The Efficient Frontier of Succession: Maximizing Practice Value

TABLE OF CONTENTS

LIST OF FIGURES

LIST OF TABLES

IMPACT POINTS

- One in 10 financial advisors is over 60 years old. Of all practices, 17% will be transitioning to a successor within two years (by 2014) and a staggering 40% will be transitioning within the next 10 years.
- Of those advisors who are within two years of transitioning their practice to a successor, 42% lack a succession plan. While an additional 13% have a plan, they do not have all the elements in place to execute it. As a result, 54% of practice owners who lack a succession plan do not know the value of their practice.
- One in three advisors who acquired a practice as part of building their own book of business reported that the acquisition resulted in a client retention rate of less than 50%. In other words, these advisors bought a practice only to find that they could not retain more than half of the acquired client relationships.
- Client retention is the top challenge for 22% of advisors who acquired their practice. Finding a suitable practice and implementing the transition also came well ahead of the financial side of transactions, such as obtaining financing for the deal.
- Almost 70% of advisors believe that it will take five years or fewer from the time they decide on a succession strategy until they can leave their practice. As internal succession is by far the most desired method of succession, five years or fewer would be tight for finding, hiring, and grooming an advisor who is a good fit for the practice.
- Mergers-and-acquisitions (M&A) consultants suggest budgeting 10 years for internal succession; this amount of time provides room for error (e.g., junior advisor turns out to be the wrong choice) and time to improve the practice value.
- When valuing their practice, advisors typically think in terms of revenue or assets, and often turn a blind eye to expense management. Practice buyers and M&A firms, however, use normalized earnings to provide a sense of profitability.
- If more than three years are available before succession, advisors have the opportunity to improve the value of their practice by addressing weaknesses (e.g., growth rate, technology, and operations platform used). Within the last three years, advisors can only focus on tactical measures, such as reducing risks (e.g., retaining key employees).
- Practice owners should aim for a client retention rate of 90% or higher, and should not agree to discount the practice valuation based on lower client retention assumptions (this is sometimes done by buyers). Instead, the acquisition contract should stipulate that the initial practice valuation will be adjusted downward should the achieved client retention rate be below 90%, and upward should the transition result in an increase in revenue.

INTRODUCTION

One of the biggest challenges that needs to be mastered by the U.S. wealth management industry is the problem of succession. The aging population in the U.S. not only requires that advisors connect with the heirs of their wealthy clients, but also that many advisors get ready to pass their advisory baton to the next generation. Advisors, like any other business owner, are attached to the practices they build, and many are making key decisions that will transition their practice to the next generation far too late.

When it comes to timing, there are great similarities between advisor succession and the concept of the efficient frontier. Published by Markowitz in 1952,[1] the concept is based on the tenet that investment performance may be maximized by optimizing the trade-off between risk and return. In constructing investment portfolios for clients, financial advisors utilize the efficient frontier concept while simultaneously taking into account the time frame in which investment returns will need to be realized or begin generating cash flow. Each client would ideally have a long-term investment horizon, but the reality is that not all do. This white paper aims to demonstrate that the time frame that underlies a succession process also has a great impact on the risk and return associated with advisor succession.

Published by NFP Advisor Services and produced by Aite Group, this study examines the current position of financial advisors in the area of succession planning, identifies when advisors should take key steps in the succession planning process, and discusses how buyers and M&A firms evaluate advisor practices.

METHODOLOGY

The analysis in this report leverages an online March 2012 Aite Group survey of 228 practice owners and interviews with leading buyers of advisor practices, brokers of practice sales, and consultants in the financial advisor marketplace. The data from practice owners has a 6-point margin of error at the 95% confidence level.

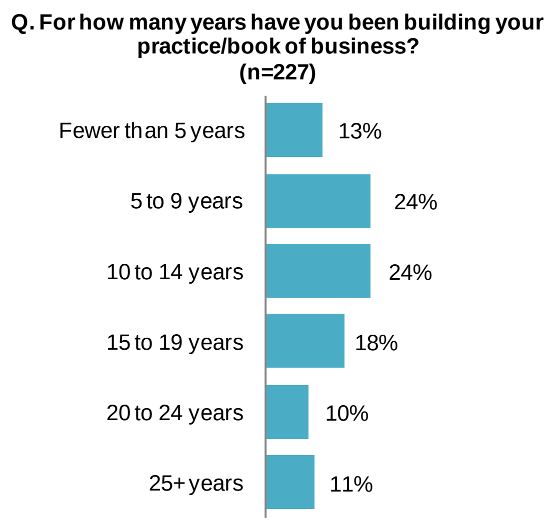
1. Harry Markowitz, "Portfolio Selection," Journal of Finance 7, No. 1 (Mar., 1952): 77-91.

THE SUCCESSION PROBLEM

THE STATE OF SUCCESSION

Given that one in 10 financial advisors is over 60, the wealth management industry is confronted not only with an aging client population, but also with an aging advisor population. Advisors who are reaching retirement age have spent 20 years or more building their practice and have built up a great deal of attachment to their books of business. There is no doubt that transitioning their beloved practice to the next generation will be hard for them.

