5 Mistakes to Avoid When Selling a Financial-Advisory Practice

by Veronica Dagher in WSJ

Even advisers with decades of experience buying and selling investments for clients may have no experience selling a financial advisory practice.

That can be an issue for these veteran advisers when they are ready to sell a business they built or perhaps transition to retirement by combining it with another firm. Some make rookie mistakes during negotiations which can cost them hundreds of thousands of dollars—or even a deal.

Here, merger-and-acquisition experts weigh in on some of the mistakes they have seen and what investment advisers should do instead.

The mistake: Seeking last-minute changes in terms

The No. 1 one mistake potential sellers of advisory firms make is trying to renegotiate material deal terms right before signing, says David Selig, chief executive of Advice Dynamics Partners LLC, a Mill Valley, Calif., firm that advises on mergers and acquisitions. This "destroys credibility and trust," he says. Recently, after many weeks of negotiation, a seller Mr. Selig was working with took it upon himself to renegotiate several parts of a deal with a prospective buyer and asked for a 50% higher salary. The buyer balked at the new terms.

The fix:

"Emotion often causes 11th-hour renegotiations," Mr. Selig says. To help minimize emotions and avoid killing a deal at the finish line, sellers should write down the key deal terms that are important to them. They should rank them in order of importance and apply values to each that they would be satisfied with, he says. But be realistic. "Look at the list critically to make sure you're not 'maxing out' each deal lever in your favor—this approach never works," he says.

The mistake: Not understanding how deals work

Most advisory-firm sellers focus on price and payment terms when a term sheet—a document that outlines the material terms and conditions of the deal—is constructed by the buyer, says John Furey, founder of Advisor Growth Strategies LLC, a wealth-management consulting firm in Phoenix. But some advisers fail to realize that buyers can add additional terms allowing them to "claw back" a purchase price if the deal doesn't go according to plan, he says. For instance, part of the payment might be based on the firm meeting certain targets for client assets at specified intervals.

Recently, Mr. Furey had a client directly contact the potential buyer because the client was upset about a clawback provision, despite the fact that this type of arrangement is typical. This set up an awkward situation in which the buyer became nervous the seller had something to hide, Mr. Furey says.

The fix:

Speak with other advisers who have sold their firms to ask what they went through and familiarize yourself with deal-making jargon, Mr. Furey says. Advisers can also get educated on buying and selling a firm at industry conferences, by speaking to transaction advisers and lawyers, and reading a book such as “How to Value, Buy or Sell a Financial Advisory Practice: A Manual on Mergers, Acquisitions, and Transition Planning” by Mark Tibergien and Owen Dahl, he says.

The mistake: Loose lips

Advisers who aren’t experienced doing deals often make the mistake of sharing too much unnecessary information with prospective buyers, says David DeVoe, managing partner of DeVoe & Co., a San Francisco M&A consulting business. Mr. DeVoe had a client who decided to accommodate a buyer’s request for a private lunch that wouldn’t include any investment bankers. As Mr. DeVoe learned afterward, his client told the possible buyer that he didn’t have any other offers for his practice. “We calculated the lunch cost our client about $200,000 in valuation,” Mr. DeVoe says.

The fix:

Sellers need to have “boundaries” in place before they speak to potential buyers, Mr. DeVoe says. In advance of any meeting, they should determine what they are willing and not willing to say and think through how certain information might weaken their negotiating position. If it is difficult for sellers to say no to a buyer’s request, they might tap one of their advisers to play “bad cop” and nix the request.

The mistake: Forgetting to discuss important details

It’s very easy for both parties to get “swept away with the excitement of the deal,” says Mary Ann Buchanan, chief executive of RIA Match, a Vienna, Va., matchmaking service for advisers looking to buy, sell or merge. Negotiating financial terms is usually highest priority for the principals, she says. However, they sometimes forget to ask each other key information. For example, Ms. Buchanan worked with two firms that were teaming up, and each founder was hoping to retire relatively soon and have the other continue on. They didn’t realize this, though, until the closing. As a result, they dropped the deal at the last minute.

The fix:

When two owners feel confident enough that a deal to combine could work out, they should create a joint vision statement for the new firm, she says. The vision statement should include the new firm's goals for the clients and staff and metrics of success, such as client retention.

The mistake: Bad manners

Good manners are important at the negotiating table, says Elizabeth Nesvold, managing partner of Silver Lane Advisors, a boutique investment bank in New York. For example, one of her clients was excited about buying a firm that seemed like a perfect fit from the "20,000 foot" level: The advisers had similar business philosophies and services. But during the first formal meeting, the chief executive of the target firm told her client some dirty laundry about a partner dispute. "It was the equivalent of showing up to a first date only to spend the entire evening talking about your ex," Ms. Nesvold says. Her client decided to pass on the deal since the sale would be phased over time and all the principals would remain in place for a while.

The fix:

Keep a professional demeanor at all times, Ms. Nesvold says. In all likelihood, you wouldn't hire a prospective employee who badmouthed a past employer during the interview; the same rings true during a sale process. Airing dirty laundry will only make you seem unprofessional and risk losing the deal, she says.