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# ACQUISITION & SUCCESSION

## Shift your focus from retirement to growth

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# Introduction: Key Aspects of Acquisition and Succession Planning

This paper offers advice on mergers, acquisition and succession planning strategies, including examples from FP Transitions. Their formidable experience implementing thousands of valuations and succession plans for independent financial advisors provides a framework you can leverage to define a future path for your firm.

## What, Retire? I Love My Work

We've all read the statistics about Baby Boomer advisors approaching retirement age. They make for good headlines. However, in our view, an exodus of 12,000 to 16,000 advisors every year over the next decade is highly unlikely.[1] We disagree with the simple conclusion. Based on our experience in working with financial advisors across the country, we believe most will retire gradually, as opposed to choosing a fixed date in the future and walking away as executives in the corporate world might do.

Our experience reveals that shifting your focus from retirement to growth permits you to think about stepping back gradually while supporting a transition to your golden years. Even if your goal is to work indefinitely, the industry is beginning to view succession planning as a growth tool. The planning discipline provides an opportunity to position your business for next-generation talent to grow your business.

At some point, being too busy to plan ahead or intending simply to "die with your boots on" could limit your options later or reduce your firm's future value. Without a growth plan, the choices for owners of advisory practices are limited and their firms will perish with their owners — boots and all.

*Throughout this white paper we have incorporated responses to a quick poll conducted by the SEI Advisor Network in May 2014 about acquisition and succession planning to understand the trends, challenges and the best course of action for independent advisors today. The survey was completed by 771 advisors.*

SURVEY

[1] http://www.fa-mag.com/news/tibergien-old-advisors-driving-young-out-of-the-business-10936.html

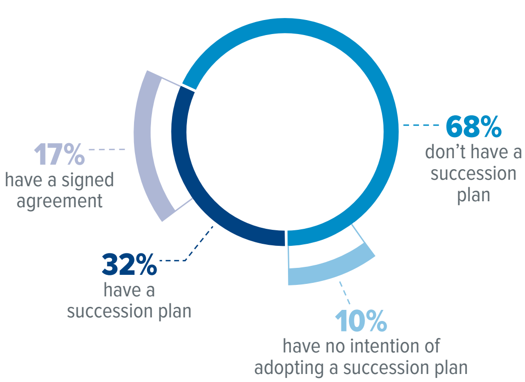
## Planning Matters

Working closely with hundreds of advisors in transition over many years, we've come to understand the many challenges you face. In this white paper, SEI Advisor Network® joins forces with FP Transitions to provide an overview of the strategic succession planning process to demystify the seemingly onerous chore. On the following pages, we summarize some of the trends, challenges and critical choices you'll have to address sooner rather than later. We offer actionable steps and practical advice — including two case studies — about ways to shift the conversation in your mind from retirement to sustainable growth.

In short, these insights can guide you to build the kind of practice that someone would want to buy when you're ready to work less, hand over the reins or sell. At the very least, even if you're not ready to relinquish control of your business or retire and dissolve your firm, we believe you should further explore the range of options available in today's evolving financial advice landscape. Or, if you are on the opposite end of the spectrum and are looking to grow your practice through mergers and acquisitions, it's necessary to understand your target audience and what their personal and professional concerns are upon selling a business.

EXHIBIT 1

### MOST FINANCIAL ADVISORS DON'T HAVE A SUCCESSION PLAN




Source: SEI Advisor Survey, May 2014.

## It's Not Just Business, It's Personal

Industry consultant Angie Herbers suggests that succession planning is "the number one challenge facing the independent advisory industry today." She notes that some 50,000 Baby Boomer owner-advisors will transfer an estimated $4 trillion in client assets to the next generation of advisors within the next decade. Research firm Cerulli Associates estimates that $2.3 trillion of those assets[2] are controlled by advisors who are over the age 60. We agree with Herbers' assessment that many firms are ill-prepared "to make the transfer of ownership when their current owners retire."[3]

### THE COLD HARD FACTS

- More than half of all advisors are over age 50[4]
- Less than 2% of advisors have a viable business[5]
- 50 to 1 ratio of buyers to sellers[6]
- Aging clients = growing capital consumption = reduced AUM and corresponding fees
- 99% of today's independent financial services and advisory practices will not survive their founder's retirement[7]
- Operating costs are accelerating (5% to 7%) at a rate higher than inflation[8]

Most advisors fail to give succession planning serious thought, much less seek professional advice about ways to initiate the planning process. For many financial advisors, their work is more than just their livelihood — it's their life. For some, imagining retirement is laden with so much emotion and so many unknowns, it's an easy subject to postpone or avoid. The evidence is in the numbers. As illustrated in EXHIBIT 1, only about one-third of advisors who responded to our May 2014 succession planning survey have a succession plan agreement, but of those, only half have a formal signed agreement. Surprisingly, 10% of survey respondents do not expect to implement such a plan.

[2] The Cerulli Edge Advisor Edition: 3Q 2012, Issue #36.

[3] Take2: The New Direction of Succession Planning, Angie Herbers, 2014.

[4] fa-mag.com/news/43--of-all-advisors-are-approaching-retirement--says-cerul.li-16661.html

[5] Mark Hurley, et al, Fiduciary Network.

[6] FP Transitions.

[7] Ibid.

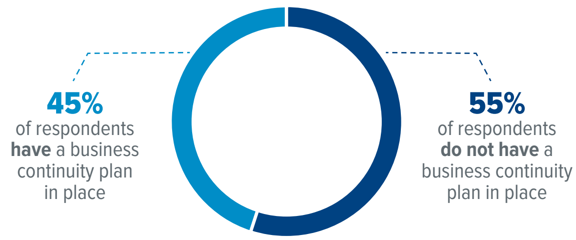
[8] Mark Hurley, et al, Fiduciary Network.

FP Transitions defines succession as a gradual transition of ownership and leadership to the next generation of advisors—preferably a team of advisors. Among other things, planning takes into account the owner's (or owners') age, health, time frame, and family needs. But making a shift also involves the owner's business skills, work preferences and staffing levels and strengths. No two businesses are alike—and transition strategies and tactics are unique to every firm. But don't confuse a formal succession plan with an idea, or the hope that it will work itself out later. It won't. You need to commit to a plan and put it in writing. Call it what you will—transition, succession, exit or replacement planning—the long-term planning process for your business is a journey that begins with the courage to envision your future.

EXHIBIT 2

**BUSINESS CONTINUITY SURVEY RESPONSES**

*Do you have a business continuity plan (a plan that identifies who will run your practice for you if you are temporarily incapacitated) in place?*




Source: SEI Advisor Survey, May 2014.

## Start Here: Your Business Continuity Plan

If you haven't done so already (you're in good company; more than half of the participants in our recent survey have yet to put a business continuity plan in place; see EXHIBIT 2), the first order of business is to implement a continuity plan.

