



# THE ADVISOR RETIREMENT WAVE

Succession Strategies for  
an Effective Transition

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Over the coming decade, nearly 70,000 advisors, controlling more than \$2 trillion in assets under management, will retire. 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. As such, how advisors go about monetizing that asset is of crucial importance.

But while demographics are intensifying the need to address succession planning, less than one-third of financial advisors have put in place an actionable plan for transitioning their firms.

A well-crafted succession plan can help a practice owner take the steps necessary to realize full value for his or her firm, and execute a successful transfer of the business.

# KEY FINDINGS

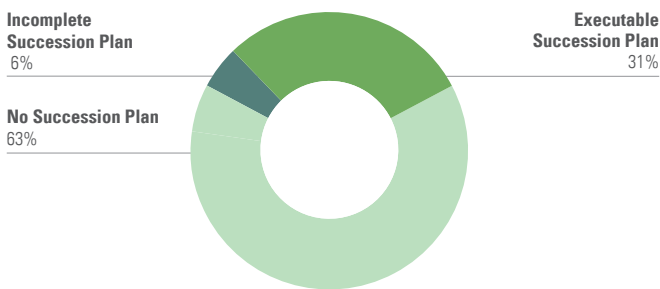
- Nearly one-quarter of advisors industry-wide plan to retire or leave the industry within the next 10 years, but two-thirds of all practice owners do not have a succession plan in place. Moreover, advisors who are within two years of retiring have about the same low level of succession planning adoption as those who are a decade away from stepping down.
- Three major succession paths are available to advisors: An internal succession, a merger with another firm, or an outright sale of the business. Each of these strategies comes with a unique set of advantages and disadvantages for practice owners to consider.
- It typically takes a minimum of five years to identify and groom an internal successor. In the case of a sale, it usually takes at least 18-24 months to find an external buyer, negotiate a deal, and execute the transition. Advisors' looming plans for retirement only heighten the need to start preparing for succession today.
- Advisors often have unrealistic ideas about what their businesses are worth. On average, owners expect their practices to be worth 2.7 times their total revenue. But for those advisors who actually purchased a practice in 2014, the average price paid was 23% lower at 2.1 times revenue.
- Higher client retention rates drive higher practice valuations. But the risk of losing clients as a result of a succession is substantial: 1 in 3 buyers reported that the acquisition resulted in a client retention rate of less than 50%.
- To maximize their business' value upon transition, practice owners must ensure an ideal client mix across age ranges and demonstrate that they are able to connect with the next generation. Since next-gen clients are often looking for a younger advisor who is likely to outlast them, it is critical to attract young, skilled talent into practices.
- Advisors who take the time to consider the emotional aspects of succession, and how they might best go about addressing them, will greatly increase their chances of engineering a successful transition.

# THE SUCCESSION CHALLENGE

Advisor succession has long been a challenge for our industry. But as the pace of retiring advisors continues to accelerate — almost 70,000 advisors, controlling more than \$2 trillion in assets under management will retire over the next decade — the need to address the issue is intensifying.<sup>1</sup>

The practices built by most firm founders represent the largest single component of their net worth. As such, how advisors go about maximizing the value of that asset and ultimately monetizing it is of crucial importance. “The lion’s share of advisory practices today need the best valuation possible to help the owner retire,” says Scott Egner, managed account solutions manager at TD Ameritrade Institutional.

**Figure 1: Succession Planning Status of Financial Advisors**



Source: Aite Group: The Efficient Frontier of Succession Planning: Maximizing Practice Value, 2012.

Succession planning is a process that gives an advisor the opportunity to monitor the value of his or her firm, shore up any weaknesses, and then execute a successful transfer of the business. But despite the clear value of a well-defined succession plan, the vast majority of advisors have yet to establish one:

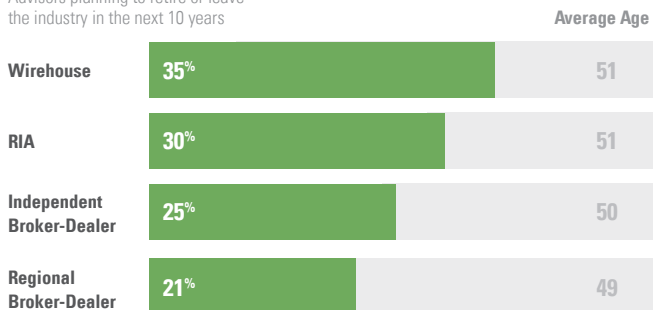
- Two-thirds of all practice owners do not have a succession plan in place.<sup>2</sup>
- 6% have only a partially completed plan.<sup>2</sup>
- Advisors who are within two years of retiring show about the same low level of succession planning adoption as those who are up to 10 years away from stepping down.<sup>2</sup>

