Letter from the Editor

By David Brent Richards, FAIA

The PM Digest seeks to provide a range of varied opinions and points of view on a topic of interest to those managing practices. This quarter we have considered Ownership Transition. As the baby boomer generation moves into retirement age, many firm owners are looking to transition out of their role in the firm and into retirement. Setting the stage for successful transition can be a long and challenging process.

Articles in this issue of the PM Digest consider several aspects of Ownership Transition. Timothy Hawk, FAIA of WSA Studio shares his personal experience in the challenges of becoming the owner of an existing firm; Hugh Hochberg of the Coxe Group Inc. speaks to the need to identify, develop and retain future leaders and to institute a transition plan early; J. Tim Griffin, P.E., MBA, LEED AP a PSMJ consultant provides insight on ownership transition from the Millennial's point of view.

Stephen Epstein, a strategic advisor with Strogoff Consulting, Inc. shares ideas related to designing an effective leadership development program; Brad Wilson, Senior M&A Consultant with PSMJ Resources considers the challenges of internal transition after the 2008 economic downturn; David S Choen, Esp, ASA provides an overview of value in a shareholder transition and John Bierly, AIA and Clark Davis, FAIA, both of the Cameron MacAllister Group, discuss three alternates for ownership transition including an ESOP.

David Brent Richards, FAIA
drichards@rossetti.com

As the Practice Management Knowledge Community, our mission is to advance the practice of architecture through discovering, generating, organizing, and sharing insights, resources, and tools that enable architects to practice more effectively.

In this issue

► Features

► New Best Practice

► Mini-MBA in Georgia

► Call for Nominations

Quick Links

PMKC Homepage

Post a Message

Best Practices

Upcoming Events

Download this Issue »

Features

Addressing relevance

By Timothy C. Hawk, FAIA, President WSA
Transitioning a firm is challenging, and only one thing can ensure success. Our firm was established at its conception with a vision: a firm rooted in respect for participants, design context, and the professional obligation of the architect.

Read more »

Leadership and ownership transition

By Hugh Hochberg, The Coxe Group
Of the many strategic and operational things that get owners' attention, high on the list is evolution of ownership. However, addressing it as an ownership issue dramatically understates and misrepresents the challenge and the opportunity.

Read more »

How to get your millennials to buy into firm ownership

By J. Tim Griffin, MBA, PE, LEED AP, Consultant, PSMJ Resources
While current Baby Boomers are looking to retire, front-edge Millennials are now just coming into the heart of their careers where they can really push a business forward. How do Millennials view A/E firm ownership?

Read more »

Designing an effective leadership development program

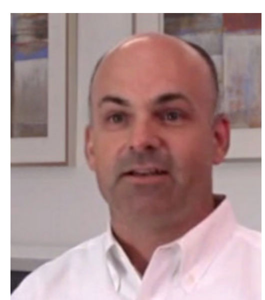
By Stephen Epstein, strategic advisor with Strogoff Consulting, Inc
Leadership is a hot topic and for good reasons: A/E firms are struggling to fill a growing leadership vacuum. An effective leadership development program can help firms fill this vacuum while creating opportunities for all generations.

Read more »

The challenge of internal transition in today's A/E arena

By Brad Wilson, Senior M&A Consultant, PSMJ Resources
If you are a firm leader looking to retire, you must do more than consider new or revised terms in your buy-sell agreements. To be successful, you need to start grooming your successors long before you decide to take your exit.

Read more »



Staying independent: transitioning to the next generation?

By David S. Cohen, Esq., ASA
Anecdotally, only about one in ten founder(s) are able to transition their ownership to the third generation. If you want to be one of the few to stay independent, here's where the challenges are and how to resolve these items.

Read more »

Choosing the best ownership transition strategy

By Clark Davis, FAIA, and John Bierly, AIA, Principal Consultants, Cameron MacAllister Group

Architecture is an intensely personal profession. Most practices are formed around a common passion, and many don't survive beyond their first leaders. If your firm is committed to long-term success, you'll need a plan for the future.

Read more »

But Words Will Never Hurt Me - Best Practice 06.01.11

A new AIA Best Practice is available by Thomas S. Townes, AIA, and Andrew J. Carlowicz, Jr.

As Architects, we are guided to focus our attention on the right details and the completeness of our overall design package. As marketers our goal is to promote the abilities and talents of our firms. It is necessary to differentiate ourselves from other firms with the ultimate intent to win a client or a project.

But at what cost? While we may believe that our liability lies only with our performance or standard of care, we must be careful not to cross the line with what we promise the client, even in the words we choose in marketing our firm or pursuing a particular project.

Read more » | Find more Best Practices »

2016 Mini-MBA Program

September 29; AIA South Atlantic Region Conference

PMKC is sponsoring a mini-MBA course in association with the AIA South Atlantic Region at their conference in Savannah, Georgia.

Industry leaders will break down the basics of business and management. We will tackle tough issues that mid-career architects are facing, and you will leave with resources to propel your career forward.

Topics include: career planning, thriving in middle-management, leading better meetings, networking, firm succession strategies, managing teams, and successful influencing leadership. Keynotes speakers are Mark LePage of EntreArchitect and Marica McKeel of MM Studio, NYC.

Learn more »

2016 Call for Nominations

We are seeking nominations for members to serve on the PMKC leadership group! Members will be required to submit a resume, a letter of interest and a letter of commitment for each committee application. The nomination process closes at **5:00 PM EST on Monday, October 3**.

Learn more »

See everything that the Practice Management Knowledge Community has to offer on AIA KnowledgeNet. Visit the PM Digest archives page for past issues.

Addressing relevance

network.aia.org/practicemanagement/blogs/timothy-hawk/2016/09/07/addressing-relevance

By Timothy C. Hawk, FAIA

Migrating firm culture to attract, energize, and empower the next generation of architects.

My wife and I loved living in Chicago. The city was always alive. It was diverse and full of people who think, and I learned to have a lot of respect for urban living. But, something was missing from my career. Practicing in Chicago just seemed like a job, and I knew I wanted something more. My dream was always linked to leading, shaping, and forming organizations.

