ACEC RESEARCH INSTITUTE

FMI CAPITAL ADVISORS

2020 ACEC Research Institute/FMI Ownership Transfer and Management Succession Survey

Executive Summary

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FMI partnered with ACEC Research Institute to survey ACEC member firms around key ownership transfer and management succession (OTMS) trends. The goal of this project was to shed light on how architecture and engineering (A&E) firms prepare to transition both ownership and management in comparison to peer companies across the A&E landscape. Our findings paint a mixed picture of how companies of all sizes are tackling ownership transition and developing and preparing their future leaders.

Current findings are based on input from 186 A&E owners across the United States. Respondents represent firms with annual revenues ranging from less than $2 million to more than $1 billion.

The following summarizes key themes and topics that A&E leaders shared with us. Coming soon, FMI and ACEC will publish a comprehensive report describing the ownership transfer (OT) and management succession (MS) trends captured during this project.

About ACEC Research Institute

The ACEC Research Institute is the research arm of the American Council of Engineering Companies - the business association of the nation's engineering industry. The ACEC Research Institute's mission is to deliver knowledge and business strategies that guide and elevate the engineering industry and to be the leading source of knowledge and thought leadership for creating a more sustainable, safe, secure and technically advanced built environment.

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About FMI

FMI Capital Advisors, a subsidiary of FMI Corporation, is a leading investment banking firm exclusively serving the Built Environment. With more than 700 completed M&A transactions, our industry focus enables us to maximize value for our clients through our deep market knowledge, strong technical expertise and unparalleled network of industry relationships.

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Key Takeaways From the 2020 OTMS Survey

1

There is a significant gap between perception and reality: Survey respondents think they're better prepared for ownership transitions than they actually are.

Key statistics from the OTMS survey:

- Almost two-thirds of firms (62%) report having an ownership transition plan in place, but only half (51%) have a clearly defined set of ownership criteria.
- Of the firms with a plan in place, two-thirds intend to transfer ownership to employees. Nearly half (45%) of respondents offer stock to executive leadership. Only a quarter (25%) offer stock ownership opportunities to department leaders, and just 9% make stock available to midlevel talent.
- Only 15% of respondents expect to sell their firm to a third party, though 36% stated they have explored such a sale.
- Almost a third (30%) of responding firm owners say they do not clearly understand the valuation and economic tradeoffs among the various ownership transfer options for their firm.
- The top three factors that influence ownership transfer are personal timing (68%), employee retention (42%) and culture (25%).

What does it all mean?

All of the research around ownership transfer and management succession confirms that most executives underestimate how long it takes to prepare and carry out successful transitions. The longer that firms wait to develop an OT plan, the more limited the options become. Different options have vastly different time horizons and must be balanced against how long current owners plan to remain in the business. In our survey, 51% of respondents do not have clearly defined ownership criteria. These firms could face a significant dilemma in the future because having a set of transparent ownership criteria is critical for recruiting, incentivizing and retaining high-potential talent. Furthermore, while many company executives use "gut instinct" to select future owners, a structured approach is far more valuable for assessing candidates fairly and reliably.

Our study also found that a third of company owners do not clearly understand the valuation and economic tradeoffs among the various ownership transfer options. Without a clear understanding of the valuation, tax and other financial implications of all available OT options, owners are less likely to optimize the benefits for all stakeholders.

Key Takeaways From the 2020 OTMS Survey

2

Size matters: OTMS approaches vary among different firm sizes.

Larger firms are far more likely to have formal ownership transition plans, but our survey found that many firms have no formal plans for ownership transition in place.

Key statistics from the OTMS survey:

- Among firms with fewer than 50 employees, only 51% have formal ownership transfer plans. By contrast, 89% of firms with 200 or more employees have OT plans.
- More than nine out of 10 (92%) respondents with 200-plus employees say they have a solid understanding of firm valuation, compared to just 18% of respondents with 25 or fewer employees.
- Nearly one-quarter of companies with fewer than 25 employees expect to sell to a third party, while only 8% of companies with 200-plus employees anticipate a third-party sale.
- Forty-one percent of firms that lack a formal ownership transfer plan have not explored any ownership transfer options (most notably among firms with fewer than 50 employees).

What does it all mean?

Our study reveals that company size significantly affects how A&E leaders plan for ownership transfer and management succession, with larger firms having more formal OTMS plans in place. That makes sense. As employee numbers and revenue volume increase, coordination and communication problems increase, new functions emerge, levels in the management hierarchy multiply, and jobs become more interrelated.

While smaller A&E firms might not be as complex as their larger counterparts, they must also address ownership transfer and identify new leaders. It appears, however, that smaller A&E firms have less clarity around what they want to do with the business or how they want to grow it. As a group, they tend to have less established internal transfer options or systems for developing next-generation leaders.

Key Takeaways From the 2020 OTMS Survey

3

Passing the baton: Retiring baby boomers increase pressure on succession management.

Management succession appears to be a blind spot for many companies but, given demographic trends, must be addressed in the near term.

Key statistics from the OTMS survey:

- While 84% of owners say that management succession planning is important to the future profitability and growth of their firm, only 58% have formal succession plans for key roles in the company, and 42% have no plans in place for any positions.
- 30% of firms, however, will need successors for critical roles within three years or less, and 33% of firms will need key successors within four to six years.
- Six out of 10 firms (58%) will look to fill the most critical roles primarily from current employees.
- Just over half of the firms (53%) believe they are prepared to transition the president/CEO role, and only 13% of firms have formal succession plans for key midlevel employees.

What does it all mean?

While most firms have formal plans to sell to employees, many lack formal systems to identify new leaders. It is critical to take the time to clarify roles, evaluate talent against those roles, and prepare potential candidates for select strategic positions. These positions can directly impact a company's strategy and, when carried out effectively, generate substantial value for an organization.

Executive transitions are sensitive and complex and require copious amounts of planning to get right. Far too many executives build successful careers, only to fumble as they transition out of those positions. This can undermine their legacies and create unnecessary challenges for the companies they poured so much of themselves into building.

While companies predictably prioritize management succession planning for the top of the organizational chart, the best-run firms also focus on developing a deep bench so they can successfully backfill at all management levels as employees move up in the ranks.