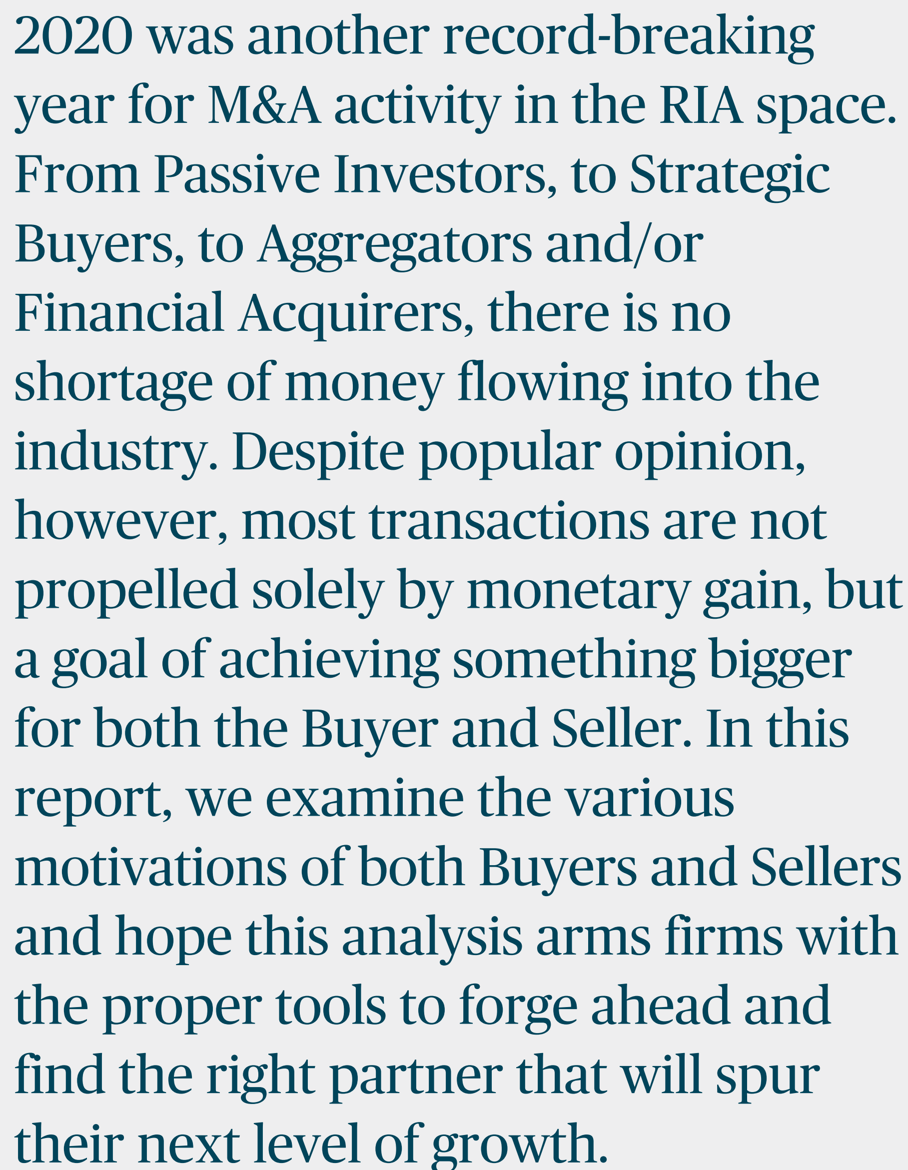
Why the Sale of Your Firm Should Be Viewed as a Catalyst for Growth

In collaboration with



2020 was another record-breaking year for M&A activity in the RIA space. From Passive Investors, to Strategic Buyers, to Aggregators and/or Financial Acquirers, there is no shortage of money flowing into the industry. Despite popular opinion, however, most transactions are not propelled solely by monetary gain, but a goal of achieving something bigger for both the Buyer and Seller. In this report, we examine the various motivations of both Buyers and Sellers and hope this analysis arms firms with the proper tools to forge ahead and find the right partner that will spur their next level of growth.