So, when I received an amazing leadership opportunity in Columbus, my young family and I packed up our things and headed back east. I haven't looked back since. Every waking hour—and during some that I am asleep—I do my best to steer the ship of my 46-year-old fledgling firm.

I joined Wandel & Schnell, Architects in 1993. By 1995 I had been offered a position as principal and partner. In 1998 I exercised my stock options and became a partner, and in 2004, when the original partners began their transition to retirement, I became the President of the Board. I cannot state that every day has been peaches and cream, but I can guarantee that I have used every single tool in my box to keep this enterprise moving forward. And through it all, I have gained exposure to an amazing collection of experiences. Here are just a few:

My collection of experiences

Ownership is not for everyone, and to be more explicit, ownership transition of a small firm can't be pulled off by most architects. It takes a generalist mentality by a tenacious, persistent personality with lots of passion. Not only does one have to juggle all of the balls that are typically a part of managing a small firm (design, project management, billing and financial oversight, business development, sales, construction administration, coaching and mentoring emerging architects); but, the transitional firm leader must grapple with the transitional lethargy of an established brand and a strong legacy which has sustained the organization over time. In my case, I commenced the transition eight years prior and fully acquired the firm in its thirty-fifth year. Now in our forty-sixth year, the firm is a much different place than it was in 1998. But, importantly, the firm has the same core mission.

Start a firm from scratch, and you have no legacy and probably need to focus on establishing a brand. Conversely, transition an existing firm, and one quickly recognizes that the legacy can overpower your hopes for the future. The firm is defined by its past, like it or not. The largest problem with a legacy is that the original partners are gone, and your public image suffers from a disconnect. Consumers and our partners in the building industry wonder if the firm will be able to maintain its status, and one slip can create a public relations nightmare. Gaining the confidence of the public and the industry will take time and a lot of sweat equity. New leaders need to be fully committed and agile.

As a transitional leader, you assume the helm of the firm at full speed. Imagine trying to take over the wheel of a beautiful old car while it is racing down the freeway at high speed. Even though you have been in the car for the ride for some time, you are suddenly responsible for the wheel and quite often have no idea what the road ahead might bring. All of a sudden, you bring a new leadership style to the helm. Existing employees might be shocked by the change. Clients grow concerned about the void that is created by the departure of "their" firm owners, and consulting teams may be concerned about your ability to maintain the firm. It is a natural reaction. Change concerns most people.

With the departure of the previous generation, new leaders fully assume all of the risk, warts and all. Architectural projects typically unfold over years, and I distinctly remember acquiring a couple of projects that were in the midst of a bumpy construction process. This can be a huge distraction from the true transitional needs. When I say the work doubles, I mean the work doubles. No exaggeration.

On the flip side, you inherit the entire portfolio and the firm's reputation. For me, a few months after I assumed the leadership position, we were fortunate to be awarded the gold medal in the State of Ohio which made the inherited legacy even more valuable. Of course, I had contributed to the firm's spirit for years, but in large part, the Gold Medal status was earned by the leadership of the firm's original partners, Bob Wandel, AIA and Tom Schnell, AIA. Their efforts established the rock solid foundation of the firm, which is pretty hard to shake.

One cannot successfully transition an organization without the support of a contributing staff. Open, transparent, and timely communication was key, and at our firm we spent a lot of energy to establish a leadership development program for emerging leaders. The message was clear: you can be a future leader too. At my firm we had four people agree to participate, and one grew to become a firm leader. Regardless, the program helped to gather minds around strategic planning which has contributed to the firm's enduring energy.

There is a lot of merit in "moving on" quickly. We migrated our name to WSA Studio to signal a new generation of leadership and to embrace our future. At the same time, we relocated our studio to a historic building in a transitioning neighborhood to provide a physical manifestation of our commitment to change. Yes, the moves created challenges in continuity, but these decisions simultaneously helped to re-focus the public on progress and clarified the firm's intent to compete in a future market.

Conclusion

Above all, know that transitioning a firm is challenging, and only one thing can ensure success. Our firm was established at its conception with a vision for a specific practice methodology. Mr. Wandel and Mr. Schnell established a firm rooted in respect for participants, design context, and the professional obligation of the architect. For thirty-five years they continually worked to implement that mission, and those of us who help it endure share that same passion. We have committed ourselves to a practice model which elevates our day-to-day work. We believe in WSA Studio.

Timothy C. Hawk, FAIA is President of Columbus-based WSA Studio and holds expertise in the design of interior environments which foster innovation. He has prepared space programs, designs, and documents for corporate and educational clients and is a strong collaborator noted for value orientation, communication skills and context driven design. Hawk holds a Master of Architecture from Ohio State University. He joined WSA Studio in 1993, became a principal in 1998 and assumed the firm's leadership position in 2004. Hawk has served as the national chair of the AIA Interior Architecture Committee, is the current Ohio Valley Representative to the National Strategic Council, and is a Fellow of the American Institute of Architects. Hawk has presented nationally on topics of interest to designers throughout his career.

(Return to the cover of the 2016 PM Digest: Ownership Transition)

Leadership and ownership transition

network.aia.org/blogs/david-richards/2016/09/07/leadership-and-ownership-transition

By Hugh Hochberg, BS and BArch (RPI), MBA

Of the many strategic and operational things that get owners' attention, high on the list is evolution of ownership. However, addressing it as an ownership issue dramatically understates and misrepresents the challenge and the opportunity. The real issue for most firms is expansion of leadership and ownership, followed by transition (in the context of not just change, but also divesting of ownership). In other words, at least 90 percent of the time the first change is that the leadership and ownership groups expand and the next change is that some owners divest ownership, which may or may not coincide with their departures from the firm.

