How, strangely, money gets downplayed in RIA deal making and why it helps explain an anemic flow

by Guest Columnist **John Furey**

Brooke's Note: The RIA deal-making business kind of stinks. See: Mark Hurley drops a new wealth management prognosis on the industry with a zero-sum flavor. It's easy to blame markets. I believe that John Furey has brought the deal-making conversation back into its proper balance. He takes what I believe is a more useful, bottoms-up approach. He goes into depth here about why advisors need to be just as certain about the deal's "accretive" nature to the counterparty as to themselves. (Note: An over-reliance on numerical formulas with discounted double-flip cash flows is just as reprehensible.) Why does this insensitivity to the numbers persist in an industry that is so conscious otherwise of numbers? Furey provides good hints here. But in my discussion with him about this column, he pointed out how sellers tend to gloss over the fact that replacing themselves will be a mighty expense. And buyers are not sensitive to just how much income the seller is forgoing by making a sale. In a business where talent is in short supply, salaries are spiralling higher and the situation only seems to be getting worse, making the "numbers" work likely to continue to be a serious issue.

There is one thing that buyers and sellers of RIAs, independents, and wirehouse advisors can agree on: Many of the good ones are taken.

In other words, buyers don't think sellers "get real" and vice versa. If the RIA M&A market weren't so tragically congested, you might think this finger-pointing was funny, but getting past the humor, what are these would-be deal-makers really trying to say? See: Schwab 2013 RIA M&A data show hope but also futility.

In the recruiting and M&A business, there is all kinds of talk about strategic this and cultural fit that. These are genteel subjects that make investment bankers and transaction advisors imagine themselves as would be matchmakers or marriage planners.

But while yenta skills help, we also realize there is a more powerful, measurable factor at work — money — and the need for advisors to know they will be making more of it after the deal than they did going in. The fancy Wall Street term for this is "accretion."

Why transitions and deals need to be accretive

The notion of accretion means that both parties are better off in the end state versus the present state of a proposed transaction. This concept can manifest itself in a variety of ways, including:

- Margin expansion for one or both parties
- Increase in value for one or both parties — both parties are more valuable together versus separately
- Ability to increase top-line revenue faster in the combined state versus the current state
- Provide certainty to a future economic outcome, usually related to succession planning in the independent advisory world. See: What I learned from four failed attempts to find a successor for my $1.5-billion AUA RIA.

The consensus at our deal=making think tank, aRIA, is that most deals get stuck when a proposed transaction is accretive for only one party. For example, I have run into many advisory firms that would like to recruit financial advisors. I ask them “what is your value proposition to existing advisors?” Sometimes the answer is, “So our firm can make money!” See: RIAs reveal their M&A war stories with 200 Schwab IMPACT attendees.

That point of view is certainty not accretive for both parties and until a win-win mindset is achieved, the probability of success will be lower. Accretion is usually achieved through operational scale, the ability to deliver revenue growth that is superior to what an advisor can currently achieve, or providing an opportunity to increase firm value. For advisors that want to be in the recruiting or acquisition game, having one or more of these attributes is key.

It’s not about the money? Really?

Whenever you hear a professional athlete who has just earned a large contract as a free agent or via a trade say the move “wasn’t about money,” it almost always is about the money! For advisors to buy or sell, many things have to line up, including investment philosophy, culture, support platform, advisory service platform, brand, and existing staff and employee branch strength, among others. See: How a $5-billion RIA is using a client’s legendary Rolodex to build a sports practice.

However, failing to realize the financial impact of a move to an advisor considering moving from one firm to another can’t be underestimated. Advisors will only transition if the pain of the transition is materially less than the perceived pain of their existing model.

This also is true as it pertains to compensation and potential for building business value. Unless advisors feel they have the potential to realize incremental value in terms of compensation and business value, there is little chance of convincing them to make a move. See: With LPL as its new BFF, CONCERT seeks bigger game and more RIAs.

Many advisors argue that prospective merger partners that don't have a sustainable business model with a growth engine could see an erosion of their business value and revenue over time. But few advisors will see the "pain," as it is not acute in their day-to-day lives. Until advisors perceive a decline in compensation or firm value from continuing in their current state, it is unlikely that they will consider another option unless it is compellingly better than what they have today.

What it really takes

Advisors that are considering getting into the world of acquisition or M&A must understand that to have material success, you must offer something accretive for you and the advisor you hope to attract. A few firms have found success here, including consolidators, RIAs and independent OSJ firms. See: An LPL super-client hits 'pause' on recruiting after an SEC inquiry and LPL is playing a parental role.

In addition to the notion of accretion, advisors must also consider solutions for key issues such as:

- Numbers game — advisors will "kiss a lot of frogs" to find the right match. See: Why the Moss Adams-Rowling Dold merger came apart despite looking picture-perfect on paper.
- Accepting any/all comers is not an option — advisors must be selective.
- You will have to go out selling — no one will hand you books of business. See: What RIAs can learn from Malcolm Gladwell's writings on entrepreneurs as risk averse.
- Your growth story and messaging must be ready for show-and-tell.

Advisors considering recruiting advisors or being part of a transaction can take stock in the fact that there are many choices available to them, and most will have great businesses with or without doing deals. However, for advisors that want to drive material success, taking the opportunity to drive accretion for both parties is a path worth taking.

aRIA's latest white paper, Realizing Your Ideal Model, was created by advisors for the benefit of advisors and is available at www.allianceforrias.com. John Furey is the principal and founder of Advisor Growth Strategies LLC, a financial advisor practice management consulting firm based in Phoenix, and also the managing director of the Alliance for RIAs (aRIA), an independent advisory think tank.