- What's the difference between a **continuity** plan and a **succession** plan? Beyond the legal and fiduciary reasons for developing one (including disaster recovery and emergency procedures), your written continuity plan spells out your intentions should you become incapacitated and unable to serve your clients. For those seeking to create an enduring legacy and retirement income source, FP Transitions defines succession planning as "a formal written plan designed to build on an existing practice or business and to seamlessly and gradually transition ownership and leadership to the next generation of advisors." They're two different exercises but, one often leads to the other. It's easier to develop a succession plan if you have a formal continuity plan in place. For many, the continuity plan often identifies internal resources or potential merger or acquisition candidates who may become part of your succession solution.
- One of the biggest threats to advisory firms is the lack of a plan to protect clients and the owner's value in the event of sudden death or disability.
- For some, the first and only solution is a life insurance policy, which ignores the welfare of your clients. Without a plan to deal with an interruption in your business, things can unravel quickly, at which point it is often too late to sell what's left of the practice for any real value.
- A continuity plan puts you and your business on a path to a more secure future.

**WHEN SHOULD YOU START DEVELOPING YOUR PLAN?**
Most experts agree that you should begin thinking about your transition plan by age 50 or at least 10-years before you want to flip the magic-moment switch to your personal retirement, however you envision it.

**PLANNING IS THE BEGINNING, NOT THE END**
Succession planning is not an end-game strategy for your business. If anything, it is about building a bigger, stronger business that one day can work for you. With a good plan, the right people, and enough time, every business can survive its founder's retirement and many can even prosper.

# A Key Point: Business Valuation

Business valuation is an art and not a science. Valuation can give you an idea of the value of your business and a benchmark against which you can track your progress over time. But the only way you will really know what your business is worth is to secure offers from willing buyers.

Joel Shaps of Bedrock Capital (see Bedrock case study on pages 8-9) says that "understanding what the industry would value your company for gives you a lot of insight into how you can make your company more valuable. Working with an expert to get some metrics on your business is also very valuable; it was eye-opening for us to discover what we needed to do to grow the equity in our company and make the right investments."

**SIZING UP YOUR FIRM'S ENTERPRISE STRENGTH AND VALUE:** Today's industry-specific valuation methods have evolved and are better able to assess the cash flow potential of a practice, as well as the risks associated with transitioning a client base to another advisor or business. The newest techniques factor in more than just the clients and their revenue, adding infrastructure to the equation, what FP Transitions defines as "enterprise strength." These variables include the number of licensed employees who remain through a transition, the nature of the service platform, referral channels, and the level of technology and system integration in the practice. **Don't make the mistake of trying to guesstimate the value you've built by applying a rule-of-thumb multiple—every practice is unique and demands a professional and experienced assessment.**

**CASH FLOW + EQUITY:** Unlike many of your other valuable assets, such as your home, your savings and investments, your business provides two levels of value: cash flow and equity that you control. Measuring equity and using the value of your business as the primary determinant for growth is practical, because equity is a reflection of your business's ability to develop and deliver services over time. It will help determine your firm's capacity to acquire businesses as well as its readiness to support a long-term growth and succession strategy. Astute and experienced buyers seek advisory practices that have more evolved business structures and are willing to pay more for these businesses.

Accordingly, the valuation process itself can serve as a planning guidepost for owners looking to increase business equity.

**PROFITABILITY NOT JUST REVENUES:** Enterprise value is a function of profitability rather than revenues. Thus, financial advisors must identify and target clients who will pay fees in excess of the actual cost of servicing them, which requires a rational process for fully allocating costs.

**DIVERSIFY YOUR CLIENT BASE:** Building demographic diversity in your client base is another ingredient that will impact valuation. Turnover and average client age (appropriately weighted by fees) are also key factors in predicting future revenues. Obviously less enterprise value is ascribed to firms whose clients are predominantly capital consumers as opposed to capital accumulators.

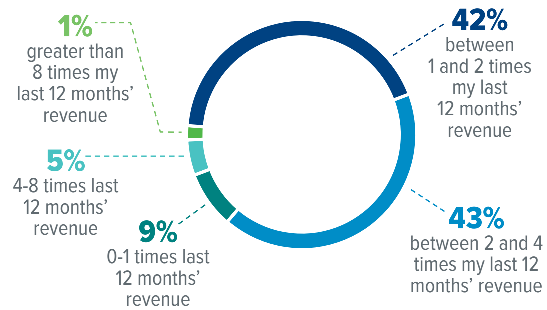
**KEY FACTORS THAT AFFECT VALUATION**

- Revenue/commission
- Geography
- Book/transition risk
- Key person dependency
- Systemic business—workflows
- Other financial levers (multigenerational, revenue growth rate, revenue/client, client affluence, referral channels)
- Type of deal
- Market demand—the hardest variable to manage

EXHIBIT 3

**ASSESSING VALUE**

*I think the valuation of my financial advisory firm is approximately…*




Source: SEI Advisor Survey, May 2014.

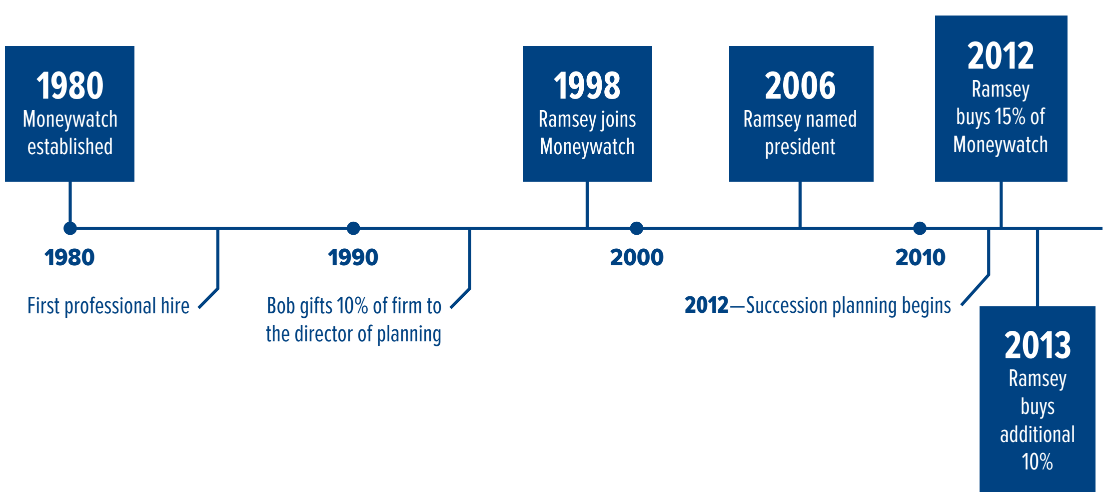
# Up Close and Personal: Two Succession Planning Case Studies

Our case studies follow the succession planning journeys of two firms that couldn't be more different from one another: A Kentucky-based father and daughter practice, and a Silicon Valley firm with nontraditional origins that offers a fresh spin on serving the complicated wealth management needs of high-net-worth individuals and entrepreneurs.