Despite all the business disruptions caused by COVID-19, 2020 saw unprecedented M&A activity across the RIA industry. The latest DeVoe & Company report, released in mid-January, listed no less than 159 transactions in 2020, which was the seventh consecutive year of record activity. To some degree, M&A activity is a self-fulfilling prophecy—as more transactions occur, more buyers come into the market, which drives valuations higher, and makes more sellers contemplate a transaction, all of which ultimately leads to more transactions, and so on. There does not seem to be any end in sight.

Taking from DeVoe's report, "The surge in activity has largely been driven by professionally managed firms with over $1 billion of AUM. DeVoe & Company expects a steady increase of small and mid-sized firms to sell externally over the next several quarters, which will extend the surge (of M&A activity throughout the RIA industry)." Later in the report they state, "We expect that a surge in small and mid-sized deals will more likely contribute to around 45 transactions per quarter for the near term."

In this report, co-written by BNY Mellon|Pershing and PFI Advisors, we hope to review the various motivations from both a Buyer's and Seller's perspective and highlight the fact that, despite popular opinion, most transactions are not propelled solely by monetary gain, but a goal of achieving something bigger for both the Buyer and the Seller. Buyers are very thoughtful in their approach to M&A and are not simply looking at growth for growth's sake—they are searching for growth components the Seller can bring to their organization that complement the components already in place. And many Sellers do not view a transaction simply as a means to an end, but as the next chapter in their growth goals and ambitions. A successful merger or acquisition is dependent on both firms' ability to integrate their own strengths to create a more holistic firm that provides better opportunities to clients and employees alike. We'd like to thank Carina Diamond of Dakota Wealth Management, Harry Jones of Edge Capital Partners, and Charlie Massimo and Peter Anastasian of Wealth Enhancement Group for providing case studies of how their recent transactions have allowed them to better serve their existing clients and spurred them to new growth.

Motivation for Buyers

Organic growth can be difficult. The 2020 Study of Pricing & Profitability, produced by InvestmentNews Research and Sponsored by BNY Mellon Pershing cites that roughly half of firms' organic growth over the past several years has been attributed to market performance. The report further states, "Independent advisory firms continue to mostly grow through client referrals, making them dependent on their founders for growth. While the industry is seeking a solution to this problem through marketing, many firms are failing to implement even the most basic sales tactics such as tracking the growth pipeline and creating processes for individual accountability." At the end of each fiscal year, RIA owners meet with their business partners to review their performance and many realize their firms are beginning to show signs of slower growth. As they review their options to boost growth at the firm, they often make the decision to switch to an inorganic growth strategy, not only to bring on more assets, but to also acquire more advisors who can help the firm grow

For Buyers willing to invest in their infrastructure and hire dedicated staff to assist in the onboarding of advisors, their clients, and their employees, acquisitions can provide a fantastic path to growth. Additional billable assets are attractive in their own right, but beyond just the AUM numbers, acquisitions can open up new geographies for Buyers—what quicker way to enter new markets than to acquire an established advisor in that locale? Additionally, an acquisition can be viewed as an "acquihire," where the Buyer picks up talented employees from the Seller. PFI Advisors worked with a recent Buyer who not only picked up $2 billion of AUM but brought aboard a new Chief Operating Officer and a new Chief Financial Officer, all in one swoop.

Buyers can also acquire a new service offering or client segment from a Seller. We've seen plenty of examples of this lately, where a Seller's client base focuses on dentists, or airline employees, etc. We've seen acquisitions where the Buyer specialized in institutional clients, and the Seller specialized in high-net-worth clients. In these instances, both the Buyer and Seller are attracted to the idea of bringing both specialties under one roof and complimenting one another. Assuming the advisors have a cultural fit, these expanded service offerings can be matches made in heaven. Some Buyers are not necessarily motivated by additional AUM or client specialization, but perhaps they are looking to acquire a new marketing strategy. Some Sellers have perfected digital marketing or have a successful podcast or radio program that can attract new clients. For Buyers facing slowing growth numbers, these additional marketing initiatives can be very valuable.

