How to let go: Best practices for planning a successful succession

By: Michelle Zhou
FinancialPlanning
Published July 29 2016, 4:19pm EDT

Handing over your life's work is a process at once emotionally taxing and strategically complex. For advisers running their own RIAs, having a long-term succession plan in place is critical to safeguarding the continued success of both the firm and the clients they serve.

To ensure a smooth transition, the focus must be on building a valuable business that's attractive for sale and keeping all of your options open, said three succession experts during a *Financial Planning* webinar covering the best practices for succession planning.

START WITH THE END IN MIND

"The fundamental question is who in their right mind would buy a firm that's centered around me? It is my firm, my relationship with clients, my intellectual property and my business strategies," said John Burns, co-CEO of Exencial Wealth Advisors, an Oklahoma City-based RIA managing over $1.5 billion in assets.

If that's all your firm offers, Burns said, then it will be a hard sell. Better to start crafting a business that's less about the principal or owner, and more about the client service and talent that would turn it into a valuable prospect. Doing so is not easy and takes time, he added, which is why advisers should start as early as possible.

Burns, 52, started planning for his succession in earnest when he was 46. He hired a third party consultant to valuate his firm top to bottom, and construct a strategic plan to strengthen growth areas and improve weaknesses. He was then able to set specific objectives and action items with binary results that made it clear whether he was on the right track or not.

“The process isn’t much different from creating a wealth management plan for an executive client,” Burns said.

TARGETED TALENT ACQUISITION

A critical element of making the strategic plan work is positioning the right people in the right places who can grow each key area of the business, Burns said. In order to do so, the firm owner needs to outline clear career paths, offer a competitive compensation plan and change the business structure to allow for additional ownership tracks.

That solid talent base can then become the foundation for developing an internal succession plan, said Michael Nathanson as part of his webinar presentation on the key differences between internal and external succession. Nathanson is the chairman, CEO and president of The Colony Group, a Boston-based firm with over $5 billion in AUM.

Internal succession is really about “attracting, developing, engaging and retaining” the best people, Nathanson said, and promoting them over the years to become the next owners of the firm. On the other hand, external succession plans, a “scary concept for a lot of people,” involve mergers and acquisitions.

PREFERENCE FOR INTERNAL SUCCESSION

Most advisers prefer the former. Indeed, 78.2% of webinar participants said they are more likely to have an internal successor in response to a live poll.

Michael Nathanson was a strategic external hire for The Colony Group's succession plan

Nathanson was one such strategic hire for The Colony Group after serving as its outside counsel. The firm spent 25 years of its 30-year history building an internal succession plan, slowly expanding its roster out to 20 owners. It enacted a formal succession plan in 2011. The process doesn’t end there however, as the company is constantly thinking about succession planning even now that the next generation is fully in place and they have everyone they need, Nathanson said.

“Succession planning is what every good business at every stage should be doing,” he stressed.

The decision doesn't have to be binary: some of the best succession plans are both internal and external in nature, Nathanson pointed out. He also warned that the timing and dynamics of an internal plan could be tricky, as the successors may become discontented with paying the principals large instalments as part of the buyout even though they are providing fewer and fewer services.

VALUE ADD OF GOOD PREPARATION

Even if selling the firm outright is not under consideration, the risk to a potential buyer is lower when your internal succession plan is taken care of, said John Furey, founder and principal of Advisor Growth Strategies, a Phoenix-based consulting firm that specializes in RIAs.

Having a lot of internal partners who can potentially take over actually increases the value of the firm, Furey said. He pointed out that the conventional rules of thumb to valuation, such as two to three times the fee revenue, four to seven times the EBITDA or one to two times the commission revenue, are not used in reality.

Buyers are really looking for long-term value as measured by size, a sustainable growth rate, human capital and client demographics, Furey said.

Deals often stall because buyers and sellers don't agree on the value of a firm, said John Furey

When those elements are missing, deals can stall. “Buyers have preconceived notions of how much a firm is worth but the seller doesn’t agree,” he noted. Accordingly, owners need to keep an open mind, Furey said.

CONTINUITY PLANNING

At the end of the day, succession planning should be about what’s best for the client, said Nathanson.

In fact, he prefers to call the process “continuity planning,” because it’s about—or should be about—continuing to provide quality service to clients rather than designing an exit that will benefit the principals the most.

Indeed, the fiduciary standard applies just as well to mapping out the future of a firm as financial planning, according to Nathanson.

Whether the succession is internal or external, strategic or not, “we have to think about the clients," he stressed. "What’s best for them may not necessarily be consistent with the absolute best transaction for us.”