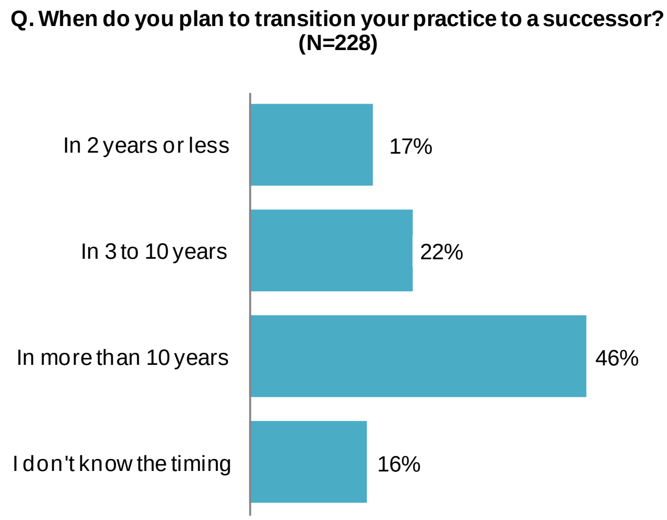
Figure 1: Age of Practice



Source: Aite Group survey of 228 practice owners, March 2012

As shown in Figure 2, 17% of all financial advisors want to transition their practice to a successor within two years (by 2014), and a staggering 40% wish to do so within the next 10 years. The topic of succession is clearly inevitable for financial advisors and is something they must prepare for.

Figure 2: Years to Transition



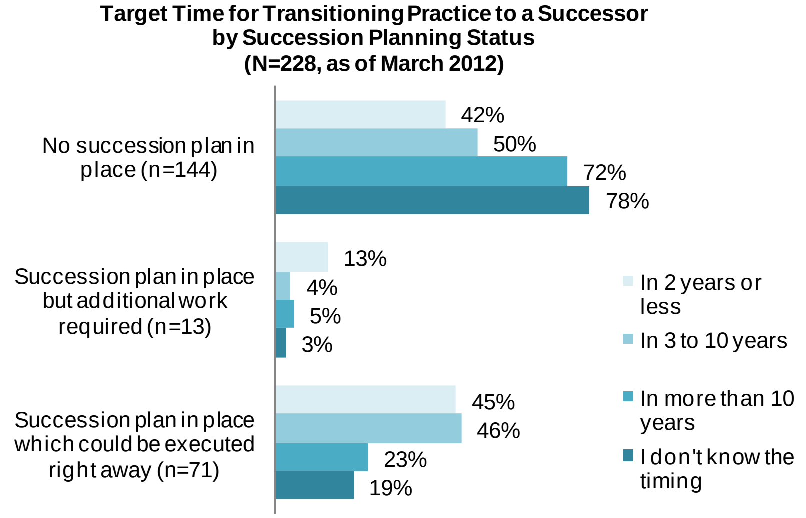
Source: Aite Group survey of 228 practice owners, March 2012

Advisors are specialists at helping their wealthy clients prepare for life events such as retirement. They would be the first to point out that having a plan—a financial plan—is a prerequisite for reaching one's goals. Is this any different than their own succession? It appears that advisors are not living up to the standards they apply to their client work; close to two-thirds of all practice owners do not have a succession plan in place.

Even worse, of those advisors who are within two years of transitioning their practice to a successor, 42% lack a succession plan. While an additional 13% have a plan, they do not have all the elements in place to execute it (Figure 3). Advisors who are three to 10 years away from succession show about the same level of succession planning adoption (46%) as peers who will transition their practice within two years.

Given that 40% of all financial advisor practices in the U.S. will have a change in ownership occur in the next 10 years (Figure 2), around one in five practice owners has either not yet realized that succession is rapidly approaching—and that a plan must be begun—or believes that he or she can go through this transition without any planning.

Figure 3: Level of Succession Planning



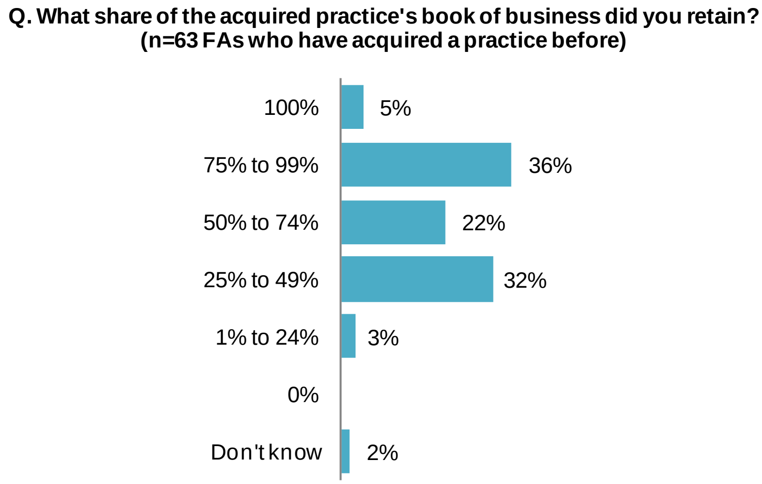
Source: Aite Group survey of 228 practice owners, March 2012

LEARNING FROM THE PAST

Very similar to retail investors who do not plan for retirement and therefore face a greater risk of missing their retirement goals, advisors who fail to plan their succession or do not start planning early enough risk jeopardizing a successful practice transition. Clearly, the ultimate test of success in the case of transitioning a practice is how many clients stay with the practice once a successor takes over.

Looking at past experience paints a grim picture. Of the advisors surveyed, 28% acquired a practice in the process of building their own book of business. One in three of these acquisitions resulted in a client retention rate of less than 50% (Figure 4), which means that these advisors bought a practice just to find that they could not retain more than half of the acquired client relationships. A further 22% of advisors lost more than a quarter of their acquired book of business. This is a drastic difference to the 90%-plus client retention rate that is commonly expected by an acquiring advisor and on which practice valuation and return-on-investment (ROI) calculations are based.