## The Clock is Ticking

Nearly one-quarter of advisors industrywide plan to retire or leave the industry within the next 10 years, with an even higher proportion of registered investment advisors and wirehouse advisors planning to exit over that timeframe.<sup>3</sup> The average age of financial advisors in most channels is above 50 and more than one-third are over the age of 55.<sup>3</sup> At the same time, it typically takes a minimum of five years to identify and groom an internal successor. In the case of a sale, it usually takes at least 18–24 months to find an external buyer, negotiate a deal, and execute the transition.<sup>4</sup> Advisors’ looming plans for retirement only heighten the need to start preparing for succession today.

**Figure 2: Advisor Plans for Retirement or Career Change**

Advisors planning to retire or leave the industry in the next 10 years



Source: Cerulli Associates, The Cerulli Report: Advisor Metrics 2014.

## The Lack of a Succession Plan Can Jeopardize Client Relationships

Advisors who fail to implement a succession plan risk losing both existing and potential clients due to concerns that the advisor may sell or retire in the near future with no obvious successor lined up. But with a succession plan in place, advisors can demonstrate to clients that they have made plans to help them successfully transition their affairs when they ultimately exit the business. “Among the very best advisors, succession planning is universally an enormous priority and something

they are constantly refining,” says Sterling Shea, Associate Publisher, Head of Advisory and Wealth Management Programs at Barron’s. “Creating a business model that can live on beyond the principal is absolutely paramount to their success.”

## Continuity Plans May Soon be Mandatory

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. When an advisor is suddenly unable to work, a continuity plan allows for another advisor to take care of his or her clients immediately. Having these plans in place is essential for ensuring clients’ well-being — without a licensed professional, client accounts can’t be accessed and investments can’t immediately be sold or rebalanced. The continuity plan is also crucial for an advisor’s family, as the absence of one could severely depress the value of the practice.

Simply put, it is good business to have a continuity plan in place. And soon, advisors may not have a choice: the Securities and Exchange Commission is currently considering rules requiring advisors to adopt continuity plans. 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 straightforward buy-sell agreements that spell out the economic and legal terms that will go into effect under various scenarios (e.g., disability or death).

# CHOOSING A SUCCESSION OPTION

## Three Major Strategies

The first step in the succession planning process is to determine which of three major succession scenarios suits the firm: an internal succession, a merger with another firm or an outright sale of the business. Each of these strategies comes with a unique set of advantages and disadvantages for advisors to consider.

### 1 Internal Succession

#### Ownership is Transferred to Someone Else within the Organization

- High degree of continuity for clients and employees
- The best leader for the firm may not exist internally
- Internal buyers often lack capital

“One of the biggest obstacles is that founders must be willing to accept the displacement of their role and relinquishment of their control.”

—**Ted Cronin**, *Manchester Capital Management*

### 2 Merger with Another Firm

#### Owner Merges the Business with Another Firm

- Provides a partial liquidity event
- Often difficult to find another firm with a compatible business model
- Integration of firms can be complex and time consuming

“No matter how good the legal documents are, a merger won’t work without a strong cultural fit and shared vision.”

—**Bob Glovsky**, *Colony Group*

### 3 Outright Sale to External Party

#### Owner Sells All Equity to an External Party

- Provides a full liquidity event
- Could be highly disruptive to clients and employees
- Valuation may be less than expected

“The highest bidder for your firm is not always the best choice for your clients.”

—**Geoff Frazier**, *Global Financial Private Capital*

# 1 Internal Succession

## The Opportunity

Internal succession is a transition to someone within the seller's organization, such as another partner, a junior advisor or a family member. This option offers a high degree of continuity for clients, since the successor is usually well known to the client base. 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.