To simplify the overall picture, it can help to consider the difficulty of various transition components. From least to most difficult:

- ·ownership transition
- management transition
- governance transition
- marketing and business development transition
- leadership transition

Let's look at each transition:

Ownership Transition

Ownership transition, though not necessarily simple, is mechanical in nature. Determine how to value ownership, decide how to price it—recognizing that sellers can adjust the price circumstantially—and recognize the critical truism: There is no such thing as truly successful ownership transition in marginally profitable firm, if one agrees that "truly successful" means providing fair value to sellers, being affordable to buyers, and serving the best interests of the firm by bringing the right people into ownership at the right time.

One of the "rules" about transition is that no rules apply universally except for the above truism. Having said that, some empirical data from a large database might help:

- To keep financial data in simple terms, the average valuation for internal transition purposes equates to 25 percent to 30 percent of annual net revenue (defined as gross revenue less consultants and non-labor project expenses).
- The average valuation for external transition—sale to an outside buyer—is about twice the internal price, or 50 percent to 60 percent of annual net revenue.More highly valued firms can sell for as much as 100 percent of annual net revenue or more, but that's pretty rarified air.These external values are the "goodwill value", which value above the liquid value (primarily cash and receivables).
- Minimal operating profitability (before retirement plan contributions and bonuses) to sustain pay competitive compensation and fund ongoing, incremental ownership transition is 10 percent of net revenue, which explains why so many firms deferred ownership transition during the economic downturn of 2008-2012, when average profitability dropped to 5 percent.

- Sellers who expect to get rich or fund their retirement exclusively from the divestiture of their ownership will be disappointed.The compensation math clearly demonstrates that an owner for 30 years in an architecture firm is likely to receive over 95 percent of remuneration in the form of salary and distributions and less than 5 percent from the sale of ownership.
- Over-pricing ownership will lead to departures of the next leaders and owners, because if they are good enough to be successors, they are good enough to be competitors.

The overview nature of this paper precludes delving into details of mechanical considerations, which include such realities and complications as tax considerations, timing, terms, internal and external funding sources, and more, each of which requires considerably more space than is feasible here.

Three more transition components

Management transition, referring to orchestrating people and resources, is relatively simple because most people follow managers' instructions even if the managers don't particularly enthuse them.

Governance transition, referring to participation in the highest level decision making about strategy and policy, is more difficult for a few reasons. One is simply the magnitude of the issues which governance addresses. Another challenge is that with expansion of the governance group, new dynamics and relationships develop, and a governance group's effectiveness depends in part on the ability to air different views and come to good decisions in a timely way. Excessive deference by newcomers to established members impedes achieving highest effectiveness.

Marketing and business development transition is a more difficult and more significant challenge, to large degree because people with the capability and passion to do those things well are few and far between. To the chagrin of many, simply being a competent practitioner—even with a focus on a specific typology—isn't enough. Another difficulty is the time it takes to earn credibility in the marketplace, and too often the expectation is too much too soon, so the effort ends before results can reasonably be expected.

Leadership transition

Leadership transition usually presents the biggest challenge, and the reasons warrant clarity. First, leadership has a fuzzy definition, with many people equating leadership with management. The real test of leadership is followship: If there's no one following you, you're probably not leading. A second challenge is that many leaders are entrepreneurial, and as a result they often seek to create new opportunities rather than advance in existing organizations.

A third challenge is that leaders are often impatient, which leads them to depart before the generation ahead of them thinks they are ready to step into leadership and/or ownership roles. This emphasizes generational patterns, with first generation ownership characterized by entrepreneurialism and external focus (evidenced by the ability to bring work) and second generation characterized by focusing on doing the work, developing the systems and processes for delivering work, and exhibiting patience (becoming owners at an average age of 41, whereas the average age of founders when they start their firms is 31).

In this overly simplified model, the third generation is more like the first than the second, and the patience of the second generation can impede leadership evolution. A firm needs the strengths of both first and second generation profiles. Absent one or the other, the firm's chances to succeed diminish considerably.

Lessons learned

Considered together, these various transition components tell us several things:

- Identifying, developing, and retaining future leaders is the biggest challenge. In other words, the "who" is far more often the bigger transition challenge than the "how".
- It is wise to institute a transition plan early, and concentrate on identifying, developing, and retaining future leaders and owners
- Profitability is a necessity, and attaining the average of the profession in most years is barely enough.
- Greed hurts transition.

Hugh Hochberg, BS and BArch (RPI), MBA (Harvard), leads The Coxe Group and has personally consulted with over 1,150 professional service firms, and the success of many have earned high respect from their peers. His wide and deep involvement includes virtually every aspect of practice. Among the clients with which he has worked, one-third are winners of the AIA Firm Award. Hugh practices nationally and lives in Gig Harbor, Washington.

He has taught and lectured at numerous highly respected universities and conducted programs for many professional societies in North America, Asia, Australia, and Africa. He has also written for several publications, including Progressive Architecture, Architecture, Design West, Oregon Architect, Oregon Business, and the AIA Handbook of Professional Practice and co-authored Success Strategies for Design Professionals (McGraw-Hill). He has been a contributing editor of DesignIntelligence and has been interviewed by National Public Radio (NPR). He can be reached at hhochberg@coxegroup.com.

(Return to the cover of the 2016 PM Digest: Ownership Transition)

How to get your millennials to buy into firm ownership

network.aia.org/blogs/david-richards/2016/09/07/how-to-get-your-millennials-to-buy-into-firm-ownership

By J. Tim Griffin, MBA, PE, LEED AP, Consultant, PSMJ Resources

While current baby boomers are looking to retire, few Gen Xers are ready to take over the reins. Because there's not a lot of them, trying to transfer your firm to Gen Xers is going to be difficult. And if you are planning ten years down the road, you are thinking the following generation, i.e. millennials. In fact, front-edge millennials are now just coming into the heart of their careers where they can really push a business forward. And so the question arises, how do millennials view A/E firm ownership? What are their reactions when approached with such an offer?

There are no simple answers to these questions as millennials come to the workplace with completely different expectations than today's retiring baby boomers. This is a big concern of the principals I work with across North America. There are a lot of baby boomers who started and own A/E firms and need to transition out. Yet, they are having difficulties finding millennials that want to step up and take over.