Motivation for Sellers

Many Sellers perform the same end-of-year analysis as Buyers and come to similar conclusions regarding slower growth rates. Upon that realization, some Sellers may think, "We had better monetize now before things deteriorate further." Other Sellers, upon performing this analysis, realize the real reason they aren't growing is the fact they have entered a new stage of their career, where they want to spend more time away from the office and dedicated to family or philanthropic interests. They think, "I want to capitalize on the years of blood, sweat, and tears I've put into this business and at the same time, take a step back in the business." Sellers in this camp are looking for a succession plan and need to ensure their clients are taken care of by the next generation of advisors, whether those are internally available, or those advisors come from the outside, as part of the Buyer's camp.

A larger group of Sellers, however, don't view a sale as an end game at all, but as a chance to open new avenues for growth in their business. They view themselves as still young and full of energy, and truly want to expand the business beyond their current capabilities. Upon deeper analysis of their business prospects, they conclude that they cannot bring the business to the next level on their own and want to bring in an external partner. In most cases, this is not a succession plan as much as it is a partnership that will spur the next wave of growth in their business. The competition and costs for client acquisition remain high, so finding a partner to help create new opportunities with different strategies can be the most beneficial decision a firm can make to continue a strong growth plan.

Avenues for Growth Available to Sellers

ESTABLISHED AND CENTRALIZED OPERATIONS SUPPORT

In speaking with advisors who are contemplating a sale, what we hear most often is, "There is just too much to get done every day," or "I'm just spread too thin." These advisors were able to handle their firm's growth in the early days, but as the number of clients continued to rise and the complexity of their requirements continued to expand, these advisors needed to add more staff, invest in new technology, and continue to evolve the firm's marketing efforts. With a low number of clients to service, advisors can stay on top of HR, Compliance, Investments, IT, Marketing, Bookkeeping, etc., but as their client base continues to grow, it becomes exponentially more difficult to handle these administrative tasks in addition to client service and business development.

By partnering with a larger organization, Sellers can rid themselves of these tasks associated with the running of the business and focus solely on clients and prospective clients. When evaluating Buyers to partner with, each Seller will want to hear from the firm's specialists who handle these areas and will get very excited at the prospects of delegating these tasks to others who will be more focused on them. This is the classic case of "addition by subtraction." By delegating all tasks not associated with client service and business development, selling advisors free up as much as 50% of their time and energy to their most valuable tasks.

Merger Profile:

Springside Partners and Dakota Wealth Management

Prior to joining Dakota Wealth Management in July 2019, Carina Diamond's Springside Partners had launched in 2014 with the goal of providing fee-only advice to individuals, families, and organizations. As her firm was well known for its impressive record, Carina stated that she was "under no pressure to sell. Nothing was wrong and my business was doing well." What Carina was looking for was "to position myself best for growth—to invest in technology and have scale, to join an organization where I would have a say. I wanted to have partners, not simply investors." This led Carina to speak to 30-40 potential acquirers and she quickly realized the importance she placed on cultural fit and vision didn't seem to be a priority to many of them. "They just wanted my assets," she said.

Carina had previously seen Peter Raimondi, CEO of Dakota Wealth Management, speak at conferences and on a chance encounter, had the opportunity to speak with him one-on-one, asking him about his background and his vision for the firm he had most recently founded. Carina said that there was a "real" quality that she saw in Peter and instantly connected with him. He invited her to meet with his entire team several times without him present. "That showed me the confidence he has in them—there obviously was total transparency." Once Carina's team was able to meet Peter's, she knew the deal would work. "We both knew as leaders that if our teams didn't like each other, we weren't going to do this."

When joining a larger organization, many firms struggle to realize they are not ready or able to give up their own branding. However, Carina had no issue with this, stating "It's difficult to have consistency with a lot of different brands. If you are going to achieve scale, you are either in, or you're not. I wasn't looking for mere back office support, I was looking to expand my family. I believe you need brand consistency in order to grow."