## The Challenges

Finding the right individual to take over a practice can be difficult. The next generation of talent required to manage and grow the firm may not exist in-house, and hiring externally for the next leader can be an expensive proposition that may create tensions with the existing staff. Even if the right talent is identified, few individuals have the ability to raise the capital required to buy a financial advisory business. For that reason, the purchase must typically be financed by the owner over an extended period of time.

Compared to the merger and sale options, the timeline is much longer for an internal succession: consultants usually suggest budgeting no less than five years for internal succession. This amount of time provides room for error (e.g., if the first choice turns for successor turns out to be the wrong choice).

## Case Study

### INTERNAL SUCCESSION IS OFTEN A LESSON IN PATIENCE

Ted Cronin, founder and CEO of family office Manchester Capital, knows firsthand that there are no shortcuts when it comes to executing a successful internal succession. Realizing that the next leader of the firm might have to be found externally, Cronin first explored the option of merging with another practice. But the process ultimately did not yield a merger partner that possessed the right cultural and business model fit for Manchester and its clients.

That meant investing in the internal succession route. "We've had to acquire talent at some expense," says Cronin. The firm initially brought in a senior hire with the intention of ultimately making that individual the next CEO. But, as is so often the case with internal successions, that initial choice did not become the successor. Manchester has subsequently brought in several potential leaders, thereby eliminating the risk that one particular hire doesn't work out. "It's been a long road, but between hiring potential leaders and grooming internal candidates, we certainly have the personnel in place now that will be fully capable of running the firm," says Cronin.

Transparency and open communication have also been important features of the firm's internal succession process. Weekly meetings are held for the CEO candidates to discuss business issues, client issues and the firm's overall direction. "Over the course of the next three years, I think it will become clearly evident who should be the next CEO," says Cronin. Also crucial was starting the succession process several years before Cronin planned to step down. "The next leader has to have sufficient tenure to gain the trust and confidence from both client families and employees of the firm," notes Cronin. "He or she can only do that over a period of time."

## 2 Merger with Another Firm

### The Opportunity

In this option, the owner is looking to merge into another firm with a similar advisory approach and cultural fit. In a related variation, the owner sells a portion of the firm to a larger collection of practices. In either case, a merger 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 firm owners benefit from the economies of scale that come with being part of a larger organization.

### The Challenges

Finding a merger partner with a similar service approach and investment philosophy can be difficult. Cultural fit is also crucial, but can be hard to attain. Integrating firms can be complex and time-consuming, and there is risk of both employee and client attrition after the merger.

### Case Study

## THE SUCCESS OF A MERGER HINGES ON CULTURAL FIT

Three years ago, Bob Glovsky, a founder of Mintz Levin Financial Advisors, made the decision to merge his firm into the Colony Group. At the time, Glovsky was bringing in the majority of the firm's revenues, a situation that was not sustainable over the longer haul. Glovsky and his partners initially considered hiring potential leaders for an internal succession. But that option, they estimated, would take about five years and entail a seven-figure capital investment, while offering no guarantee of success. So the firm instead hired an investment banker and investigated potential merger partners.

About 18 months later, a deal to merge into Colony Group was negotiated. One of the major benefits of the merger is that Colony is large enough to employ a full-time staff of 10 professionals dedicated to running the firm, including a CEO, COO and CIO. "It takes the pressure off the advisors to have to be managers as well," says Glovsky. "That operating leverage was very compelling for us." The merger also enabled Mintz Levin to assure its clients that there would be an ongoing structure in place for them and the advisors who were serving them.

The two firms also planned what the organization would look like when it was combined, right down to making sure the offices were interspersed so to avoid an "us versus them" feel. And all professionals in the combined firm work together on best practice committees. "The reason we were able to do the merger is because there was a real cultural fit," says Glovsky. "At the end of the day, the real question is: Are you owner and seller, or are you partners? If it's the latter, then your chances of success will go up dramatically."



# 3 Outright Sale to External Party

## The Opportunity

In this option, the owner seeks to sell his or her entire stake in the business and transition 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.<sup>5</sup>

## The Challenges

For clients and employees alike, the risk of disruption following an outright sale is high. Clients will likely not stay with the new firm if they detect a noticeable change in a practice's investment philosophy, service level, or fee structure.

