

## **TAX AND WEALTH ADVISOR ALERT: FINANCIAL ADVISOR SUCCESSION-PART ONE: GOAL CLARITY**

Given my combination of experience (13 years in the home office of a national life insurance company) and expertise (working with clients on the creation and execution of succession strategies), a growing part of my practice is in leading financial advisors in the creation of a succession plan that ultimately leads to the sale of a practice. It only takes a glance at the demographics of the advisory world to understand what is at stake. The average age of an American financial adviser goes up materially every year as the recruiting and retention statistics in the industry continue to get more dire. In the next few blog posts, I wish to explore some issues that must be dealt with in the transition of an advisory practice:

1. Goal clarity of both the selling and buying advisor.
2. Valuation of the practice.
3. Transition of client relationships.
4. Managing the risks to the buyer.
5. Taxation of the transaction to the seller.

### **FINANCIAL ADVISOR SUCCESSION-PART ONE: GOAL CLARITY**

I think it might have been A. A. Milne in the book "Winnie the Pooh" that first coined the saying: "If you don't know where you are going, any path will get you there." With something as intellectually and emotionally challenging as financial advisor succession, it is critical for both the buyer and seller to be very clear and precise about what they want and need from the transition.

In my experience working with advisors, the set goals are rarely clear; however, the seller wants to get as much purchase price as possible while the buyer wants to pay as little as possible. Certainly price is a factor. The goal of the business owner in developing a succession plan is to maximize value and take care of the people the business owner cares about. But, the successful advisors I have worked with share a common attribute, their financial success is due to their selflessness. Their systems, structures, practices, values and beliefs all center on the achievement of their clients' wishes, hopes, dreams and desires.

With this cultural mindset, it is not uncommon for the number one goal of the seller to be ensuring his or her clients are taken care of. I am working with a seller right now whose top transition goal is “making sure my clients are taken care of as well or better than I promised. In fact, I want the top goal of this transition to be just that; the buyer must be committed to delivering the promises I made to my clients.” Powerful, right? But also, clarifying. That goal has had immense impact on client transition strategy, staff retention, and even price and terms.

So, as I reflect on the numerous financial advisor transitions I have quarterbacked, here is a representative list of seller goals:

- Client satisfaction
- Providing an advisor who is young enough to “be around when my clients most need the advice”
- Staff retention
- Strong “fit” with referral sources and advisory team members (including other advisors, attorneys, accountants, bankers and investment bankers)
- Values align
- Personality consistency

Again, maximizing price to the seller, particularly on an after tax basis, is always on the list. But, again in my experience, it gets little focus compared to other goals, probably due to the fact that these advisors built attractive businesses by concerning themselves with doing the right thing rather than the proceeds of any particular transaction.

On the buyer’s side, the goals tend to surround client retention. We will talk in a later blog post about typical pricing in these transactions, but, to put it in the simplest terms, the “typical” price of an advisory practice is very enticing to the buyer if the buyer can retain a high percentage of the client relationships and their resulting revenue. With that in mind, the buyer’s goals tend to focus on the transition period:

- The seller’s advocacy of the buyer as the right person for the client
- The successful transition of client relationships
- The successful transition of referral relationships
- An in depth understanding of the seller’s systems and processes and how those impact the client experience
- Oftentimes, a desire to be mentored by the seller on business, relationship building and substance

As to where the most common goal conflicts exist, the top one is the contingency of the purchase price. As I stated above, simply put, in my opinion, if retention is high, when a market common purchase price of 1.5 to 2x recurring revenue is used in the sale of an advisory practice, the buyer is getting a great deal. Given that, most of the time, the seller is not willing to make the purchase price contingent upon retention. But, again given the

critical importance of retention, it is as common for the buyer to want a purchase price contingent on retention. The buyer's strategy is twofold: one, obviously, is to shift the risk of retention to the seller. The other is to financially motivate the seller to economically own retention and to take all possible steps to insure the client stays with the buyer. One place where we have sometimes bridged this gap is to use a contingent purchase price wherein the seller gets the full purchase price with average retention and gets a material increase in purchase price with high retention.

The other common area of goal conflict is staff. This conflict is natural and understandable. The seller believes strongly in the staff he or she put together and sees it as the most obvious way to keep the clients and their revenue intact. The seller believes the client has bought "the team" and thinks the buyer would be crazy to change it in any way. The buyer, on the other hand, often has a different style with different strengths. These differences might mean that the buyer's best team has different strengths and skills than the seller's perfect team. Also, the buyer might have a team already and want to use that team to service the seller's clients. These conflicts can often be resolved with creativity, but, in my experience, lack of agreement on the post-transaction team is the issue that craters the transaction.

So that is the first step to a successful advisory transition. Capture each party's goals and see if they are consistent. If so, then the transaction can move forward. If not, the parties need to determine if they can creatively compromise. If they figure out a workable solution, it is on to the next topic- valuation or, stated another way, an agreement on price.