## Moneywatch Advisors

**moneywatchadvisors.com**

| | |
|---|---|
| **Headquarters** | Lexington, KY |
| **Type of firm** | Independent fee-only RIA |
| **Established** | 1980 |
| **Clients served** | 200 families and individuals |
| **Principals** | Robert J. Bova owns 75% of the company stock and Ramsey P. Bova owns 25% of the company stock. |
| **Annual revenues** | Approaching $1 million |
| **AUM** | $120 million |
| **Size** | 2 full-time advisors; 1 semi-retired advisor; 2 support staff |



## A man with a plan

Bob Bova's career paralleled the evolution of the financial services industry itself. Bob joined Thomson McKinnon in 1968 as a stockbroker and his success ultimately led to a managerial position as director of "packaged products." At the time, packaged products were a euphemism for innovations that many stockbrokers initially shunned but would later embrace: mutual funds, limited partnerships and financial planning. An early financial planning adopter, Bob formed Moneywatch Advisors in July 1980 while completing an MBA at the University of Kentucky. His daughter Ramsey was four years old. His first professional hire would later become a partner when Bob gave him 10% of the business—shares Bob would buy back nearly 20 years later for about $85,000 when he retired.

## A family affair

Fresh out of school and armed with a Bachelor in Finance from Clemson University, Ramsey Bova went to work for her dad in 1998, determined to forge a path in the business. It was Ramsey who approached her father with the idea of becoming a partner after she completed her Certified Financial Planner™ (CFP®) certification and was named president of Moneywatch Advisors in 2006. The subject, she says, was not open for discussion. In truth, Bob admits that he "didn't know how to go about it." If anything happened to Bob, his "plan" was to bequeath the firm to his wife and three daughters. "At the time," Ramsey confides, "I was very disappointed. I had invested a lot of time and energy in the firm's success, while my sisters had neither expressed an interest in nor made a meaningful contribution to the firm," she said.

## A game-changing event

In the fall of 2011, Bob and Ramsey attended a national conference. "My father had encouraged me to go to a breakout session about succession planning with him, but I thought, why should I?" she said. "He came out of that session with a different mindset. The presenters convinced my dad that a succession plan was the right next step and that they would guide us every step of the way."

Bob recalls that **"our succession consultant did for us what I couldn't do for myself. It's like hiring a financial advisor—I didn't know where to start or how to structure a solution."**

Bob financed Ramsey's purchase internally, enabling her to buy the first 15% of the firm in 2012. A year later, in 2013, she bought an additional 10% position. While they have a formal agreement, the buyout schedule is structured flexibly to adapt to their needs and business growth plan.

"The moment I became an owner everything changed; not that I wasn't motivated before, but any time you have a sizeable debt in your name, you're going to work harder to pay it off," says Ramsey Bova.

When asked about his biggest fear during the process, Bob admits it was the idea of giving up control. "Once I was convinced that Ramsey was the right person," Bob said, "I never considered any other path. She made a commitment to be my partner and had the ability to carry on and grow the company bigger than it had been. We just made a first quarter profit distribution, and even though I own less of the company now than I did a year ago, my distribution was $10,000 higher this year," he added.

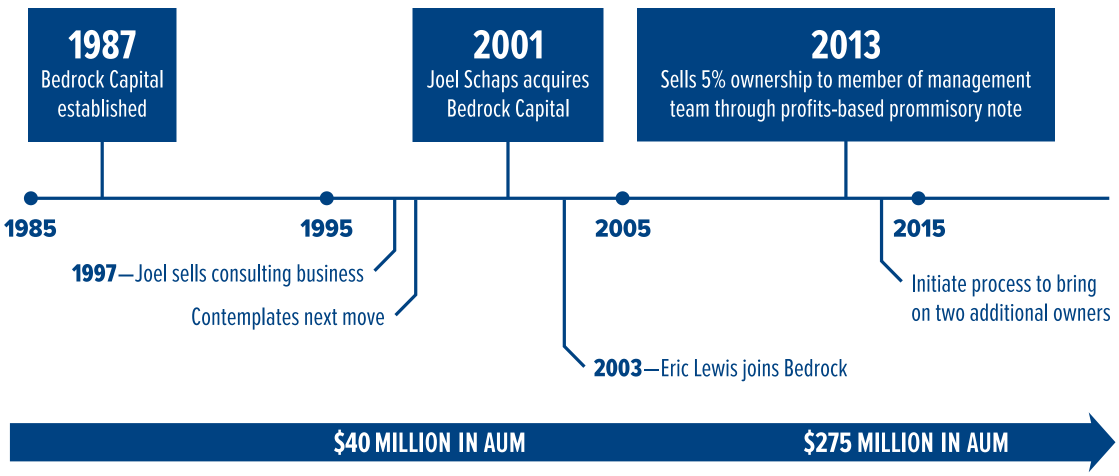
**His advice:** You need to be confident that the person you're going to make a partner is going to be a long-term growth asset. Dealing with family can be difficult, but Ramsey and I have a genuine and successful business relationship.

**Her advice:** Ramsey suggests that, "if a son or daughter is showing an interest, encourage that interest—don't close the door." [The same can be said for other key employees or advisors.] "Founders see it as giving something up; this is my baby, I built it and I'm not going to give it away. But I would say you're giving a part of it away to make your share more valuable." She also believes that "potential owners should be working in and playing an active role in the company."

# Bedrock Capital Management

**bedrockcapital.com**

| | |
|---|---|
| **Headquarters** | Los Altos, CA |
| **Type of firm** | Independent fee-only RIA; NAPFA member |
| **Structure** | S Corp — 3 partners; 1 majority, 2 minority |
| **Established** | Original firm formed in 1987; acquired in March 2001 |
| **Clients served** | 120 high-net-worth individuals |
| **Principals** | Joel Shaps, majority owner + 2 partners, actively engaged in the business |
| **AUM** | $275 million |




## Act I: A Successful Entrepreneur

Joel Shaps' path to CEO and president of Bedrock Capital is anything but conventional. After a successful corporate career, Joel built a thriving consulting business offering auditing services to high-tech companies in the Silicon Valley. He knew how to grow the business. In fact, his company was named one of the 500 fastest growing companies in the U.S. in 1996 and 1997 by *Inc.* magazine. Joel sold the firm in 1997 and stayed on for a period to ensure a smooth transition.

With a keen sense for opportunity and a knack for deal-making, Joel considered his next move and the chance to own and grow a different kind of business. He turned to Bedrock Capital, which was in business for nearly 15 years and managed money for his company's profit sharing plan. "I talked to the owner about getting involved with Bedrock and asked him about his exit strategy. He didn't have one," Joel said.

## Act II: Acquisition

Joel purchased Bedrock Capital in 2001 with the idea of broadening the firm's service offering and expanding the wallet share of existing clients. He structured a deal with a 10-year payout. "I gave him a minimum payment up front based on a factor of revenues. But it came down to what I was willing to pay for the business. We settled on an equitable solution and as the revenues grew, the former owner shared in that growth. We capped it at a certain number and, as it turned out, I paid him the full value — despite the market decline." Joel set out to learn everything he could about the business and enrolled in financial planning classes over a three-year period to complete his CFP certification. He met another Ivy-leaguer, also in transition after a corporate career, and invited Eric Lewis, now a CFP and Chartered Financial Analyst® (CFA®), to join him at Bedrock. "We used a consultant, FP Transitions, to help value the business when I brought Eric into the firm as a partner. It helped to have a third party come up with the numbers and guide the process."