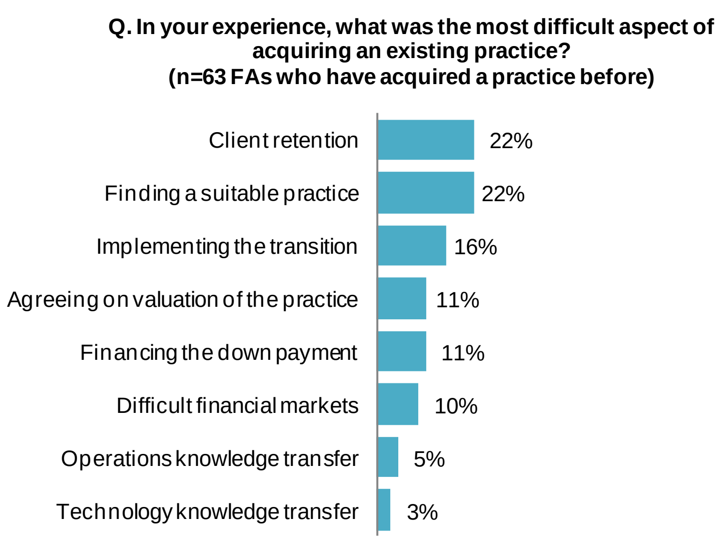
Figure 4: Client Retention for Acquired Practices



Source: Aite Group survey of 228 practice owners, March 2012

Client retention was the top challenge in acquiring a practice, with 22% of advisors who have gone through this process citing it as their biggest challenge (Figure 5). Finding a suitable practice and implementing the transition were the next highest ranking challenges.

Figure 5: Acquisition Challenges

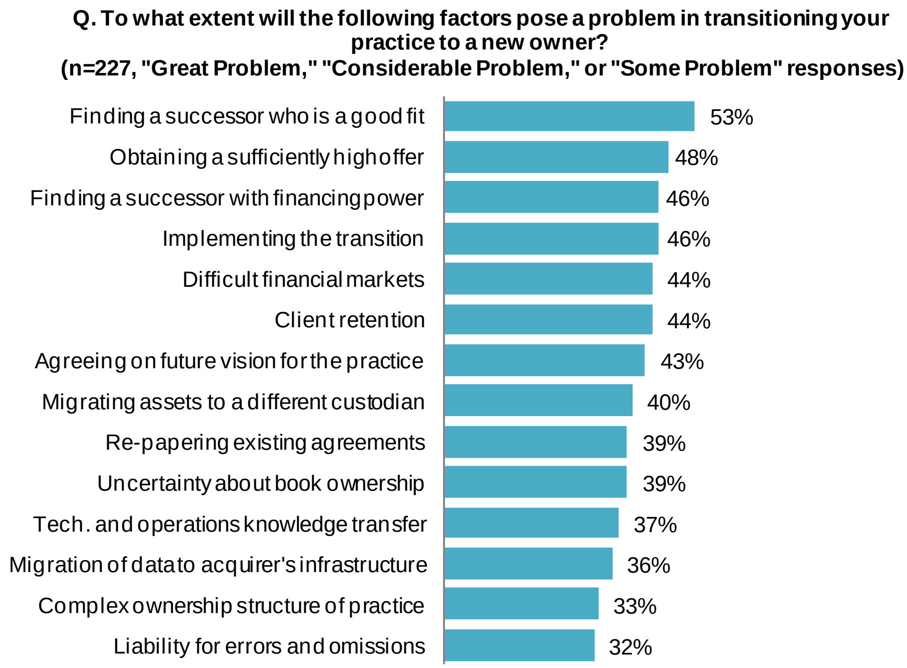


Source: Aite Group survey of 228 practice owners, March 2012

MASTERING SUCCESSION

Financial advisors realize that many areas could pose problems during the transition of their practice to a new owner. Finding a successor who is a good fit is considered the top issue for a majority of practice owners, followed by obtaining a sufficiently high offer from a successor and finding a successor who can actually come up with the funds to pay for the acquisition. While the implementation of the transition and client retention were ranked somewhat lower than what advisors' experience from past acquisitions has shown, these aspects did make it near the top.

Figure 6: Succession Challenges Anticipated by Practice Owners



Source: Aite Group survey of 228 practice owners, March 2012

Recognizing that there might be challenges is the first step to preparing for and avoiding them. Being prepared for a smooth succession is in the best interest of all involved parties:

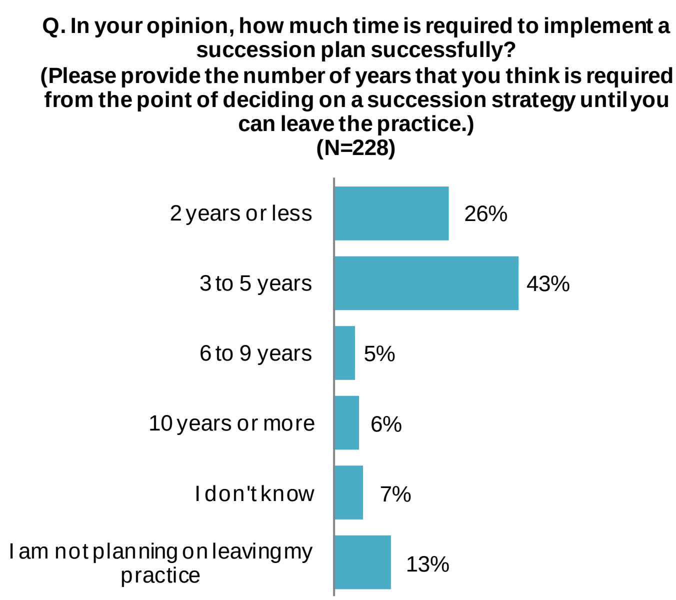
- **Clients** will not stay with the new advisor unless they are convinced the new entity is the right one to help them with their financial concerns.
- **Selling advisors** will see the value of their practice deteriorate in the case of low client retention and will face demands for a lower purchase price.
- **Acquiring advisors** are confronted with a difficult start with new clients and risk falling short of their set ROI goal.

