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Profitable, attractive firms under $2M, and especially those under $1M, sold in a market with many potential buyers, usually fetch 100% to 150% of fees. If this is the case, why do 90%+ of CPA firms value goodwill for retirement or buyout purposes at no more than 100% of fees, averaging 80%? (Source: The Rosenberg Survey)

I’ve had countless discussions with multi-partner firms (mostly $5-10M or more) on

Supply/demand. With a small practice, there is a huge pool of willing external buyers. (The obvious exception is a firm in a small town). But with an internal retirement, the universe of buyers is limited to just one – your partner group. When there are many buyers, the law of supply and demand increases the price. The reverse is true if there are few buyers.

Conservatism. Firms like to be conservative in valuing their firm for internal buyout purposes. Who knows what the future will look like in 10-20 years when the next partner retires. As a hedge on this uncertain future, firms often lower the valuation percentage below 100% of fees. This also makes younger partners and partner prospects feel more comfortable signing on to this substantial obligation.

Client loss. Eighty per cent of all firms have no penalty for client loss after a partner retires (per The Rosenberg Survey). 10-20 years or more ago, it was much more common for firms to have such a penalty. This shifted because firms increasingly operate under the “one firm” concept, servicing clients as a team instead of the partner. This greatly reduces the possibility of clients leaving when the lead partner retires.

Also, firms want to avoid arguments over who is at fault if clients leave after the relationship partner retires. Was it the retiring partner’s fault for doing a poor job of client transition? Was it the new partner’s fault for doing a lousy job of servicing the client? Or was it nobody’s fault?

My observation is that this reduced goodwill valuation is like a bad debt reserve. An example might look like this: Instead of paying 100% of fees with a penalty for client loss, the firm prefers to pay 80-90% of fees *without* a provision for client loss.

Partners are busy with their own clients. In an internal retirement, the remaining partners are busy with their own clients and feel they have little time to take on clients of the retiring partner. Pushing down the valuation eases the sting for the

similar firms.

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Marc Rosenberg is a nationally known consultant, author and speaker on CPA firm management, strategy and partner issues. President of his own Chicago-based consulting firm, The Rosenberg Associates, he is founder of the most authoritative annual survey of mid-sized CPA firm performance statistics in the country, The Rosenberg Survey. He has consulted with hundreds of firms throughout his 20+ year consulting career. He shares his expertise regularly on The Marc Rosenberg Blog.

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