## Case Study

### KEEPING EXPECTATIONS IN CHECK

Recent research shows that advisory firm owners often have unrealistic ideas about what their businesses are worth, thanks in large part to the ever-growing number of buyers in the marketplace. On average, advisors expect their practices to be worth 2.7 times their total revenue. But for those advisors who actually purchased a practice in 2014, the average price paid was 23% lower at 2.1 times revenue.<sup>6</sup>

Marty Bicknell, the chief executive officer of Mariner Holdings, can attest to that disconnect. Bicknell notes that in 2012, Mariner's wealth management arm acquired a majority stake in four advisory firms, followed by two acquisitions in 2013 and one in 2014. That declining number of purchases over the years was not planned by Mariner, nor was it due to a lack of potentially attractive sellers. "It was mostly about valuations," says Bicknell.

Moreover, as older advisors begin to retire and put their practices on the market, buyers will command more leverage. Another factor to consider: nearly half of advisors' clients are now over the age of 60. This could put 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.<sup>7</sup>

**Figure 4: Expected versus Actual Price Paid for Acquired Practices**



Source: Cerulli Associates, The Cerulli Report: Advisor Metrics 2014.

# LAYING THE GROUNDWORK FOR A SUCCESSFUL TRANSITION

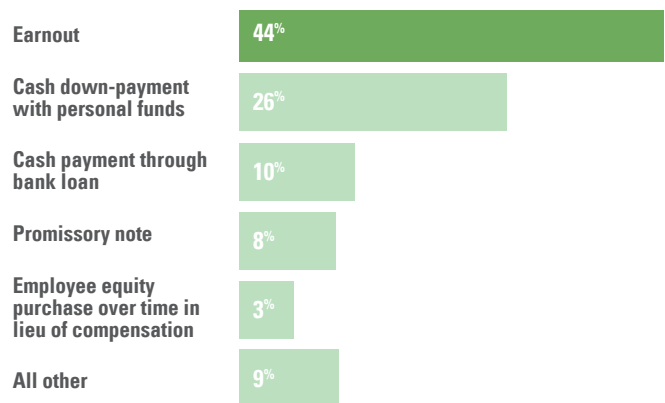
Developing a succession plan can seem like a daunting task, which is one reason why many advisors choose to avoid it for as long as possible. The following steps can help kick-start the process and will lay the groundwork for a successful transition.

## ✓ Have a Practice Valuation Performed

Regardless of the succession option chosen, having a practice valuation performed by an independent third party is an important first step in the process. For starters, it serves as an important point of reference for negotiations with either internal or external buyers. The valuation process can also uncover weaknesses in the business and help owners direct their efforts towards maximizing the practice value before the succession takes place. For that reason, consultants across the industry recommend that advisors aim to complete a valuation at least five years before they plan to transition the firm.

The value of an advisory firm is commonly expressed as a multiple of revenue, with practices typically valued at roughly two to two and a half times recurring revenues.<sup>8</sup> 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 individual characteristics of the business. A key factor is a practice's client demographics: aging clients who are depleting assets, an over-concentration of large clients, or too many small clients will all depress a firm's value. Other important value drivers include assets under management, physical location of the business, revenue mix (e.g., recurring versus commission), product mix, operations and technology platforms used, and the financial terms of the deal.

**Figure 5: Deal Financing Structures, 2014**



Source: Cerulli Associates, The Cerulli Report: Advisor Metrics 2014.

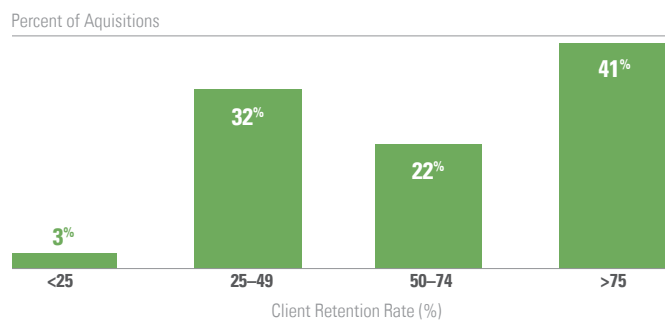
## ✓ Focus on Client Retention

Higher client retention rates drive higher practice valuations, but the risk of losing clients as a result of a succession is substantial. “Client turnover during transitions can be a major issue,” says Geoff Frazier, president of Global Financial Private Capital. Indeed, one in three buyers reported that the acquisition resulted in a client retention rate of less than 50%.<sup>9</sup>

Many deals also incorporate an earn-out component, which provides the selling advisor with a monetary incentive should certain client retention rates be reached, or results in the price being reduced if retention rates are less than expected. For deals completed in 2014, nearly half were financed with an earnout.<sup>10</sup> The earnout component represents a risk to the seller, since the buyer agrees to pay the seller over a period of time, with the final amount tied to client retention rates.