To a large degree, selling advisors hold the key to success when it comes to transitioning an advisory practice to a new owner, as many risk factors can be avoided if enough time is available to address issues early enough in the process. In the following pages, this white paper provides key insights that can help improve the succession process by reducing or eliminating some of these challenges. The remainder of this section discusses key milestones in the succession planning process and the methodology commonly used for practice valuation.

TIME IS OF THE ESSENCE

One of the major issues in succession planning is that advisors start planning for it far too late. When asked how much time they think it would take to transition a practice to a successor, almost 70% of practice owners indicate that it will take five years or less from the time they decide on a succession strategy to the time they can leave the practice. Only 11% of advisors believe it will take six years or more (Figure 7). Considering that M&A consultants suggest starting to prepare for an internal succession at least 10 years before the planned transition, it is notable that only 6% of practice owners realize this much time is required.

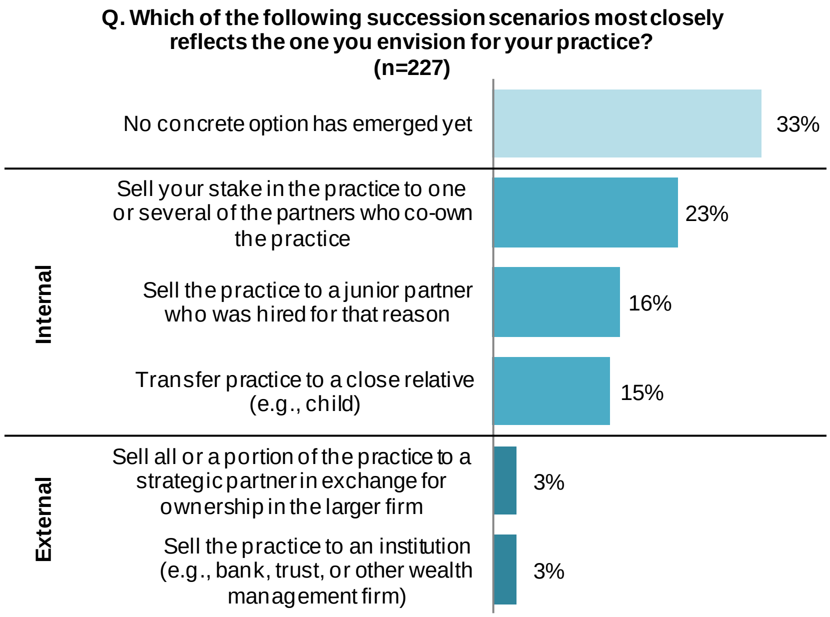
Figure 7: Expected Time Required for Succession



Source: Aite Group survey of 228 practice owners, March 2012

The time required for implementing a succession strategy will vary depending on what strategy the practice owner chooses. When asked what succession strategy they would prefer, however, one-third of all practice owners state that no concrete option has yet emerged (Figure 8). Around half of all advisors are planning for an internal succession, and only 6% of practice owners see an external sale as their goal. A lacking succession strategy paired with a short transition time frame poses a real risk for practice owners. It should also be noted that the choice of available strategies narrows once a financial advisor has less than 10 years to orchestrate the transition.

Figure 8: Preferred Succession Strategies Across All Practice Owners



Source: Aite Group survey of 228 practice owners, March 2012

While determining the succession strategy is critical and should be executed at least 10 years before the desired transition point to optimize the outcome for sellers, succession is a process—not just a single event. A number of key milestones must be considered in this process.

AROUND 10 YEARS BEFORE TRANSITION

- **Consider the impact of succession on your clients.** Consider what type of strategy will serve the practice's clients well and how they will react to a significant change in practice structure. This is particularly important if clients consider you as the advisor and owner of your practice and the sole or primary source of investment guidance and communication.

- **Decide on an internal or external succession strategy.**

  - Does the practice owner want to monetize the practice value or hand the practice to a junior advisor (e.g., family member)?

  - Does the practice owner want to stay involved once the practice has been handed over, or is a full departure from the practice the preferred option?

  - For internal succession, is the preferred successor known (e.g., family member, current partner) or is a new hire required to fill this position?

- **Establish a detailed succession plan** that lays out the details of the succession process and identifies any known risks that need to be addressed (e.g., business mix, age of client base, technology and operations issues, etc.).

FIVE TO 10 YEARS BEFORE TRANSITION

- **In the case of internal succession, hire the potential successor and define the length of the trial period.** To limit the risk if one hire does not work out, it would be prudent to bring several potential successors on board and determine over time which one (or several) would be in the best position to take over the practice.
- **Calculate a practice valuation** that can be used for identifying weaknesses and targeting efforts to maximize the practice value by the time of departure. Possible activities could include upgrading the firm's technology platform, segmenting clients by profitability, and putting greater focus on growing profitable relationships or on growing the firm's fee business.

TWO TO FIVE YEARS BEFORE TRANSITION

- **Consider handing over the practice to internal successors in several stages.** For example, three years before fully transitioning the practice to the successor(s), the practice owner could hand over a share of the client base while retaining relationships with key clients.
- **In the case of external succession, practice owners should start the search for an external buyer** and develop a short list of firms that would be a good fit for acquiring the practice. At this point, the practice owner should consider engaging an M&A consultant to help with the preparation of the sale and work with the selling advisor to avoid any potential roadblocks.
- **In either case, a practice valuation should be produced** that can be used as a guideline for talks with successors. The last three to five years of results are particularly important, for they allow the practice owner to demonstrate growth to a buyer.
- **Practice owners should also focus on getting their house in order.** Areas to focus on are improving expense management (i.e., eliminating unnecessary and non-operating expenses) and ensuring that all employees have good contracts in place and that key employees have an incentive to stay beyond the transition point. Streamlining technology service providers will further ensure that costs are minimized and that the transition will be more turnkey for a buyer.[2]
- **Adjust corporate structure.** Lastly, the practice owner must make sure that the corporate structure meets the needs of the succession strategy. For example, many advisory firms set up in the 1990s are S corporations (S-Corps)—a structure that makes it difficult to distribute equity. A limited liability company (LLC) is the preferred structure.

