Expanding Your Practice

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When expansion-minded financial advisors talk about “buy” and “sell” these days, listen up: It’s not stocks and bonds they’re talking about—but books.

The downturn in the market and the introspection that followed Sept. 11 caused many forward-thinking advisors to rethink their business-building strategies. The result? A swell of activity in the acquisitions channel.

Consider: Online sign-ups at FPtransitions, the Portland, OR-based firm that brings together buyers and sellers of financial-advisory practices, are on pace to triple this year over last.

“Without question, acquisition is the way to go if you are serious about building your business, if you have a goal, you are capable,” observes Jeff Turner, a principal with Turner Feher, a San Francisco-based matchmaking service. “It’s hard to get a new client nowadays. You can’t cold-call. Seminars are hard and expensive. For someone who is ambitions, acquisition is a great option.”

The bad news? Without a tremendous amount of planning, most acquisitions fail.

“The reason they fail is because they fail to plan,” noted John Bowen, chief executive officer of CEG Worldwide, the financial services consulting firm with headquarters in New York and Northern California. “They don’t do the analysis. They don’t have a clear vision of what they are trying to accomplish. Somebody says ‘Gee, a firm is for sale,’ and they race over to do a deal. They get caught up in the chase instead of the hundred other elements they ought to be considering.”

Excited by the opportunity in the acquisitions arena? You should be. But, buyer beware.

As Mark Tibergien, practice leader of Moss Adams’ LLP, Securities and Insurance Niche in Seattle, puts it: “I think the biggest fools in this market today are buyers who think they can take an old and dying practice and transform it into a vein of gold. A couple of years ago, sellers were motivated by greed. Today, it’s fear or burnout. There’s a fair amount of bad logic in prices going up because the reality is most people in this business have experienced a flat couple of years and have not been adding clients, so you have to ask: What does that book of business really look like? What’s the quality of what’s being transferred? What’s the future potential?

To help answer those questions, *Research* asked a number of industry experts for their best advice for financial advisors who want to ramp up their practices through merger or acquisitions. Here’s what they said:

First, Are You Ready?

“The first thing, and this part people don’t think through, is be introspective – first of yourself. Then take a look at existing clientele. In many cases, you can leverage that,” says Bowen, who has brokered 22 deals. “You don’t have to buy to build.”

Get a Pro on Your Team

Before you even launch your shopping trip, hire in-house professional management to coordinate the process or get a business agent. Otherwise, you risk throwing your practice into disarray.

“You should be very cognizant of the fact that doing all the things necessary to consummate a transaction takes an incredible amount of time and can be incredible disruptive,” according to Dan Seivert, managing principal of 3C Financial Partners, a merchant bank in Manhattan Beach, Calif. “Hire a professional. Otherwise, it can end up taking as much as 70 percent of your time.”

The presence of a professional will also help protect you from getting overly emotional about the process. “M&A work is exciting. You get charged. As you get closer to closing the deal, very professional people can get very emotional, sometimes unwisely,” says Bowen. “We encourage financial advisors to get professional help. These are deals.”

Study the Marketplace

Make sure you fully understand the competitive pressures in your marketplace. Would you be stronger joining forces with the competition, instead of fighting it? Leverage your financial partners – your broker dealer, your clearing operation, your wholesalers. “Think of the classic wholesaler,” Bowen notes. “They are out and about and have more conversations, often more intimate, than any advisor would have the chance to do.”

Also, seek out firms with strong and lasting client relationships. “You want someone who has built good relationships with the client so they can transfer them,” he adds. “Ideally, you have better processes so you can add value above and beyond that. When that happens, retention rates are phenomenal.

Moreover, identify the firms, typically fee-based or fee-only, that would help make you dominant locally or regionally. “A lot of people have tried to develop a national strategy and it hasn’t worked,” says Tibergien, whose group will help negotiate approximately 100 deals this year. “Almost all sales are local. It just doesn’t make sense if you’re in L.A. to buy a practice in Connecticut.”

Clarify Your Motives

The single most important item on your shopping list should be this one: Structure a deal that adds value.

“There are various ways one can do that,” says Seivert. “Buy at a low price. Buy where you can carve out a significant amount of expense or where you can realize meaningful synergies. And the one overarching element that you sort of have to make sure works is that it fits into your overall strategy. Are you building depth within a region? Finding a property that complements your product line in an area where you don’t have strength? Complementing a customer segment?