For both internal and external transitions, advisors should proactively and consistently communicate with clients to keep them engaged and 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. Introducing a successor well in advance of a transition, and including his or her name on communications, will help familiarize clients to the new owner.

**Figure 6: Client Retention for Acquired Practices**



Source: Aite Group: The Efficient Frontier of Succession Planning: Maximizing Practice Value, 2012.

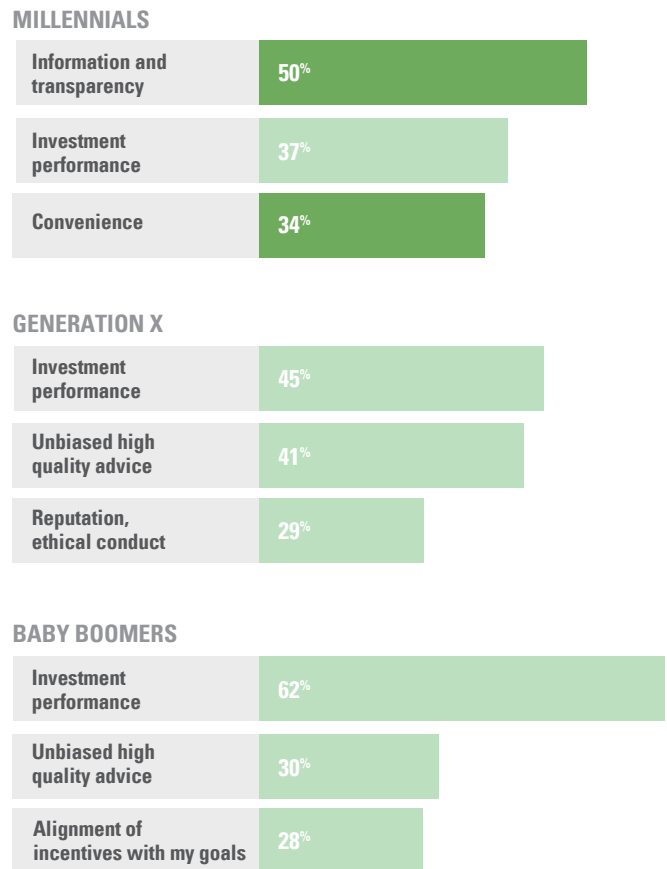
For internal successions involving sale to a junior advisor, that advisor should start to take a lead role in client meetings, in order to earn clients’ trust. In the case of an external sale, selling advisors should collaborate with buyers to ensure that clients have continuity in the areas of investment management, product selection and service levels. “Client relationships need to be the primary focus of a transition,” says Frazier. “And the highest bidder for your firm is not always the best choice for your clients.”

**✓ Connect with the Next Generation of Clients**

To maximize the value of their firms, advisors must capture a broad client mix across age ranges and build multigenerational relationships with their clients’ families. To this end, practice owners need to demonstrate that they are able to connect with younger clients.

Research shows that next-generation investors place a far higher premium on information, transparency and convenience than do older clients.<sup>11</sup> New technologies can help advisors better execute on these criteria, but reliance on technologies alone will not be enough. Younger investors also value face-to-face contact and have a more collaborative planning style, real-time information delivery expectations, and a movement toward a holistic, goals-based approach to wealth management.

**Figure 7: Top 3 Value Drivers When Evaluating Advisors, by Generation**



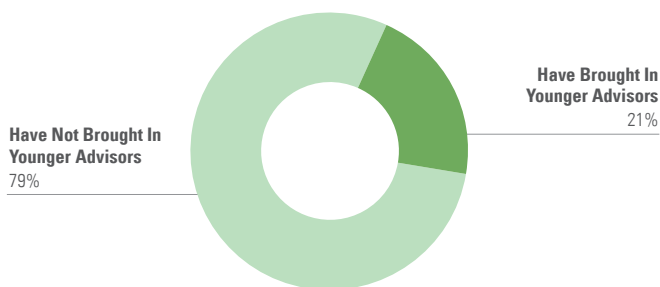
Source: State Street Center for Applied Research, “Influential Investor,” 2012.