### Act III: Grow the business, build an enduring firm

Growth at Bedrock over the past decade has been organic, with the majority of new business coming through referrals from family members or co-workers. They've added more new clients in the last two years than in the previous four. Joel says "it's very gratifying to find clients whose complicated financial lives are measurably improved by our services," he adds. Joel and his team also made it a priority to stay on the leading edge of system integration and technology. "Our planning manager developed an intricate software tool to analyze Social Security benefits— a free tool that is offered to some 2,000 subscribers from our firm's website," he notes. Last Fall (2013), the firm received *Investment News'* "Best Practices Award for Overall Use of Technology" among top-performing firms.

### Act IV: Transition time, again

Over 13 years, Joel and his partners grew the firm sevenfold, from $40 million to its current $275 million in AUM. Today, Bedrock Capital's team includes five CFPs, two CFAs, and expanded its profile as a comprehensive wealth management firm. In 2012, Joel and Eric started getting serious about their next chapter as well as for Bedrock Capital. "We asked ourselves, what is our transition plan? I'm 61 and Eric [is] 55," he said. "Both of us realize that sometime in the next 10 years we're going to have to transition the firm. I can't imagine not working, but I don't want to have to work past 70," he said. Last year, he and Eric offered an ownership percentage to a key employee who manages the portfolio side of Bedrock Capital. "He was able to buy into the company through a self-funding approach that involves a note that is paid back with profit distributions. That's another way we've started to share equity in the firm. We are in the process of selling a small percentage of the firm to other key employees, discounting the stock so they get a good deal up front."

"He was able to buy into the company through a self-funding approach that involves a note that is paid back with profit distributions. That's another way we've started to share equity in the firm. We are in the process of selling a small percentage of the firm to other key employees, discounting the stock so they get a good deal up front."

—Joel Shaps, CEO and President, Bedrock Capital

# Three Critical Steps: What You Can Do Now to Initiate a Successful Transition Plan

We created a road map to various destinations to help you visualize a suitable path for your business. While none is mutually exclusive, most destinations are prescribed by the firm you own now, and the one you imagine it becoming in 10 or 20 years. Based on our experience, we've identified the type and sequence of critical steps along the way that will facilitate your planning efforts. These include benchmarking your practice, options for transitioning your firm and searching for talent.

Like your business, your road map will be distinctively yours. Considering the possible paths your business could take is the first step in developing a strategic succession plan. A plan looks at all the things your business could do and narrows it down to those that align with your goals. The road map also helps you determine where to spend time, human capital and money. Developing a strategic plan might seem like an overwhelming process, but if you break it down, it's easy to tackle. Here's our three-step approach.

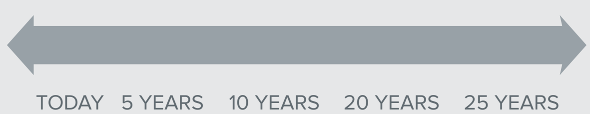
## STEP 1: Assess Your Business, Clarify Your Goals

Only when you clarify your personal goals can you contemplate your options and get serious about your succession plan. (That sounds a bit like the advice you give to clients, doesn't it?) You may want to create a legacy, spend less time in the office, cash out or maintain current cash flow for as long as possible. These all are valid goals and a good place to start building.

The succession planning process begins with thinking about how you envision your retirement and what you want from the business you built. You'll consider where you are now, if and when you'll retire, and whether or not you wish to grow the business into an enduring enterprise.

**TIMING:** Are you 65 and want to work another five years? Or, are you 55 and expect to work for 20 years? Choose a reasonable time frame, and identify the events or opportunities that might accelerate or delay your timing. What would change if a health condition prevents you from working? Would you sell tomorrow if you were approached by a complementary buyer? Having enough time to formulate and implement a plan will determine your eventual success.

**How Much Longer Do You Want to Work?**




**POSITIONING:** What kind of firm do you have today? Is it positioned for growth? How many advisors or planners work for you? What about capacity—are your systems integrated and your operational workflows automated? Are you able to accommodate an increase in the number of clients you serve? Operational and revenue analysis as well as benchmarking will help you pinpoint where along the spectrum your firm is situated.

**What Is the Size, Type and Structure of Your Firm?**


**STRUCTURE:** How is your firm organized and structured? A sole proprietorship, or a corporation or LLC with just one owner, will likely come to an end with the retirement, disability or death of its owner. As FP Transitions concludes, "that model is built to die." A corporation or LLC with multiple generations of ownership serving multigenerational client bases, on the other hand, has the potential, along with proper planning and staffing, to last well beyond any one advisor's career or lifetime, and create an enduring business with significant transferable value. This business value, in turn, can support an income-perpetuation strategy for the founder even as he or she retires on the job, as many entrepreneurs tend to do.

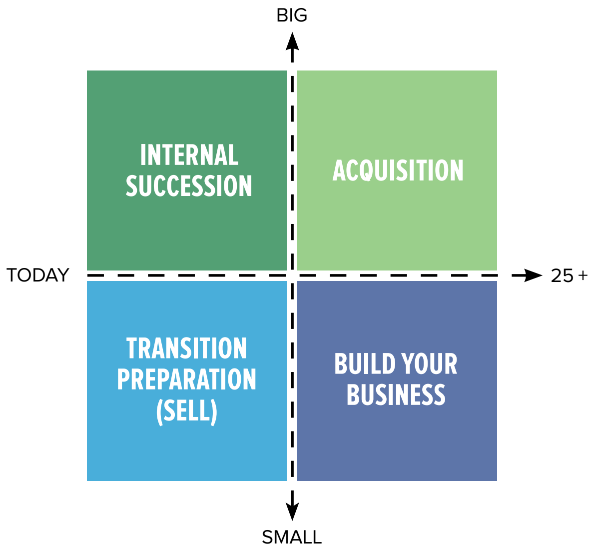
**EDUCATE YOURSELF:** Do your homework—talk to associates you respect who have successfully implemented a transition plan. You can further explore succession strategies by talking to your service providers about resources they know and trust; talk to your company's board and your accountant for their insights; or hire a specialist firm such as FP Transitions that understands the wealth management business, has experience working with firms similar to yours, and a proven track record in mergers, acquisitions and succession planning. In the end, you control your own future. What our experience has taught us is that you're going to need good information, a good plan and the persistence to execute it through inevitable twists and turns along the way. You may be surprised where your journey will lead.

## STEP 2: Develop a Strategy for Your Transition

The completion of Step 1 leads you to consider a number of legitimate paths you might pursue — any of which will require you to imagine how you see your business surviving or winding down. Your choices will likely fall into one of four categories: sell your business; orchestrate an internal succession plan; acquire another firm; or build your business with the intention of retiring gradually with an income while positioning your business for an eventual transition solution.

These choices are not mutually exclusive and, in fact, may lead to one or more potential growth strategies. Even if your decision is to continue your practice into old age, you have to make a decision and set expectations for everyone — your team and your clients. Leaving your practice behind through attrition or selling to the best match for the best price and terms you can get in a seller's market are exit strategies, not succession strategies. You need to evaluate your current position, honestly assesses the value of what you've built, and decide for yourself what makes the most sense: a succession plan or an exit strategy.

