CHAPTER 1

The Basics You Need to Know

AVOIDING THE CRITICAL MISTAKES

There are two critical and common mistakes that independent financial advisors make in the mergers and acquisitions (M&A) space. One is to treat every sale or acquisition target the same way: applying the same valuation approach, the same set of documents, and a common set of payment terms or financing elements, regardless of the size or structure or sophistication of the opportunity. The second mistake is to equate exit planning with succession planning—the two concepts are completely different and advisors must understand the differences if they are to succeed in this arena and correctly structure a transaction, whether as seller or buyer.

The specific purpose of this book is to help advisors understand how to sell what they've built to someone else for maximum value and at optimum tax rates, and/or to successfully complete an acquisition and become someone's exit strategy, on the best possible terms, with minimum risk, writing off the entire purchase price over time. These are not disparate goals; they are connected in every way and part of a win-win-win strategy that must be the ultimate goal for the buyer and seller, the good of this industry, and the client base that serves as judge and jury over the outcome of the M&A process.

For most independent financial advisors, their book or practice or business is easily the largest and most valuable asset they own. Critical mistakes cannot be allowed to happen. The process of sorting out the issues, learning the basics, and then mastering the more complicated aspects starts right here, right now.

Exit planning results in a transaction with either an external buyer or an internal buyer, but the commonality is that the process is completed in one step—usually not suddenly, just completely. External buyers usually have a very similar practice model but are often much larger than the seller in terms of size and value, while an internal buyer is someone you've hired, know, and trust (maybe even a son or daughter), but who is often without the financial resources and the experience of the external buyer.

A succession plan is quite different; it is designed to build on top of an existing practice or business and to *gradually* and seamlessly transition ownership and leadership internally to the next generation of advisors. The founding owner in a succession plan is not a "seller"—they're a business partner or a shareholder, and long-term, sustainable growth powered by multiple generations of collaborative ownership is the number one goal. This book is not about succession planning. If that topic is of interest to you, please consider reading our first book, *Succession Planning for Financial Advisors: Building an Enduring Business*.

As part of exploring the various exit strategy options and how to structure those transactions, this book will also explain the different value and valuation techniques and their applicability given various situations. You'll learn the difference between an asset-based deal structure and a stock-based deal structure, as well as how to employ various financing methods such as a promissory note, performance-based or adjustable notes, revenue-splitting or revenue-sharing arrangements, and earn-outs. The element of bank financing will also be carefully considered because this is a powerful tool when used correctly. We'll also evolve beyond the basic concept of silos versus ensembles in the process toward a more sophisticated and accurate classification system.

One of the fundamental tenets of this book is to *not* treat all advisors the same as though one approach to valuation, contracts, payment terms, and contingencies fits all situations, sizes, and revenue models across the spectrum. In fact, there is no one single method, one single view of this unique industry that works every time for every buyer or seller. It depends on what you've built and how you've built it. Using your specific vantage point, our goal is to explain what works and what doesn't work, and how to do the job right, whether you're a buyer or a seller. In the end, we all need the best buyer to prevail, not the first on the scene or the one with the most money.

If you approach all M&A opportunities in this unique industry with one set of tools, one set formula, and just one valuation approach or method to be applied in every instance—the way most writers, consultants, and practice management personnel recommend—your view of the world will always be partly right, but mostly wrong, not unlike the blind men and the elephant from the Indian folktale told in a poem by John Godfrey Saxe:

The Blind Men and the Elephant

It was six men of Indostan
To learning much inclined,
Who went to see the Elephant

(Though all of them were blind),
That each by observation
Might satisfy his mind.

The First approach'd the Elephant,
And happening to fall
Against his broad and sturdy side,
At once began to bawl:
"God bless me! but the Elephant
Is very like **a wall**!"

The Second, feeling of the tusk,
Cried, "Ho! What have we here
So very round and smooth and sharp?
To me 'tis mighty clear
This wonder of an Elephant
Is very like **a spear**!"

The Third approached the animal,
And happening to take
The squirming trunk within his hands,
Thus boldly up and spake:
"I see," quoth he, "the Elephant
Is very like **a snake**!"

The Fourth reached out his eager hand,
And felt about the knee.
"What most this wondrous beast is like
Is mighty plain," quoth he,
"'Tis clear enough the Elephant
Is very like **a tree**!"

The Fifth, who chanced to touch the ear,
Said: "E'en the blindest man
Can tell what this resembles most;
Deny the fact who can,
This marvel of an Elephant
Is very like **a fan**!"

The Sixth no sooner had begun
About the beast to grope,
Then, seizing on the swinging tail

That fell within his scope,
"I see," quoth he, "the Elephant
Is very like **a rope**!"

And so these men of Indostan
Disputed loud and long,
Each in his own opinion
Exceeding stiff and strong,
Though each was partly in the right,
And all were in the wrong!

VALUATION: THE GREAT DEBATE

There is a lot of debate in the financial services industry as to the best approach and method to apply when valuing a financial services practice. Some feel an income approach (focused on earnings or profitability as espoused by the discounted economic cash flow method) is best. Others prefer to use a direct market data method that relies on market "comps" or comparable transactions between buyers and sellers of similarly structured practices or businesses within the same industry. Some buyers prefer a much simpler valuation approach, applying basic revenue splitting, revenue sharing, or earn-out payment terms to measure actual success over a period of years—a *wait-and-see* approach. Some buyers insist on using a multiple of top-line revenue or adjusted bottom-line earnings.

Buyers tend to use the one method that they understand, or a method that has worked well for them in the past, regardless of the size and structure of the acquisition opportunity. Sellers are often embarking on the valuation trek for the first time and sometimes have only a limited understanding of this crucial topic. Practice management personnel at the various broker-dealers and custodians have their own agenda and weigh in on the valuation debate with their own preferences. Each party to the process has a goal, and the goal really isn't about finding *the right answer*; the goal too often is to find the answer each party needs to be true to advance their own cause. As a result, there is a lot of unnecessary and unjustified confusion about how to value a financial services practice or business for M&A purposes.

The goal of valuation, aligned with the proper approach and method, should be to bring the parties together, not to serve as a wedge and to bludgeon the other side with an argument about who is right or wrong and why one party's approach is superior to the other's. Valuation in the financial services industry has become the single most divisive issue in the M&A process. Valuation disputes stop most deals before they even start. Let's end the debate with the goal of completing more transactions and taking better care of the clients who have placed their trust in an independent advisor.