Since joining Dakota Wealth Management, Carina has grown her assets by over $50 million. This merger has opened the door for many opportunities not historically available to her, such as developing new partnerships that she could not have entertained at her firm's previous size. With the backing of Dakota Wealth Management's team and infrastructure, Carina was able to secure a deal with a local CPA firm and execute an ongoing joint venture with them.

Many firms view merging as simply a means to an end. For Carina, joining a larger firm was the next step in her firm's evolution. Dakota Wealth gave her a stronger foundation on which to service her clients, a long-term plan for growth, and a true partner to execute with.

RENEWED FOCUS ON CLIENT RELATIONSHIPS

By ridding themselves of the daily minutiae of running a business, selling advisors find themselves spending more and more of their day on the tasks they enjoy and are reminded of the energy and enthusiasm they had when they first entered the profession. "I'm back to working with clients I love and dedicating all of my energy to solving their unique financial problems—I feel like I'm 10 years younger!" one advisor told us shortly after selling to a larger organization. Many advisors became "accidental business owners" as their firms grew (to steal a phrase coined by Michael Kitces), never that interested in managing staff or building scalable processes and workflows into their organizations. These advisors became victims of their own success, being pulled away from client work and into business management tasks. This has sapped their energy and resulted in frustration as they have tried to tackle tasks they are not suited for or interested in.

When advisors get back to a place where they are truly excited when they look at their calendar every morning, clients and prospects can pick up on the enthusiasm in their advisor's voice and find more engagement in the conversations that follow. This excitement and enthusiasm transcends the advisor-client relationship and is a key determinant to more client referrals. The advisor tackles each day with more energy, able to achieve more calls to clients and prospects not just because they have physically freed up their time, but because they have a renewed passion and focus on their business. It is impossible not to grow when you are filled with such enthusiasm and vigor each morning.

ADDITION OF SPECIALIZED RESOURCES AND TECHNOLOGY

Just as a Buyer can pick up specialists focused on different segments of clients through an acquisition, a Seller can pick up additional solutions to offer their clients, which oftentimes leads to a greater portion of wallet share for the advisor. By joining a larger organization with more AUM and more employees who can specialize in certain investment classes or service offerings (tax preparation, bill pay, financial planning, etc.), selling advisors can leverage that expertise and have confidence that their clients will be better served. Not only do these "departments" allow a smaller advisor to offer more complex solutions to his/her clients, but by handing over the servicing responsibilities to these respective teams, it allows the advisor to get back to growing their clients and not having to worry about the day-to-day servicing of accounts. This leads not only to a greater wallet share of existing clients, but a whole new pipeline of clients that the selling advisor was unable to accommodate previously.

Larger organizations will most likely have bigger technology budgets than the selling advisor had with his/her previous firm. Plugging into more up-to-date technology and operational excellence gives the selling advisor greater confidence that their clients will experience an upgrade in service and operating leverage, and the selling advisor can confidently go after larger and more complex clients. "At the end of the year, we mapped out where we wanted to go as a firm, and then calculated the cost and time required to do it ourselves. When we looked at (the Buyer), we realized they had already built it, so why not just partner with them?" one advisor told us.

Merger Profile:

CJM Wealth Management and Wealth Enhancement Group

Prior to joining Wealth Enhancement Group in September 2020, Charlie Massimo and Peter Anastasian ran CJM Wealth Management, a hybrid RIA headquartered in Deer Park, NY. The firm was founded in 2003 with a goal to provide planning-centric, wealth management for individuals and families, as well as 401(k) plan management. By 2019, Charlie and Peter found themselves at a point where they wanted to grow and develop their business but “lacked the consistency and big company structure” to do so efficiently. Although they had been approached by several firms with offers to sell their busines in the past, it was only once they solidified their visions of growth and development that entering into an M&A deal felt like a viable option to achieve their goals.

