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Making Your Exit: Succession Planning for Private Equity Partners

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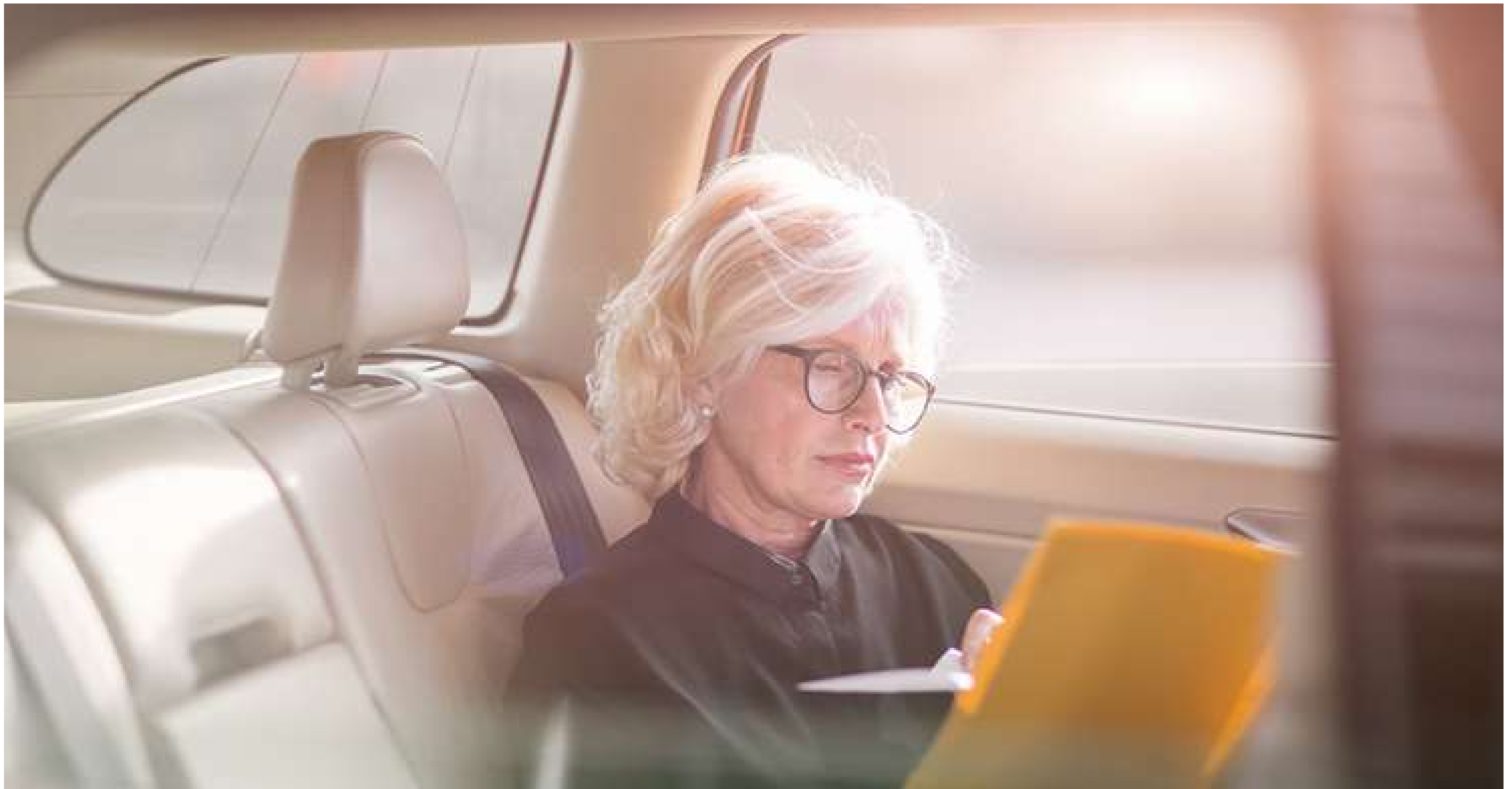

Successful succession planning is, regardless of industry, rarely simple. The nature of private equity, however, adds additional elements of complexity into the mix, from long investment life cycles and illiquid assets to the specialized roles partners play within their own firms.

With many industry professionals of the baby boomer generation pondering life after private equity, now is a critical time for firms to consider their succession planning strategies.

Here are a few important factors to consider as you unwind ownership in a partnership or management company and plot your own future course.

Don't underestimate the challenge

To be sure, the long life cycle of private equity funds — anywhere from seven to 12 years, sometimes longer — requires advanced planning. Similarly, placing a value on an equity interest in a management company or on future carry proceeds can be difficult. It is not uncommon for retiring partners to hold differing opinions on valuations. Even valuation consultants may have disparate views.

Additionally, the brand value of and firm-level goodwill attributable to the retiring partner should be considered. Some partners, for example, may have key relationships with limited partners or may possess specific expertise or networks in a particular industry.

How does that retiring partner transition those relationships? Should they stay involved as consultants? If Partner X is not with the firm tomorrow, how does that impact the firm's ability to continue investing and raising new capital?

These aspects of a succession plan are often underappreciated and overlooked. Indeed, limited partners may see the departure of a key partner as a red flag. And even if there is a clear successor in place, the impact can still affect many stakeholders.

As private equity professionals and their respective firms grapple with questions of valuation and shifting responsibilities, they need a plan for a successful transition. Many firms address transfer of ownership in the operating agreement, but it is not always black and white. Some options may include:

- Transferring ownership in the management company gradually as part of the overall compensation of junior partners and employees
- Selling ownership interest outright to remaining partners, including potential financing options
- Setting up a new management company to segregate the existing partnership structure from the new one

Regardless of approach, partners will want to understand how these decisions will impact their own finances, including potential tax implications.

Start early and seek outside expertise

Private equity professionals often assume their experience structuring deals easily translates to their own journey.

Just as race car drivers do not necessarily make the best mechanics, a private equity partner should not assume that they can structure their own exit without outside advice.

While every situation is different, structuring a sound exit will likely entail working with attorneys and advisors who have specific expertise in succession planning. An experienced mediator can also prove essential in helping partners agree on such potential sticking points as valuation, terms and the future role of a retiring partner.

Advance planning is crucial. Given the long-term nature of private equity, it may take several years to structure a successful exit. For example, it is not uncommon for a succession plan to span more than one fund. A partner may see a current fund through its investment period then work in an advisory capacity on exiting investments or raising subsequent funds.

If possible, make succession planning a part of regular strategy discussions and revisit it at least annually. This may include appointing someone at the firm to help develop best practices and establish a playbook for exiting partners. Going forward, such a playbook can help simplify the process and minimize the potential for disputes and

disruptions to the business.

Lay the groundwork for a smooth transition

Private equity professionals know all too well that the difference between a difficult and smooth transaction hinges on execution. The same can be said with regards to succession planning — retiring partners should not underestimate how disruptive a transition can be for their fellow partners and junior members of their team.

Once partners have worked out the big-picture details of an individual exit, it is essential to map out the details. This includes drafting a timeline and action plan covering all elements, such as when and how roles will shift as well as who will assume certain key responsibilities. Such a plan should include the firm's communication strategy for appropriately communicating transition details to team members, portfolio companies and limited partners.

There is no one-size-fits-all formula for executing a graceful exit, but partners and their firms can lay a foundation for a smooth transition by planning well in advance, integrating succession planning into their strategic decisions, recognizing when to bring in outside expertise and communicating with their stakeholders every step of the way.

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