**EXHIBIT 4: FOUR OPTIONS FOR FINANCIAL ADVISORS CONSIDERING BUSINESS TRANSITION**



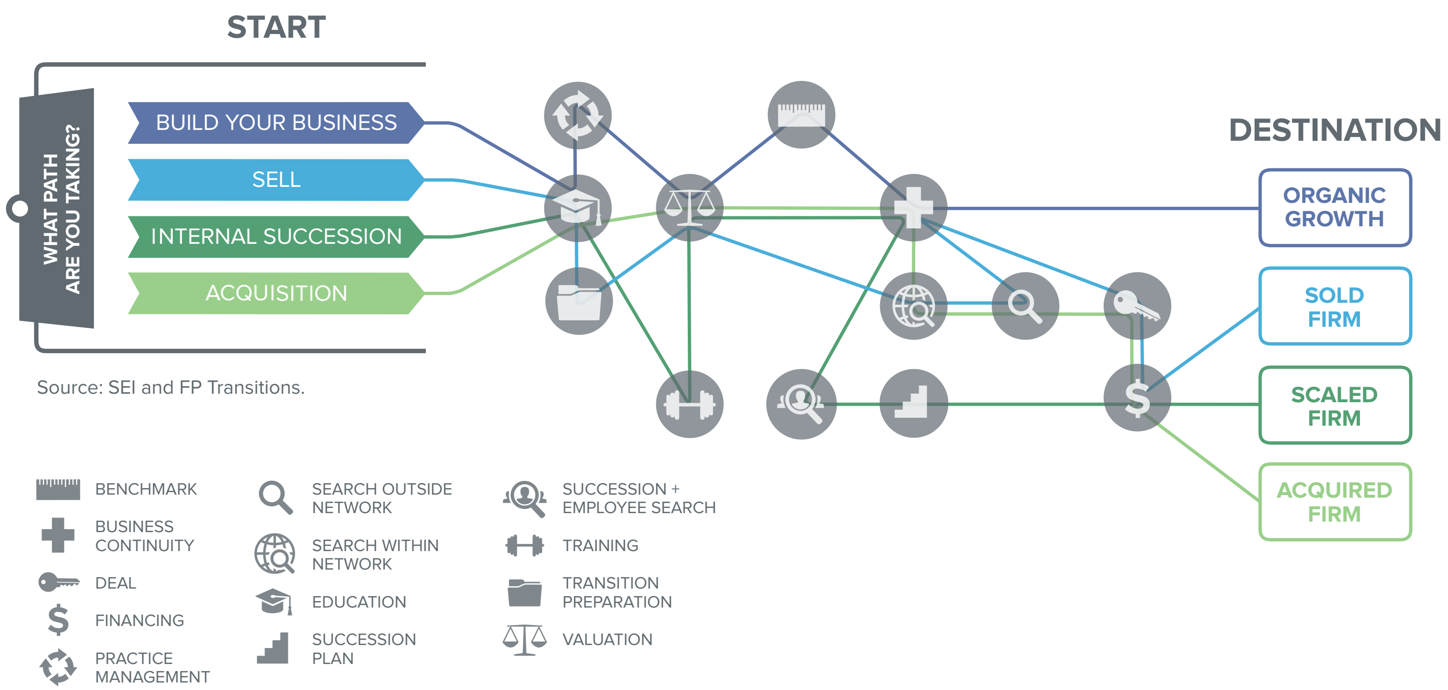

**NAVIGATING YOUR PATH:** Think of the industry and your potential choices as a matrix (above) — wherein each quadrant comprises a range of market positions for virtually every size and type of advisory business. The Y axis represents the spectrum from small to large firms, while the X axis represents the time frame you have in mind and a trajectory for the life of your business. While a firm can migrate from one quadrant to the next, transitions from one to another, depending on where your firm is situated, may be extremely difficult, costly and/or time consuming to effect. Some are downright impossible without drastic changes in your business model.

## SEI Succession Planning Road Map

After you've evaluated your personal and business goals, start down your path by selecting a succession planning track. Depending on the route that you select, numerous steps are needed to help ensure that you get to your destination — whether it be growing your firm, selling internally or to an outside buyer or pursuing the acquisition of another financial advisory firm.

Refer to SEI's Succession Planning Road Map below for guidance on your journey.

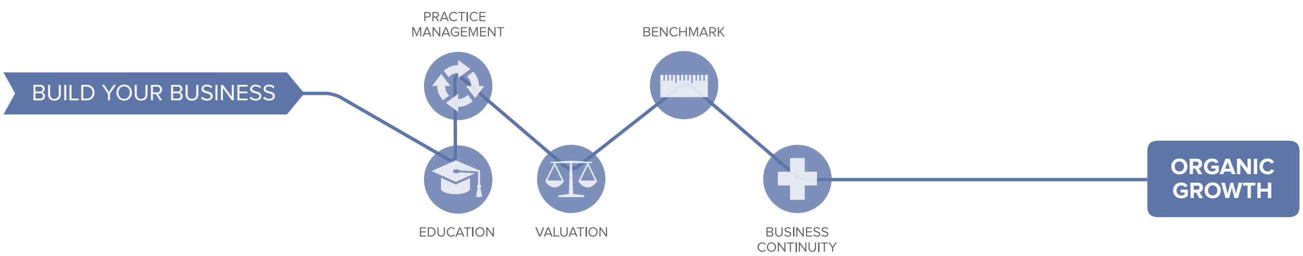
### EXHIBIT 5: SEI SUCCESSION PLANNING ROAD MAP




Source: SEI and FP Transitions.

## Option 1: Build Your Business

Many owners of successful advisory businesses will decide to keep doing what they're doing with the hope of growing their business one client at a time—the same business model that served them in the past. In fact, the majority of independent advisory practices falls into this category and are typically one- or two-owner practices with limited capacity and reach.




In this example, as the next generation builds on the established business, and as the team of owners (old and new) work together to build a stronger and deeper organization, the reward is illustrated both in the improving multiple of gross revenue (GRM) and in the total realized equity value by the founder(s). The sum of all equity tranches is equal to about six times the starting point, not including a reasonable salary for the owner. In addition, founders benefit from a reduced workload in the final years, and a built-in continuity plan to protect business value.

### EXHIBIT 6: WHY GROWTH IS SO IMPORTANT—AN ILLUSTRATION OF A GROWTH PLAN IN TRANSITION

| | Year 1<br>Sell 25% | Year 6<br>Sell 25% | Year 11<br>Sell 25% | Year 16<br>Sell 25% | Total |
|---|---|---|---|---|---|
| **Fair Market Value** | $1,700,000 | $2,900,000 | $5,000,000 | $8,500,000 | |
| **Gross Annual Revenue** | $750,000 | $1,200,000 | $2,000,000 | $3,150,000 | |
| **Annual Rate of Growth** | 10% | 10% | 10% | 10% | |
| **GRM** | 2.25 | 2.4 | 2.55 | 2.7 | |
| **Overhead[1]** | 43% | 43% | 43% | 43% | |
| **Retained Profits by Founder** | $208,000/year | $270,000/year | $240,000/year | | |
| **Equity Realized by Founder** | $3,750,000[2] | $725,000 | $1,250,000 | $2,125,000 | $4,475,000 |
| **Total Profits and Equity** | $1,765,000 | $2,450,000 | $2,750,000 | $2,125,000 | $9,090,000 |

[1]Not including founding owner's annual compensation of $150,000/year.
[2]Includes minority discount of $50,000.
Source: FP Transitions.

