Life after planning
a reality check

If you're thinking of retiring in the near future but you're not planning your exit from your advisory business, you may well be limiting your personal financial options – and heading in a direction you advise your clients to avoid, writes CHARISSE GRAY

According to industry specialists Business Health, 80 per cent of financial planning practitioners don't have a succession plan. It's a staggering figure.

A business is a financial asset. Business succession planning is about balancing and protecting the asset, ensuring the business continues into the future, protecting the interests of employees, securing the quality of the service rendered to clients, and increasing the economic value of the business to the owners.

Bill Hovey, chief executive officer of Linchpin Succession Management, sees a well-planned succession strategy, developed sooner rather than later, as the blueprint for ensuring the continuity and future success of a business. Hovey says it's not only a prudent management measure to protect the lifetime of a business well beyond its current operation and ownership structure; it is about taking control of the inevitable. Exiting the business is not a question of 'if' but 'when', and planning for the eventuality helps provide you with some say in how the future unfolds.

The lack of attention to business succession is not limited to the financial planning industry. A recent survey by Australia's largest business group, NSW Business Chamber, reveals that over 55 per cent of business owners do not have a succession plan in place. Of these, 68 per cent haven't identified an appropriate successor; and of those who have, less than half of those potential successors have agreed to their role in the planned succession. Hovey says that this reflects a common problem in SMEs – that assumptions are often made in relation to succession and that those assumptions are either mistaken or unsupported by advice, planning and action.

NSW Business Chamber's chief executive officer Kevin MacDonald says these figures also show that while many business owners appreciate the importance of succession planning, they often relegate it to the 'too hard basket'.

However, as Steven Davison, national manager GROW (AXA Australia) says: "What is surprising, is the level to which our industry is affected. Paradoxically, advisers are coaching clients through the wealth accumulation and retirement stages of their lives at the expense of their own plans."

Davison explains that part of the problem can be explained by a simple lack of awareness of the alternatives. Many practice principals

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believe that selling their client base constitutes the best exit strategy available to them. But, selling a client base tends to generate a lower value than may be realised from selling a business that has been structurally readied for sale.

Another explanation is the tendency of many advisers to see their businesses more as their 'baby' than as an asset, making it difficult to separate their businesses from themselves.

Davison suggests an issue driving debate around succession planning relates to the need for consolidation within the financial planning industry. "Practitioners are realising that as the industry evolves and clients' demands increase, real profits lie in having truly scalable businesses. Many advisers with long futures in the industry are seeing acquisitions as an opportunity to achieve this scale."

Jim Stackpool, managing director of Strategic Consulting & Training, sees the prevailing market conditions as the best they have ever been for any financial planning practice.

"With remarkably high Buyer-of-Last-Resort formulas over-valuing client bases, many owners, who don't see their long-term future in financial planning, are taking the opportunity to sell out.

"Also, many established practice owners realise that they have to share more equity with their emerging talent to ensure they don't leave – the real assets in financial planning practices go home every night."

Stackpool advises: "For those with a longer than five year view, succession planning is crucial to retain, attract and collaboratively build a new client proposition that will be accepted and profitable in 2010 and beyond."

Hovey suggests that the real exit challenge to financial advisers will come when the 'Buyer-of-Last-Resort' phenomenon passes and financial planning practices are then bought and sold on valuation principles which apply in just about all other industry sectors.

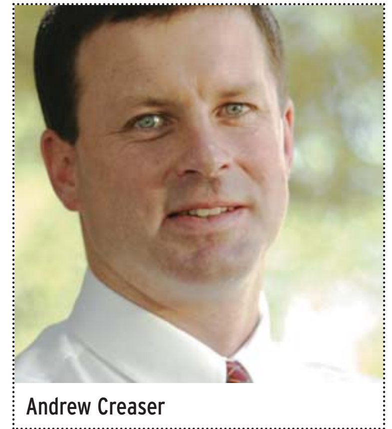
But if you are the principal of a practice considering selling your business soon, don't expect to hang a 'For Sale' shingle out for an immediate sale. Genesys Wealth Advisors executive director Andrew Creaser explains:

"Vendors need to give themselves time to get these transactions right. Selling a business is not a decision to make overnight and the process is often very complicated. Vendors should give themselves at least a year to get the deal done and preferably two. Realistically, it needs to be treated like any other project and managed accordingly."

What to expect over the next five years

Changes in practice ownership models are expected over the next five years. Creaser explains how this will impinge on succession strategies.

