RIAs Ignore M&A Market at Their Own Peril

By John Furey for Barron's

Mergers and acquisition activity among independent advisory firms has been growing at a breakneck pace the last few years, but the majority of firm owners choose to ignore opportunities outside of being in full control of their business. These advisors may not see the perfect storm of competition that is bearing down on them. The coming years will require owners of RIAs to be nimble, run scaled operations, or both.

The RIA world was not exempt from the systemic gut punch of Covid. It scrambled to adopt remote service. The market shock in March 2020 forced firm owners to think about the sustainability of their businesses. Job losses from the pandemic accelerated the rate of retiring boomers. RIA owners are not exactly a youthful bunch, either; they have to reckon with their own succession planning.

Given all of this, you'd expect to see a surge of M&A and ownership transitions. But in spite of the constant drumbeat of deal announcements, the truth is that the vast majority of RIA owners are not considering a transaction now or in the immediate future.

In a survey of more than 100 RIA owners by my firm, Advisor Growth Strategies, in conjunction with our annual RIA Deal Room Report on the M&A space, more than half of the respondents were firms managing over $1 billion in assets—firms large and complex enough to make the leap to sustainable business from lifestyle practice. Despite billion-dollar firms having greater optionality for ownership structure, only 11% said the pandemic increased their interest in M&A. And just under one-fifth said they were somewhat likely or very likely to consider selling or merging with another firm in the next 12 months.

CONTROL SMALL KINGDOM VS. JOINING A BIG TEAM

Buyers do not share their reluctance. Almost half indicated they were at least somewhat likely to consider M&A in the near future. So why are most of the potential targets giving acquirers the cold shoulder?

When asked, 60% said they did not want to give up control of their business. Another 25% worried about the impact on their client service. RIA owners would rather control a small kingdom versus the potential of being part of something bigger outside their walls.

In my experience, advisors tend to think of themselves as self-made entrepreneurs and struggle removing themselves from that reference point. A historic bull market certainly helped validate their business decision to go it alone. After riding that kind of success, most of our clients and owners we know would not be thrilled to become someone else's employee. And we're talking about an industry that doesn't like change. Advisors crave stability, for a lot of valid reasons.

Despite the benefits of owning an RIA, going it alone can come with a real opportunity cost. For example, while nearly half of respondents to our survey said they preferred to handle succession internally, RIA founders and owners can't look at ownership transition in a vacuum. External buyers can offer seller-friendly deal structures, and growing valuations exert pressure on the viability of internal transactions. With a typical internal succession plan taking at least five years to fully implement, time is not on the side of many RIA founders.

MORE OPTIONS, BUT MORE COMPLEXITY

There have never been more options for sellers in the RIA space, but there has never been more complexity. Advisors do not have to take part in deals that are not a clear fit for them, their team, or clients. And ever-increasing valuations do not tell the whole story, either: RIA sellers approaching the deal table need to be sure the other side comprehends fundamentally what they want to get out of a transaction.

The trends driving M&A are not going away any time soon. An acquisition is not right for all RIAs, of course, but the burden is on them to fully understand their options. No matter how self-assured RIA owners may be as entrepreneurs, they are not immune to the rapid changes of the advisory world.

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