Millennials value work-life balance

One of the biggest challenges has to do with the value millennials consign to work-life balance. As a result, they often show a resistance to the owner/partnership track, which has been a core part of our business forever. It took time to figure out why, but this dilemma can be attributed to nothing less than the overprotective and goal-oriented parenting received by this younger generation.

If you think about it, when they were babies, their parents were trying to get them into a great kindergarten, so they could get off to a good start. In elementary school, they were told, "If you work really hard, you'll get into all the advanced programs in high school. And if you take all these advanced courses in high school, and do all these extracurricular activities, then you'll get into a great college."

And when they get into a great college, they are told if they work hard, get great grades, and do lots of extracurricular activities, then they will get a great job. And finally, they come into our firms, and are told, "If you work hard and sacrifice for twenty years, you can be a partner just like me, and you'll be set." Their response is "I think I heard this story before, and I don't buy it anymore."

The other problem is that boomers do a terrible job selling firm ownership. Millennials look at the boomers with dark circles under their eyes, stress lines everywhere, and families falling apart because they are not spending enough time at home. And so the millennials say, "I don't know if I really want that life."

Millennials are risk averse

Furthermore, any idea of loyalty to an employer was broken in their parent's generation, where there were massive layoffs in the Great Recession. So millennials don't buy the idea that "if I put my head down and work hard for an employer, they will take care of me for the rest of my life." They think it's a lie.

There are a lot of forces working against millennial's interest in firm ownership. In addition to distrust in the process and an aversion to sacrifice, there is also the financial element. A core of millennials graduated from college during the Great Recession, so they are risk averse when it comes to investment.

For one, millennials are disproportionately not in the stock market. Also, their debt load is very high due to student loans. So when you ask them to take ownership of a business, and buy in, they just don't have the financial wherewithal. If it's going to happen, firm leaders need to come up with a smart plan to transfer ownership over time.

Another financial challenge in trying to bring early-stage millennials into firm ownership is the fact that many have kids and need to save for their college education. They don't have a lot of free cash. If firms can help them get financing, and it will not impact their day-to-day budget, it is very attractive.

Smart firms that have an ownership transition plan usually include some financial help with the buy in. It's not discounts on the value; it is loans from the firm's bank, and a plan that will show that their investment is going to earn more than enough to pay off that loan.

If you bill it over time, it is very easy to do. A well-run architecture firm is a profitable investment. But you have to communicate that to your millennials, so they understand it from an investment standpoint and know what it means for them financially, so they don't just think you are asking them to get a loan so you can retire.

Millennials need leadership training

While financial help can make it easier for millennials to move toward ownership, successful transition cannot happen if firms do not engage in training their future leaders. That means identifying stars early in their careers by putting them in situations where they have the opportunity to thrive. Here are some guidelines to help you maximize the generational forces in your firm as you start to move toward ownership transition:

1. Call upon boomers to resume their youthful role as change leaders. Now is the time to abandon hierarchical norms, sink-or-swim management, and one-size-fits-all career paths.
2. Prepare Gen Xers for supervisory responsibility and leadership roles. Gen Xers are now entering their prime working years in short supply and full of attitude. Xers want status, authority, and rewards, but often resist traditional management roles. Create new paths to leadership, redesign leadership roles, and develop the new generation of leaders for those roles.
3. Accelerate the professional development of millennial employees. Recruit new employees at younger ages, get them up to speed faster, and trust them with important roles involving critical tasks and responsibilities. There's no choice; there won't be enough older experienced workers to get all the work done. Teach managers to coach these seemingly high-maintenance younger workers through every step.

Also, millennials are an impatient generation when it comes to advancement. They feel that after a few years out of school they should be the CEO of the company. So there needs be a lot of interim steps in their career advancement. It's too long to say, "You will get there in five years."

Emerging leaders not only need to understand technical skills, but also how the business works and the leadership skills they are going to need to be successful. It is essential to have a leadership development program that is formalized within your organization. By doing so, firms encourage their best stars to stay by investing in them. They also attract potential stars who want that type of training. Since very few firms are doing this, it is a powerful recruiting and retention tool.

Millennials want to see a career path

And finally, firms need to develop a realistic and well-thought out ownership transition plan. It takes ten years to do an ownership transition right—with people selling out and people buying in—and everyone happy with how it works out. So it is very important that the generation that wants to sell out have realistic expectations on the age that they will exit.

I have spoken to firm owners all over North America, and the consistent theme is “I am going to retire in five years.” And five years from now, they are still going to retire in five years. That drives millennials nuts.

If you want to do an ownership transition, the right time to do it is around social security retirement age. That’s the time to step back and let others people step up. It is those folks in their 30’s and 40’s who are going to have the passion to really move your firm forward into the future.

J. Tim Griffin, P.E., MBA, LEED AP has published numerous management articles and trained hundreds of design firm principals across North America in the best business practices. In addition to his work as a PSMJ consultant working with A/E firm leaders to develop the full potential of their teams, Tim is a Partner and Branch Manager with RMF Engineering, Inc., an engineering consulting firm that works internationally. He is the author of the top-selling book, Winning with Millennials, which addresses the challenges of integrating new and young talent into today’s architecture/engineering firm.

(Return to the cover of the 2016 PM Digest: Ownership Transition)

Designing an effective leadership development program

network.aia.org/blogs/david-richards/2016/09/07/designing-an-effective-leadership-development-program

By Stephen Epstein

Leadership is a hot topic and for good reasons. Due to rapidly shifting demographics and an expanding economy, firms that provide architectural, engineering, and other professional design services are struggling to fill a growing leadership vacuum. The good news is that an effective leadership development program can help firms fill this vacuum while creating tremendous opportunities for baby boomers, Gen X'ers and millennials.

Shifting demographics

In the U.S., over 10,000 baby boomers reach retirement age every day. "Boomers" are increasingly focused on the critical and immediate need for future leaders; however, within the design professions there is a dramatic shortage of fully qualified successors. The recession of the early 1990's and subsequent economic cycles caused many future leaders to leave the profession and the Great Recession of 2008 diluted another generation of talent.

