economia

A piece of the cake

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The model of company ownership by partners is tried and tested. But, asks Nick Martindale, is it starting to be found wanting?

Is company partner ownership structurally failing?

Like many aspects of the UK's regulatory environment, the apparatus around business ownership structures has evolved over time on a piecemeal basis. The concept of partnerships, in particular, conjures up images of 19th century lawyers meeting in the back rooms of London pubs – Dickensian characters such as Tulkinghorn or Jaggers, perhaps.

But the business model has served several sectors – notably law, accountancy and doctors – tolerably well, both in the traditional form and more recently the limited liability partnership (LLP) structure common among such entities today.

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"Partnerships work well where there are a relatively large number of individuals who are responsible for attracting the vast majority of work to an organisation and where part of that attraction is based on their personal following," says Peter Bennett, partnership executive officer at Bates Wells & Braithwaite. "Another attribute is where those individuals are undertaking a significant proportion of the work of the organisation."

Rakesh Shaunak is chairman of accountancy firm MHA MacIntyre Hudson. For him, the benefits include being able to attract, retain and reward talent. "The reason we're constituted as a partnership is because we feel it gives the sense of being owner-managers of the business," he says. "We don't

sell products; we sell expertise. A lot of the goodwill and therefore the value of the business rests in the rainmakers. I trained with a top-five firm and even at that level it's very much the case that the work follows individuals."

Yet despite the obvious attractions of owning a share in a successful partnership, individuals need to do their homework before accepting any offer. Many organisations offer a variety of levels through which people can move before becoming full equity partners but there are essentially two main kinds: salaried and equity partners.

"To the outside world these are one and the same but, as the names suggest, a salaried partner earns a fixed sum whereas an equity partner takes a share of the profits," says David Sykes, a partner at Averta Employment Lawyers. "But job security is largely governed by the partnership agreement and in most cases salaried partners are considered to be self-employed without any employment rights." They also have little control over the partnership and limited earning potential, he adds.

Equity partners, too, can find themselves in treacherous territory, says Fiona Hotston Moore, corporate partner at Reeves. "Many partners do not fully appreciate the legal status of a partner and how this compares to that of a senior employee," she says. "The rights and obligations of a partner are set out in the partnership deed but there is no industry standard and every partnership agreement is different." Financial ties can be particularly difficult to resolve, she adds, and may only be repayable after a certain period.

Nor is it just employment rights that individuals forfeit once they agree to give up their employed status. Jeremy Black, a partner in Deloitte's professional practices group, highlights the current legal debate over whether partnerships can impose mandatory retirement ages – the argument being that failing to do so could block the path for new partners. Another recent case established that partners are not entitled to the same protection around whistleblowing as employees enjoy.

Spencer Wright, chief executive of UK200Group member firm Dains, was aware of this when the business took the decision to move from a traditional partnership model to an LLP in 2007. "One of the things that I and one or two other partners who had joined in the mid-2000s identified was that it was quite easy to get swept up in wanting to be a partner in a professional services firm and to not do enough due diligence," he says.

In the new LLP model, with its greater emphasis on disclosing accounts and performance, he instigated a system where potential partners examine historical performance and the balance sheet as well as outlining potential liabilities. "It's a rigorous process because we don't want partners to turn around at any point and say they didn't know what they were getting into," he says. "But I think it's an area where the profession needs to tidy up its act."

For many, though, it will be the prospect of accepting liabilities that causes most concern. Moving to an LLP model removes for many firms the risk of taking on liability up to the value of an individual's own assets. But according to Aster Crawshaw, partner at Addleshaw Goddard LLP, there are still dangers. "Members have a similar liability status to directors of companies and so could be liable for wrongful and fraudulent trading or breach of fiduciary duty," he says. "On insolvency, they could also have up to two years' profit distributions clawed back and lose their current year's drawings."

There are issues with the partnership model for owners to consider, too, which could make incorporating as a limited company a more attractive proposition. "A partnership isn't a good model if you want to retain funds in the business because you'd still pay whatever the marginal rate of tax is, whereas as a corporate you'd only pay corporate tax," says Black. "So partnerships end up fully sharing out all the profits every year whereas in a corporate it's easier to retain funds for the future."