**ORGANIC VS. INORGANIC GROWTH:** Growth of any kind is generally measured in terms of increased revenue, profits or assets. Growing organically requires focused sales and marketing efforts to attract new clients while retaining the most valuable ones; penetrating new markets; or investing in technology or human capital to differentiate your services and create competitive advantages. In some ways, businesses that pursue an organic growth strategy are at a disadvantage because each new client relationship and its corresponding assets are added incrementally. Competition and other market factors, including market performance, also pose greater threats to the organic growth model.

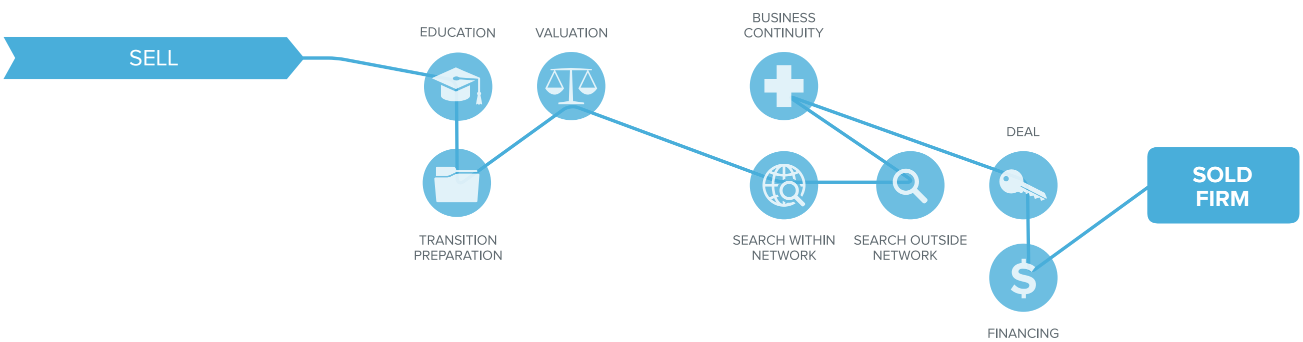
Organic growth is a slow-going, resource-constrained proposition. Your firm can only generate and absorb growth on a limited basis before it needs to expand further. On the other hand, an organic growth model is easier to manage, and there are fewer cultural and integration challenges with which to contend. Another advantage is the personal satisfaction you enjoy from shaping the values and business principles that contribute to your success, that of your clients and your business overall.

Inorganic growth is typically reserved for much larger firms that have the ability to acquire in terms of capacity and infrastructure. It's not impossible, but it's extremely rare for a small firm to acquire a much larger one. Inorganic growth strategies sound exciting, but they are far more difficult to execute.

**ARE YOU A BUYER OR A SELLER?** You may think you know but until you initiate the succession planning process in earnest, your position on the subject and the choices available to you will remain nebulous. The planning discipline will help you figure out whether you are a legitimate seller or buyer. The process also will help you discover and prioritize what you need to do to convert your practice into a viable business that eventually has potential transferable value.

## Option 2: Sell

You may choose to sell your practice to a partner or key employee, or to a third party. Contrary to what you may have read in the industry press, less than 10% of independent financial advisors will ever sell their practice or business. Most entrepreneurs aren't wired to sell and prefer to keep working indefinitely. Our experience is reflected in the most recent survey responses (See EXHIBIT 7) in which only 11% of participants expressed a desire to sell their firms. But for some, selling represents a choice to consider now, or at some point in the future when the demands of the job or health reasons point to the end of a career.

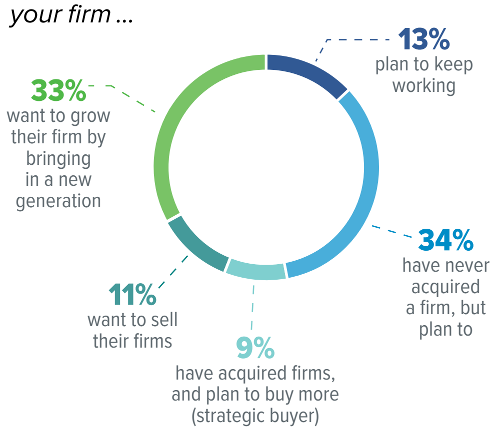



**SELLING CRITERIA:** Practice values have been slowly increasing over the last decade, fueled in part by a strong seller's market. FP Transitions estimates the current buyer-to-seller ratio at about 50 to 1. What that means for you is choice. It means you can focus on the best match for your clients; find the one person or firm, in the right location that can replace you and earn the level of client trust you've enjoyed. The quality of the match represents one of the most critical factors leading to a sale. Sellers tend to prefer buyers with similar client bases, revenue streams and investment philosophies, but larger in terms of cash flow and value. In this realm, businesses tend to buy practices. Another criterion is geography, with a preference sometimes for a buyer close by, and in other cases one that isn't, especially for sellers that want to keep their office open for a period of time. The last issue is price and terms — a complicated formula that can only be extracted by careful benchmarking, practice management assessment and valuation. One of the biggest mistakes buyers and sellers make is to underestimate the factors that contribute to value. Today's independently owned financial service practices have measurable equity, a quantifiable valuation system, and a stream of transaction data on which to base sales and acquisition decisions.

EXHIBIT 7

## STRATEGIC TRANSITION DECISIONS

*Identify the statement that best describes your firm ...*




Source: SEI Advisor Survey, May 2014.

**STRUCTURING A DEAL:** Understanding the dynamics of the deal-structuring techniques associated with buying and selling a financial services practice is a prerequisite to understanding equity value. The first mistake that many buyers and sellers make when approaching a transaction is to focus on determining the purchase price without fully considering the underlying deal terms and tax allocations. In the acquisition or sale of a professional services practice, value is inextricably tied to the terms of the deal — the amount of the down payment, the use of contingent financing (such as an earn-out or an adjustable note), the duration of the financing period, the tax allocation strategy, and even the interest rate the seller will charge to finance the transaction.

