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Defining Internal Succession and the Next Generation Owner

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Internal succession takes meticulous planning and execution.

News flash ... the advisor population is aging. Anyone in this industry knows this. Industry advocates have consistently called for better succession planning, that which promotes the long-term sustainability of RIA firms. This call must be heeded, and yet time and again, advisory firms are forced to turn to outside buyers or merger partners as a succession solution. And for some, perhaps the right choice is to find a buyer or a larger firm within which they can execute a smooth transition. But a firm's options should not exclude one that many advisors prefer – one which requires meticulous planning and execution: the internal succession.

Planning for the next generation of owners is required for firms that want to remain independent or want increased succession options in the future. However, a lack of execution may result in a lack of confidence with the next generation of professionals within a firm. In order to move beyond “lip service,” consider the following five steps to engage the next generation:

- Establish if you have a willing and able next generation owner.
- Collaborate with the next generation on roles and responsibilities as part of the transition.
- Clarify financial expectations and be willing to compromise.
- Execute in the face of an uncertain outcome.
- Facilitate an open dialogue and let plans evolve.

The next generation must be willing and able to be an owner.

Succession starts with identifying talented professionals that have the desire and ability to become owners. For firms fortunate enough to possess next generation talent, it may appear that a majority of the work is complete. But what happens if the next generation of professional is not willing or able to be an owner? Does the next generation owner understand what it takes to run a firm? Do they have the desire to share in the risk as an owner? Is there a shared belief that the next generation has the required skillset?

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There are unique challenges that come from transitioning from a professional to an owner. Setting expectations ahead of time will allow both current and next generation owners to form realistic goals as it pertains to professional growth and succession. The next generation should seek to gain perspective and be ready to create an action plan around becoming an owner.

The next generation must believe in what they are buying.

Internal succession is a blend of art and science. The process and associated risks will not resemble those an entrepreneur takes starting a firm. The next generation may not want to accept the same risk as a founder. For internal succession to work, the next generation needs to share the current ownership’s belief in the firm, or, believe in what the firm can become.

It is important that the next generation owner has an opportunity to articulate their own ideas for the future of the firm. Feedback may include structural changes to the client experience and defining how life will change for current and next generation owners during a transition. By considering how professional roles may change in the short-and-long-term, what level of change is acceptable to both parties, and what if any financial changes will result is key to discuss with potential next generation owners. Collaborative thinking will help crystallize the shared vision and create confidence.

The discussion will eventually get down to dollars and cents, and financial obligations may be perceived as high risk by the next generation owners. Given current valuation levels, the next generation should be ready for “sticker shock” when asked to buy equity from the current ownership group. The next generation must have a very clear view of the financial obligations and agree to the construct in principle. Compromise from both sides is needed to reach shared goals and flexibility on the terms of financial obligation can make it more feasible for next generation owners.

Uncertainty should not stop execution.

A lack of execution of a proposed succession plan may result in a lack of trust. For internal succession, execution means measurable progress towards integrating the next generation owner. Aim for measurable progress in a span of six months or less that could include transfer of responsibilities or a small portion of ownership. Such a quick win will build momentum towards the greater goal.

Internal succession takes time to craft, and longer to execute. Circumstances that change along the way may make it impossible to fully transfer internally. Even if a full internal succession is not executed, integrating the next generation into the planning process can be beneficial in more ways than one.

A recent AGS client added a younger professional as a minority owner and fully integrated them into the management team. The current generation needed to wind down immediately, but the next generation did not have the time to fully execute the internal transition. An outside partner was identified. Having a next generation owner with a longer runway gave an eventual buyer added confidence in the process while being a minority owner provided more leverage for the next generation.

Engaging the next generation resulted in a win/win even without fully executing the original plan.

Thoughtful and flexible approach required.

The role of the next generation owner in succession is fluid and an open dialogue on what works, and what doesn't, is critical for success. Defining internal succession and engaging the next generation will provide more certainty and, at a minimum, increase options for the future. It is easy to become immersed in the day-to-day, and it is extremely challenging to take the time to properly execute a succession plan. Make no mistake, it can be among the most important business decisions you will ever make.

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