Taking the time to speak to a handful of the firms who had made offers, Charlie stated that he and Peter learned a very important lesson early in the process: “A key component for any seller is having the right investment banker to help you evaluate the different Buyers and determine which would provide not only the greatest platform for growth, but the most robust platform to service existing clients as well.” Charlie and Peter felt they didn’t have enough direct experience to be able to compare deal specifics to one another or to industry benchmarks. With the investment banker’s guidance, when they met with Wealth Enhancement Group (“WEG”) and saw WEG’s culture, growth plan, and even ownership structure (every advisory team owns equity in the organization), they knew immediately that it would be a successful partnership marrying infrastructure to better serve clients and growth tools to attract new ones.

One of the most important aspects of Peter and Charlie’s partnership with WEG was the increased investment a larger organization could devote to marketing. Charlie stressed that, in this area of business development, consistency is paramount. Instead of having to juggle the nuances of client service with developing and deploying competitive marketing efforts (which is a full-time job in and of itself), Charlie and Peter found that they could utilize WEG’s robust marketing team. Shortly after closing their merger, Charlie and Peter began joining WEG’s scheduled weekly marketing call to talk about firm-wide initiatives, internal marketing, and relationships with the major custodians. Charlie believes that with this support, they will not go “off course” and will have more time to better serve their clients.

With Wealth Enhancement Group’s partnership, Charlie and Peter have set an aggressive goal of doubling net new asset growth from the previous year. In fact, their new partnership has already begun paying dividends. They have gained a client from a WEG referral source and have met with a custodian to establish a relationship that will benefit existing clients. The partnership with WEG has allowed them to offer more resources to bring on larger clients while giving them assurance that all their clients would be taken care of well into the future.

BEING PART OF A LARGER ORGANIZATION = LARGER PROSPECTIVE CLIENTS

Not only do the capabilities of the Buyer—from a technology perspective, a products and services perspective, and a scalability perspective—allow the selling advisor to go after larger and more complex prospective clients, but the simple fact of having a larger denominator opens new doors for the selling advisor as well. "When we were a $120 million firm, we really couldn't go after $25 million and larger clients because they didn't feel comfortable being that large of a percentage of our overall AUM," one advisor told us. "Now that we are part of a $2 billion organization, we consistently find ourselves in conversations with prospects in that range. It's really allowed us to go up-market."

BEING PART OF A LARGER ORGANIZATION = MORE CAREER OPPORTUNITIES FOR EMPLOYEES

Joining a larger organization allows the advisors to grow their network of potential clients and provides more career path opportunities to employees of the selling firm. Many sellers are firms consisting of 5–10 employees, and they may be joining organizations that have 50 or more employees. This allows for specialization of roles and responsibilities, and employees of the selling firm can take on new responsibilities within the larger organization and have teams of employees reporting to them. These larger organizations can provide career advancement beyond what the selling organization was able to offer. Happy and engaged employees who are advancing their careers, coupled with more robust technology solutions, adds significantly to the growth prospects of any organization.

Growth Capital Profile:

Edge Capital Group and Focus Financial Partners

Propelled by the desire to utilize the unique benefits of the RIA fiduciary model for their clients, Harry Jones and his partners left Goldman Sachs and Credit Suisse and founded Edge Capital in April 2007. With the financial backing of outside stakeholders, they registered their RIA and took the next steps in the evolution of their business. Of this time, Harry says, "The financial crisis made people realize the benefits of the fiduciary model and our business really started to take off." This client-centric approach has been a catalyst for growth for many RIA firms in the decade-plus since the financial crisis.

While the majority of Edge Capital's growth had been organically driven, they made two small acquisitions over the next several years. The first brought a partner from an existing RIA and allowed the firm to add an office in Charlotte, North Carolina. In 2015, with the goal to add more talent and another custodian to their repertoire, they bought a smaller RIA in Atlanta who was custodied with Charles Schwab. Things plodded along nicely for the next several years, but 2018 brought a shift in leadership that became an important inflection point for the firm.

One partner wanted to transition into a reduced role at the firm, and another partner wanted to exit the business altogether. With these changes to the capital structure, Harry and his partners saw this as a great opportunity to buy out the outside stakeholders and take full control of the firm. During this soul-searching, he mapped out aggressive growth goals for the firm—goals he realized would be hard-pressed to achieve solely with the organic path he had relied on in the past. Harry determined he would need to pursue an inorganic growth strategy, and for that, he would need growth capital.