The place to start is to fundamentally understand that there is no right or wrong answer to the question, "What is my practice worth?" The answer will vary depending on what is being bought or sold (a book or a business, assets or stock, a minority interest or a controlling interest, etc.), who the buyer is, why the valuation is being performed, the motivations of the parties, and even who's performing it. When the time comes for you to sell your practice, the first question shouldn't focus on which approach to use to arrive at a proper value. The appropriate series of questions leading to a valuation solution should be:

- What am I selling and why am I valuing my practice?

If you're a buyer, the focus should be on this question:

- What am I buying and why am I buying it?

Purpose Informs Value

In other words, you need to know what you are trying to solve for before you attempt to answer the question as to how to solve it. No one single valuation approach and method solves every problem, every time. There are many tools in the *valuation toolbox*, and as a buyer or a seller, you need to know at least the basics of how to use them and when to apply them, or at the very least, when to call for help and what questions to ask.

Of course, selling a relationship-based practice or business isn't like selling a fast-food franchise in which you hand over the keys and a *How-to-Run-It Manual*. In this M&A space, the clients get a vote, and most sellers care about what their clients think of their final act—something that buyers need to understand as well. Best price and terms should always take a backseat to "best match," another consistent theme in this book.

So what does all this have to do with elephants and blind men? Last year, I sat on a four-person panel where we were asked to discuss the intricacies of value and valuation as applied to independent advisors who were interested in acquisition or selling. Two of the panelists were practice management specialists, one with a large independent broker-dealer (IBD) and the other from a custodian. The other panelist was an investment banker. The investment banker was adamant that the discounted cash flow method his firm produced and sold was the single best way to perform a valuation in this industry, every time—anything else was just silly and a wild guess. Another panelist opined that for most of the thousand-plus advisors in his

IBD, what worked best on a daily basis was a simple rule of thumb, or a multiple of revenue or earnings. Over the length of his career, this method had proven to be practical, affordable, and good enough to do the job in most cases. The other panelist thought that it was simply a matter of "wait and see," paying value for what a buyer actually received using an earn-out arrangement or a basic revenue sharing approach; in his opinion, formal valuations or appraisals, even multiples of revenue, weren't even called for.

Each panelist was partly in the right, and *all* were in the wrong, but these points of view reflect what we hear and experience every day. There is no single valuation methodology adequately suited to the range of revenue streams and structural components now represented in this fast-growing and rapidly evolving industry. That is why buyers and sellers need to adjust and elevate their level of understanding and thinking about how to buy, sell, and value a financial services or advisory practice or business. On that note, another of our goals in this book is to help you understand not only how to determine value, but how to apply the payment terms so as to motivate a seller and to protect a buyer in order to ensure that the clients' best interests are never overlooked in the process of realizing or paying that value.

ASSESSING WHAT YOU HAVE BUILT (OR ARE ACQUIRING)

There's a clever use of terms and concepts in this industry. One good example is describing the organizational structures of independent financial practices as "silos" or "ensembles." The basic notion is that a silo is a single "book of business." The term "ensemble" is reserved for a business with multiple professionals who truly work together as a team, pooling their resources and cash flows, creating a bottom line, and then distributing profits to the owners of that business. These terms are certainly relevant in this industry, but they do not form a complete system to use in assessing what an advisor has built or seeks to acquire.

This binary system of categorizing all financial advisors as either a silo or an ensemble model does accurately reflect one critical element about this industry—the importance of organizational structure. For this contribution, we are indebted to our predecessors Mark Tibergien and Philip Palaveev, authors of *Practice Made Perfect* and *The Ensemble Practice*, respectively.

But the evolution continues and structural issues go well beyond just organizational elements and must include the choice of an entity (such as a C corporation, an S corporation, or a limited liability company), or not, as with a sole proprietorship, and the ownership level compensation system, which directly affects and supports growth rates and the underlying profit structure. These foundational elements, or the lack thereof, affect

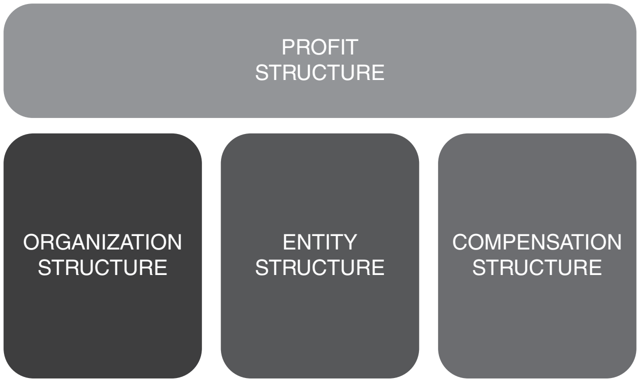

FIGURE 1.1 Structural Elements of an Independent Financial Services/Advisory Model

every advisor, broker-dealer, and custodian in this industry. More to the point, these basic foundational elements, whether weak or strong, dictate the structure, success, and value of every M&A transaction (Figure 1.1).

As you study and master the concepts and strategies in this book and begin to consider your exit plan or acquisition strategy, start with these basic questions:

"What have you built and are considering selling?" or,

"What exactly is it that you want to acquire?"

The answers to these questions require more descriptive and precise terms than just "silo" or "ensemble." We suggest you consider the following terms for classifying the levels of independent ownership in the financial services and advisory industry, which, in turn, accurately reflect how each level of ownership is built and operated:

- A job (or a book)
- A practice
- A business
- A firm

These descriptive terms, within the context of this M&A guide, also reflect how each level will likely be acquired, grown, or disassembled. These terms and the working definitions that follow form very practical tools that we have developed and use on a daily basis and contribute to help advisors understand the impact of the various structural elements of their transition plans. In other words, if or when you're thinking of selling, what you've built, and how you've built it, will often determine how you sell it and what you sell it for.

A *job*, often and appropriately called a *book*, exists as long as the advisor or financial professional does the work. Job or book owners are independent and "own" what they do, for the most part. W-2 or 1099, registered rep or investment advisor or insurance professional—it makes no difference—they can all fit equally well in this category. But when a job or book owner stops working and someone else starts, it becomes the new advisor's job; the cash flow attached to that job belongs in whole or in substantial part to the person doing the job. Of course it is about production; in fact, it is about nothing else. A job owner works under someone else's roof, owns none of the infrastructure, and has no real obligations to the business other than to produce and get paid while taking care of his or her client base. This is the basic definition of being independent.

