to actually increase the outgoing attorney’s personal income, just at a time when it would usually be declining. So the transitioning-out attorney earns more personal income even before the sale is completed. And this decreases the need to set a “sale” price so high that it scares away a potential successor.

So, beyond revenue goals, what does this timeline look like?

The first piece is, for instance, a first year “audition” period for the potential successor, with specific performance and skill criteria they must met in order to move to step two.

Step two is the initial buy-in – or rather, the awarding of, say, 10% ownership – without cost. This is an attractive part of the initial offer that has the potential successor say “yes” and step into the process. Again in year two there are marks for the transitioning attorney to hit

Step three comes at the end of year two, when the attorney is now sold another, say, 15%, again at a very reasonable cost. Again, the successor must continue to meet specific performance marks to qualify.

Step four is at the end of year three, when the successor can purchase another 15%.

Step five comes at the end of year four, which is the make-or-break year. If the successor has measured up, they now have the ability to buy another 15% and become majority owner, and take over effective control of the firm. But the original buy-in-buy-out agreement contains a clear hook: if at this point the outgoing attorney does not trust the rest of the process and/or the long-term viability of the incoming attorney, he or she has the right to buy back all shares at the original purchase price and end the relationship.

This is why the best timeline is the longest. Even with the most exacting planning, false starts with wrong candidates are possible, which argues strongly for clear and frequent performance evaluations. Five years is the optimum, since it allows time to recover from false starts.

Also in year five, the outgoing attorney begins the transition into “advisor” and “of counsel” status, focusing more on the marketing and client relationships and less on the legal work, and the incoming attorney assumes the reins of operational control.

The remaining 2-3 years of the ideal transition continue the process of ownership transition until the outgoing attorney holds no ownership.

But within the original agreement are two valuable elements. First, the ability for the outgoing attorney to remain a part of the practice so long as they meet a minimum level of revenue – say, $50-60,000. That means the outgoing attorney has a place to stay and play, and keep his or her hand in the game and the profession. So they have an agreeable place to continue to practice at a lower level, and with none of the ownership responsibility.

Second, they can also earn origination for work they bring in that is passed to others in the firm – during and even after the attorney decides to stop working. This means that while they stay in practice, they can earn income from legal work and also from bringing work in for others.

So, the two last parts of the agreement are actually "stealth" components of the "selling price" of the practice, laid on top of that original, reasonable price which helped attract the successor in the first place.

Wading Through the Murky Job of Identifying a Successor

The traditional attorney succession plan usually begins and ends with the hiring of an associate and a hope that this person may wish to – and be qualified to – take over the firm. But this traditional process seldom creates the desired result. Few attorneys have the expertise to make the best hire under even the most normal of circumstances, and most hires are made because of work pressure, meaning the first candidate that seems to meet reasonable – but vague – criteria – is hired.

The philosophy of "hire slow and fire fast" is even more important here. The attorney must take time in the beginning to maximize the likelihood of making the right "hire" – because in the beginning it is truly a "hire."

The process needs to include such elements as development of a detailed profile of the legal skills and personal characteristics of the ideal candidate, and the use of every tool available, such as personality profiles, test projects, background checks and multiple cross-interviews by other attorneys and trusted professionals to maximize the likelihood of making the right choice.

Evolving the Successor Into the Leader

Part of the written transition plan must include stepping the incoming attorney into management responsibility over time. It starts with defining the roles – operations management, staff management, financial management, and eventually marketing and client management. For succession to occur in an orderly fashion, these roles must be defined, and a timeline developed for transferring key roles to the successor over time and providing mentoring.

Management and leadership are distinctly different, although irrevocably interlocked, issues. In sole practices or small firms, staff tends to view the attorney as the "spiritual" as well as functional head of the firm.

The transition plan must also address how to effectively transition this informal role over time, so that staff accept the succeeding attorney as the authority, and do not maintain sub rosa allegiance to the transitioning attorney. Too often, loyal staff may abandon the practice as the senior attorney steps back, damaging the practice and successful completion of the succession.

Transitioning the Business Development Role

The transitioning partner typically holds most of the business origination through decades of relationship development with other professionals.

A specific part of the succession plan must be a plan to transition these highly valuable referral relationships to the successor, to protect the firm's current and future health and revenue stream. Successful marketing – and a successful transition of the valuable referral relationships – is a subject for another chapter. But suffice it to say that the transitioning-out attorney must have strong marketing systems in place, and be skilled in the marketing role in order to be able to transition the marketing, and mentor the successor.

Transition of Client Relationships

In assuring the short and long-term success of the firm, transfer of primary client responsibility and relationships is as essential as the transfer of referral relationships. Just as with the referral relationships, the transfer is not accomplished quickly, but through a planned and gradual shift from the transitioning partner to the incoming partner. Initially the senior attorney introduces the successor as a member of his team, but then allows and encourages the successor to build relationships with the client (exactly what many jealous attorneys are unwilling to do).

Evolution of Compensation Structure

There must be a compensation structure which directly rewards originations, and clearly defines compensation for all attorneys in the firm, for two important reasons:

First, this facilitates the transitioning partner's long-term objective of reducing their billable work and focusing on the origination role.

Second, for the firm to attract the highest quality of successor attorney, that attorney must be able to understand clearly how they will be compensated, what they must accomplish to gain their desired income, and the incentives to either work harder or smarter to achieve higher personal income. They must also have reasonable assurance that the majority of their compensation will be objective, and not the result of the subjective decision of the transitioning attorney.

The Fruits of a Successful Plan

Obviously, the best succession plan is a complex, multi-year process fraught with potential problems. It is unlikely to be fully executed without the initial planning support and long-term guidance of a professional succession planner and advisor.

But the payoff is immense. It can turn a transition "wish" into reality. It can produce many thousands of dollars more in personal income over the transition period, and a tidy "buyout" in the process. It can assure a successful, continuing firm for the buyer. And finally, it can provide a role in that continuing, successful firm which allows the transitioning attorney to stay active in the profession and continue to earn money after the transition.

Dustin Cole is President of Attorneys Master Class and a Master Practice Advisor for attorneys and law firms, helping them increase efficiency and profit, cope with market change, and manage sales, mergers and transitions. He has provided programming for more than 30 Bar Associations and has keynoted or spoken at nearly every Bar solo & small firm conference. In June he will keynote one more, the Hawaii State Bar Solo and Small Firm Conference. His blog, www.resipsalawyer.com, provides practice management, marketing and transition tips and resources, as well as the occasional blasphemous comment on technology and the pursuit of happiness.