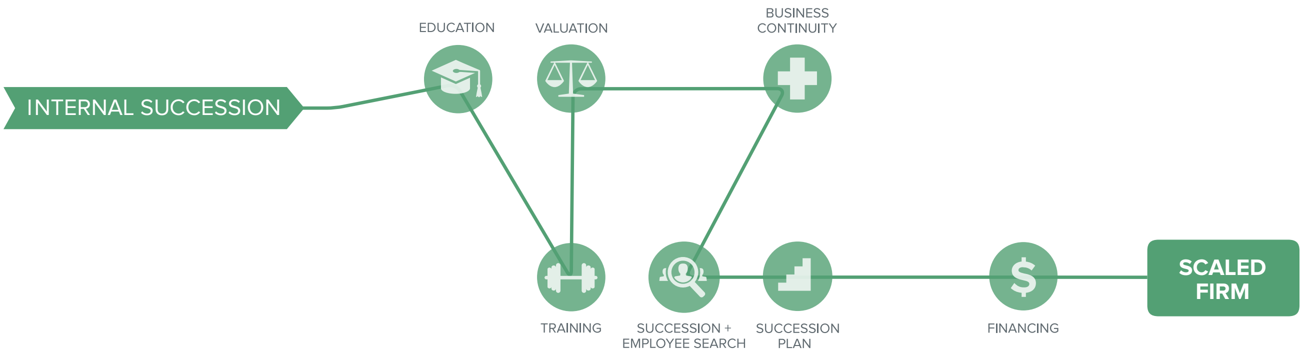
FP Transitions reports that the most common deal structure is about one-third of the purchase price paid as a nonrefundable down payment, with the balance seller financed over three to six years. Typically, the more recurring revenue there is, the larger the down payment and the shorter the financing terms. Seller financing usually contains some type of contingency to make sure that the assets and cash flow actually transfer and can be retained for a period of time. The most commonly used contingent financing method is a performance-based promissory note. Earn-outs are used less often these days due to regulatory concerns and licensing issues.

**FINANCING:** Once you have a plan in mind, explore the various financing options available. While most transactions we've observed are seller financed, bank financing is increasingly available from qualified and experienced lenders. Whether you're considering selling your business externally to the best qualified buyer, or internally to a team of successors, bank financing solutions can provide powerful tools to reshape or accelerate your plans. Qualified banks are now lending to next-generation advisor-owners, providing retiring principals with the ability to cash out if the business has the necessary infrastructure and personnel in place. In other words, you can decide exactly when, over the course of a 10- to 20-year plan, and you can plan to relinquish the firm's leadership to a team of internal successors who proved themselves capable on the job.

The first mistake that many buyers and sellers make when approaching a transaction is to focus on determining the purchase price without fully considering the underlying deal terms and tax allocations.

## Option 3: Internal Succession

The first place to look for your succession team talent is internally—the people who work for you now.




While your current employees probably weren't hired with ownership or succession planning in mind, they deserve your consideration. There are basically two types of internal staff members that can support your succession plan goals: those that keep the organization humming and producers with a book of business. The latter often represent greater upside in that they can generate revenue. That does not automatically qualify them for ownership, but it is an important consideration.

These key employees or staff members typically are active participants who have a high degree of client contact and are licensed, registered or qualified to provide investment advice. Fee-only registered investment advisors (RIAs) have more latitude in this area, whereas FINRA-regulated advisors have less—either way, plans can be tailored to fit the circumstances. The bigger questions that naturally follow are, do these individuals want to take on more responsibility (and potentially sizeable debt), and do they have the skill set to do so. There may be a temptation to try to clone yourself, but Steps 1 and 2 outlined above may help you discover other skills and strengths that could benefit the organization.

**INTERNAL VS. EXTERNAL SUCCESSION:** While planning and executing an external sale of your entire business is the fastest exit strategy, it is the most uncommon too. Also rare is the one-time internal transfer of 100% ownership in a lump sum to next-generation advisors or key employees. Internal transition plans, when executed thoughtfully, provide greater longer term benefits: business growth and stability. Most financial advisors hope to be rewarded for a lifetime of success by perpetuating their business and generating an income stream 10 to 20 years beyond their retirement. Regardless of the outcome you envision, building a business of enduring value, one that achieves a balance of "revenue strength" and "enterprise strength," is smart business.

Joel Shaps of Bedrock Capital says "develop the next generation if you can—it's much better to develop and train people in your own culture, business model and values than to try to buy talent or merge with somebody who may or may not be compatible."

These can be tough questions to answer, but they are impossible to tackle if you don't have a plan that clearly illustrates the benefits for all involved. Get outside help, if necessary, to evaluate your team members, prioritize the skill sets you'll need to help them develop—including training and nurturing—and formulate a schedule so that they will be in a position to assume a larger role in your organization.

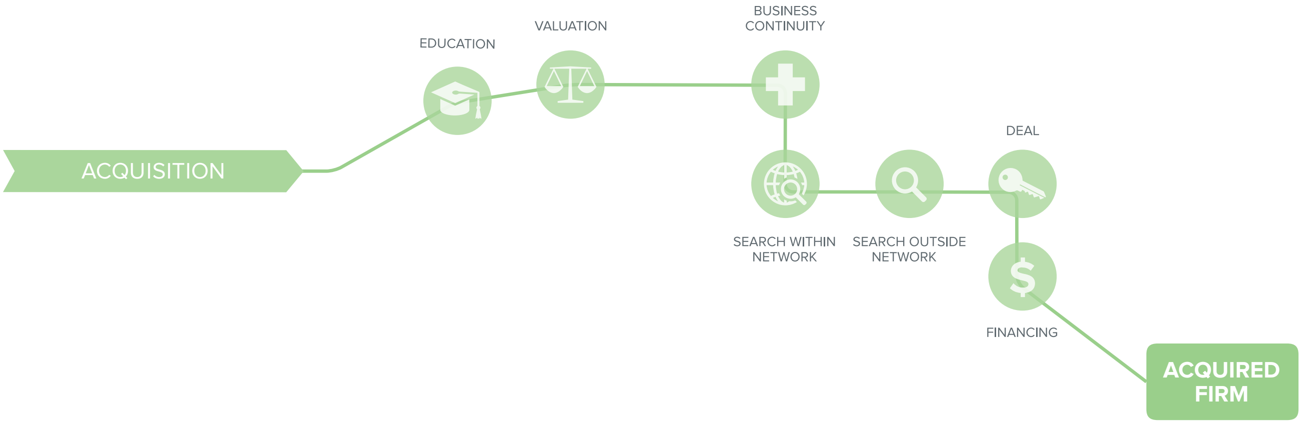
**RECRUITING YOUNGER TALENT?** The challenge of age relates as much to succession planning for the firm's leadership as it does to developing strategies to reach a younger clientele. Quality people are becoming more valuable, more difficult to source and more expensive to train. You'll want to consider the age dynamics of your business and develop strategies that will ensure the long-term viability of your firm. A strategy for attracting and retaining younger advisors as well as clients is essential to the sustainability of most independent firms.

For younger advisors looking for a career move, a business with a succession plan offers something far more valuable than a place to work. It offers a career path and an ownership opportunity that comes with a paycheck and a mentor. That's an enticing package for a career-minded professional. It doesn't matter that your younger partner only owns 10% or 20% of the business — it matters that he or she is an owner and a collaborative partner.

Ramsey Bova of Moneywatch Advisors believes that "building an enduring firm demands finding the right people and offering them ownership; the hardest part is finding the right people."

## Option 4: Acquisition

Only a small percentage of independent advisory firms are in a position to merge with or buy another business. That said, an acquisition or merger is an effective strategy that enables you to quickly increase market share and scale. The resulting expanded business is more valuable, which may make it easier for you to attract new talent and access capital when you need it. You may also benefit from the skills and expertise of added staff members.

