Safe Harbors

a case study on end-game strategies
by Peter Piven, FAIA

As a result of my work with design professionals since the recession, I realized that there is a new way of dealing with ownership transition that can benefit some principals who face difficulties in achieving successful exit strategies. This is a case study around a composite firm that describes the situations and concerns that principals faced, and how they were resolved.

<u>The firm</u>
Alan Able and Bruce Baker formed *Able Baker Architects*, as equal partners after working together in other firms for several years and securing their registrations. Initially working on residential and small commercial projects, they managed to secure commissions for small, infill retail spaces in shopping centers. Regular contact with shopping center developers and managers allowed them to become knowledgeable about the project type and how they were developed and managed. They parlayed their relationships and experience into complete shopping centers, movie theaters, and other large commercial projects.

The firm grew and prospered, benefitting from the economic growth in the country in general, and the growth in large commercial developments in particular. Abel and Baker realized the importance of expanding the ownership to maintain an appropriate principal/staff ratio to prepare for eventual ownership and leadership transition and eventual succession. They created criteria to evaluate staff members, identified several as viable candidates, brought them into ownership at modest levels, and began a process of leadership training and mentoring. All was well … until it wasn't.

As money for large, commercial developments became scarce during the recession, almost all the firm's clients stopped work on projects, regardless of their degree of completion. Accounts Receivable became uncollectible. The firm used its cash reserves to keep the firm afloat, but eventually reduced staff, starting with the new owners and extending down through the firm. Equity evaporated. As they were approaching retirement age, Abel and Baker chose to remain in practice with a small staff to try to rebuild the firm and its equity.

The economy recovered, but slowly. Although the partners were successful in securing new commissions, the firm suffered because they had lost the experienced architects who had shouldered the responsibility to execute and manage projects, and the partners were getting and feeling older. They needed an exit strategy and began to consider their options.

<u>Options</u>
The owners/leaders of design firms anticipating eventual transition of ownership and leadership can consider several options. They can elevate from within, bring in a leader from outside, merge with an approximate equal, become acquired by a larger

firm and, as a last resort, liquidate. All are valid but all rarely are appropriate for any one situation.

Elevation from within would allow Able and Baker to maintain control, salary and perks, continue the firm with people who had become inculcated in the firm's culture and processes, and assure themselves of a reasonable financial return. Unfortunately, they no longer had capable and trustworthy staff in whom they were confident, nor enough time to train and mentor them to improve their ability to be viable successors.

Bringing in a leader from outside would provide an opportunity to continue the firm if the transfer was successful, and might provide redirection and rejuvenation of the firm. Abel and Baker might have considered this option seriously if they had relationships with people they thought would work. However, they perceived several disadvantages that dissuaded them from considering it – the risk associated with unknown personalities, the need to share information and governance with a newcomer, the high levels of compensation and perks that might be required to attract such a person, and the possible need to redirect the firm's marketing and projects.

Merging with a firm of comparable size and compatible objectives would provide for the continuity of the firm, albeit in a new configuration, and would permit the owners eventual retirement and return of capital. Able and Baker briefly considered this option, but were concerned about working with new partners in an unknown and untested relationship, and sharing governance and control, particularly on matters of finance and marketing.

Acquisition was a possibility that would allow the partners to continue practicing their profession, functioning at principal levels with reasonable compensation and benefits, at least for a few years. Although Abel and Baker would have to relinquish control and live within the acquirer's financial and cultural framework, the probability of a higher return on equity was enticing, so they began to seek potential acquirers.

Liquidation was a last resort, if no other reasonable solution was available or desirable. Although they would maintain control up to the point of liquidation, maintaining compensation and perks as long as they were sustainable by the business, the partners were concerned about their ability to reduce expenses as revenues dwindled. They also faced the likelihood of staff defections along the way and, very important, the likely significant negative impact on the firm's accrual basis book value.

<u>Consultation</u>
We helped Abel and Baker identify firms that merited further exploration as acquisition candidates, contacted those firms to determine interest, and then arranged discussions to explore possibilities. In that exploration, Abel and Baker found a firm that was interested in them and offered a ***safe harbor***. In its broadest sense, *safe harbor* is defined as "any place that offers refuge or protection." (Random House Dictionary, © Random House, Inc. 2017) For Abel and Baker, the safe harbor was a

Larger Firm that was interested in acquiring Abel Baker's principals, personnel, projects and prospects **without acquiring the firm itself or paying for it.**

<u>Benefits</u>
Abel and Baker merged their practice into the *Larger Firm,* which assumed responsibility for Abel Baker's salaries and benefits going forward, and for completing Abel Baker's projects in exchange for the fees remaining on them. Able Baker kept their cash, accounts receivable and accounts payable – essentially 100% of their equity. They assumed principal-level responsibilities with principal-level compensation, benefits, schedules and retirement provisions. They continued practicing their professions, with their staff, in the same place, with more administrative support, and with secure retirement in place. They were able to maintain relationships with their clients, assuring the completion of their projects, and with their staff, assuring that they would be able to complete the projects on which they had worked so hard. At the end of the day, Abel and Baker transitioned the firm in a creative way that made sense for them.

The *Larger Firm* acquired principals and staff at a time that experienced and talented professionals had become increasingly difficult to secure. *Larger Firm* also widened its reach with a new geographic location, and deepened its market penetration with new projects and relationships, both at virtually no cost.

<u>Observations</u>
Recessionary periods put additional stresses on firms beyond those of diminished workload/revenues.

- Overall strategies need to be adjusted to reflect and address probable reduction in size and volume, rather than the growth that may have been originally anticipated.
- Endgame strategies – the means, timing, scheduling and amounts planned for the divestiture of the current owners – should be reconsidered and adjusted to meet the exigencies of the changing times.
- Consideration should be given to maintaining an appropriate range of staff experience, not only to be able to properly address workload needs, but also to provide an opportunity to transfer ownership and leadership to professionals in the next generation.
- It is important to think about and plan for the future, especially if the present is troublesome.

Win-win solutions are possible, regardless of whether they are planned or anticipated. Good results are possible and are especially rewarding when they are achieved.