The "value" of a job/book is tied almost entirely to how much money the producer or advisor takes home every year. Think in terms of gross revenues, or GDC, of less than $200,000 a year (although we do see cases of the "super producer," described in more detail in our first book on succession planning—that group has much higher production- or revenue-generation capabilities, but all other aspects still fit this defined category). In this industry, by our watch, about 70% of advisors are owners of a job or a book (Figure 1.2). Jobs or books are most likely to sell at the lowest price, and on the worst terms with the worst tax structure—at least when compared to practices, businesses, or firms.

A *practice* is more than just a job or a book, often involving support staff around the practitioner and the ownership of at least some basic infrastructure (phone system, computers, CRM system, desks and chairs, and so forth) usually within an S corporation or an LLC. But like a job, a practice exists only as long as the practitioner can individually provide the services and expertise. Practices are limited to one generation of ownership, after which someone else takes over. The practice may be sold outright, transferred through a revenue-splitting arrangement, or be dissolved with the clients finding their own way to another advisor. Practices have one owner, but often encompass one or more additional producers (usually categorized

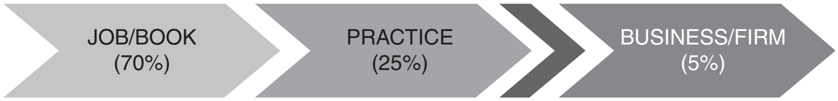

FIGURE 1.2 Industry Segmentation

as owners of a job or a book) with whom they share time, expenses, and support. About 25% of the advisors in this industry fall into this category.

Jobs/books and practices are "strongly held," a term we employ to reflect a single owner who dictates direction and results—the typical founder and entrepreneur. The focus for job or practice owners is entirely on revenue strength. There is little need for enterprise strength at these levels. There is also no significant "bottom line" or profitability at these levels (yes, we're talking about 90% to 95% of the industry at this level and below) and there doesn't need to be. No one invests in these models, at least in terms of becoming a formal shareholder or partner. Earnings are mostly paid out as compensation to the producers through some form of an eat-what-you-kill (EWYK) system or a salary/bonus structure tied in some way to top-line production, as opposed to actual profit distributions or dividends. None of this is written in stone—many practices have the ability to do much more, as is the case with jobs or books. It is simply that, historically, the advisor/owner takes home what was produced, a legacy of the wirehouse-brokerage model.

The more valuable practices tend to sell using a formal documentation process that creates and supports long-term capital gains tax treatment for the seller and write-offs for the buyer. Practices have a stronger value proposition than jobs/books, providing the owner with more options, a higher sales price on better terms and at better tax rates, and tend to have lower transition risk (see Chapter 3 for more information), an important element for buyers to consider.

If a practice is to grow and evolve into a business, it will need to enhance and bolster its organization, compensation, and profit structures along the way in order to facilitate a new generation of owners/advisors. Businesses and firms have or are implementing a compensation system that supports strong growth and sustainable profitability. Books and practices often have strong growth rates as well, but almost always at the expense of profitability, arguably irrelevant in a one-owner model. Revenue sharing or other EWYK compensation systems accomplish only the production and cash flow goals, leaving profitability and equity unattended to. In the end, these elements signal the divide between a job/book or practice on one side, and a business or a firm on the other side. We'll continue to build on these concepts and expand the thinking around revenue strength and enterprise strength later in this chapter because it effects every aspect of the M&A process.

A *business* has certain foundational elements in place, such as an entity structure, a proper equity-centric (or ensemble) organizational structure, and a compensation system that gives it the ability to attract and retain talent while generating a sufficient profit margin (i.e., 30%+) to reward and attract a multigenerational ownership structure. The revenue stream may be singular or diversified, but usually about 75% or more is fee-based. The business is built to be enduring and transferable from one generation to the next. It operates from a bottom line approach and earnings are used to reward ownership and encourage investment in the business. The ownership-level compensation system shifts to a base salary plus profit distributions. Continuity agreements are a given and take the form of a Shareholder Agreement or a Buy-Sell Agreement. A business gains its momentum and cash flow from revenue strength and its durability and staying power from its enterprise strength. Businesses tend to have a much stronger value proposition than practices, affording an owner a range of options, including retiring on the job, selling at maximum value with the best overall tax structure possible, or building a legacy, all with little to no transition risk. About 4% of independent advisors presently fall into this category, though this group is growing rapidly.

A *firm* is an established, multiowner, multigenerational business, and it got there through proper succession planning. It is built with a strong foundation of ownership and leadership by recruiting and retaining the very best people in the industry. It operates primarily from a bottom-line approach and earnings are the measure of success, at least as important as production and growth rates. Again, the revenue stream may be singular or diversified, but about 90% or more is usually fee-based. Continuity agreements aren't just a safety measure. They are a means of internal growth and strength. Anticipating the loss of one generation means planning for the success of the next generation. Collaboration among owners and staff is the rule. In a firm, the goal isn't to have the best professionals, but rather to have the best firm. Firms offer the best value proposition and are almost always supported with a strong internal succession plan that provides a culture of ownership, attracting and retaining the best advisors, who attend to multiple generations of clients. About 1% of today's independent advisors are owners of a firm and we expect this group to double in size in the coming years.

In this book, from this point forward, we will use the terms "job/book," "practice," "business," and "firm" very specifically and within the context of the preceding definitions. Depending on whether you are selling or buying a job/book, a practice, a business, or a firm, your choice of valuation methodology, financing, payment structuring, transfer mechanism (assets or stock), and even the paperwork to complete the transaction is often tied to the seller's level of ownership and what they've built—even how they've built it. This conclusion is reflected in the following section showing how advisors tend to leave or retire from each level of ownership.

Special Note: The ownership level of a *firm* tends to sell internally through a formal succession plan. As such, this book focuses on firms only with respect to their role in acquiring smaller businesses and practices and omits use of the term "firms" in most instances, including selling through an exit plan.

