

TRANSITIONING THE FIRM TO NEW LEADERS
HOW OPERATIONAL MODES ARE IMPACTING THE EVOLUTION
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This column is an excerpt from materials in Chapter 7 of the new PCPS Succession Resource Center, which is FREE to PCPS members and only \$35 per CPA to join (with a maximum fee of \$700 per firm). Visit <http://pcps.aicpa.org/Resources/Succession+Planning/> for more.

Over the years, many CPAs have assumed that they would work in a practice, become an owner, work some more as an owner and then retire by selling their ownership interests to the other people in the practice. While that has always been a reasonable assumption to make, for many practitioners, the reality of this scenario has not matched up to their vision of it. Why? Because the partners and people in the firm are not supported by a structure and processes that can easily move beyond the founding fathers (typically founding fathers are the original founding owners of a firm, but sometimes, they are also a few like-minded entrepreneurial, dominant owners that split off, took over, or bought out others to take over controlling interest in a multi-decade old firm). In short, most entrepreneurs default to building organizations custom tailored to suit and leverage their personal skills and therefore selling/merging the firm is the only real option since the organization they built doesn't work without them.

This is a critical point to understand if you are trying to build your firm to operate successfully long after you are gone. The problem is NOT finding new leaders ...but rather, what the existing leaders have put in place that will derail and handcuff the success of those future leaders. We have tried to clarify this by identifying common modes we have seen for running a CPA firm. While we are not suggesting this is an all inclusive list, we hope these definitions help loosely describe how your mode of operation could be helping or impeding your ability for a successful transition of your firm. The modes of operation, as we named them, are:

- **Survival:** at the initial stages of being an entrepreneur, we are driven by the instinct to pay for the roof over our heads and put food on the table.
- **Safety Net:** once we feel like our business will generate the resources required to cover our basic needs, we focus on building the business in a way to generate enough cash that we can build a fat savings account, pay off our business notes, and create a cushion in case times get tough.
- **Success:** now that we don't feel desperate about our financial security, we start thinking about evolving our firm in a way that makes the owners, and the people we are hiring, want to work there. Additionally, the firm becomes an entity we think about protecting. The firm's success, reputation and strengths still are reflective and synonymous with those of the owners in this mode.
- **Continuation:** At this point, our focus shifts from our success (where the owners have done well financially and are secure in their own accomplishments) to creating an organization that has its own institutional identity and that can survive without them.

So at the "Survival" level of operating a CPA firm, it is all about maintaining a firm that will pay the bills, like providing food and shelter for their families. As the firm moves to the "Safety Net" mode, owners tend to focus on generating enough cash each year to build a strong enough nest egg to create some financial security. As they pay off their notes and build cash reserves, owners often shift to a "Success" mode of operating where they start paying more attention to creating the kind of environment that makes them and their people enjoy coming to work and

allows them to be proud to be a part of their respected organization. They efficiently build the firm and its processes around the key people in the organization. This is, for many, the highest mode of operation they achieve because when many owners are ready to go, they just look for someone to buy them (with backup collateral) and they walk away. And finally, at the “*Continuation*” level, owners start thinking about their life’s work and want to start taking actions so that the firm can survive and prosper long after they retire. This is a critical mode of operation to be in place for financial reasons if the acquisition/merger market is soft.

We realize that our analogy is very simplified, that all CPA firms don’t go through these phases, and even those that do don’t necessarily go through them in a step by step manner. But as you will see in a minute, we are trying to drive home what we believe to be some important points.

When you are just starting your firm, you aren’t thinking about developing leadership. As we said, it is about paying the bills, making a living and keeping the doors open. Once your bills are no longer an everyday threat, your focus shifts to setting aside enough money so that the anguish of living from paycheck to paycheck doesn’t happen again. We want to build our organization solid enough to generate greater financial security. During these two modes of operation, the best and easiest way to fulfill these needs is for the owners to work hard, depend heavily on our own skills and build a support structure that leverages their time.

As our firms continue to thrive, owners start thinking about the culture they are creating and the concept that there is more to life than money (partially because they now have money). It becomes increasingly important to many entrepreneurs that they enjoy coming to work and that they are part of a well respected and highly thought of organization. The firm, and the owners, while separate legally, have the same identity.

During this “Success” mode, the firm continues to evolve into a kinder and gentler place to work. The choices being made every day are driven by the idea of enhancing the success and profitability of the organization while promoting the desired culture and living up to the current values and reputation of the firm. The strategy is to maximize the talents of people within the organization under the management and control of the founding fathers.

The final mode, “Continuation,” is about separating the identity of the firm from the owners and building infrastructure and governance that transcends the founding fathers. This stage is far different than the other three stages because it often requires an organization to restructure and move away from the mode of operation that has been fundamental to current success. The “Continuation” mode turns the business model up-side down from the “Success” mode because rather than building the organization around the creativeness, talents and management skills of the founding fathers, it requires the founding fathers to step back into the shadows and allow others to evolve.

Once the founding fathers see the need to step back, stay involved, but take a much less prominent and dominant role, they quickly balk at many of the systems that they built because they are not comfortable giving others the power they have taken. And that is the key point here. The systems in the “Success” mode were built efficiently and expeditiously around specific people, rather than organizational roles and responsibilities. And those systems typically fail when dominant players, or controlling interests, are removed from the system.

So, in the “Continuation” mode, your objective is to set up systems of governance, operational processes, voting rights and privileges, accountability, compensation, etc. that revolve around interchangeability. As an example, you don’t create the job description for the managing partner

as if a specific person were filling that position, but rather as if anyone elected would fill that position. If the powers, limitations, expectations, responsibilities and accountability of a position are tailored to a specific individual, then you are likely operating in the “Success” mode. If they are right for whoever is elected, then you are probably much closer to operating in the “Continuation” mode.

Taking this example a step further, often, a managing partner who is a founding father has more power built into that position than they should be entitled to have. However, if the managing partner job description was created after the founding fathers retire, then it is likely that the managing partner position has been stripped of almost all of its power (still “Success” mode, just a more dangerous deviation because the organization is still operating around specific people rather than required authority and accountability to effectively run the organization). In the “Success” mode, the firm is not thought of as an entity that is an asset which needs to be protected, nurtured and managed, but simply a conduit for financial gain. Owners treat the entity as insignificant, with all of the value being attributed to specific people and their achievements. To move from the “Success” to “Continuation” mode, the founding fathers have to be visionary enough to realize that the long term success (beyond them) of an organization requires that the entity, its governance and processes have been established in a way that it can shed (terminate) and effectively manage around a few bad or dysfunctional future owners.

Now that we have shared this concept, in my next column, we will apply it to a case study to provide greater insight as to how these modes impact the way firms’ approach the leadership development objective.

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