The silver lining is increased access to significant leadership opportunities for emerging professionals. To capitalize on this opportunity, current leaders must facilitate leadership development through targeted training, active coaching and refinement of their own leadership and coaching skills.

Younger boomers and Gen X'ers are at the front of the line to assume leadership responsibility; however, their careers have typically focused more on getting and doing the work, and less on running a business, thereby limiting leadership development opportunities. These dedicated and seasoned professionals must quickly fill an expanding leadership gap, making training an urgent priority.

According to Deloitte's 2016 Millennial Survey, for the first time emerging professionals in the 20-35 age range represent the largest segment of the workforce. The survey indicates that two-thirds of millennials expect to leave their current jobs within the next few years. Inadequate leadership training is cited as a primary factor contributing to this lack of loyalty with 70 percent of millennials dissatisfied with how their leadership skills are being developed.

A new emphasis placed on leadership training

When evaluating an existing position or a potential career change, millennials rank opportunities to progress and become leaders as one of the most important factors. In addition, those currently positioned to assume leadership recognize the immediate need to acquire new skills. It is clear that leadership training must be an integral part of a firm's talent retention policy. Current leaders need to identify a stable of candidates with leadership potential and implement a training strategy that accelerates their advancement.

Designing an effective leadership development program should include independent study, collaborative learning, mentoring and coaching, and professional training. When combined, these learning approaches form the basis of a lasting leadership development culture.

Independent study

Design professionals are highly educated and adept at learning, but a design-focused education is typically void of advanced leadership theory. Over the past few decades, a considerable body of leadership research has developed. Emerging leaders must invest the time to assimilate the information that is most applicable to their situation and apply what is learned to daily practice. Elevating a complex skill set like leadership requires periods of intense personal exploration.

Independent study opportunities include:

- Establishing and prioritizing a list of research topics, for example:
    - Self-leadership techniques
    - Workplace behavioral science
    - Management vs. leadership
    - Change management
    - Leadership communication
    - Business sector and typological expertise
    - Finance and business operations
    - Profitability and efficient project delivery
- Writing and referring to a “lessons learned” outline for each topic
- Drafting six-month study plans with specific learning objectives and a detailed schedule
- Committing to reading an article every week and a book every month
- Studying and modeling leadership behavior from within and outside the design community

Collaborative Learning

Operating a business, leading clients and project teams, and designing and delivering responsive projects require effective collaboration. Seasoned professionals have learned to be highly skilled collaborators, and millennials enthusiastically embrace collaboration. These characteristics can be leveraged to bring about potent learning experiences that foster a sense of urgency, comradery, healthy competition, and incentive to achieve common goals.

Collaborative learning opportunities include:

- Seeking diversity in learning partners
- Establishing collaborative learning relationships at all levels of the organization
- Demanding both personal and group accountability
- Creating opportunities to write with others, e.g. marketing materials, project briefs, business letters, articles, blogs
- Attending lectures and training seminars with learning partners and discussing conclusions
- Sharing articles and books with colleagues, and discussing how concepts relate to current workplace situations
- Seeking advice from colleagues related to specific leadership issues that arise in daily practice
- Debating difficult issues
- Developing collaborative forums and groups of learning partners outside of your organization

Mentoring and Coaching

Mentoring and coaching, while complimentary and essential components of an effective leadership development program, serve distinctly different purposes. Mentoring focuses on building relationships through general professional development dialogue. It is essential for long-term personal and professional growth, and for ensuring a healthy professional culture. Coaching focuses on specific performance improvements within a fixed time frame that achieve targeted results, initiate change, and cultivate undeveloped potential.

Mentoring and coaching opportunities include:

- Providing mentors, coaches and trainees with adequate process training
- Recognizing that even the most senior of current and future leaders will benefit from mentoring and coaching
- Creating committees that evaluate individual needs, solicit coaching requests, and establish mentoring pairings and coaching assignments
- Identifying individuals that would benefit from external professional coaching
- Requiring written coaching plans with clear objectives and timelines
- Conducting regularly scheduled mentoring/coaching meetings

Professional Training

There is a broad range of options available in the field of leadership training. Executive-level courses in leadership and related fields of study are offered by well-respected institutions. Also, there are numerous seminars, webinars, and training videos available. Consultants with extensive A/E industry experience are uniquely qualified to provide relevant training with immediate and long-term results. Professional training is an efficient, focused and cost-effective learning approach.

Professional training opportunities include:

- Developing long-term relationships with A/E industry strategic advisors
- Attending institutional executive courses like Harvard's Professional Development Programs
- Leveraging online tutorials, webinars and training videos including industry-specific providers
- Conducting and attending in-house workshops
- Working with professional executive coaches
- Retaining one-on-one professional career coaches for emerging leaders

A Bright Future for Leadership

As leaders develop and communicate a compelling vision of the future, they motivate others to implement that vision. The same can be said of design professionals, but within a different context. Design professionals are, by nature and by training, critical thinkers and creative problem solvers. Given the opportunity to acquire practical knowledge and develop crucial behavioral skills they can fill the leadership vacuum by becoming inspirational and effective leaders.

Stephen Epstein is a strategic advisor with Strogoff Consulting, Inc. Prior to joining Strogoff Consulting, Stephen was a Principal with an award-winning national architectural firm where he led the financial, operations, human resources, and project performance initiatives. Stephen can be reached at Stephen@StrogoffConsulting.com or 310-694-7991.

(Return to the cover of the 2016 PM Digest: Ownership Transition)

The challenge of internal transition in today's A/E arena

By Brad Wilson, Senior M&A Consultant, PSMJ Resources

Summary

If you are a firm leader looking to retire, ownership transition is probably forefront in your mind. Looking at internal sales of stock ownership, processes, and partnership agreements, however, much has changed since the 2008 downturn. Generational forces at work in today's architecture firm present a major challenge to effective ownership transition.

Thus, as a firm leader, you must do more than consider new or revised terms in your buy-sell agreements. To be successful, you need to start grooming your successors long before you decide to take your exit.

