WHO ARE THE BEST BUYERS FOR RIA FIRMS?

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Should RIA founders sell to an outside buyer or to junior partners already in the firm?

The internal vs. external sale debate proved to be one of the liveliest at the recent Deals and Deal Makers Summit in New York.

RIA owners should begin the decision-making progress by clarifying their goals for a sale, said Mark Tibergien, chief executive of Pershing Advisor Solutions. "If the goal is to maximize value, selling to an external buyer is always better," he said. "If the goal is based on commitments to clients and associates, selling internally is better."

External sales usually mean both higher prices and greater simplicity, agreed **Dan Seivert**, chief executive of **Echelon Partners**, the Manhattan Beach, Calif., investment bank and consultancy that hosted the conference. "There's also a lot fewer moving parts, and less succession planning -- but not no succession planning," Seivert added.

Selling to an outsider also usually means higher down payments and shorter payment periods, executives at the conference said, adding that such a deal also requires less lead time for the seller.

The biggest potential downside for an external sale? The possibility that the buyers won't live up to their promises, Seivert said. "What you see isn't necessarily what you get," he warned.

LESS RISK, MORE GOODWILL

Internal sales carry fewer risks, Seivert said: "You're selling to people you know." And selling to a firm's current associates spreads goodwill, rewards advisors for loyal service and gives owners more freedom in structuring a deal, Seivert said.

But not everyone agreed that such a deal was best for client retention.

"Clients still have to be handled carefully," said Greg Freidman, CEO of Private Ocean Wealth Management in San Rafael, Calif. "Many of the larger clients are used to having a relationship with the firms' founders, and that will be changing."

Indeed, clients can become quite "jittery" about management and ownership changes -- "even if those changes are for the betterment of the firm and, therefore, them," agreed one owner of a midsize RIA who asked that his name not be used because his firm is in the middle of an ownership transition.

And the staff may not be ready to take over, some veteran dealmakers pointed out. While firm founders to be rainmakers and entrepreneurs, salaried employees may not necessarily have those traits. "Employees usually haven't been owners, and some haven't aspired to be owners," Friedman said. "In a lot of cases, extensive training and mentoring is required."

FINANCING INTERNAL DEALS

For internal sales, financing remains one of the biggest challenges, because most younger advisors don't have enough money to be able to buy equity outright.

Owners will typically help junior partners finance the sale through a note, but payouts can stretch out for seven years or more.

In addition, owners are in effect buying themselves out, argued Matt Cooper, president of Newport Beach, Calif.-based Beacon Pointe Advisors. When an owner sells the stock to the next generation for a note, Cooper said, "The buyer then receives the earnings associated with that stock and uses those earnings to buy the stock from the founder/owner. If the owner had not sold, he [would have] kept those earnings."

Over the past few years, however, internal buyers and sellers have increasingly sought financing from lenders such as PPC Loan and Live Oak Bank. PPC Loan will lend money to junior partners based on the firm's expected future earnings, said the firm's director of investment advisor services, Dustin Mangone -- allowing owners to receive larger down payments and a shorter payout period.

"We want [borrowers] to be able to articulate why they are the appropriate successors for the firm; how they see their role as an owner and what they will do and do differently," Mangone said. "We want the junior partners we lend to be entrepreneurial and understand ownership."

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