2. See the NFP white paper authored by Aite Group: *RIA Technology Integration: The True Opportunity Cost of Inefficiency*, July 2011.

AROUND ONE YEAR BEFORE TRANSITION

- **Make a final decision on who will succeed the practice owner and agree upon the terms of the practice acquisition.**
- **Develop a detailed plan that defines the steps of implementation for necessary technology and operations migration, and necessary product changes.**
- **Develop a communication plan to define how the succession will be communicated** to clients, employees, stakeholders, and business partners (e.g., vendors, custodians, broker-dealers, etc.).
- **When introducing the successor to each client, conduct meetings similarly to how they have always been conducted with that client.** To achieve the greatest possible client retention rate, the practice owner should hold at least three meetings with top clients:
    - In a first meeting, the selling advisor should inform the client about the succession plan, the timing involved, and any steps that will involve the client (e.g., re-papering).
    - A second meeting should be used to introduce the successor to the client. The meeting should be led by the selling advisor.
    - In a third meeting, held jointly, the buying advisor should take control of the relationship.
- **Get client consent,** which is required as a condition for closing per the U.S. Investment Advisers Act of 1940. A 45- to 60-day window is typical for obtaining the consent from all clients. This consent could be obtained as part of one of the meetings that introduce the successor to the client.

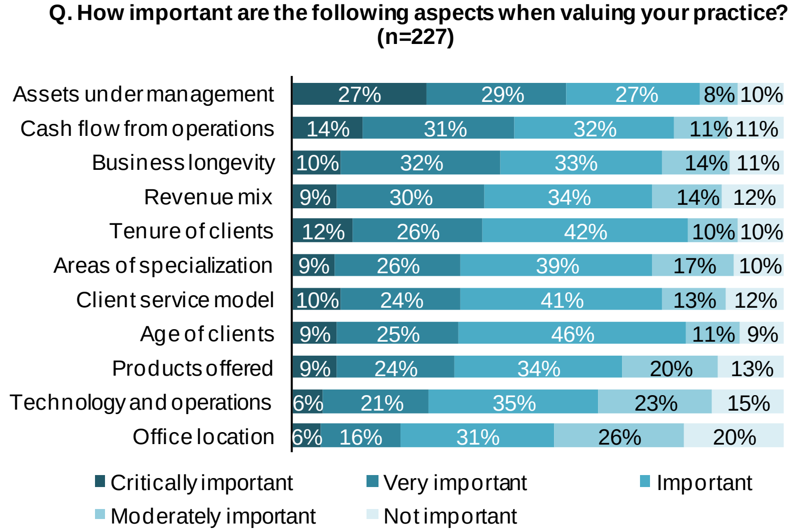
AFTER THE TRANSITION

- **The selling advisor could stay for a number of months, post-acquisition,** to guarantee a smooth transition. This could also be structured as an earn-out, which gives the selling advisor an incentive should certain client retention rates be reached.
- **Ideally, a departing advisor would continue to work in an ambassador role with his or her successor, providing the emotional connection with long-standing clients.** The departing advisor could work 20 hours per week in the first year and reduce work time gradually thereafter, while at the same time stepping down the salary received from the practice.

VALUATION AND THE IMPORTANCE OF CASH FLOW

As shown in Figure 6, obtaining a sufficiently high offer is a major concern for practice owners. What constitutes a fair offer might differ depending on who is doing the valuation (the buyer or the seller, say) and how the valuation is calculated. While assets under management are typically considered a valuation driver, advisors do realize that many other aspects influence the value of their practice. Almost all practice characteristics listed in Figure 9 are deemed important by at least two-thirds of respondent practice owners.

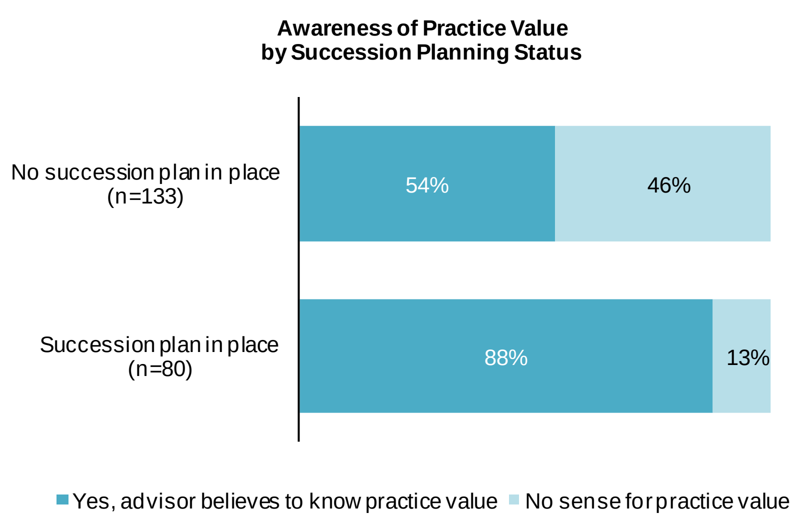
Figure 9: Important Aspects of Practice Valuation



Source: Aite Group survey of 228 practice owners, March 2012

Despite knowing that many factors influence their practice value, advisors often do not know what their practice is worth. As shown in Figure 10, the majority of practice owners (54%) who lack a succession plan do not know the value of their practice. Across all practice owners, one in three does not know the value of his or her practice.

