



## Conversation With David Selig

CEO, Advice Dynamics Partners

### **"Succession Planning and Enterprise Value"**

*Saturday, March 9 at the FPA Business Solutions 2013*

*Depending on which study you may read, there are anywhere from 50 to 100 RIA merger and acquisition (M&A) deals in a given year. David Selig, CEO of Advice Dynamics Partners, believes that the numbers are vastly underreported, as there are 20,000 RIA firms – the majority with owners age 55 and older who are no doubt thinking about succession planning. "There is likely a lot of activity between firms that we just don't know or read about," says Selig. It's a pressing issue for the profession and for individual practices. According to a new report from Aite, 40 percent of practice owners surveyed in 2012 say they want to transition their practice to another party within 10 years, but among advisors within two years of transition to a successor, more than 40 percent lack a succession plan. Selig will present a session on **"Succession Planning and Enterprise Value"** on Saturday, March 9, at the FPA Business Solutions Conference.*

#### **1. If "value" is the biggest factor in selling your firm, what do advisors need to know about how value is determined?**

Value is based on the future profitability that a firm is going to deliver to the buyers. We look at firms' bottom lines and extrapolate a valuation from that using discounted cash flow analysis. The valuation process also involves analyzing client base demographics because we're trying to determine how attractive and transferable the business would be to a buyer. It's quite a deep dive into a firm's metrics.

#### **2. What are some of the most common misconceptions about buying or selling a firm?**

The first one is that an accurate measure of a firm's value is based on applying a multiple to top line, revenue. It's very outdated and is misleading to buyer *and* seller – two firms with the same top line may have very different cost structures and growth rates. Revenue is not a proxy for value. You just can't be accurate using this approach. The second misconception has to do with a seller believing that he or she can stay with the firm after the sale and make the same income as before the sale *after* the business has been sold for a high valuation. Of course, it is a preferred scenario for the seller to stay on for a while to ensure a successful transfer. But that misconception is the one we call having your cake and eating it, too. The only exception would be for very large firms, say, with \$20 million in revenue or more.

#### **3. "Transferability" of a business almost sounds like we're not talking about real people – clients. What are the key things to consider?**

The most important one is that the seller continues on with the firm for a couple of years. The premise behind a sale to an outside buyer is that you don't have people internally who can buy your firm. So if you want to sell externally and get top dollar, it's almost imperative to stay for a while to

ensure that all the client relationships are transferred intact. Rule of thumb: Sell to a firm *at least* three times as large, in terms of number of advisors, as your firm. So if you're a solo advisor with 100 clients and you sell your firm, it should be to an acquirer that has *at least* two or three advisors so the clients can be absorbed and nurtured over time. If you sell to a buyer without enough capacity, you're just transferring your succession problem to someone else – a very risky proposition.

#### **4. Why do the best laid succession plans go awry?**

If a deal is going to blow up, it's usually right before the deal closes, or during the closing period – sellers get cold feet or buyers see that clients aren't moving over as the attrition model predicted. Deals that fall apart post-closing tend to do so because of culture, conflicts, or control issues. The lesson is simple: buyer and seller must get to know each other and their respective firms very, very well. How are clients treated? What is the investment philosophy? How are employees measured and compensated and how are incentives determined? What is the leadership style? If you're aligned on these issues, there's a really good chance the transaction will succeed.

For internal succession, different dynamics are at work. A 2011 Schwab study indicated that more than 70 percent of advisors prefer internal succession. This takes as much planning and attention to detail as an external sale. Are one or more junior advisors really ready to take over? Can they lead clients and make tough but smart decisions? How are they going to write you a check for, say, a half a million dollars on day one and millions more over the next few years?

#### **5. What about all of the thousands of solo advisors out there?**

There are many happy and successful solo advisors out there who have created what is often called a lifestyle business. They work the hours they want, and with the clients they choose, call all the shots, and make a really good income. But if they expect to be able to gracefully and successfully exit, internal succession is just not going to happen unless they're willing to make a lot of changes – and well in advance of their planned exit. That means not waiting until you're 60 years old and your business is in harvest, not growth, mode.