WHO IS SELLING? TRANSITION STRATEGIES BY OWNERSHIP LEVEL

So, who is selling? Where are the sellers? As a buyer, it is important to know where to look, and what to look for to make acquisition a reliable and profitable growth strategy. The numbers tell an interesting tale, one most advisors don't understand (Figure 1.3). What a seller has built, and how they built it, greatly influences their eventual transition strategy.

Each year, FP Transitions performs formal valuations on over a thousand advisors' jobs or books, practices, businesses and firms, a process that fuels a large and deep database. What advisors do next—once they know with greater certainty the value of what they've built—is simply a matter of observation. The data is clear. Across all ownership levels, we're seeing that about one in 10 advisors sell externally (to a third party), but the numbers vary significantly by ownership level. Perhaps the real story lies in what more than 8 out of 10 advisors do if they aren't going to sell.

Currently, the primary exit strategy for job/book and practice owners is attrition. Independent owners at these levels don't sell as a first choice, certainly not as often as they should. This is a surprising choice given that,

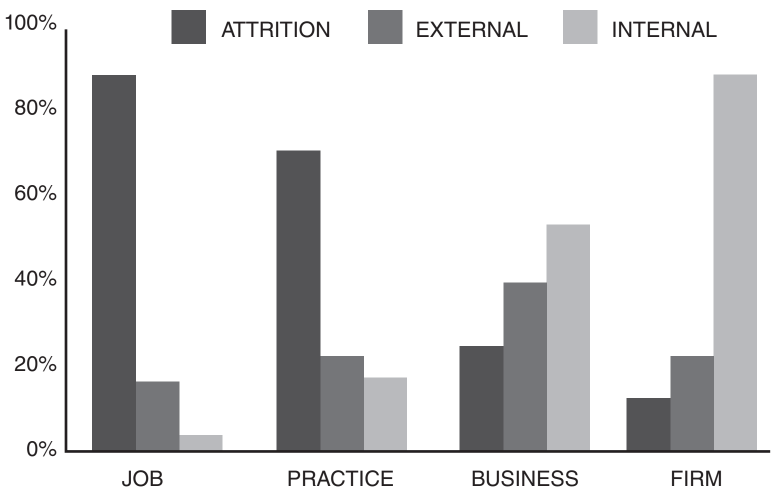

FIGURE 1.3 Transition Strategy by Ownership Level

for most advisors, their books or practices are usually the most valuable asset they own. Under the attrition route, these advisors enjoy their income streams for as long as they can while gradually working less and less, spending fewer days in the office and less time and energy on marketing and technology and then, one day, when there is nothing much left to sell, they call it a day. The work just dwindles to an end, and the remaining clients are given a few referrals to peers or friends and that's it. No cymbals clanging, no bells ringing. It just ends quietly.

This outcome is bad for the industry, and especially for the clients who look to their independent advisor for professional financial advice and mistakenly assume that their advisor will be serving them on a timeline tied to their lives and needs, not their advisor's planned (or unplanned) career length. And this really needs to change. But it would be equally incorrect to conclude that every job/book or practice owner needs or should attempt to create a succession plan.

Most books and many practices are not capable of generating a qualified internal successor because of how they are assembled. The primary culprit is the use of wirehouse-style employee-based compensation and reward systems that make production and sales achievements the pinnacle of a career. Durability and profitability are not the goals of book owners and most practice owners. As a result, it is far more likely that independent advisors will build one-generational books as opposed to an enduring business.

Think about it for a moment before we continue our discussion on transition strategies by ownership level. What would it take to prompt at least half of the job/book and practice owners (about 95% of the industry by our headcount) to either build an enduring business or, worst case, to sell their work at peak value to a business or a growing practice that could serve those acquired clients for generations to come? More knowledge of the M&A process? A better value proposition? Better payment terms, with a larger down payment and shorter or no seller financing? Could bank financing be the answer, allowing sellers to cash out more quickly and completely and with less risk? Would one or more of these things make the difference? We're about to find out because this industry is changing rapidly—whether it changes for the better, or worse, or just stays the present course, will be decided in large part by today's buyers and sellers and builders.

The next most popular strategy after attrition, at least at the practice level, is selling or transferring the cash flow to a third party. Those who do sell tend to be around age 60, though the sellers range in age from 40 to 70 in any given year. Sometimes the sale is prompted by an advisor who wants a good, old-fashioned, well-earned retirement. Sometimes the seller has no intention of retiring, at least not in the commonly used sense of the word. Entrepreneurs forever, many sellers have something else in mind and, once their clients are well taken care of, they use their time and energy (and money) to do something they've always wanted to do.

Take Glen Janken, for instance, who gave us permission to share his unique and fascinating tale. In 2010, we listed Glen's practice for sale. After 25 years as a financial advisor, Glen decided he wanted to become a math teacher. After using the open market system to find a handpicked replacement, Glen did just that. Today, he is in his fourth year of teaching math at the Notre Dame Academy in Los Angeles, California. Next year, he ups his game from teaching algebra to teaching calculus, and he couldn't be happier! Glen took care of his clients first, and then chased down his dream.

At the business level of ownership, transition strategies are a completely different story. Here, advisors have a full range of choices because they've taken the steps to plan ahead and take control of their futures—real control. The leading strategies at this level of ownership are to sell internally, sometimes completely and all at once to a son, daughter, or key employee (an exit plan), and sometimes gradually over many years to a team of internal successors (a succession plan), together comprising 75% of this group. Attrition is the least popular strategy.

In most cases, there is too much value at this level to just wind it down and get nothing out of the process. Attrition persists because the planning process sometimes starts too late or the concept of equity is just not understood or appreciated. Clients' expectations also weigh in heavily at this level. Have you ever been asked the question, "What happens to me if something happens to you?" Clients expect and deserve a good answer and business owners appear to have one, for the most part. At this ownership level, we are observing a rapid increase in building enduring businesses or selling them at career end to another business or a larger firm.

At the firm level, almost all transitions are through a succession plan where a team of successors gradually step in and take over, one at a time, learning on the job and earning their way up the ladder. Succession planning is about growth, and such growth depends on the firm attracting and retaining the best talent. To do that, equity must come into play. Advisors must have an opportunity to buy into ownership and to enjoy the benefits of *cash flow plus equity.* It's no wonder that firms are the most valuable and durable models.