Figure 10: Practice Valuation



Source: Aite Group survey of 228 practice owners, March 2012

A basic valuation question is what key business indicators should be used for the calculation. While a valuation based on total client assets and revenue might be the simplest and most intuitive way of calculating a valuation, it does not reflect the health or growth prospects inherent in a practice. To reflect the firm's expense management, buyers of advisor practices and consultants active in the wealth management business use some type of normalized earnings, such as free cash flow, adjusted net income, earnings before owner compensation (EBOC), or earnings before interest, tax, and amortization (EBITA). These measures hold in common that the income and the expense side of the practice balance sheet is reflected in the calculation. A practice valuation is performed as shown in Table A.

Table A: Valuation Formula

	Component	Description
	Production	Trailing 12 months of income generated by the practice. If buyers are only interested in acquiring fee business, any commission revenue might be excluded from the valuation.
–	**Compensation expenses**	All salary and salary-related costs like benefits and insurance—aside from any staff working for the practice. The salary paid to the practice owner must also be included in this component. Compensation should not represent more than 75% of total expenses.
–	**Non-compensation expenses**	All costs not related to salaries are included here. These include technology costs, operating costs (e.g., custody, reconciliation), office rent, marketing fees and sales materials, consultant fees, travel expenses, etc.
=	**Normalized earnings**	Normalized earnings should be 30% or higher of total production. This earnings measure is taken as the basis for calculating the practice valuation.
x	**Valuation multiplier**	The practice value is determined as a multiple of normalized earnings. The typical multiplier is between five and nine times normalized earnings, depending on qualitative factors such as the growth rate of the practice, average tenure, and age of clients. The bulk of practices would be valued with around six-and-a-half to seven times normalized earnings.
=	**Practice value**	

Source: Aite Group Analysis, M&A consultants, Buyers

A valuation has to take into account the unique features of a practice beyond its income and expenses. As each practice is different from the next, the precise valuation multiplier used will have to be adjusted to the particular case. Some of the key aspects considered are:

- **Practice growth rate**: Financial advisor businesses typically see an average annual asset growth of between 7% and 12%. Given the recent difficulties in the financial markets, however, any growth beyond market appreciation could be valued at a premium.

- **Scale of practice**: Practices vary greatly in business maturity. While the measure cannot be seen in a vacuum, the amount of client assets managed by the practice can give a good indication of it. Given that the independent financial advisor market is made up of many small practices and very few larger ones, a practice that can demonstrate scale (i.e., has reached a certain size while at the same time being able to maintain its asset growth momentum and control over expenses) will fetch a premium. Practices with client advisory assets less than US$250 million will fetch a low valuation multiple (around five times normalized earnings), while those with more than US$750 million in assets could command a premium (multiples by eight times normalized earnings and higher).

- **Age and tenure of client base**: While a large share of clients with a long tenure at the firm is a good sign, buyers will take a careful look at the age distribution across the client base. It is not uncommon that the average client age is aligned with the age of the retiring advisor. This will raise a red flag for buyers, as advisors typically lose a large share of assets as their clients pass assets to the next generation (i.e., through intergenerational wealth transfer). Practice owners are well advised to demonstrate that they are able to connect with the next generation.

- **Ratio between recurring and commission-based revenue**: Buyers frequently prefer a fee-based revenue stream—its recurring nature gives it more stable revenue (i.e., "stickier"), which is often easier to transfer to another advisor and gives a better basis for projecting future revenue.

- **Geographic location**: The location where the selling financial advisor is active will determine the growth potential for his or her practice. Is it an area where wealth is created or to which wealthy clients migrate?

- **Quality of technology and operating infrastructure**: Buyers of an independent practice who intend to keep the practice on the same technology and operating platform will put a premium on a solid infrastructure that is not only reliable, but also allows them to grow the practice without making significant technology investments. Ease of asset transferability (e.g., investment management continuity) will assist in client retention.[3] Of course, there will be less focus on technology and operations if the intention is to migrate the acquired practice to the buyer's infrastructure

Separately, buyers might be looking for particular practice characteristics (e.g., an established client base in a particular industry segment or geography) and might be happy to pay a premium for a practice that meets set criteria.

When it comes to their practice's valuation, practice owners have a number of considerations:

- **Practice-owner compensation**: It is typical in a financial advisor's practice for the entire income to be consumed by expenses (i.e., a practice that generates an income of US$500,000 would have expenses of the same amount), meaning that very little of the

3. See NFP Advisor Services white paper authored by Aite Group: *RIA Technology Integration: The True Opportunity Cost of Inefficiency*, July 2011.

income is retained in the firm for investments in the business. This not only signals low levels of business maturity, but also makes a practice valuation impossible—normalized earnings would be zero where no income is retained. The practice's finances must be normalized; the practice owner should take a salary that is in line with a customary salary in the industry. This salary will be treated as compensation-related expenses and will allow normalized earnings for the firm to be determined. In addition, it will make it easier for financial advisors (and buyers) to get a sense for the cash generated by the practice that can be used for reinvesting in the business.

- **Client retention**: Because the real value of a financial practice lies in its client base, retaining clients must be a major focus in any succession process. Buyers and M&A firms expect to retain more than 90% of the practice's assets and revenue. A well-implemented succession process might even lead to increased production; the systematic discussion and hand-over of client cases and the associated client discussions could uncover client needs that have not been previously addressed. Client retention should not be factored into the initial valuation (e.g., discounted cash flow), however, as it is close to impossible to predict a retention rate with sufficient precision. A much better approach is to initially assume the client retention rate will fully meet the buyer's expectations and reset the valuation during the process should assumptions not be met. Structuring the deal in multiple phases is one approach to achieving this goal. For example, the departing advisor could receive a fixed down payment up front, an interest-bearing note that gets paid over time, and an earn-out component that reflects the success of the transition. The earn-out could be initially budgeted at one-third of the total valuation, but, depending on client retention, could come in above or below that amount. This could also give the departing advisor an incentive to stay involved in the practice and ensure a smooth transition.

