How Private Equity Is Reshaping Wealth Management

By Brandon Kawal for WealthManagement.com

No matter where you sit in the wealth management world, it's impossible to miss the surging presence of outside capital in our industry. Major private equity players have taken an active hand in directly or indirectly cultivating mergers and acquisitions in the RIA space. In fact, more than 65% of the firms that completed multiple deals over the last five years enjoyed the support of a capital partner, according to Advisor Growth Strategies' recent RIA Deal Room Report.

Is this something our industry should welcome? And what can we learn from the massive influx of outside capital?

This kind of investor attention wouldn't happen if they didn't see plenty of value creation in our future. Over the next few decades, advisors will guide the wealthiest generations through the most complicated, high-stakes financial decisions of their lives. Whether they need to protect their assets, ensure their legacies, or advance the causes that are dear to them, people are willing to entrust a great deal of money to an advisor's care.

But, the deluge of external capital is raising the valuation of RIAs, and their need for scale and platform strength, at a breakneck pace. An advisor doesn't need to be in direct talks with private investors for this trend to have a real impact on their work. An orderly, internal succession plan for an RIA might go flying out the window in a climate where firms receive valuation multiples of 8 times their EBITDA.

Private Equity Helps the Winners Win More

After researching 33 M&A deals in 2020, we learned that a "median" 8x valuation is not a guarantee. Sellers backed by private equity were often able to command higher prices based on the strength of their platforms. Investors looked for the ability to offer modern client service at scale. The extent to which these brands could pivot overnight to remote service had implications for their power to reach new clients far beyond their traditional regional territory. The market has separated premium sellers from the rest, and private equity has been able to play kingmaker in this regard.

On the buyer side, acquisition brands armed with a war chest of external capital have accelerated their dealmaking activity. Success begets confidence, and acquirers have steepened the ramp for new buyers to enter the RIA space. With so much capital readily available, sellers tended to pick known, proven acquirers over untested newcomers.

Competing in the Shadow of Big Acquirers

While major acquirers jostle for the attention of RIAs, not every advisor wants to hand their business to a national acquisition brand. We have seen two compelling alternatives emerge. The first takes a systematic, platform-based approach to M&A. That means building muscular back- and middle-office infrastructure and combining it with client-facing systems for sales, marketing, or a broader offering of services to encourage growth and help sellers stand out from the crowd.

The second buyer strategy takes a defined approach to inorganic growth. Recruiting advisors from captive models, acquiring smaller practices, or solving a specific problem faced by RIAs are ways these buyers have found to grow outside of the “traditional” M&A world.

In a survey of more than 100 RIAs, we found that only 35% of potential sellers would prefer an acquisition brand buyer, with 30% favoring local partners and the remaining 35% preferring regional buyers. Local and regional buyers succeed when they take a platform- or practice-based approach, but those take time. If an RIA needs a deal partner in a shorter time frame, it usually chooses a national buyer -- backed by outside capital.

What Happens Next?

For better or worse, private equity will shape the competitive future of the RIA world. That doesn’t mean advisors should cede control of their futures as entrepreneurs. I would encourage advisor teams to be frank with one another about the elephant in the room. Leaders should engage their talent and build real conviction around their internal strategy to avoid the distraction of voracious acquirers.

And in a situation where a deal is the right answer, advisors need to educate themselves about the M&A climate. There is a lot of money out there, but money isn’t the only thing that matters. Not all capital partners offer the same results for your team, your business, or the clients you serve. In the end, the interest of external capital is a sign that your work is valuable. We should all worry when that interest subsides.

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