## ✓ Attract Next-Generation Advisors to the Practice

Older advisors hoping to gain the business of next-gen investors may find that younger clients are looking for a younger advisor who's likely to be practicing for some time to come. And indeed, older advisors typically lose a large share of assets as their clients transfer wealth to the next generation.

Mike Stevens, director of national sales at State Street Global Advisors, notes that leading-edge firms are addressing that threat head-on by directly involving the next generation of advisors with their clients — and treating them as experts, not just support staff. “The 30-year-old advisor is getting involved in every aspect of every client meeting,” says Stevens. “Clients can therefore see that the younger generation of advisors is smart, eager, and willing to serve and they are increasingly comfortable dealing directly with them.”

**Figure 8: Advisory Firms Hiring Younger Advisors**



Source: State Street Global Advisors' Survey, "Money in Motion," June 2015.

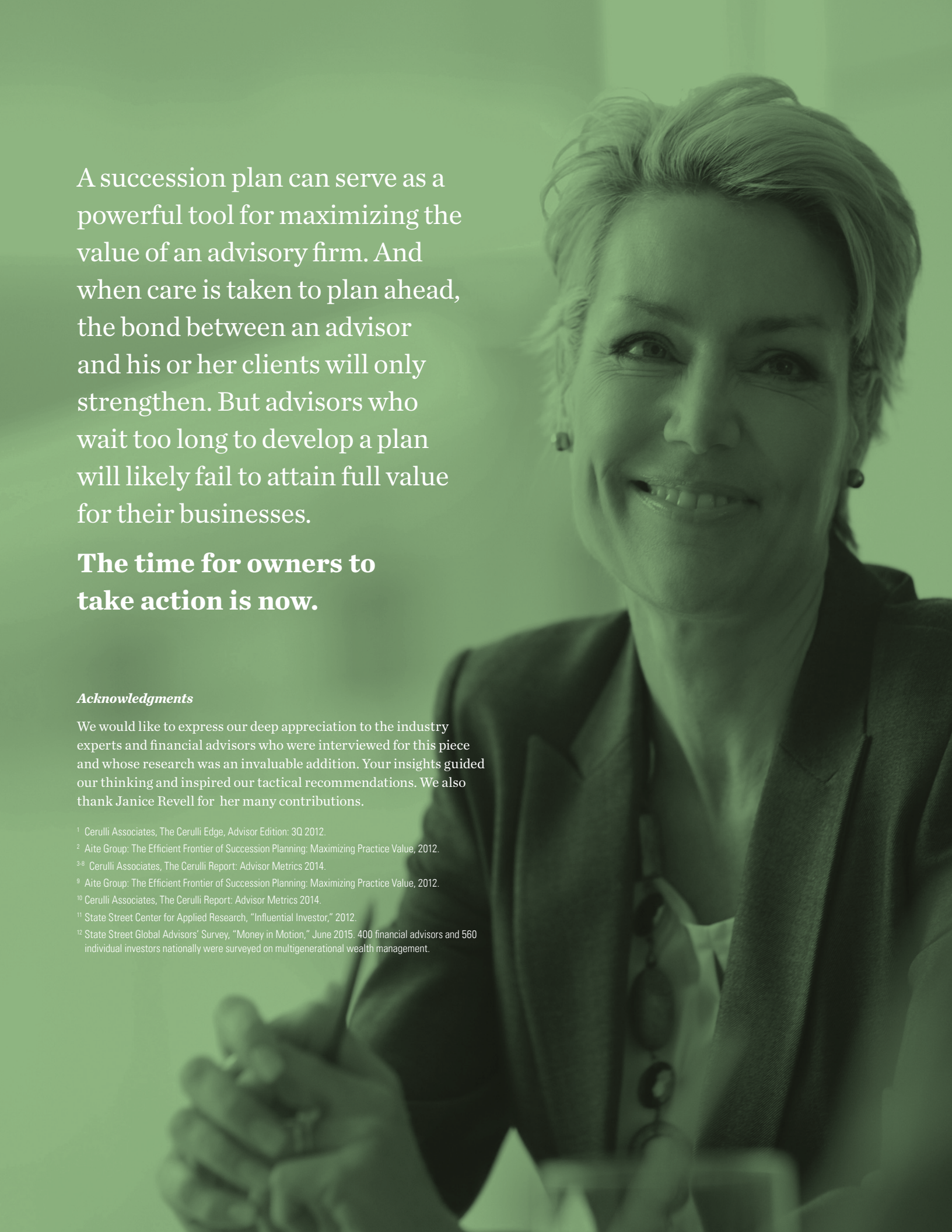
But while it's clearly critical from a succession standpoint to recruit young, skilled talent into advisory firms, much work remains to be done on an industry wide basis: only 21% of advisory firms surveyed have hired younger advisors in an effort to connect better with the next generation of clients.<sup>12</sup>