Clearly, the valuation of an advisory practice is a complex matter that involves a mix of hard numbers as well as many qualitative factors. It is no surprise, therefore, that many financial advisors do not have a good sense of the value of their practice. Advisors who plan to transition their practice to another advisor should not wait until the last moment to establish a valuation of their practice. Instead, they should complete a valuation at least five years before their planned departure—especially if they want to maximize the value of their practice by addressing weaknesses.

CONCLUSION

Advisor succession is an urgent issue for the wealth management industry in the U.S. Forty percent of practice owners plan to transition their practice within the next 10 years, and half of these advisors have yet to develop a plan that will help them master the challenges of succession, such as finding the successor who is best suited for the practice's clients and obtaining the maximum value for the business that advisors have often spent decades building. Similar to investment options narrowing when the time horizon for the investment shortens, all options for succession are only available if a practice owner starts planning at least 10 years ahead of the targeted transition point. While a 10-year horizon would be optimal, Aite Group's advisor survey shows that for many practice owners it is not a reality.

Nonetheless, there is much that advisors can do regardless of where they may be in the horizon leading up to the succession of their practice. Every practice owner should go through a business assessment and practice valuation exercise, ideally with a consulting firm that specializes in advisor practices, to evaluate their current situation and identify and prioritize the areas on which to focus. However, the levers available to financial advisors largely depend on the time they have left before they plan to transition their practice.

- **Financial advisors with more than three years until practice transition can influence the practice valuation**. If addressed early enough, many of the components that drive valuation can be influenced by the owner of the practice. For example, if the weak point of a practice is its technology and operating model, a migration to a different infrastructure or to an outsourced platform could be considered. If an aging client base is an issue, a concerted effort to win younger clients or connect with the clients' children will be beneficial. Similarly, more than three years are required if a successor needs to be hired and groomed or if the practice has to be handed over in stages to a successor. Clearly, identifying issues early on in the process will give the practice owner the necessary time to tackle them and to choose the most appropriate solution path.
- **Financial advisors with less than three years until practice transition should focus on mitigating existing risks**. Most valuation drivers can rarely be substantially changed within a matter of months or a few years. As a result, once fewer than three years remain, the practice owner will no longer be able to increase the enterprise value of the practice in a meaningful way. The focus of the last three years before a successor takes over the practice should address existing risks, such as ensuring that key employees will stay at the firm post-transition, and streamlining technology service providers to help minimize costs and ensure a turnkey transition for a buyer. At this point, the decision about what succession strategy to follow will need to have been made long ago, and all the attention should be put on taking tactical measures to implement the chosen succession strategy.
- **Regardless of where they may be in the succession planning process, financial advisors can—and should—focus on client retention**. Client satisfaction is the key driver for retention before and after succession of a practice, and will drive higher valuations. Ensuring that clients are being actively and systematically communicated with will keep them engaged and provide advance warning should they consider transitioning their

account to another advisor. Having a strategy that provides client continuity post-transition—relative to investment management, account access, performance/statement reporting, product selection, communication, etc.—will provide the least amount of disruption and likely the highest level of retention.

RELATED RESEARCH

NFP ADVISOR SERVICES WHITE PAPERS

RIA Technology Integration: The True Opportunity Cost of Inefficiency, July 2011.
To request a copy, visit www.nfpasg.com/whitepaper.

AITE GROUP RESEARCH

Top 10 Trends in Wealth Management, 2012, January 2012.

Financial Advisors' Use of Social Media 2011: The Bloom Is Off the Rose, December 2011.

U.S. Retirement Income: The Shift from Accumulation to Decumulation, November 2011.

Managing Wealth: Advisor Perspectives on Investment Products and Fee Business, November 2011.

Efficiency in Wealth Management: Mobile at the Gates, October 2011.

Wealth Management on the Move: The Moment of Truth, June 2011.

CRM for Wealth Management: Approaching Total Practice Management, April 2011.

ABOUT AITE GROUP

Aite Group is an independent research and advisory firm focused on business, technology, and regulatory issues and their impact on the financial services industry. With expertise in banking, payments, securities & investments, and insurance, Aite Group's analysts deliver comprehensive, actionable advice to key market participants in financial services. Headquartered in Boston with a presence in Chicago, New York, San Francisco, London, and Milan, Aite Group works with its clients as a partner, advisor, and catalyst, challenging their basic assumptions and ensuring they remain at the forefront of industry trends.

Partner. Preserve. Prosper.™

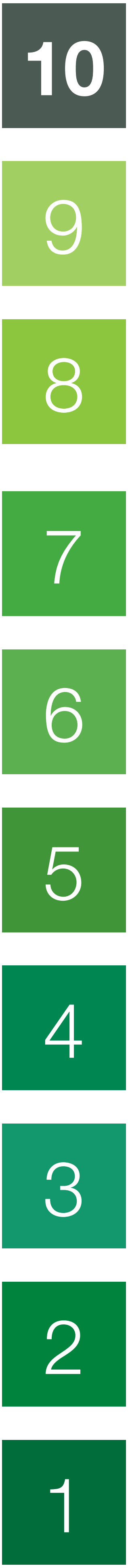
NFP™ Benefits Insurance Wealth Management

Succession planning is a process —

not an event.

Maximize Practice Value Now
for a Profitable Succession Then

NFP™
Advisor Services



Ten years.

That’s the amount of time that mergers-and-acquisitions (M&A) consultants believe financial advisors should budget for successful succession planning.

Five years.

That’s the amount of time nearly 70 percent of financial advisors believe they should budget for successful succession planning.

