



# SUCCESSION AND EXIT DISCUSS UNDERSTAND PLAN RESOLVE

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The  
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Essential Risk & Business Insight for Law Firms

# SUCCESSION AND EXIT

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**In our latest White Paper, our guest author David Green, Co-Founder of The Strategic Partner, explores the issues facing the legal market and owners of law firms in relation to succession and exit.**

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### Introduction

This paper explores the issues facing the legal market in relation to succession and exit planning.

Many law firms have not given full consideration to the exit of the owners, planned or otherwise, and the impact this may have on the firm and those left behind.

It is an industry wide problem with small to medium law firms impacted the most.

### The Issue

When setting up a firm or becoming an owner of an existing firm, an exit plan should be implemented which covers owners, key fee-earners and the “mass exit” of a team or support staff. The plan must be robust and stress tested with hypothetical scenarios including long term illness, absence and death.

The exit of an owner is inevitable and succession, exit or cessation should be addressed to avoid potential disputes. The exiting owner has a right to exit the firm; the remaining staff need a strategy to follow ensuring a smooth transition in what could be a challenging period.



Scenarios a firm may face if successions and exits have not been planned:

**1. Partnerships and shareholders agreements** – The agreement may have been drafted a long time ago and not revisited or updated since. New parties may have taken equity in the firm, changing or possibly leaving the previous plan redundant.

**2. How does it address the issue of resignation, retirement or death in service?** - How has the firm changed and will the provisions made stand the test of time and meet the requirements of the firm today or into the future. Often agreements have not fully contemplated exits and instead have used standard, basic clauses for this purpose which do not reflect or take care of the needs of the individuals or indeed the firm. If it is the requirement on leaving to only leave with your capital account, has that been fully documented and understood? What happens if an exiting owner would like to continue as a consultant without the risks of equity?

**3. Financials** – Plans sometimes fail to address the financial implication of an exit and what happens when an exiting owner wishes to receive a monetary reward for the goodwill and value of the firm generated over the years? What happens if the firm cannot meet the reward? If, as is likely, money was put into the firm to obtain equity, has that been protected in a high interest saving account or (as often happens) has it been used as working capital? Does the firm use the money from a new entrant to pay out the exiting owner? Is there a new entrant available and willing to invest money into the firm? Does that sum meet the requirements of the retiring owner? What is the state of the capital account? Is the individual owed more money than has been accumulated through the years? There are a number of considerations and eventualities and most have a common denominator. MONEY!

**4. Too late to train or recruit** – If partners have not discussed their future retirement plan or retirement is brought forward prematurely due to illness or change in circumstances, does the firm have time to find, recruit and train a replacement? If it is a sudden exit almost certainly not. What is the notice requirement? Is a year adequate time? It may seem like a lengthy period but, if the resigning person is one of two partners or a department head for a specialist area this may not be long enough to manage the transition. A firm might consider finding an external partner or training from within. They could change the structure and replace the missing skills. However, what happens if no replacement is found or the internal staff are not ready or willing to be trained / become owners?

**5. Loss of staff** – An unplanned exit which results in a dispute will quickly reverberate around the firm. The staff will be aware and this could lead to individuals feeling vulnerable. This can result in staff splitting into political factions. If staff feel threatened and their security is at risk you can expect them to look for alternative employment. This loss of staff will only serve to further damage the business. The firm's reputation will also be at risk if employees begin to approach other local firms.

**6. Loss of experience and knowledge base** – An existing owner holds irreplaceable knowledge and skill sets that cannot be replicated. This issue is common and often magnified in smaller firms where owners have deliberately specialised or the firm does not have the need or finances for other staff in that specific area. This is a huge challenge and the replacement may require two or more people to cover the deficit which will put additional stress on finances.

**7. Loss of clients** – What happens within a firm if a fee earner or business developer with key relationships leaves? These relationships and the development of new business is not something that can be transitioned to another employee or indeed learned over night. If a relationship has not been forged with a client and the work transferred to a new relationship manager, will the client have the confidence to stay? What if the existing owner is moving to a new firm, what can be done to stop the clients following? Does your contract include a non-compete? Business development is a skill, it can be learned but has to be mastered and losing an owner with this skill or someone who holds key client relationships could deal a devastating blow to the firm.

Failing to address succession and exit planning is an arguable breach of the mandatory principles of the SRA Handbook (Principle 8 – run your business or carry out your role in the business effectively and in accordance with proper governance and sound financial and risk management principles).

### The Solutions

At the outset, owners should discuss and be honest about their personal exit plans. It may be uncomfortable but a well thought out and stress tested plan could prevent the practice being thrown into turmoil. Denying the business a chance to plan could result in forced succession or run-off. Discussing and agreeing plans early will enable all the owners of the firm to understand the intentions of the others and plan for their eventual retirement.

The solutions find themselves in a number of guises: -

**1. New entrants and training** – A firm should have a clear path to equity. What are the firm's requirements for an external appointment to ownership? Building a path to equity is not just sensible, it sets out the core skills and requirements needed to become an owner and provides an incentive to the staff. It demonstrates what is required to elevate themselves in a firm. Retention of good staff is critical for the success of any business. Having a plan that sets out the path to ownership should include:

- The steps to follow in the firm (trainee, associate, partner, senior partner, equity partner).
- If there are minimum periods expected in each step what are they?
- What technical skills are required?
- What business skills are required?
- What qualifications and training are needed?
- What training will the firm provide and how and when will it be provided?
- When, why and how will the firm consider a new entrant to ownership?
- Financial consideration to becoming an owner. What is involved and how can the firm help?