In terms of considering an external sale, it is important to consider the role played by consolidators and "roll-ups," viable exit planning options in their own right. Though the terms have broad application generically, there are but a handful of enduring and reliable consolidator/roll-up models, at least on a national level. After 25 years in this space and seeing such models come and go on a regular basis, I'm reluctant to name names in a book with a shelf life that will extend beyond most of theirs. But occasionally these can be good and qualified buyers who offer an interesting and different opportunity to independent owners thinking of selling or merging or growing—with unique buy-in formulas that tend to keep the founding owner in place and in command but with additional support and capital.

Consolidators and roll-ups should be considered, but include regional models in your analysis as well. Start with a formal valuation of what you've built so that you have a center point from which to negotiate. Understand the realm of choices available to you and evaluate these unique opportunities comparing facts to facts. Consolidators and roll-ups can be the right answer, but only for a very specific group of today's practice and business owners.

Nothing in this section or the preceding graph should be taken as implying that there is a preordained fate that awaits you when it is time to sell (or buy) or internally transition. Armed with a good road map and accurate information, the future belongs to you.

OVERCOMING ATTRITION: PUBLIC ENEMY NO. 1

Most independent advisors who consider retirement wonder if they should sell internally or externally. The truth of the matter is that, at least at the job/book and practice levels, neither result is going to occur in significant numbers—not yet, anyway. The number one exit strategy, as you've now learned, is attrition.

Attrition is the process of enjoying the cash flow provided by the work for as long as it will last once the single owner stops investing their full time, attention, energy, and funds. Eventually, the book or the practice just dies, but not before providing an extra 5 to 10 years of gradually decreasing income and cash flow to the founder. The attrition strategy centers on the advisor's needs, goals, and career length. That is a problem because a client's needs will almost certainly extend beyond the longevity of a founding owner's career. Not only does this leave the clients to fend for themselves, possibly at a time and an age where such a transition is very difficult, but it also leaves a lot of money or value on the table from the advisor's perspective. In years past, we accurately identified this issue, attrition, as the independent industry's Achilles' heel. Nothing has changed.

From the perspective of an independent broker-dealer, custodian, or insurance company, the fact that more than 80% of their advisors' books or practices won't be selling at career end, possibly to a competitor, is often treated as good news. It's not. The data is clear that those same books and practices will stop growing and will decline in production, cash flow, and value *for about 10 years before* the practice actually dies out. They will gradually shed their clients to other advisors, perhaps within other networks. Imagine what the clients of this industry think . . . and decide on their own along the way. This is the toll of attrition.

But the news is not all bad. Slowly but surely, advisors are beginning to create formal succession plans that are designed to build a multiowner/multigenerational structure sophisticated enough to last for many years to come, and to acquire every book and practice in their path. Currently, the independent financial services/advisory industry looks something like Figure 1.4.

Interestingly, many practice management consultants employed by the various independent broker-dealers, custodians, and insurance companies focus almost entirely on not losing the 10% who will sell. All available resources are spent to make sure this 10% sells within the same network. Almost nothing by comparison is spent on helping those who are building, or who could build, an enduring business. These businesses, in turn, tend to acquire many, many jobs, books, and practices. Growth by acquisition is the foundation for most businesses' marketing strategies, and such growth demands the recruitment of younger, next-generation talent, that is, today's book builders.

We have been pressing the argument for some time now that the focus of the practice management personnel at the IBDs and custodians should be on the vast majority of independent advisors who do nothing but wither on the vine, who choose death by attrition, or who make no plans at all. The question(s) should be: How do we help these advisors and all the clients they serve? How do we get more advisors to sell to someone (preferably a business or a firm) who can serve their clients for more than one generation?

We don't think the answer, or the problem, centers on value or valuation, at least not in the sense that a higher value or sales price will cause every book and practice owner to sell. Independent advisory books and

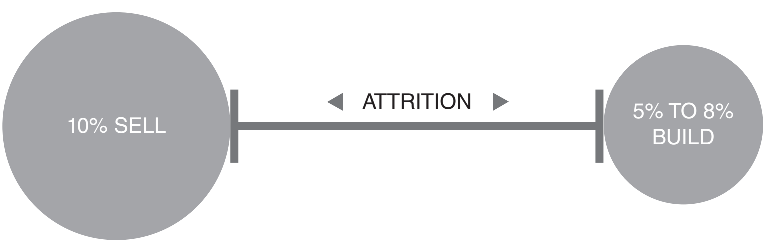

FIGURE 1.4 End of Career Transition Strategies for Independent Advisors

practices already command a value of two to three times that of most other professional service models. We think the problem is twofold:

1. The abysmal payment terms that create a total disconnect between the valuation opinion and the actual realization of that value years later.
2. The failure to create a formal, written, executable plan (whether an exit plan or a succession plan) early enough to benefit from it.

Slowly but certainly, advisors have been coming to grips with the notion that their practices have value, above and beyond the cash flow generated every month and every year—in many cases, a great deal of value. Most advisors have a plan to realize the cash flow element for as long as they can work, but most advisors do not have a plan for how to realize their equity value *and* ensure that their clients are taken care of for the rest of their lives as opposed to the career length of their advisor.

Revenue sharing agreements, one of the most commonly used "solutions" by book and practice owners interested in selling, deserve at least part of the blame. These simple two- or three-page agreements, provided by the practice management personnel at an independent broker-dealer or custodian at no cost, are a favorite of buyers. First of all, these buyers, with their broker-dealer or custodian's full support, bypass the competitive buyer-to-seller ratio in the open market, and enjoy starting and finishing with a 1:1 ratio. Second, buyers pay nothing down, bear no obligation to perform, and simply pay for what they choose to keep, sharing the revenue with the seller for a period of three or four years. Agreeing to pay 50% of everything earned from a seller's list of clients for four years might sound like a multiple of two times, but in fact, most sellers will only realize about 60 to 70 cents on the dollar, which represents the clients and cash flow the buyer elects, in his or her sole discretion, to retain and work with. Essentially, the buyer is able to cherry-pick the best clients and pay out on that select group only. Add in the fact that there is basically no liability or ongoing responsibility on the buyer's part. If something happens to them, whether a heart attack, stroke, car accident, early retirement, and so on, and they don't come back to work, the seller gets 50% of nothing.

With terms that belie the actual value proposition, perhaps it is no wonder that sellers simply retain control of their own client base and cash flow until they simply cannot do the work any longer. Selling what is left, or simply passing the remaining clients off to a friend or colleague is the attrition route.

