The average advisor is 50 years old and only 11.7% of advisors are under age 35. While awareness about continuity and succession risks has increased in recent years, more than one-quarter (28%) of those within 10 years of their anticipated retirement are still unsure about their succession plan. Financial advisors are aging and the industry has been scrambling to find a proactive solution to this demographics problem. Advisors who are 55 years or older manage 36.9% of assets and comprise 39.2% of headcount.¹ Much is riding on how they handle that transition: The practices built by most advisory firm owners represent the largest single component of their net worth.²
Developing a succession plan can seem like a daunting task, which is a key reason why many advisors choose to avoid it for as long as possible. But, it is a process that gives you, the owner-advisor, an opportunity to monitor the value of your firm, shore up any weaknesses and then execute a successful transfer of the business.

Done well, a succession plan can serve as a valuable roadmap to comfortable retirement and can allow clients to rest easy, knowing their investments will be safe should anything happen to their advisor.

The following steps may help you jumpstart the process.
Prioritizing Succession Planning

1 Consider the Pros and Cons of the Major Succession Strategies

The first step in the succession planning process is to determine which of the three major succession scenarios suits your firm given the unique set of advantages and disadvantages that comes with each.

Internal Succession

A transition to someone within the seller’s organization, such as another partner, a junior advisor or a family member. The current owner is in charge of identifying and training the successor, and can help ensure job stability for other firm employees. He or she can also retire on the job and maintain a limited role in the business if desired.

- High degree of continuity for clients and employees
- Owner can retire on the job and maintain a limited role if desired
- The best leader for the firm may not exist internally
- Internal buyers often lack capital

Merger with Another Firm

Provides the owner with an immediate liquidity event for a portion of the business. Payment is usually in the form of cash or a combination of cash and equity in the merged firm. Clients are provided with a relatively high degree of continuity, while the firm’s owners benefit from the economies of scale that come with being part of a larger organization.

- Provides a partial liquidity event
- Achieves scale benefits from being part of a larger organization
- Often difficult to find another firm with a compatible culture
- Integration of firms can be complex and time consuming

Outright Sale to an External Party

Involves selling the entire stake in the business and transitioning client relationships to the buyer after the deal has closed. This strategy provides an immediate liquidity event to owners; common deal terms involve an upfront cash payment (often 20% to 40% of the negotiated price) combined with an interest-bearing note that gets paid over time.

- Provides a full liquidity event
- Fastest, least complex option for owners who wish to fully retire
- Could be highly disruptive to clients and employees
- Valuation may be less than expected
Prioritizing Succession Planning

## Budget Ample Time for the Transition Process

There are no shortcuts when it comes to executing an effective succession plan. In the case of a sale or merger, budget at least 18–24 months to find an external buyer or partner, negotiate a deal and execute the transition. Finding a merger partner with a compatible service approach, investment philosophy and culture can be difficult. Integrating firms can likewise be complex and time-consuming. There is also risk of both employee and client attrition after the merger.

The timeline is even longer for an internal succession. For starters, the next generation of talent required to manage and grow the firm may not exist in-house, and hiring externally can be time consuming — particularly if the first hire turns out to be the wrong choice. Moreover, few individuals have the ability to raise the capital required to buy a financial advisory business, so the purchase must typically be financed by the owner over an extended period of time. For that reason, budget no less than five years for an internal succession.

### YEARS 1

- **Set personal objectives and determine which succession scenario suits your firm**
- **Have an objective practice valuation performed and then make adjustments to address areas of weakness**
- **Identify internal successor or external buyer**
- **Structure and execute on succession plan, with emphasis on client retention and recruitment of next-generation advisors and investors**
- **Finalize transition**

### YEARS 3–7

- **Budget at least 18–24 months to execute a transition to an external partner**
- **Budget 5 years or more for an internal succession**
- **Be prepared to finance an internal succession**

An effective succession plan can take several years to execute.
Prioritizing Succession Planning

3. Understand the Drivers of Practice Valuation and Address Weaknesses

The value of an advisory firm is commonly expressed as a multiple of revenue, with practices typically valued at roughly 2 to 2.5 times recurring revenues. In assessing a practice, buyers will typically use the revenue multiple as a starting point and then make adjustments up or down to reflect the following individual characteristics of the business:

- Assets under management
- Client age and tenure
- Revenue mix
- Product mix
- Operations and technology platforms
- Financial terms of the deal
- Business location

For many firms, a major weakness is a high concentration of clients over the age of 60. This puts downward pressure on practice valuations, as older clients have less potential to generate future cash flow and retired clients are continually drawing down their accounts for living expenses.

A Major Weakness for Many Firms is a High Concentration of Older Clients, Which Depresses Practice Valuation

Age of Advisory Firm Clients By Channel

<table>
<thead>
<tr>
<th>Channel</th>
<th>Under 40</th>
<th>40 to 60</th>
<th>Over 60</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wirehouse</td>
<td>10%</td>
<td>41%</td>
<td>49%</td>
</tr>
<tr>
<td>National &amp; Regional</td>
<td>12%</td>
<td>43%</td>
<td>46%</td>
</tr>
<tr>
<td>Independent Broker-Dealer</td>
<td>11%</td>
<td>42%</td>
<td>46%</td>
</tr>
<tr>
<td>RIA</td>
<td>11%</td>
<td>43%</td>
<td>45%</td>
</tr>
</tbody>
</table>

Prioritizing Succession Planning

4 Attract and Retain Next-Generation Advisors

To maximize the value of their firms, advisors must be able to capture younger clients. Older advisors typically lose a large share of assets as their clients transfer wealth to the next generation. More than two-thirds of children who inherit money transfer it away from their parent’s advisor.¹

For that reason, it is critical to recruit young, skilled talent into advisory firms. On this front, much work remains to be done: Only 11.7% of advisors industrywide are under the age of 35, and the shortage of next-gen talent exists across all channels.²

To successfully attract and retain the next generation, firm owners should try to provide junior advisors with a clear understanding of their career tracks within the firm. Compared to older generations, millennials are more comfortable receiving advice and actively seek out collaboration opportunities. Flexibility of time, including the ability to work how and when they want, is also a highly important form of currency for junior advisors.