When looking for owners externally, a set of principles should be established to ensure that any lateral hires are right for the firm. As discussed above, unwinding from an equity appointment is a tumultuous journey. Making it clear what is required at entry will ensure both the firm and the entrant understand expectations:

- How long must an individual have been with the firm before ownership is offered? If immediate, what are the conditions and expectations?
- If bringing clients or people too, in what time frame are they expected to arrive? Are covenants likely to be breached? What are the implications of this?

- If financial targets are to be met, what are they and when should they be achieved?
- If there is a requirement to purchase equity, how much and on what terms?
- How does the partnership agreement provide for a new entrant and will they be given advanced sight of the requirements and documents?
- In what circumstances would the firm not proceed in offering equity and what are the consequences of this?
- What are the expectations and requirements of each new owner? How must they conduct themselves and represent the firm, what decision making powers and corporate responsibility will they have?

**2. Financial planning** – It is likely that a firm will expect any person seeking equity to provide financial commitment to acquire shares. How will that be provided and what support can the firm offer either itself or through third party funding? Would the firm be willing to consider salary sacrifice or will it expect the individual to raise the capital personally? Many banks and finance houses are willing to consider the provision of loans to an incoming equity owner, but what are the terms of such a loan and will the firm need to act as guarantor?

Funding in today's financial environment can be a major issue or barrier to bringing people in as equity partners; all options must be fully investigated and addressed.

**3. Partnership agreement** – Ensure the Partnership or shareholders agreement has fully addressed the firm's requirements when an owner exits. Importantly, revisit the agreement every two to three years ensuring it is up to date, relevant and keeps pace with the individuals and the firm. The agreement should typically cover such areas as:

- How an owner is removed and on what grounds?
- What is the impact on staff and clients when removing an individual from the firm?
- What is the notice period, the restrictions and covenants?

- If there is a sudden or immediate exit, how will this be addressed?
- Are there to be special considerations for 'founding owners' i.e. a founding owner cannot be removed by a non-founding owner?
- What are the financial considerations, what is an exiting owner entitled to and when?
- Is consultancy after stepping down an option, if so what terms will apply?
- What happens if an owner wishes to reduce their hours or responsibilities?
- How will disputes be dealt with?

**4. Regulation** – If an existing owner holds a regulatory position will there be a qualified person to step into the role? Does this leave a gap somewhere else in the firm?

**5. Merger or sale** – If a firm's succession strategy involves merging with another firm or simply being taken over it is imperative that the owners of that firm truly understand the expectations of a merger or sale. Do they want immediate value? Would they want an ownership status in the new firm, if so on what terms? A poorly planned engagement will waste time and is likely to fail. Both sides of an acquisition or take over will have requirements; these must be set out, discussed and agreed at the start of the process.

**6. Closure** – How will the firm approach closure? A law firm that is approaching closure may need to spend up to two years planning. There are significant financial consequences to be considered, the most notable of these being run off cover. However, other factors will need to be budgeted for too such as redundancy, archiving and closing / transferring client files. If closure is a long term strategy, careful planning is essential and the firm must consider the financial, regulatory and operational requirements.

When an owner wants to exit the key is planning. This is achieved through understanding and openness. When owners are honest about their intentions (which may change as time passes) the firm has the ability to plan and respond. A lack of clarity and understanding can be the instigating factor in the breakdown of succession and exit planning.

### Prevention

1. **DISCUSS** – Owners of firms should discuss their plans, requirements and expectations. These can remain fluid to reflect an individual's right to change their mind or priorities. Setting out a potential path to retirement enables the firm to plan for the eventuality.
2. **UNDERSTAND** – When discussing future plans ensure there is an understanding. What is driving a decision and what is the chance of this being a reality or being subject to change? Also what are the implications of an exit by an owner? What skills and experience will the firm lose if and when they leave? A full understanding and appreciation will allow for detailed planning and the removal of surprises that could have a negative impact on the firm.
3. **PLAN** – With understanding a plan can be built. As firms move closer to the exit of staff members plans can be instigated and discussions had to establish if there is any change in mentality. If so, the plan can be adjusted. If not, a strategy can be implemented to minimise impact.

When a new firm is built these conversations should take place during the initial phases of set up. This will be the easiest time to achieve a meeting of minds and for a sensible plan to be agreed upon. As a firm becomes more established they become more complex. If you are in a firm that has not addressed succession and exiting, a plan should be implemented sooner rather than later.

### Next steps

Contact The Strategic Partner; we are experts in assisting law firms to build a succession and exit strategy. We will assist in the drafting and the completion of partnership or shareholder agreements. Whether you are a Sole Practitioner, LLP or Limited firm, succession and exit planning should be a primary consideration.

Whether your firm is starting up or well established The Strategic Partner will work with the partners individually and collectively to understand your requirements. If required The Strategic Partner will broker agreements and help find resolutions over the course of contentious discussions.

In our experience, the involvement of an independent expert will help facilitate much swifter resolutions if issues arise and will enable us to deliver a robust plan for the future protection of the firm, the owners and the staff.

For more information about The Strategic Partner's Success and Exit Planning service you can call us on 02078421830 or email us at [info@thestrategicpartner.co.uk](mailto:info@thestrategicpartner.co.uk).

You can also visit our website, [www.thestrategicpartner.co.uk](http://www.thestrategicpartner.co.uk) to see what we do!



## About The Author

David Green is a co-founder of The Strategic Partner. After many successful years in the Insurance and Legal Sectors, he now works across a portfolio of businesses as an Investor and Owner, providing strategic support, financial management, operational input, business development and general consultancy and guidance.



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