A formal three- to five-year exit plan can help to ensure that a practice owner considers cash flow and equity, tied to realistic growth rates and profitability levels and tax rates. Armed with a solid plan backed up with good and reliable information and data can help independent advisors make good, long-term decisions and implement a transition strategy that not only meets their needs, but performs as it should. Whether an owner decides to build and grow, sell, or enjoy the cash flow for as long as possible as the practice winds down, that decision should be based on sound information and a plan.

One of the purposes of this publication is to help job/book owners learn what practice owners know and do, and how to realize the value of what they've built. In turn, practice owners can learn from what business owners know and do. In the course of our explorations, we'll examine practical, relatively easy steps to improve valuation results *and* the actual realization of those numbers through knowledge, planning, and execution.

We will also take the time to focus on the future and the major changes that are starting to affect the M&A process through the bank financing channel. Over the past 20 years, almost every transaction between a buyer and a seller of a book, a practice, or a business, has relied on seller financing. Imagine buying or selling a house if the seller had to extend a land sales contract to complete the sale. The marketplace would be fairly limited, but that is an accurate description of where things are or have been most recently in this industry. With the advent of bank financing options, many aspects of the M&A process are changing. Sellers now have the option to largely cash out and be done at closing if they have a plan and build properly and smartly for this purpose, and find a worthy buyer from a pool of qualified applicants.

In sum, there are many choices equal to or better than attrition. Learn, investigate, and make a decision, but don't let what you've built fade away because you think you don't have a better choice. You do. Remember, you pay good money to your broker-dealer or custodian. Demand that they support your efforts to build or to actually realize the full value you've spent a lifetime growing.

WHAT IS BEING SOLD?

In the 1970s, I was a teenager living in the Midwest and I was bored much of the time. I lived for the *Wide World of Sports* on Saturday afternoons. One such afternoon, I was introduced to a mesmerizing figure, a daredevil named Evel Knievel.

In 1971, Mr. Knievel made news, and my whole summer, when he announced his intention to jump a remote section of the Snake River Canyon on a rocket-propelled motorcycle—the X-2 Skycycle! Judging by the black-and-white pictures in the newspaper, it looked more like a rocket with wheels than a motorcycle. This was exciting stuff. All it needed was a fearless pilot and that slot was filled.

From the red, white, and blue leather jumpsuits to the Las Vegas–style production and choreography of his incredible feats, this guy was fascinating. He was brave. He was an entrepreneur. He was a modern-day superhero, and he could do things others only dreamed about. Or at least he could try. . . .

Sadly, nothing about the Snake River Canyon jump actually worked. ABC Sports declined to pay the price Mr. Knievel's team demanded, so the event ended up on closed-circuit TV, which in those days no one I knew could afford. And the X-2 Skycycle wasn't actually rocket-powered. Instead, it used a more pedestrian steam-powered concept. It was probably closer to a carpet cleaner than a rocket! Whatever it was, or wasn't, it didn't work. Fortunately, no one or nothing was killed—just my imagination.

The gap between those who own a job or a book or a practice on one side, and those who build a business or a firm on the other, is about equal to a leap over the Snake River Canyon, or so it seems. In fact, things have changed and for the better. We now collectively have the technology and the experience to succeed on a regular basis. Even better, there's a bridge not too far away from that launch ramp that will accommodate anyone who wants to make the trip in a more professional and conventional manner! It takes some time, but if you want to get to the other side, it can be done. Not everyone does, and that's okay, but understand that such a decision will affect your choices and options at career end.

The chasm between the ownership levels in this industry is best expressed and understood as the balance, or imbalance, between "revenue strength" and "enterprise strength." If you're selling or buying primarily revenue strength, you're selling or buying clients. If what you're selling or buying has a balance between revenue strength and enterprise strength, you're selling or buying a business. There is a huge difference. Which side of the canyon are you on? Are you building a book, or a business? What does the acquisition opportunity present? Are you sure?

By our estimate, more than 9 out of 10 advisors focus primarily or exclusively on revenue strength elements. The analysis of revenue strength covers an array of benchmarks, but focuses on the areas of revenue production, cash flow quality, and pricing competitiveness. The goal is relatively simple: increase the number of good clients (and recurring revenue, if possible) and hang on to all of it. (See Figure 1.5.)

Most independent financial service professionals understand how to build revenue strength. The challenge in building a practice to the level of an enduring business lies in creating a balance between revenue strength and enterprise strength. Enterprise strength is a term we use to refer to an advisory business's legal, organizational, compensation, and profit structures, all elevated to a high and sustainable level.

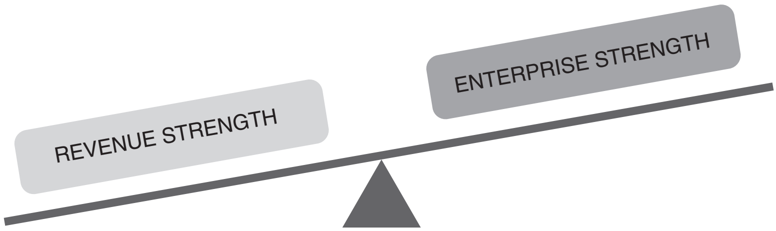

FIGURE 1.5 Most Advisors Focus on Revenue Strength Elements

Increasing both components (revenue strength and enterprise strength) may seem like a sensible and obvious approach to increasing value and equity, but the process can be quite challenging. For example, increasing the number of clients and retaining those relationships as a business's leadership ages may require a substantial investment in staffing, training, retention, and operational capacity, while pursuing a strategy of significantly increasing the revenue generated per client may require a change in culture, deliverables, skill-sets, and operational systems. In either case, any increase in revenue that is accomplished by emphasizing one strategy or the other does not directly correlate to an equal or proportional increase in the equity value of a financial services business, nor its ability to sustain the rate of growth and to realize that value upon transition. Sometimes, founders simply don't have the skill-set, the time, or the drive to make the change(s).

In fairness, almost every advisor must start out with a singular focus on revenue—a financial services professional, especially on the independent side, has to make money and grow in order to survive. The art of production, learning how to give great advice, and sell appropriate products and services is how advisors make a living, and for that reason, revenue strength is the principal component in determining the value of a privately held, independent financial services job/book or practice. Building revenue strength is almost intuitive to advisors, but rarely is it balanced by enterprise strength. (See Figure 1.6.)