“Ultimately, people are doing these deals in the hopes of creating value. The most important thing is that they fit into the strategy that they originally developed and that they are executed and integrated in a way that optimizes the overall performance of the company. What I mean by that is that the deal keeps the professionals happy and retained and keeps the clients happy and retained.”

Secure Your Financing

The capital requirement for making a buy can be stiff. Examine your options: Can you self-finance or do you need to raise capital? Turner even suggests asking your broker/dealer for a loan.

“Most won’t admit it, but they will finance,” he says. “For them, they lock you in as a broker because you owe them money and they get all this production really at no cost.” And, sometimes, in the case of mergers involving an exchange of stock, money doesn’t change hands at all.

“The real key in every deal is understanding the terms,” advises Tibergien. “If I were a buyer or a seller, what I would focus on is what is the net going to be—the taxes, structure, financing, terms, period of time. What will the net be and will the cash flow be affordable to the buyer and fulfilling to the seller? If I’m doing a merger, I’m less concerned about price as about future prospects.”

How much are practices going for? Of the 104 deals that FPtransitions completed last year, the range swung from a low of $75,000 to a high of $1.8 million. The average was $580,000, according to David Grau, a principal in the firm. Typically, buyers using the service apply a down payment of 20 percent to 30 percent with the rest of the purchase price paid over four years.

Tibergien, who is not a fan of earn-out arrangements, says price should always be based on profitability or the cash flow of a business. “If you’re bored or burned out or old or sick and you want to get out, buyers, if they are smart, won’t be paying you top dollar. Why overpay for a depleted oil well? What we're interested in are deals that add capacity, clients and depth. Strategic buyers are playing in the growth market."

Find the Right Match

It doesn't always work this way but, typically, buyers are looking for firms that mirror their own in terms of size and philosophical mission.

"You just don't want to bite off more than you can chew. Take what you can handle. I'd say get a smaller business, frankly," says Turner. "And the really important thing is that there's a personality match between the two. Those are the best deals out there."

Adds Seivert: "A lot of the ultimate success is driven by how willing the two different firms are to adopt each other's best practices and how willing they are to make some compromise. Oftentimes, firms come in saying their template is the best and they want to overlay that on you. If both are somewhat malleable and respectful of the successful people, policies and processes that the other developed, usually that's one of the hallmarks of a successful firm."

Also, plan to spend some time on the process. Tibergien says buyers generally vet as many as 10 practices before finding a good fit. "The mating dance is a good 18-month process where you are really testing the flexibility and the culture and the willingness to adapt on both sides," he adds. "If you're the firm that's being absorbed, you need to demonstrate the ability to adapt to the mother culture. That's very hard for an independent [advisor.]"

Make It Last

The work doesn't stop when the paperwork is signed. A complete cultural integration usually takes two years, according to Tibergien.

You've got to be committed to making it work. The best advice I could give to somebody contemplating a merger is to try to anticipate what the business would look like post-merger and build integration strategies around that. Don't even worry about price and terms until you have a cultural fit."

Among the issues to address: Who's accountable for what? How do you integrate systems? In terms of clients, who's going to be serving whom? How do you tap into each other's resources? As for sales and marketing, which clients will you pursue and why? What sorts of people do you want in your organization? How are you going to develop them and how are you going to pay them?

And, as Seivert notes, these are the sorts of questions that should be asked sooner rather than later.

"You need to look at people, processes and resources," he says. "What we like to do is help the buyer and seller list all of those things and identify which ones you want to retain and which ones you want to eliminate, and develop strategies and tactics to do that. This isn't a conversation you start having once the paper is signed. This is something you start working on in the early stages of the process to make things fit."

About ECHELON Partners

ECHELON Partners (ECHELON) was formed in 2001 to offer investment banking and consulting to a subset of the financial services industry known as "investment product developers and distributors" (IPDADs). Since that time, ECHELON's professionals have helped hundreds of senior executives envision, initiate, and execute a multitude of complex business strategies and transactions. ECHELON's business is making companies more valuable through delivering advice and orchestrating transactions. Accordingly, ECHELON measures its success in the enterprise value it creates for its clients. Companies that strive to outperform their peers choose to work with ECHELON because we are as passionate about their results as they are.

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