



Succession Planning: It's Never Too Early To Start

Taking a few key steps now can help secure your firm's financial future and enhance your retirement.

The next time you attend an association meeting, look to your right and left. Odds are better than one in three that the person sitting next to you is your age or older. Did you know that 33 percent of the entire US Environmental Protection Agency will be retiring in the next five years? Or that 40 percent of

the physicians in this country are over 55 years old? The baby boom included its proportionate share of design professionals as well, and they're all headed for retirement at the same time.

What this means to you depends on how you've managed your firm up until now.

Principals who have invested in training the generation behind them in the skills needed to run the firm are in good shape. Note we did not say, "Principals who have invested in training the generation behind them in design skills" As many design firm principals have learned, the skill set needed to run a design firm doesn't necessarily include superior engineering or architectural skills. To stimulate an active market for your firm's stock, the interior buyers have to know how to run the firm after you're gone. Since a large part of a design firm's value is predicated on the sustainability of future earnings, owners should be training younger associates on how the business of design is actually conducted.

The opening line of Tolstoy's *Anna Karenina* is, "Happy families are all alike; every unhappy family is unhappy in its own way." So, too, with design firms.

A few rules the Design Professional group of the XL Insurance companies has observed among "happy" design firms with successful succession plans are these:

- **Start early** – It takes from five to eight years to successfully transition the shares of a majority shareholder without unduly straining the firm's capital (barring outside capital inputs). If you wait until you turn 60 to begin planning your transition, you may well be working until you are 68.
- **Implement a mandatory divestment age** – Many successful firms do not have mandatory retirement ages, but have ages at which principals must divest themselves of their stock. This gives younger associates their chance to run the firm and forces the aging principals to plan for the future. It is not uncommon for many designers to want to work into their 70s, but it may endanger the firm to wait that long for succession.
- **Have a realistic valuation expectation** – Many principals of smaller design firms have been taking the money out of their firms every year, and have only reinvested to maintain the firm over the years. Then, when it is retirement time, these same principals think that the firm's value has increased considerably over its equity value. Unfortunately, since the profits have been taken out in distributions, to expect that the firm has gained considerable value is to expect to be paid twice for the same work. The profits have already been distributed and are no longer inherent in the firm.
- **Educate your next generation** – The only hedge you have for insuring the future earnings of the firm is the ability of the next generation to run the firm profitably. Since, in almost all cases, it is the future earnings of the firm that are used to pay off the retiring principals, the best investment a firm can make is in the management skills of the succeeding generation of firm leaders.



The information in this article is the product of over 30 years of front-line claims experience and is part of the educational service provided to the design industry by the Design Professional group of the XL Insurance companies. For more information, other loss prevention resources and to find an agent in your area, visit xldp.com or phone 800-227-8533 ext.2102508.

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