Focus Financial Partners had proven their ability to offer RIAs capital for ongoing growth and acquisitions, as well as providing M&A expertise. Even more important to Harry, he was hoping to tap Focus to strengthen Edge's back-office infrastructure to become an attractive landing spot for other advisors. With their internal changes behind them and firm's plans for the future solidly laid out in his mind, Harry saw Focus Financial as the logical partner to take the next step in his firm's growth trajectory. Edge Capital closed their transaction with Focus Financial in August 2018.

In an attempt to take one step back before taking two steps forward, Harry points out that the first year was spent delving deep into their technology, people, and processes and making the necessary investment to "beef up our internal operations and support our infrastructure." By utilizing Focus' expertise in strengthening their robust back office to accelerate growth and scale, Harry and his team were able to make themselves an attractive buyer for other teams, and ensure that they were able to handle any merger opportunities that would come their way.

At the end of 2019, Edge Capital started to aggressively reach out to other firms and advisors to discuss potential mergers, but Harry chose to halt conversations in early 2020 in order to focus on client relationships during the unfolding of the COVID-19 global pandemic. In June 2020, they re-engaged conversations and began to ramp up their M&A pipeline once again. Edge Capital is currently considering multiple potential deals and feels the groundwork has been established for their next phase of aggressive growth.

PARTNERING WITH A LARGER ORGANIZATION INCREASES SUCCESS OF FUTURE SUB-ACQUISITIONS

Many advisors start down the path of pursuing an acquisition strategy, only to realize they need the resources of a larger organization to help them successfully execute their inorganic growth goals. As stated earlier, many advisors become stretched too thin as they grow their client base and try to manage the day-to-day operations of their firm. When you add in the complexities of recruiting on top of running the business and servicing clients, advisors can become overwhelmed very quickly. Successfully completing a transaction and realizing the promised synergies takes a full-time, focused effort by one or more management principals. Thus, it is critical that the acquiring firm has management capacity available to follow through on the many logistical details, legal issues, financial implications, negotiations, and due diligence requirements associated with each transaction. Many Sellers join larger organizations to provide this level of assistance when looking to add advisors to their team. Trying to remain a stand-alone firm, these Sellers realize the odds of getting a deal to the finish line are very low.

In addition to the logistical issues associated with M&A transactions, the larger organization can also line up financing for these acquisitions and even provide guidance on deal structure and valuation. Once a transaction is finalized on paper, it is critical that a majority of the client assets transition to the new firm and that clients have a good experience in order to ensure retention. Larger organizations can provide dedicated post-M&A transition strategy and onboarding resources to ensure that client transitions go smoothly. Without these dedicated resources, smaller RIAs have a hard time competing with larger organizations in the M&A arena. By joining a larger firm and tapping into their greater resources, financing options, and specialized teams, the Seller can now combine organic with inorganic initiatives to their growth strategy.

What Can Sellers Do to Prepare for a Sale?

With so much demand for recurring revenue businesses, it is the Seller's responsibility to showcase a steady, safe, and hopefully increasing profit margin, which ultimately results in a higher valuation for the Seller. The Buyer is mostly focused on the cash flow produced by the business once it is fully integrated with their technologies and has adopted their processes and workflows. Buyers also seek a healthy profit margin to cushion any short-term reductions in revenue from client attrition or market pullbacks. The more streamlined the business is, and the more profit/cash flow displayed, the more demand there will be for the business from multiple buyers. Ultimately, there are only two sides to the profitability equation that can boost cash flow: increasing revenue or decreasing expenses.

As discussed earlier, Sellers who have a unique client base or a specialized system for attracting clients will be in high demand. An innovative digital marketing strategy, or a niche podcast or blog will attract Buyers who are looking to expand their own marketing efforts. If a Seller is located in a geographic region that a Buyer wants quick access to, or if the Seller can show command of a certain client segment (Millennials, Ultra-High-Net-Worth, Institutional Clients, etc.), a Buyer will be excited by the prospects of increased revenue from these new client niches.