That’s a big difference — one that should make every practice owner think twice about their succession approach. *Or lack of one.*

The Time Is Now

A staggering 40 percent of practice owners anticipate a succession event within the next 10 years, yet only one-third of all practice owners have a succession plan in place, according to a study commissioned by NFP Advisor Services Group and produced by independent research firm Aite Group.

Every day, financial advisors work to maximize investment outcomes for their clients by optimizing the balance of risk and return to fit a client's time horizon. That same thinking needs to be applied to an advisor's succession planning.

Yes, more planning time gives you more options. But whether your time horizon is two years or 20, there are steps you can take right now to maximize the value of your practice.

Maximizing Practice Value

Because many advisors don't have a full 10 years to plan for practice succession, the study – which leverages interviews with leading buyers of advisor practices and brokers of practice sales, as well as a practice owner survey – suggests three actionable steps financial advisors can take to improve the value of their practice across any time horizon:

- **Advisors with three+ years until practice transition**

  Focus on influencing practice valuation

  If the weak point of a practice is its technology and operating model, a migration to a more effective and efficient structure could be considered. Or if an aging client base is the issue, a concerted effort to win younger clients might become the focus.

- **Advisors with less than three years until practice transition**

  Focus on mitigating existing risks

  At this point, all attention should be on mitigating risk, such as employee retention post-transition. There's also still time to implement streamlined technology and efficiencies that will be turnkey for a buyer.

- **At any point in the succession planning process**

  Focus on client retention

  The real value of a financial practice lies in its client base, so retaining clients must be a major focus. Buyers and M&A firms expect to retain more than 90 percent of a practice's assets and revenue. That means you need to find ways to spend more time building and solidifying relationships before transitioning them and after succession occurs. You also need a strategy in place that provides client continuity relative to investment management, account access, product selection and communications.

Source: *Aite Group. "The Efficient Frontier of Succession: Maximizing Practice Value."*


Only one-third of all practice owners have a succession plan in place.

NFP Succession Planning

Getting ahead of the sell or buy opportunity

Buy or Sell

NFP Succession Planning, an NFP Advisor Services resource, is a forward-thinking transition readiness program that enables you to prepare for a buy or sell by closely examining the practice you've built, or one you're considering, in tandem with your future goals. Whether you use the resulting knowledge to develop a comprehensive succession plan or to create a clear runway for expansion, our personalized consulting, third-party expertise and specialized technology guide you through the multiple options and processes.

Every advisor, not just the 1 in 10 who is over 60 years old, needs a detailed succession plan. The earlier planning begins, the more time there is to build practice value, implement turnkey efficiencies that buyers prize and mitigate risks. NFP Succession Planning helps you to estimate your worth and manage it over time, and to create a customized internal or external exit strategy that protects your clients and a lifetime of work.

Buying the right practice requires as much foresight and planning as a sell. Prevent missteps and missed prospects by walking through a stepwise series of critical considerations, conversations and actions with NFP Succession Planning. You'll have a clear understanding of what you're looking for before you begin the search, and, when you're ready, the support you need to confidently carry out the transaction.

NFP Succession Planning does more than prepare you for a sell or buy opportunity — it helps you maximize it.

Explore NFP Succession Planning

NFP Succession Planning is designed to ensure that the critical areas of a buy or sell are taken into account now, so that there are no surprises later.

NFP Succession Planning Guide

The complex process of building a sound succession plan or preparing for a buy is made clearer with the NFP Succession Planning Guide, a technology-based planning and documentation tool backed by the support of your consultant. Housed under the Practice Enrichment Program in AdvisorComplete—,NFP Advisor Services Group's single-touch advisor workstation, the tool allows you to capture, document, house, share and, ultimately, prepare the information that you need to execute on your buy or sell opportunity.

What’s Your Practice Worth?

If you don’t know what your practice value is, how are you going to maximize it? Among the two-thirds of owners who don’t have a succession plan in place, more than half don’t know the value of their practice. Across all practice owners, 1 in 3 doesn’t know the value of his or her practice. Don’t be one of them.

Use the below valuation formula, created by Aite Group Analysis with input from M&A consultants and buyers, to determine what your practice is worth. Then read more about key financial and non-financial valuation factors you need to consider in “The Efficient Frontier of Succession: Maximizing Practice Value.”

	Production	Trailing 12 months of income generated by the practice. If buyers are only interested in acquiring fee business, any commission revenue might be excluded from the valuation.
–	**Compensation Expenses**	All salary and salary-related costs like benefits and insurance aside from any staff working for the practice. The salary paid to the practice owner must also be included in this component. Compensation should not represent more than 75% of total expenses.
–	**Non-Compensation Expenses**	All costs not related to salaries are included here. These include technology costs, operating costs (e.g., custody, reconciliation), office rent, marketing fees and sales materials, consultant fees, travel expenses, etc.
=	**Normalized Earnings**	Normalized earnings should be 30% or higher of total production. This earnings measure is taken as the basis for calculating the practice valuation.
X	**Valuation Multiplier**	The practice value is determined as a multiple of normalized earnings. The typical multiplier is between five and nine times normalized earnings, depending on qualitative factors such as the growth rate of the practice, average tenure, and age of clients. The bulk of practices would be valued with around six-and-a-half to seven times normalized earnings.

= Practice Value

Source: *Aite Group. “The Efficient Frontier of Succession: Maximizing Practice Value.”*

Maximize your business now, so you get the money you want then.

It’s never too early – or too late – to make your business worth more. Find out how NFP Advisor Services’ integrated technology and service solution for independent advisors can help you leverage your strengths and capitalize on new opportunities.

Contact us at 800-966-9474 or at nfpadvantage@nfp.com.

Visit www.nfpasg.com for more information.

NFP™
Advisor Services