As is the case with next-gen investors, next-gen advisors also have unique needs that must be accommodated. Keith Robinson, managing partner with Focus Consulting Group, notes that compared to older generations, Millennials have a much stronger need for mentoring, career pathing and leadership development. “Generation X workers will say ‘Just point me in the right direction and I’ll figure it out myself,’” says Robinson. “But Millennials say ‘I’ll do the work, but you have to give me the recipe and help me understand what I need to do.’” Robinson also notes that the flexibility of time, including the ability to work how and when they want, is a highly important form of currency for Millennials. When thinking about how to attract the next generation of leadership, practice owners need to be attuned to these types of expectations.

### ✔ Consider the Emotional Aspects of Succession

Succession planning can be an emotional process. And one reason advisors are often not eager to get started is that they must evaluate not only their internal teams, but themselves as well—an exercise which can be challenging at best. “Fewer than 30% of all business people, even at the CEO level, can express what their strengths are,” says Colleen Boselli, an executive coach and principal at Strength Catalyst Partners. Boselli notes that we are culturally raised to focus less on what we do well and more on what we need to fix—concentrating on the B’s and C’s in a report card, for instance, rather than the A’s. “So if you’re not really aware of what your strengths are, then how can you be intelligent about hiring around you?” says Boselli. By getting a clearer perspective on their strengths and weaknesses, advisory firm owners can be much more strategic about the talent gaps that need to be filled before they retire.

A successful transition also requires that founders be willing to step back and hand control of their firm over to someone else—a concept that is naturally difficult for many entrepreneurs. “It’s called Founder’s Syndrome and it can be a major problem,” says Robinson. “Owners don’t want to let go for a variety of reasons, and a lot of it is driven by fear.” The fear of making an irreversible mistake is another factor that holds many advisors back from establishing a succession plan. But it shouldn’t. “You’re not locking yourself up forever,” says Frazier. “A succession plan can be amended.” Advisors who take the time to consider the emotional aspects of succession, and how they might best go about addressing them, will greatly increase their chances of engineering a successful transition.



A succession plan can serve as a powerful tool for maximizing the value of an advisory firm. And when care is taken to plan ahead, the bond between an advisor and his or her clients will only strengthen. But advisors who wait too long to develop a plan will likely fail to attain full value for their businesses.

**The time for owners to take action is now.**

#### *Acknowledgments*

We would like to express our deep appreciation to the industry experts and financial advisors who were interviewed for this piece and whose research was an invaluable addition. Your insights guided our thinking and inspired our tactical recommendations. We also thank Janice Revell for her many contributions.

<sup>1</sup> Cerulli Associates, The Cerulli Edge, Advisor Edition: 3Q 2012.

<sup>2</sup> Aite Group: The Efficient Frontier of Succession Planning: Maximizing Practice Value, 2012.

<sup>3</sup> Cerulli Associates, The Cerulli Report: Advisor Metrics 2014.

<sup>9</sup> Aite Group: The Efficient Frontier of Succession Planning: Maximizing Practice Value, 2012.

<sup>10</sup> Cerulli Associates, The Cerulli Report: Advisor Metrics 2014.

<sup>11</sup> State Street Center for Applied Research, "Influential Investor," 2012.

<sup>12</sup> State Street Global Advisors' Survey, "Money in Motion," June 2015. 400 financial advisors and 560 individual investors nationally were surveyed on multigenerational wealth management.

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\* Assets under management were \$2.37 trillion as of June 30, 2015. This AUM total reflects approximately \$26.8 (as of 6/30/15) with respect to which State Street Global Markets, LLC (SSGM) serves as marketing agent; SSGM and State Street Global Advisors are affiliated.

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