In terms of improving bottom-line results, we suggest Sellers ask themselves some tough questions before kicking off an M&A process in earnest:

- Are we overspending on technology tools that are more robust than we really need (the equivalent of buying a Ferrari to shuttle back and forth from the grocery store)?
- Have we under invested in certain areas, which has caused us to over-hire people to manually process things that could/should be automated?
- How can our systems run more efficiently?

- What workflows can be restructured?
- How can our collective systems integrate with one another better?
- What, if any, systems should be updated and/or replaced altogether?

With answers to these questions in hand, the Seller can look to streamline operations wherever possible, in ways that will not affect client service. Can certain functions be outsourced, perhaps? Another area to focus on would be client segmentation. The goal of any client segmentation exercise is to determine the proper resources to allocate across the client base. Is every client being serviced in a profitable fashion, based on the complexity and the fees being paid? Wherever a Seller can detail profitability and streamlined systems and processes that would easily plug into the Buyer's existing processes, the Seller can guarantee more interest and a higher valuation.

Who Are the Buyers of RIA Businesses?

With the continued success of the RIA model, offering a steady stream of recurring revenue, there has been no shortage of Buyers entering the space over the past few years. Advisors contemplating a sale for any of the reasons listed above have ample options of partners for added services and growth opportunities. It is important for Sellers to understand the nuances of each Buyer, as each have slightly different motivations and relationships with the firms they partner with.

PASSIVE INVESTORS

More and more passive investors have entered the RIA space in the past 12-18 months. These firms are looking for minority investment stakes and will allow the Sellers to retain full operating and voting control of their firms. Sellers can use the capital infusion to upgrade infrastructure, make key hires, or use the funds to make sub-acquisitions, hopefully with the guidance of the acquirer.

STRATEGIC BUYERS

These acquirers provide more capital than passive investors but are looking for a controlling interest in the selling firm, in hopes of driving efficiencies after the transaction closes. These transactions often include an earn-out provision for the Seller. While this scenario allows for less control for selling principals, a unified strategy and brand can drive growth as Sellers are allayed of unwanted business functions, allowing them to focus solely on client service and business development.

AGGREGATORS

These transactions typically involve both cash and equity consideration, as well as an earn-out based on the earnings/cash flow of the Seller. While Aggregators typically make smaller investments than Strategic Buyers, they often allow the Seller more control over future operations. Sellers benefit from the Aggregator's expertise in executing M&A transactions, internal succession plans, or operational best practices, and can leverage the knowledge from other RIAs inside the Aggregator's network.

FINANCIAL ACQUIRERS

These scenarios typically involve an all-cash infusion from a private equity firm who is taking a majority equity stake in the Seller's business. This investment will allow the Seller to execute their business plan by providing needed capital. Unlike the Aggregator model, the Seller will likely have limited interaction with other firms inside the private equity firm's investment portfolio.

INTERNAL SUCCESSION

Advisors who want to give up the least amount of control may look to an internal succession, where they slowly transition ownership to key staff members over a number of years. This scenario may provide the least growth opportunities, however, as it does not provide an infusion of capital into the business in the short term. Bank or seller financing is often required, as the next generation oftentimes cannot fund the transition themselves.

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Concluding Thoughts

While 2020 imposed many business challenges, it also provided RIAs the opportunity to shine thanks to recent enhancements in technology and business processes as the industry continues to rapidly evolve. Many RIAs were able to adapt more quickly than larger financial institutions to the ever-changing environment we all faced as the impact of COVID-19 wore on month after month. While it was a year like no other, it provided growth opportunities for many firms and opened the eyes of many advisors to the possibilities that lie ahead. Many are realizing they cannot achieve their grand business goals solely on the infrastructure they have in place today and will look for outside partners to help them achieve their business dreams. This analysis is intended to arm firms with the proper tools to forge ahead and find the right partner that will provide the biggest catalyst for growth.

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