Op-ed: A succession plan benefits advisory firms and their clients

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In a time of record mergers-and-acquisitions activity for financial advisory firms, designing and implementing a succession plan has become a critical element for success.

This volume and breadth of M&A activity has increased the pressure on, and options for, firm owners.

The median registered investment advisor firm valuation jumped more than 20% from 2019 to 2020, according to the 2021 RIA Deal Room. This attracted the attention of numerous well-capitalized partners, as well as growth-oriented RIA platforms and investors that are seeking to buy or partner with advisory practices.

This offers firms an unprecedented assortment of economic models, degrees of control and exit-timing scenarios.

For firm owners, this is good news. Not only have the choices for exiting the business increased, but so has the support for independent firms looking to develop and implement a succession solution.

While succession planning is important for the firm and its long-term viability, it's just as critical for the firm's clients and any investors. To that point, clients should care if their advisor has a plan in place, because it impacts who will handle their money if the firm owner leaves, retires, or passes away.

While advisors are more likely to explore their succession planning options as they near retirement, 73% overall lack any formal succession plan, according to a 2018 study by the Financial Planning Association and Janus Henderson Investors.

Meanwhile, the industry has developed a new cohort of talent, providing founders with more options to transition the business they lovingly grew to the next generation as an alternative to outside partnership.

Advisors should create or review their business or succession plans to create more options and greater flexibility. The lack of a solid succession plan can create confusion, misunderstanding and conflict that interrupts – or even disrupts – business continuity.

Succession planning defined

Succession planning is the intentional process of transferring the management, ownership and goodwill of an advisory firm from one generation or one entity to another. This shouldn't be a standalone event. It should cohesively bundle several elements:

- **Strategic planning**: the process of outlining a firm's purpose, vision, mission and values, along with a tactical plan to bring that vision to life;

- **Continuity planning**: the process of planning for an unforeseen event; and
- **Sale planning**: the process of preparing a firm for sale to a third party.

The RIA market is increasingly complex as the ecosystem grows and competition increases. RIAs have an appealing and flexible model, but the industry has no defined model or consistent approach for when an advisor needs to retire or exit the business.

As a result, succession planning provides strategic benefits and addresses several areas of risk:

- **Client attrition risk**: Clients, especially those with a high net worth, value continuity and stability and may decide to move to another firm.
- **Growth risk**: Discipline in business and succession planning will mitigate the risk that a firm's growth stalls or declines as current owners wind down their professional contributions.
- **Staff attrition risk**: Involving the next generation professional in succession and business planning will create a sense of commitment and promote a long-term tie to the firm.
- **Enterprise value risk**: RIA valuations are based on either discounted cash flows or multiples of free cash flows, with discounts and premiums based on elements such as revenue growth, client demographics, employee tenure and stability and management quality. Lacking a plan may negatively impact the valuation and attractiveness.
- **Optionality risk**: Lacking a defined plan or waiting too long to create one will reduce options available to owners. This isn't typically a quick process: Internal succession can take five to 10 years to execute, and a sale can take upwards of two years, according to Advisor Growth Strategies.

To build a succession plan, owners should start by setting personal goals and objectives. Are they seeking to build a legacy, maximize a financial income or both? Then, identify viable succession plan options guided by personal and business needs.

Firms should tap legal counsel to define voting rights for potential internal and external buyers, the event that will trigger succession planning execution — typically death, disability and/or age — the valuation methodology for internal succession and the buying party and funding source.

Owners also must pinpoint the time horizon of their exit from the firm, giving them enough time to find the right buyer or groom an internal successor.

Meanwhile, perform due diligence to identify a potential buyer or successor. They should identify what is important to them and build an evaluation scorecard to list the strengths, weaknesses, opportunities and threats of each choice.

Then, select a model and structure the deal. Firm leaders may hire a consulting firm or investment bank to negotiate on their behalf.

Once the plan is finished, it should be reviewed yearly, at a minimum. Succession plans generally have a long time horizon and will require updates as conditions change.

The execution of a succession plan is critical. Clients will continue to monitor the safety and security of their assets and will expect a detailed plan from their advisory firm.

A well-crafted plan can be a competitive advantage to attract new business, retain clients and increase employee engagement and retention.