A significant imbalance between revenue strength (usually the stronger of the two) and enterprise strength (often the weaker of the two) at career

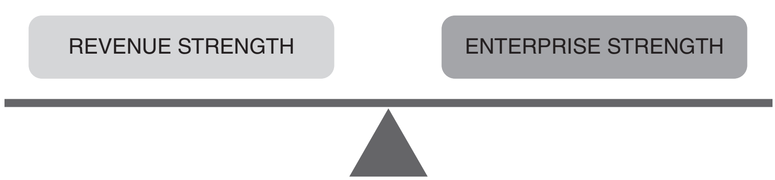

FIGURE 1.6 The Goal: A Balance between Revenue Strength and Enterprise Strength

end is best solved with an exit plan. In other words, sell the book or practice to a business or a firm where the imbalance can be quickly resolved and is an immediate value-add. A preference to build or enhance enterprise strength is best addressed internally with a succession plan.

This issue also bears on the valuation process. Revenue strength models (jobs/books and practices) have one owner and really aren't built for profits. The focus is on production. Accordingly, advisors need to take a different approach to determine value, especially when most buyers are twice the size in terms of value and cash flow of the sellers they acquire and, as a rule, purchase assets, not stock or profits. At this level, what is being sold is a revenue stream and not much more; the focus of a valuation should be on the top line. Businesses and firms, in contrast, are built for profitability and require a valuation approach that focuses on the bottom line. Here, what's being sold includes all the infrastructure, including expenses, liabilities, and even debt in some cases.

The first point to consider is this: if you're buying revenue strength and nothing more, you will value it and pay for it very differently than if you are acquiring enterprise strength *and* revenue strength. That is the difference between jobs/books and practices on the one side, and businesses and firms on the other side. Buyers, your acquisition strategy, valuation approach, and application of payment terms and financing must adapt to the opportunity and specifically to what you are buying. Sellers, understand what you're selling and factor the appropriate methods into your forecasted results.

The closing point is that sellers *can* build enterprise strength over the last 5 to 10 years of their career in order to generate better value and a wider array of choices at or near career end. Alternatively, prospective sellers can choose not to embark on such a journey and simply sell earlier, albeit for less value. Obtaining a formal valuation and learning from the process and talking to a qualified consultant can help you make a smart and practical decision.

ORGANIZING THE MARKETPLACE

In 1999, FP Transitions was founded to create a systematic way for a seller to find a buyer of a financial services or advisory practice and to efficiently handle the many details of selling, documenting, realizing value, and successfully transitioning the client relationships. Since its founding, FP Transitions has successfully sold and transitioned over 1,500 financial service or advisory books, practices, businesses, and firms. The marketplace is now organized and it works.

The part of this organizational effort that many advisors overlook is that selling, as a strategy, was the necessary first step to establishing and proving the concept of *value* in this industry. That was an incredibly important accomplishment. But while value has been proven, it still may not be *realized* because certain elements in this marketplace have conflicting agendas. Buyers and sellers need to be aware not only of where to find each other, but how the seller's choice of "selling venue" may also affect the realities of value and payment terms, for better or worse.

The seller's regulatory structure will likely shape the acquisition process and the venue or marketplace where they, as a seller, can be found. In other words, a fee-only seller will likely start their buyer search within their primary, current custodial network, even though RIAs/IARs might work with more than one custodian. A fee-based, FINRA-regulated seller with an independent broker-dealer (IBD) will tend to look for a buyer within the same IBD network. Being independent means having lots of choices and flexibility, at least theoretically. As a matter of practicality, however, these choices tend to be limited and center on one of these primary selling venues:

- An **open market** sale, defined as an unrestricted sale of a book, practice, or business that could take place, at the owner's discretion, either within the same IBD/custodian or outside of the seller's broker-dealer/custodial network. This venue provides a very competitive marketing opportunity for sellers to find the best strategic or economic buyer for what they've built and how they've built it, at best value and best terms. It is effectively a national search for the best qualified buyer, who may or may not be local.

  FP Transitions operates and continues to organize the open marketplace for independent advisors. It is what we do, at least in part. But FP Transitions also operates and supports several closed market systems because IBDs strongly prefer this approach (that's a kind way of saying that most IBDs do not like the choice afforded to sellers through an open market platform).
- A **closed market** sale is one in which a book, practice, or business is offered only to certain buyers because of a limitation imposed by a third party, such as a contractual agreement with a broker-dealer, or simply because that is the seller's preference. Typically, all of the potential buyers are with the same IBD or custodian, which ultimately means less competition and, at least conceptually, an easier and faster transition in terms of buyer selection, documentation, and client/asset transfers. This venue can also result in a lower price on less favorable terms when compared to the ultracompetitive open market process, but it really depends on how well it is run and who is running it, and the number of participants in the marketplace.

Handled professionally, there is nothing wrong with a closed market venue. The problem is, not all closed market venues are handled professionally or have sufficient scale to do the job right. The reality of the closed market and bulletin board systems discussed further on requires that we introduce a new term of art at this point, that of a "predatory buyer." Predatory buyers buy everything and anything with complete disdain for "market value" and professional deal terms. They're good at what they do and often employ static multiples of revenue or earnings and deal terms that create a "heads I win, tails you lose" approach. Worse, they have the blessing of their IBDs/custodians because they keep the clients and assets in the network, regardless of the monetary loss to an exiting/retiring advisor. Sellers need to be aware and understand that despite a long and close relationship with a single IBD, when it comes to selling and retiring, your agenda may no longer match theirs.

- A **bulletin board** is an online meeting place that typically provides few if any other benefits—no formal valuation (other than a free online system using a proprietary formula and with no supporting database), no documentation or qualified authority other than a list of third-party providers you can hire on your own. The point is to expose prospective sellers to prospective buyers, which is certainly important and relevant. The process may also be free of charge. Many IBDs and custodians operate their own bulletin board systems.

  Bulletin boards tend to list everything and anything, and sellers usually list for free, so the sellers may or may not be qualified and properly valued or serious. Prospective sellers are the bait and they tend to attract a lot of paying, hopeful buyers. For the most part, no harm, no foul. But do be aware that some bulletin boards are run and organized by recruiters and predatory buyers, and confidentiality tends to be a low priority.