Today's perfect storm

Internal ownership transition has become one of the most difficult things to do today. In fact, we have just run into what could be called the "perfect storm." The number of baby boomers who own shares in the architectural industry and want to get out is at an all-time high. It is going to get higher yet, but it is peaking with the current demographic of firm owners.

While current boomers are looking to retire, however, few Generation Xers are ready to take over the reins, and the following generation—millennials—have different expectations. Also, many of these younger folks coming up the line are still shell-shocked from the recession. They saw themselves and all their friends get laid off. Also many—and I hate to generalize this—have an entitlement attitude. They expect to be given the ownership; that, in effect, they have already earned it by being a good employee.

Because of a reduced demand for shares inside the firm, there are not a lot of buyers out there for internal ownership. And, of course, this doesn't fit with the retirement plans of the Baby Boomers, many of whom are behind schedule because of the losses they incurred during the recession. And so, when you combine a pressure for value with the fact that the younger folks don't want to pay, the result is nothing less than a logjam.

Deep discount vs. external sale

We see a big separation in valuation between what a seller—who owns shares and wants to sell—can get from an outside firm versus what they could possibly get with a discount sell to an internal shareholder. Also the difference between internal and external sales has become much starker. We used to see a 25-30 percent discount from an external to an internal sale. Now we are seeing double that, at least a 50-60 percent difference between what firms could sell themselves for externally versus internally.

It gets down to what the outside buyers are willing to pay versus what the inside buyers can afford. Sellers are looking at the situation and saying: These younger folks seem to be hard workers, but they have an entitlement attitude and they don't have any money. And I can get so much more if I sell outside, why wouldn't I do that?

Firm leaders, however, should not assume that an external sale is always a good fallback position. There's a good chance that the younger folks would not come along in a sale. For sellers to be able to deliver firm value, they have to be able to bring their key staff with them. And so, the process is circular: it runs right back into itself.

To say it another way, retiring baby boomers must consider how an external sell would impact firm culture. Moving from an internal to external sale greatly increases the influence of money on your decision. If you have operated a practice-centered business for a generation, and then all of a sudden you need to get the place ready for an outside sale, you are now money-motivated.

Thus, when you change to a business-centered practice to make more profit, the firm falls apart. The middle management does not get it: They joined and stayed at the firm because of the way it operates. You might be able to turn a screw here or tighten up a bolt there, but the culture turns very slowly even in a small firm. Making the switch from an internal to an external focus requires whipping your firm into the opposite direction, and it’s likely that your employees will not come along.

ESOPs find new popularity

Employee stock ownership plans (ESOPs) have become more popular. They’re less overhead burdensome then they used to be and less expensive to set up. Some firms put an ESOP in place as a last resort for ownership transition. They think: “We don’t want to sell to a big firm and we can’t sell internally, so let’s do an ESOP as a fallback position.”

The problem is that an ESOP comes with a cultural change. And firms often don’t understand how an ESOP shifts the culture of the firm into one where everybody is now an owner. Sometimes firms prep for that and do some lead-up. If firm leaders talk it up and become more open book, than the firm may not change in bad ways.

But generally, our view has always been that you can’t make people act like owners just by giving then stock. People need to act like owners first, and then an ESOP might be a good solution. You can’t do it in reverse.

Financial planning for ownership transition

Many firms want to stay independent. Their owners say: “I don’t want to or I don’t think I could sell to an outside firm, and I don’t want to stick around here very much longer. I have to do whatever it takes to make this go.” And so, in order to induce the younger folks to buy, buy/sell agreements are becoming much more negotiated in the favor of the buyer. This includes much more financial assistance to the buyers, reductions in valuations for the firm for internal transition, and less-restrictive non-compete clauses.

The other thing firms are doing in the good economy right now is finding ways to maximize profits, and then increase the distribution to the owners as much as possible. If you can absorb the discount to keep the firm independent and give it to the next generation—and you can sell it at a value they are willing to accept—that’s great.

Prior to that, however, the firm would have had to set up an earnings club, i.e. where as much profit as possible is distributed each year to the shareholders. You have to maximize that for a few years, and then hand it off to the next group of leaders. Maybe they are prepared to handle it or maybe it’s the death of your firm. You never know, but as the baby boomer, you have your money at that point. Firms interested in staying independent in this way need to begin planning at least 10 years in advance.

Time to invest in young entrepreneurs

We also find that firm owners often turn to an outside sale as a fallback position because they have not done any leadership development or mentoring. In about 4 out of 5 assignments that we do, the owner wants to sell internally, and finds out that he can't.

So if you're considering an internal sale, start by investing in your younger employees now. Grab your top two entrepreneurs and train them up. This means investing in your people even before you consider an ownership transition.

If you want to have the choice of selling internally, you need to grab people early in their career and invest in them. Find someone you know who has 6-8 years before they're ready for ownership. Provide them with management and business training. Make sure they understand all of the services you offer and all of the types of clients you serve. The goal is to give them a broad base of experience, and not let them get pigeon-holed.

It is by sharing information with your entrepreneurs—showing them the way the firm operates, how much money it makes, and how much money it costs to keep the place open—that you begin to generate an ownership mentality. This should be job number one or you are not going to get out the way that you want to. You are multiplying your choices the more time you spend with your young entrepreneurs.

Then, if they choose—their eyes are completely open and they have complete understanding of the challenge, that's great. And if they choose not to buy—because they don't want it or their situation doesn't allow—then you have the opportunity to say: "We gave you the chance. Now we have to sell externally because I am 65 and not getting any younger, so are you sure?"

If you have been down that path, an external sale is the best scenario, and is the way the transition has to be managed. It is all about not letting yourself get painted into a corner. Don't wake up some morning at age 64 and say "I want to retire in a year, so I better do something about it." That's the worst case scenario because you will never catch up.

The interest in selling firms internally is probably at an all-time high, and is going to continue to increase as the baby boomer generation works its way out of the A/E industry. Some firms prepared for this, have done it well, and were ready. Still, the number of external sales versus internal sales has really gone to the external side in the last couple of years. Father Time is ticking away on them, and retiring firm leaders have to do something.