Nick Johnson is a partner at Manchester-based Glaisyers Solicitors, which is considering moving from an LLP model to a limited company. For him, the driver is to have a greater degree of control over the stakeholders in the business, both by attracting talented individuals such as marketing directors from non-legal backgrounds with equity stakes and making it easier to remove underperformers.

“With a limited company there’s more of a tradition of the equity – the shareholding – being separate from those who run the business,” he says. “The problem with the old partnership model is that you have partners who put in money and want a say in how it’s run but they may not be the best people to run the business. It’s harder to get rid of a partner than it is an employee; very few partnership agreements state that if you’re no good at your job you have to leave.”

RSM Tenon is an example of a large accounting practice that has always been set up as a limited company. According to chief executive Chris Merry, when the business was created as Tenon in 2000 the idea was to create a vehicle that would be able to rapidly acquire other practices. “It was all about capital – being able to go out to shareholders to raise money and then integrate those firms without asking partners to put their hands in their pockets,” he says.

What would be right for a small UK-based partnership would not work for a large global business

But the business has run into several issues with this, including the practice of calling its most senior people directors rather than partners. “Most of the big firms use partner as the most senior title and director as the next one down,” he says.

“We were sending our most senior person to clients but they would think they were the second most senior. So we changed that back to partner as an indication of the type of job they do.”

As a listed organisation, the business is subject to far greater scrutiny than its competitors, says Merry, which has caused many in the organisation to call for a return to the partnership model. But Merry is not convinced – many of the larger professional services firms subject themselves to external scrutiny as a matter of course, he says, including publishing annual results and audit reports. “In many ways they’re treating themselves as corporates,” he says.

Other structures have emerged recently to further muddy the waters. In the legal profession, alternative business structures (ABS) mean firms can now be owned by or accept investment – potentially through flotation – from non-lawyers, as well as being able to link up with non-law firms to offer extra services. “You can still be a partnership or a company as a legal form but you have to get registered by the Solicitors Regulation Authority and they have to put this ABS wrap around to say that you’re authorised,” says Black.

Another trend is the emergence of hybrid structures that include both corporates and LLPs. Dains, for example, has created a corporate entity as a member of its LLP, which it uses as a vehicle to pay out goodwill to retiring partners to avoid the need to do so out of the taxed income of ongoing partners. “Effectively it’s a savings vehicle where we’re putting some of the profits of the limited partnership into the company,” explains Wright.

At the same time, the number of organisations becoming LLPs is on the up, says Ronnie Fox, principal at specialist partnership law firm Fox, partly because of the more favourable tax regime that treats partners as self-employed. “The limited liability partnership vehicle is being used increasingly often for things that aren’t professional partnerships, such as property joint ventures, private equity joint ventures and finance companies,” he says. “It may be down to the tax regime but also people wanting to have a partnership vehicle holding them together.”

Fox himself still practises as a sole trader but says he will convert it to a partnership to ensure he’s able to retain the talent needed to grow. Whether there is a particular size that is best suited to partnerships or limited companies seems to split opinion, with some seeing the process as a linear journey and others two distinct paths taking businesses in very different directions.

According to Crawshaw, however, the key is for partnerships to regularly review whether the structure remains fit for purpose. “What would be right for a small UK-based partnership would not work for a large global business,” he says. “As businesses grow and change, their governance structure will need to adapt. This may involve delegating more authority to executive management or setting up

separate governance bodies to represent the interests of partners not involved in management. It may also involve adopting more sophisticated performance management and remuneration structures."

Yet for Merry at RSM Tenon there's a danger of being bogged down by detail and losing sight of what really matters. "If we were to become a partnership at this stage the differences would probably be around the intangibles and the culture rather than anything legal or factual," he says.

"It's quite hard to move from a public company with shareholders financed by bank debt to an LLP. My answer has generally been that the structure is not as important as how you run the business. It's possible to have a good, positive culture, whatever structure you choose."

LEARNING THE HARD WAY

When entrepreneur Matthew Stibbe set up Intelligent Games in 1988 shortly after leaving college, he realised he needed to attract experienced individuals to develop the business.

Stibbe admits that the business would not have taken off in the way it did without such individuals, and that handing over equity meant he was able to pay them less.

But there were also disadvantages.

Eventually his own desire to retain control, and that of others to further develop the business, led to a management buyout in 2000. But the experience meant Stibbe approached his next venture

Nick Martindale