Next-Generation Advisors are Crucial to Succession Planning but are in Short Supply Across All Channels

Advisors under the age of 35

<table>
<thead>
<tr>
<th>Channel</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>National &amp; Regional Broker-Dealer</td>
<td>13.8%</td>
</tr>
<tr>
<td>Wirehouse</td>
<td>7.8%</td>
</tr>
<tr>
<td>Independent Broker-Dealer</td>
<td>3.6%</td>
</tr>
<tr>
<td>RIA</td>
<td>1.5%</td>
</tr>
</tbody>
</table>

Prioritizing Succession Planning

5 Take Proactive Steps to Maximize Client Retention

Succession deals frequently incorporate an earn-out component, which results in the price being reduced if client retention rates are less than expected. Indeed, from the buyer’s perspective, client retention is by far the most challenging aspect of a practice acquisition. For both internal and external successions, firm owners should proactively and consistently communicate with clients to help reduce the likelihood that they will move their accounts to another firm. Ensuring that employment contracts and non-solicitation agreements are in place for the advisory staff should also be part of the client retention process.

In the case of an external sale, selling advisors should collaborate with the buyers to ensure that clients have continuity in the areas of investment management, product selection and service levels. For internal successions involving a sale to a junior advisor, that advisor should start to take a lead role in client meetings well before the transition takes place in order to earn the clients’ trust.

Client Retention is the Top Concern of Advisory Firm Buyers
Most challenging aspects of a practice acquisition, percentage as cited by buyers

Continuity Plans Protect Clients
When the Unforeseen Happens

Simply put, it is good business to have a continuity plan in place. While a succession plan addresses the transition of a business at the end of an advisor’s career, a continuity plan takes effect in the event that he or she dies or becomes incapacitated. Having these plans in place is essential for ensuring your clients’ well-being. Without a licensed professional, client accounts can’t be accessed, and investments can’t immediately be sold or rebalanced.

And, more and more, these plans are being required by regulatory bodies. FINRA’s Rule 4370 requires all members to have a business continuity plan in place, as do NASAA’s Model Rule 203(a)-1A and the NASDAQ’s Rule 1013. The NASDAQ filed notice in November 2015 that they intend to begin to test the plans on file, in addition to requiring them. The SEC’s Rule 206(4)-7 assumes that part of an advisor’s fiduciary responsibility to their client is to take steps to protect the client’s interests should something happen to the advisor or their business. The SEC proposed a rule in 2016, and while it has not been finalized, succession planning is clearly an ongoing focus of regulators.

A continuity plan need not be nearly as extensive as a succession plan. The first step for advisors is to identify a licensed person who is willing to service their clients in the case of an emergency. A lawyer can help draft relatively simple buy-sell agreements that spell out the economic and legal terms that will go into effect under various scenarios.
Prioritizing Succession Planning

6 Identify Key Criteria for Evaluating Potential Successors

Evaluating successors is a complex process. In the case of an internal succession, the new leader must, at a minimum, be able to gain the trust and confidence of both clients and employees of the firm. Owners should define the length of the trial period for potential successors and set clear parameters for performance evaluation and feedback. Transparency and open communication are critical features of this process.

For an external sale or merger, owners should identify what is important to them and build a checklist to evaluate the strengths and weaknesses of potential buyers when it comes to clients, competitors and firm management.

Questions for External Buyers or Merger Partners Should Address the Key Areas of Clients, Competition and Firm Management

**CLIENTS**
- What is the firm’s main value proposition to clients?
- Who are the firm’s target clients?
- What is the target client service model for the firm (e.g., investment management, tax, insurance)?

**COMPETITORS**
- Who are the firm’s main competitors?
- How does the firm’s strategy differentiate it from them?
- How do the firm’s fees compare to industry standards? Do they put the firm at a competitive advantage or disadvantage?
- Where is the firm looking for new clients?

**FIRM MANAGEMENT**
- Is the firm’s incentive system aligned with both employee and client interests?
- Does the firm have sufficient resources to execute against its growth objectives?
- What are the key risks to the firm’s growth plans?
- Does the firm have a well-defined succession plan in place?
Prioritizing Succession Planning

A succession plan can serve as a powerful tool for maximizing the value of an advisory firm. Start planning early. Now is the best time to start thinking about succession planning for your business. Begin with the end.

What do you envision happening to your practice and your clients when you can no longer run the business?

Develop a process. Every practice is different and each succession plan requires a well thought-out road map.

Advisors who wait too long to develop a plan will likely fail to attain full value for their businesses. The time to take action is now.
Prioritizing Succession Planning

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2 CLS Investments: Reinvent Your Practice: Alternatives To Traditional Succession Planning, 2014.
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