Checklist on general principles of ownership transition

You need to take every opportunity to prepare yourself before you make that big leap. So get to work on this ownership transition checklist today!

_____ There is no single one right way to do an ownership transition.

_____ To keep talented people, you need an ownership transition plan.

_____ Consider internal transition before you look outside.

_____ Preparing your successors is one of your major leadership responsibilities.

_____ The firm has to fund an internal transition.

_____ Know whether you're creating a culture of empowerment or a culture of control. This will affect all aspects of your transition plan.

_____ Ownership is not leadership.

_____ The next generation of leaders should have a personal financial risk in the firm.

_____ Plan everything. Don't leave anything to chance.

_____ There's no such thing as "equal partners."

_____ Remember the rule of thirds: one third of revenues should go into retained earnings, one third to employees, and one third to the principals.

_____ Build your plan on actual revenues, not the assumption of increased revenues.

_____ Understand the value of your firm: it's worth only what someone is willing to pay for it.

_____ No company should be liquidated. Any firm can be sold.

_____ Review buy/sell agreements every two years.

_____ Don't get lawyers involved until you've already decided what you want to do.

_____ Make sure lawyers and accountants understand that your assets are your people.

_____ The ultimate transition question for an owner who's leaving is: What are you going to do after you sell?

Brad Wilson joined PSMJ Resources, Inc. in 2002 as one of the senior Mergers & Acquisitions consultants. Since, Brad has facilitated both the purchase and sale of A/E/C firms of all types and sizes. Brad's hands-on assistance with valuation and deal structuring has allowed many PSMJ clients to achieve their strategic growth goals or their ownership transition through a merger or acquisition. His broad-based knowledge of design firms' cultures and operations has also been invaluable in integration planning and execution resulting in the achievement of financial goals for buyers and sellers. Additionally, Brad regularly facilitates PSMJ's CEO Roundtables on Mergers & Acquisitions.

(Return to the cover of the 2016 PM Digest: Ownership Transition)

Staying independent: transitioning to the next generation?

network.aia.org/blogs/david-richards/2016/09/07/staying-independent-transitioning-to-the-next-generation

By David S. Cohen, Esq., ASA

Anecdotally, merely about one-in-three founder(s) are able to transition their ownership to the second generation and only one-in-ten make it to their third generation. The remaining nine firms either decide to close up shop or find an external transition plan by becoming a part of another firm through mergers and acquisitions. So how do you create a firm ownership transition program that would facilitate you to be one of the 33% and then one of the 10% to stay independent? The following is what we are hearing at seminars, conferences, and from our clients about where the challenges are and how to resolve these items to create a successful ownership transition program.

Plan early

First, there is no such thing as starting your ownership planning program too early. It typically takes about ten years to transition 100% of the firm by utilizing the company's cash flow while continuing to re-invest in the business and following through on the strategic plan. As such, it is unreasonable to think that you will be able to transact 84% of ownership in the firm with a window of a three year retirement timeframe, while receiving a market level of value. In order to accomplish such a task, something would have to give, either the timeframe or the value at which you are willing to transact your shares. There are still so many firms out there who continue to wait, with the belief that the major shareholder can simply sell all of their stock back to the firm when they retire and walk out the door.

A program that would facilitate the example provided above would create a tremendous legacy cost (a cost associated with someone who is no longer with the firm) and risks for all parties (including the company) involved. We are seeing a trend where the next generation of buyers are saying "no thank you" to the idea of this type of legacy cost (another example of a legacy items would be a deferred compensation program).

Buyers typically like the selling shareholders to transition their ownership while that person is still working at the company and contributing to generate the revenue and profits that will be utilized to fund and finance the transaction. They are not interested in working for the next seven-to-ten years only to have most, if not all, of the company's profits be utilized to pay off a promissory note to the retired shareholder. And the risk, for the seller, is that the note payments aren't made and that they would have to come back to the company. Typically, the most successful transactions have the bulk of the stock paid for before the shareholder retires.

Setting timeframes

Why are the shareholders so apt to hold on to their stock so late in the game? Part of the rationale for these sellers for holding on to their ownership is that we are seeing a trend of owners planning on working longer. Retirement timeframes are increasing with life expectancies and an emphasis on maintaining healthy lifestyles. Furthermore, the world of design is a "calling", and many who practice in this industry see it as part of their life and do not view it as work. It is not about ego, or not just about ego, but this profession has a way of defining a person.

However, firms need to keep the ownership transitioning within reasonable timeframes. We are seeing more and more, shareholders' agreements with divestment age clauses governing when a shareholder has to start selling their shares. However, there should be no forced retirement. In fact, many of these clauses allow a shareholder to hold some percentage of their shares until they are ready to retire. The remaining percentage helps them stay connected and continue to drive shareholder value while, at the same time, not creating too much burden for when they do decide to ride off into the sunset.

Incentives and valuation

With the timeframe in mind, the next step is creating an incentive for the shareholders who are getting closer to retirement to begin to sell their shares earlier. This is where valuation comes into play. If your firm is relying on book value and the shareholder return is based on annual profit distributions/dividends/bonuses, then there is very little incentive for these shareholders to sell their shares earlier as there will be a dramatic impact to their annual compensation. But if you are relying on a market valuation for the stock, which could be 1.5 – 2.5 times your book value, this higher valuation drives greater capital gain returns for the shareholders giving them an incentive to begin selling down earlier.

The stock has to be a dual-fold investment where there is both appreciation in the stock price and annual yields to shareholders. If all the value is tied to the annual yield you run into the disincentive to sell shares, or if all of the value is tied to the stock price, the investment becomes a retirement benefit only, which is not of interest to the next generation and their continuously increasing annual cost of living expenses.