"While there will likely always be practices owned by a single individual, over the next five years the trend will move far more towards corporatised practices owned by many individuals all working in the business as advisers or managers. The benefits of this model allow greater scale, multiple relationships to clients rather than key person dependencies, and an opportunity for the business to broaden its offering across different disciplines in financial planning. This model will be far more sustainable for the longer term. There is also likely to develop a model where practices are owned as part of a broader corporate network, where advisers working in the practice may own some equity but other equity is owned by a larger institution interested in the financial planning space."


Andrew Creaser

Davison believes this type of structure will provide greater 'after tax' value realisation for incumbent owners, yet flexibility for new advisers and/or staff to become owners of the business. This will potentially see a reduced use of sole trader and partnership structures; and combined with a shift away from valuations based on ongoing revenue will result in an increased focus on practice profitability.

Davison adds: "For the majority of advisers, their ongoing revenue is tied to markets through assets under management. Advisers/principals considering sale in the short to medium-term should consider how to maximise their practice's value now, in the event that economic growth slows. When that happens it is likely more advisers will seek to sell, thereby creating a 'double whammy' as more sellers will increase supply and this may see sale prices decline. Future regulation or minimum requirements to provide advice could further compound this situation."

Xavier Craven, director of Australian Financial Counsellors, says that one of the

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more commonly used strategies is to give or sell a small amount of equity to the planners already working in the business, and then sell them the remainder over time. This strategy is often preferred as these planners already know the clients and it locks in good staff.

However, he warns: "A baby boomer planner to retire needs to extract the best outcome for themselves and their clients, and while businesses are now selling for multiples of revenue rather than multiples of EBIT, this situation may not last."

The next generation

Davison sees new advisers either building their own business organically and therefore not relying on acquisition, or seeking to acquire if there is a suitable return on investment. When debt funds the acquisition, practice profitability will be critical for acquisition success. This factor will reduce the current market emphasis of valuing a business on a multiple of recurring income.

As many next generation advisers are employees in practices today, they expect their current employer to provide a path to equity. If not, they will 'vote with their feet' and join a business that does.

Creaser suggests access to capital is one of the most difficult issues for the next generation of financial planners who may wish to buy businesses which over the last 20 years have become very valuable.

A further challenge for the next generation, according to Creaser, is to navigate the difficulties of working with the vendor through two transitions: client handover and business handover. "Often, vendors cannot 'let go' and find it difficult to 'report to' younger people that they have themselves recruited."

Hovey regards this as one of the critical elements in the transition from entrepreneurial baby boomer owner to the next generation.

Another challenge for the next generation will be to continue to grow the profitability of the business, which is critical debt servicing and value creation.

Growth should be underpinned by an increase in profitable sales revenue. "However, much of the training and education that is available today focuses on the technical aspects of planning and not on sales," says Creaser.

"The education system has all but made 'selling' a dirty word, but, in fact, the habits of good sales people are among the most important skills that a new owner must bring to the table. Tragically, the current generation of planners have, in the main, been unsuccessful in passing these skills on."

Managing the difference between price expectations and practice valuation

The key to any good transaction is to ensure that both parties get a good deal. The ultimate question for a vendor to ask is: "If I were a buyer, what would I be prepared to pay for my business?"

The difficulty in the financial planning industry is that value can be derived and defined differently.

"An advisory business being sold as a going concern should be priced to a multiple of EBIT," says Creaser. A business being sold

Jim Stackpool

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and 'tucked-in' to another business may be valued on a multiple of recurrent revenue, since most of the business costs will be stripped out when the 'tuck-in' takes place, thereby freeing cash flow for the purchaser.

In reality, the valuation is likely to be a combination of recurrent revenue and the potential profit that the additional economies of scale deliver to the purchaser. Where a business is likely to be purchased by an institution, then the valuation will also be influenced by the potential profitability of underlying products held by clients within the business.

While a 'tuck-in' might provide a solid alternative, Hovey warns against the precipitous 'merge', where the cultural and emotional issues can pose significant dangers if they are not adequately mapped. He recommends that potential players in a 'tuck-in' or merge undertake a rigorous cultural and emotional 'audit'.

Creaser emphasises that the economics of the transaction should enable the purchaser to continue to provide the kind of advice and service that the clients have traditionally received.

"Inevitably, friendships develop between advisers and clients. As such, exiting advisers should ensure that on exit they are leaving those client relationships in the best possible hands," says Creaser. ✤

Charisse Gray is a senior business writer at NSW Business Chamber.

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