



Eric Schwartz
Chairman & CEO
Cambridge Investment
Research, Inc.

SUCCESSION PLANNING CHALLENGES FACING TODAY'S INDEPENDENT ADVISOR

As a trusted advisor, you deliver comprehensive financial planning advice to your clients, but have you focused on your retirement goals or developed a plan to transition the ownership of your business? Do you know where to turn for advice and guidance?

Ownership and transition of ownership is one of six trends* that will impact the future of independent advice for the next 10 to 20 years. As rep-advisors' practices become valued into the millions, ownership considerations loom large. How rep-advisors resolve these continuity planning and ownership issues will be key differentiators determining winners and losers for the future. It is time to start building solutions to these business challenges.

The good news for rep-advisors – increasing valuations mean your business building efforts are creating equity that you can tap into as part of your retirement plans. The challenge is how to do this successfully while maintaining your company's culture, values, entrepreneurial spirit and dedication to servicing your clients when you are no longer there. On the other hand, transitioning practices to the next generation advisor may meet your emotional and cultural goals, but how can that generation afford to pay what your practice is worth?

As the valuation and numbers get large for rep-advisors, the best liquidity options from a price and speed of payment perspective is selling to an institution. But, for many rep-advisors, these options go against their other objectives.

Looking to the future, at Cambridge we have been working with a steering committee of about 20 of the top advisory firms in our system to develop a new strategy that reflects a visionary departure from traditional thinking and focuses on solving the largest challenge facing rep-advisors and their clients in an exceptional way. This new effort will not replace existing strategies, but augment those that remain popular with rep-advisors while addressing one of the biggest challenges we foresee over the next 15 years.

First, let's consider the need for succession planning. At Cambridge, about 75 percent of our largest offices are owned by rep-advisors who are 50 years old or older. A recent survey of this group indicates that while 80 percent are highly concerned about succession planning, only 15 percent had a plan in place and only half of those plans actually included a funding mechanism for the plan. Therein lies the problem – we know advisors should have succession plans in place but most do not. Why is that the case?

The key issues begin with whether an advisor is actually the owner of their business. You can do this by owning your own RIA or affiliating with

* *The Future of Independent Advice: Leveraging the Trends of the Future* by Eric Schwartz; Copies of this white paper are available through Cambridge: www.joincambridge.com

a truly independent broker-dealer that is supportive of you building equity in your business. In other words, the broker-dealers' overall written agreement with you and your clients, and their privacy policy, must provide you the flexibility necessary to buy or sell your practice. Architecture is also an important consideration as a broker-dealer with open architecture makes the transition process easier and paves the way for a bigger universe of buyers and transactions that are more flexible. For example, you may want to buy or sell a practice that is presently at Schwab, TD Ameritrade, National Financial or Pershing. Your alignment with a broker-dealer that can work with any of these platforms will make an acquisition easier and more successful, and add value to any succession plan you want to create.

A second key issue is identifying the appropriate successor. You need someone who will maintain the quality you have established but also someone who has the means to pay you for the equity you have created in your business. Institutions may be able to deliver the money, but often they destroy the client-centric culture and legacy you have built with professional care and dedication. On the other hand, junior partners can be found that will likely maintain your culture and level of care for clients and staff, but they may have to finance the transaction, resulting in some combination of below-market risk-adjusted valuation, risk of buyer default, and/or limited short term liquidity.

So, how can you get full market value from your successful practice and still “hand-pick” the best solution for your clients? Your broker-dealer should offer

well structured succession and acquisition programs that will help you navigate the complex opportunities available to you for your business. If this is not the case, perhaps another broker-dealer or consultant can help you.

Any such program must address the issue of a funding mechanism. This can be a big problem given that the funding dollars required are often so large that even large broker-dealers cannot afford to back them. For example, values range from one times GDC for a smaller commission practice to over two times or higher GDC for a larger fee practice. This can translate into hundreds of millions of dollars for a broker-dealer program and has resulted in many broker-dealers offering only a patchwork quilt of transaction assistance for rep-advisors.

It is clear that the traditional options for succession and acquisition planning are far too piecemeal and limited to resolve the issues rep-advisors are facing. Therefore, we set out several years ago to create a comprehensive solution unlike any other we are aware of across the industry. It is an innovative approach focused on succession and acquisition for advisors.

Cambridge has had a Practice Management division in place for some time, and similar to our competitors, this includes the basic offering relative to effectuating succession and acquisition plans. But, recognizing the enormity of the need and related impact on the future of the industry, we have created a unique, comprehensive solution that in years to come may well be regarded as the

game changer in terms of succession and acquisition planning.

Consideration and development of this concept began over four years ago with the insight and interest of many of our top offices. Many of these offices have committed to building with us their own long term succession plans.

This comprehensive approach is designed to locate buyers, if a potential successor has not yet been identified, and provide flexible financing and structure, as well as expertise to help rep-advisors through the process. In addition, it is designed to offer opportunities and financing to assist with branch building and recruiting as rep-advisors seek to acquire practices. Acquisitions are the flip side of continuity and succession planning – for every seller, there is a buyer. Our solution provides expertise, assistance and financing to help acquire practices.

This solution is designed as a comprehensive model that combines succession planning with a financing vehicle. This solutions based approach focuses on helping advisors maintain and grow their independent businesses while giving junior rep-advisors funding to buy out practices from senior rep-advisors. In contrast to the traditional consolidation or buy out approach, this model preserves control of the rep-advisor's business with the rep-advisor who continues as the owner of their own firm.

If you are over 50, you are probably worried about how to create a succession plan that will protect your clients and the security of your family, whether your exit is sudden and unexpected or a well-planned

retirement. Our advice is to get serious and build a plan that works for you – it will be worth the effort. In addition, if you are under 50, you are facing great opportunities to build your business quickly as many seasoned professionals are seeking the right successor for their valued business. We recognize that succession, acquisition and continuity are among the biggest concerns held by rep-advisors, and these concerns have become increasingly visible over the last five years. We see a funded solution as being a big next step in providing unique services and creative options to rep-advisors for succession planning and continuity options. In terms of the future of our industry, I believe some of the greatest opportunities we will face in the next 15 years will be in the areas of succession, acquisition and continuity planning.

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² Financial Planning magazine, June “FP50”, Top 50 Independent Broker/Dealer Issue, 2001-2011. The information discussed herein is general in nature and provided for informational purposes only. There is no guarantee as to its accuracy or completeness. Nothing in this white paper constitutes an offer to sell or a solicitation of any offer to buy any type of securities. Reprinted by permission for use by Cambridge. All rights reserved.

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