However, it is imperative that this market value is based on a reasonable multiple of cash flow as it is the cash flow that will support the transaction. A complaint that we often hear from the buyers is that the stock price is too expensive. Thus, any transactional value must relate to how profitable the firm is after normal operating expenses, including retirement plan contributions and performance-based bonuses. It is the remaining free cash flow that will be available to fund the ownership transactions.

In addition, it has to be made clear to the buyer that the investment is not one that is meant to be completely painless. There should be some “skin-in-the-game” and if it takes the buyer three or four years to pay for their stock, it should be viewed as reasonable from an investment perspective. If the stock is too easily purchased or given away, then there really isn’t an investment decision on the part of the buyer and this will create a disconnect between ownership, leadership, and motivating shareholder behavior.

Conclusion

It is not always the easiest path to follow, but it can certainly be rewarding to transition your firm from one generation to the next. If you balance the goals and objectives of the sellers and buyers against what the company can afford, taking into consideration timeframes, cash flow, and the number of buyers being included in the process, you will improve your odds of successfully transitioning your firm and remaining independent. The examples and the issues presented above are certainly not applicable to every firm or situation and we work with our clients to formulate a plan that is catered to the firm’s specific ownership transition needs. Please feel free to reach out to me if you have any questions or anything to add.

David Cohen is a Managing Director with Matheson Financial Advisors, and the firm specializes in business valuations, ownership transition planning, ESOPs, and mergers and acquisitions as part of exit strategies and strategic plans. They also conduct seminars on these financial management topics for design industry organizations, as well as leading in-house educational programs for firms nationwide. David can be reached at *dcohen@mathesonadvisors.com or 508-655-9700.*

(Return to the cover of the 2016 PM Digest: Ownership Transition)

Choosing the best ownership transition strategy

By Clark Davis, FAIA, and John Bierly, AIA, September 7, 2016

If your firm is committed to long-term success, you'll need a plan for the future

Architecture is an intensely personal profession. Most practices are formed around individuals or partners who share a common passion for their work, and many don't survive beyond their first-generation leaders because no one took the necessary steps to create long-lasting firms.

What is your firm's life expectancy? Are you committed to a future beyond your current generation of ownership? If so, what are you doing about it?

We see these challenges in firms of all types, sizes, and locations. There are countless good architecture practices that are led by baby boomers now in their sixties; some have made plans for ownership and leadership transitions, and some have not. Those who haven't need to consider the options available.

Ownership choices

There are three basic alternatives for firm ownership transitions: internal ownership transfer, employee stock ownership plans (ESOPs), and sale or merger of the firm. Typically, the biggest benefit economically comes from a sale, followed by an ESOP, and then an internal transition. There is an inverse relationship, however, when it comes to firm culture, and owners need to assess their priorities when selecting their approach.

Internal transfer

The great majority of architecture firms are privately held, either as partnerships or corporations. It's common for a senior generation of owners to sell their interests, over time, to younger principals identified as future leaders. Leadership and ownership are like opposite sides of the same coin: both must be addressed when strategizing to build something that'll last.

Internal sales require willing buyers: next-generation principals who are committed to a firm's future, have the right leadership skills, and possess the means to invest financially in ownership. New partners or shareholders may be willing to borrow money to buy in, but they must be able to provide adequate salaries and bonuses to support their investments. This demands that the firm be profitable and consistent in financial rewards for its principals and staff.

Employee stock ownership plans

ESOPs are often created to redeem the ownership interests of senior principals when there isn't sufficient capital available from future leaders. An ESOP also generates a broad base of ownership across a firm's entire staff, giving everyone a "piece of the action." ESOPs typically hold 30 percent or more of a firm's ownership in order to maximize tax benefits to the sellers. Most consultants feel that a firm needs to have at least 50-60 employees for an ESOP to be feasible.

> *What is your firm's life expectancy? Are you committed to a future beyond your current generation of ownership? If so, what are you doing about it?*

An ESOP is usually set up with outside financing used to buy the senior principals' ownership shares; the firm then becomes responsible for paying off the debt through an ESOP trust. Again, this demands a firm be consistently profitable in order to meet the debt obligation. One or more ESOP trustees will also have a long-term role in the firm's governance, usually as members of its board of directors.

External sale or merger

Mergers and acquisitions take place throughout the AEC industry, with consolidation benefiting both sides of the equation. Like an internal transition, an external sale requires a willing buyer and a practice offering itself up to be acquired. A "selling" firm may not have the market position or future leaders required to succeed on its own, but ideally there will be strategic synergy and value for both parties.

What's your firm worth?

The economic valuation of a firm is a factor in any ownership option, but it is essential for any external sale or merger discussion. Architectural practices have limited physical assets, so a firm's value is based largely on its backlog, revenue, profitability, and receivables for work already completed and invoiced. "Book value" is a common valuation method, representing the actual cash value of physical assets and receivables less accounts payable. In our experience, firm valuations follow a "bell curve" pattern where 1.00 represents book value. Some firms adopt very nominal share valuations, and some use significant multiples of book value.

Six steps to making your firm last

Here are the basic steps that any firm should take to prepare for ownership transition:

- **Start now**. Many firms wait until it's too late and their options are severely limited.
- **Maintain a profitable practice**, as required for any transition beyond a "fire sale" of the firm's assets.
- **Assess your internal leadership and ownership candidates**. Are they ready and willing to step up? If not, what help do you need in developing your people?
- **Adopt an overall transition strategy**. Choose between internal sale, ESOP, or external sale of the firm. This will focus your efforts and your messages to key stakeholders.
- **Develop a "road map" and financial plan** for the transition, including shareholder agreements and other important legal documents. Ask for help.
- **Communicate your plans to your clients and your staff**. Today's talented young professionals want to know how their firms work and what future leadership and ownership opportunities await them.

Clark Davis, FAIA, leads Cameron MacAllister Group's services in strategic positioning, practice management, organization, governance, and leadership development. Contact Clark at davis@cameronmacallister.com.

John Bierly, AIA, joined Cameron MacAllister Group to help clients achieve strategic growth of their practices; he currently leads the group's work related to ownership transitions, mergers, and acquisitions. Contact John at bierly@cameronmacallister.com.