Tibergien, Seivert Debate 5 Critical M&A Questions for Retiring Advisors

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Advisors planning to retire have several critical choices to make if they want to cash out and have their business continue: They can sell their firm to an outside company or to one or more insiders who will stay on. They can get paid in cash or equity or a combination of the two.

But well before making any of those decisions, advisor-owners should consider what their firm values most — growth or profitability — and what services it offers clients, such as proprietary investment management or open architecture investment management.

These characteristics can affect their ability to sell as well as the price they'll receive, according to Mark Tibergien, CEO of Advisor Solutions at BNY Mellon's Pershing and a longtime Investment Advisor magazine contributor, and **Dan Seivert**, the CEO of **ECHELON Partners**.

The two executives debated what matters most when considering a merger or acquisition at Pershing's recent Insite conference in Orlando, Florida, taking opposite sides for purposes of a lively discussion after which audience members could cast their own votes for either position.

Keep in mind that M&A activity among RIAs is on the rise. In 2017, a banner year, the number of deals increased 22% from the prior year to a record 168, and the average assets under management of acquired firms topped $1 billion for the second consecutive year, according to ECHELON Partners. The firm projects 196 deals this year.

Here are the issues advisory firms should keep top of mind when considering a merger or acquisition, according to Tibergien and Seivert.

1. Prioritize Growth Over Profits?

"Think of value as a function of the future, not the past," said Tibergien, who argued that growth trumps profits when valuing an advisory firm because growth suggests the future potential of a firm while profits and revenues record the past.

He favors the formula: EBITDA/(Risk-Growth) = Value. The higher the risk, the lower the value and vice versa, said Tibergien.

Growth is especially important in the current environment where many firms have aging advisors and clients. Buyers want to avoid acquiring firms whose client assets are shrinking due to decumulation, rather than growing from accumulation, Tibergien explained.

Profitability, along with cash flow, is also an important consideration, said Seivert, because it reflects the quality of a business, including its cost management capabilities. Advisory firms interested in a merger or acquisition should exhibit both profitability and growth, he said.

The audience chose growth over profitability by a slight margin.

2. Offer Investment Management That's Proprietary or Open Architecture?

If investment management is a core proposition of an advisory firm it should own it because that will yield higher revenues, but in the current market, financial planning is a more valued offering, said Tibergien.

As a result, more firms now offer asset allocation services and outsource investment management rather than maintaining it in-house, which costs money for research staff and time, said Seifert.

It follows then that "there is a wider pool of buyers for open-architecture firms than for firms with proprietary investment management," said Seivert.

The audience favored Seivert's position by a vote of 85% to 15%, but Tibergien noted that the trend toward open architecture makes it harder for advisory firms to maintain the price structure they have set, based on AUM, when investment management is not their key offering.

3. Holistic or Narrow Service Offering?

With the move away from proprietary investment management comes a broader, more holistic offering of services from advisory firms, essentially a "one-stop shop" for clients, said Tibergien.

That sounds good for clients, but it can involve potential conflicts. One-stop firms may have a greater incentive to cross-sell products that a client doesn't need or want and to sell more expensive products and services, said Seivert. In addition, he noted, in those circumstances it's not clear who "owns" the client, who is most responsible for making sure that the client receives the services he or she needs.

The audience overwhelming endorsed holistic services versus a narrower offering by 2 to 1.

4. Sell to an Internal Successor or Outside Third Party?

There are pluses and minuses to both types of sales, but even those are subject to debate.

Selling to an insider allows the continued connection between clients and staff and increases the probability of a successful transfer of power and the future success of the firm, said Tibergien.

Not necessarily, said Seivert. An internal sale "can tear a firm apart, causing irreparable damage," since only one or few current insiders will become the new owners. In addition, he said, the buyers usually have no experience running a firm and the firm's price won't benefit from a competitive process, which could increase its value. Selling to an outside entity usually involves a premium price; selling to an internal successor, a discount, said Seivert.

Tibergien didn't dispute the price discount/premium argument but asked whether selling to an outsider can insure that the business will last. "The reality" is that 25% of firms continue for a second generation and only 10% last for a third, said Tibergien.

The audience was almost evenly divided on who makes a better buyer, an insider or outsider.

5. Take Cash or Equity in a sale?

Cash carries no risk and can be invested in a market that's more liquid than an advisory firm, Tibergien said. An equity stake, however, can grow, providing the seller a greater upside than a cash payment would, Seivert noted.

"It all depends on how a deal is structured and the reinvestment risks in the public market, said Seivert.

He recalled a working with a client who was planning to sell his firm to an outside buyer but died a few months later. His wife subsequently sold the firm in an 80/20 cash/equity deal, receiving $3 million in cash and holding a stake worth $20 million several years later. Like profitability and growth, advisor-owners don't have to choose between cash and equity. They can choose both.