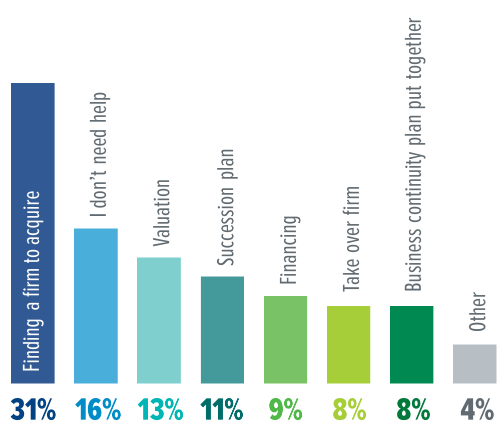



**WHO'S BUYING:** To understand your position in the acquisition marketplace, completing Steps 1 and 2 (above) will facilitate your planning efforts. Most successful buyers are approximately twice the size of their target firms in terms of value. A value-based assessment takes into consideration not only the revenue of the firm, but the revenue-producing characteristics of the business as well. Your firm likely has the resources to grow through a variety of channels, and pursuing both acquisition and recruitment can lead to significant gains in equity value.

To determine where your time is best spent, evaluate how your business compares to your peers, but also to businesses with twice your value. Such an assessment will help narrow your focus, but remain alert to an opportunistic merger, acquisition or recruit. As you lay the groundwork for these powerful growth strategies, make sure you have the knowledge — or have access to the expertise — to execute the partnership quickly and correctly.

EXHIBIT 7

### WHERE ADVISORS SEEK THE MOST HELP




Source: SEI Advisor Survey, May 2014.

Finding the right advisory firm match can be a daunting task. Even when a potential firm is identified, how do you go about putting a deal in place and securing financing? Finding a suitable match for your business requires a focused search for professionals that complement your business approach and philosophy. Whether the goal is to identify the prospect with the longest career to invest in your business and be part of the next generation of leaders, or to locate an advisor who needs a successor for their book of business; the fit matters most. There are a number of recruitment specialists who can help you identify potential targets. Your service providers are an invaluable resource that also may be able to assist you.

## Step 3: All Options Lead to Growth—Build a Business That Will Outlive You

In previous thought-leadership articles we've written about the difference between running a practice and building a business with measurable enterprise value. (See "Advisor as Business Owner: How independence, integration and intelligence can transform your practice into a sustainable business," SEI Advisor Network, September 2013.) Shifting from practice to business involves taking a more strategic approach to aligning personnel, technology and marketing. Characteristics of a business include a culture that encourages clients to identify with the firm as a whole, rather than just with the advisor-owner; operational efficiencies that led to profitable and loyal client relationships; and differentiated service offerings that generated higher-than-average return-on-investment.

Fiduciary Network defines enterprise value as the "economic value that an investor captures from owning the equity of a company. Because wealth management firms have virtually no tangible assets, their only enterprise value is their future (in particular, after their current owners departed) profits either as standalone businesses or as part of another entity."[9]

**IT'S NOT YOUR RETIREMENT DATE—IT'S YOUR GROWTH RATE:** Growth of a financial services business entails more than just an increase in gross revenues or profitability. Growth often means that the organization will be larger with multiple professional employees and greater and more complex infrastructure (office space, technology, administrative staff, etc.), which FP Transitions considers the essential elements of "Enterprise Strength." Equity growth, or an increase in the value of the business, occurs as a result of building both revenue and enterprise strength, which together can generate not only additional revenue, but a higher value per revenue dollar. A well-run business with measurable enterprise strength (infrastructure) can result in an increasing multiple of revenue per dollar of revenue.

**DON'T GO IT ALONE—SEEK PROFESSIONAL ADVICE:** It doesn't take our industry long to recognize and seize on an opportunity. Across the country, succession experts are cropping up everywhere offering services for all or part of the transition planning process. Leadership of many of these firms represents second careers of formerly successful advisors and independent firm owners. While they understand many of the challenges you face, make sure they also have the experience to lead you successfully through the process.

Do your homework—talk to associates you respect who implemented a successful transition plan; ask your service providers about firms they know and trust. Moreover, talk to your company's board and your accountant to ensure that you've considered all the issues.

Hire a specialized firm that understands the wealth management business, has experience working with firms similar to yours, and a proven track record with transactions for mergers, acquisitions and succession planning. A professional can help you ask the right questions, facilitate the process and help you make better decisions.

Finally, being mentally prepared to step aside may be a bigger challenge. An executive coach or consultant may be your most valuable investment. It's an exciting time to consider your personal next step and to build on your success.

[9] *Creating, Measuring and Unlocking Enterprise Value in a Wealth Manager,* Fiduciary Network, June 2010.

# Final Thoughts

Throughout this paper our observations focused principally on you as the owner of a thriving business. But thinking about your clients' welfare — regardless of the succession path you choose — should also be a factor in your overall planning process. The risk of client attrition is always present — but it can become an even greater threat whenever there is a change in ownership. Successfully transitioning clients and their assets from one owner to the next is an essential step in the sales or acquisition process. Transferring the trust and loyalty of clients is best accomplished with a carefully coordinated transition plan. Ideally, the effort should be choreographed with both buyer and seller, and their support staffs to ensure a professional handoff.

Building a great business — not just a great practice — means empowering those around you to achieve more as a group than you ever could as an individual entrepreneur, and not being afraid of achieving that goal. Whether your goal is to retire with an income plan, build a legacy, merge with or acquire a complementary firm, you'll need a formal succession plan. Work with a team of industry professionals to understand your options and implement a detailed plan — one that engages all your stakeholders, including your family, legal and tax counsel, partners and next-generation advisors — that fits your lifestyle, your time frame and your business.

The purpose of a succession plan is to help your business outlive you, so count on it being a long process. Every good plan should be flexible to adapt to new opportunities, reassessment and course changes. At a minimum, plan for annual evaluations to monitor value and develop benchmarks using that valuation data to track your operational progress.

None of the choices we've presented in this paper is mutually exclusive. A comprehensive plan incorporates all the possibilities, but helps you establish a hierarchy based on your goals and resources, and the factors within and beyond your control. Most of these strategies can and should be linked together to provide flexibility and the greatest potential for success.

# About SEI and FP Transitions

**SEI** is a leading global provider of investment management business outsourcing solutions, investment processing, and fund processing that help corporations, financial institutions and financial advisors. As of March 31, 2014, through its subsidiaries and partnerships in which the company has a significant interest, SEI manages or administers $582 billion in mutual fund and pooled or separately managed assets, including $239 billion in assets under management and $343 billion in client assets under administration.

SEI Advisor Network offers expertise focused on the financial advisor community encompassing deep expertise in the advisory, investment management and administration and operations aspects of the business. SEI currently works with over 5,700 independent advisor clients who leverage our core competencies to run more profitable and scalable businesses.

The new SEI Business PathFinder program, joins our experienced relationship managers with industry-recognized FP Transitions and The Bancorp to provide the most comprehensive acquisition and succession program available to financial advisors today.

Established in 1999, **FP Transitions** is the nation's leading provider of equity management, valuation and succession planning services for the financial services industry. Based in Portland, Oregon, FP Transitions operates the largest open market for buying and selling financial service practices in the U.S. It has completed more financial service transactions than any investment banker or business-broker in the country.

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We encourage you to contact an SEI representative for more information, insight and guidance about increasing the transferability and value of your business.

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