  Sellers should be aware that many buyers within an IBD network, or within a closed market or bulletin board site, feel they should be entitled to special pricing because if it appears that an advisor "has to sell," the response might be that the buyer is doing the seller a *favor* by stepping in and helping out with a quick and easy sale. Once established, this dynamic can be quite difficult for a selling advisor to withdraw from, especially when engaged with a very experienced buyer.
- A **private transaction** is the case in which a seller decides to sell to a friend or an associate or someone provided by the IBD's or custodian's practice management team. It may also be the result of answering one of those acquisition-oriented letters you and everyone else at the practice level or above receives in the mail a couple of times a year. A private transaction represents a *handpicked* buyer in some sense and is almost always within the same IBD or custodial network. This is the process

not of ending with a 1:1 buyer-to-seller ratio, but starting with a 1:1 buyer-to-seller ratio.

As a general rule, bigger buys smaller. Statistically, only about one fourth of the buyers are the same size or smaller than the seller they are acquiring, and private transactions make up the bulk of these sales. As you might expect, the value and payment terms are somewhat compromised when compared to those of a competitive buying environment, but this approach gets points for being quick and easy and "friendly."

Selling advisors tend to choose just one selling avenue until it is successful or the possibilities have been exhausted. The problem isn't that prospective sellers in this industry need more than one venue to achieve success—they don't. The problem is that too many sellers don't understand the limitations and end results of their choices. Speed, efficiency, and confidentiality are all important issues, but most sellers assess the ability of a chosen selling venue to deliver on these issues from unreliable sources, or sources with an agenda of their own. The continuing point that we'll make in this book, to every advisor and to their IBDs and custodians and the practice management personnel who are hired to assist in this process, is that sellers need support. They need a steady, reliable narrator to guide them on this onetime journey.

Buyers, don't despair. A smart and informed seller will succeed 100% of the time and that should mean more, good, affordable acquisition opportunities in which the clients are willing participants.

EXIT PLANS VERSUS SUCCESSION PLANS VERSUS CONTINUITY PLANS

It is common for advisors and practice management consultants to equate the terms "exit planning," "succession planning," and "continuity planning" and to use these terms interchangeably. However, these terms are very different, providing unique benefits and demanding different levels of preparation and investment to achieve the desired outcome. As an independent advisor, you need to understand and correctly apply the terminology to navigate this area and achieve your specific goals.

Here are the working definitions that apply to the independent financial services/advisory industry, each with a brief explanation.

Exit Plan

An **exit plan** results in a transaction with either an external buyer or an internal buyer, but the commonality is that the transaction is completed in one

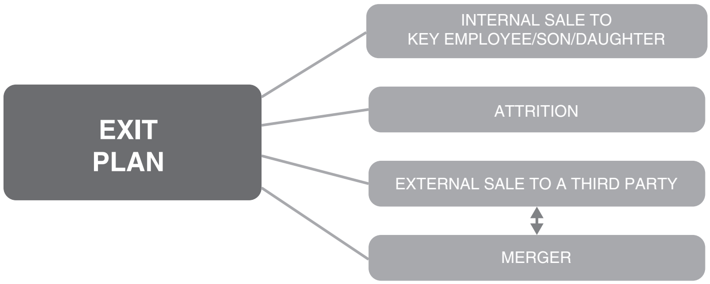

FIGURE 1.7 Exit Planning Strategies

step—usually not suddenly, just completely. External buyers usually have a very similar model but are about twice the size and value of the seller, while an internal buyer is someone you hired and trained, know, and trust. When sold externally, which is most common at the book and practice levels, the book/practice comes to an end, with a larger, similar practice or business or firm taking over the seller's duties and responsibilities. Documentation for a job or book is often a basic revenue sharing agreement, while an exit plan at the practice level typically revolves around an asset purchase agreement. There are four primary exit plans or strategies, as shown in Figure 1.7.

The most common exit plan involving transfer of ownership and control is a complete sale to a third party, and is often called a "merger" whether or not the legal and tax requirements support the definition of a statutory merger. Exit plans can be structured to last for five or six years, or be substantially completed in three to six months. These and other variations are explained later in this book.

Relatively few exit plans involve internal sales, which is best explained by the structure of the ownership levels. There just aren't many licensed and capable employees at the job/book or practice levels ready to step in and commit to the acquisition process. Internal exit plans at the practice level, if that is a choice, tend to be complete sales, all at one time, to one key employee, or a son or daughter. At the business and firm levels of ownership, internal sales are the preferred and common choice, but the methodology and documentation shifts to succession planning and follows a more gradual sale/purchase of stock or membership interest over many years.

Succession Plan

A **succession plan** is a design for growth and endurance. The process of succession planning builds on top of an existing practice, business, or firm and gradually and seamlessly transitions ownership and leadership internally to

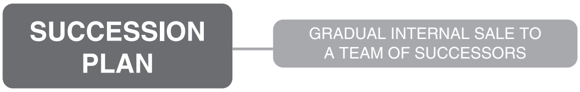

FIGURE 1.8 A Succession Plan

the next generation of advisors, often called a "successor team" (Figure 1.8). The founding owner in a succession plan is not a "seller"—they're a partner or a shareholder, and long-term, sustainable growth powered by multiple generations of owners is the number one goal. A succession plan means your business or firm will continue after your career comes to an end. Most succession plans include the founder's continuing assistance and presence in the day-to-day operations for several years beyond the traditional retirement age. Documentation for a succession plan is more complex, but centers on a stock purchase agreement(s), or the equivalent for a limited liability company.

There are an infinite number of options available under the succession planning category, but all center on a gradual internal transition. No two succession plans are exactly the same. Like hiring an architect to design your dream house, the outside reflects the people on the inside and their unique goals, time frames, talents, and preferences. Every succession plan must be customized to fit the specific fact pattern at issue. It is a challenging process and it requires a skilled team of consultants to make it work. It is about building an enduring business.

Jobs/books and at least smaller practices do not need and probably cannot reasonably hope to construct a formal succession plan, absent a serious, long-term investment of time and money into the process. Larger, stronger practices, businesses, or firms can and should choose either an exit plan or a succession plan, perhaps both, depending on the circumstances. A succession plan certainly doesn't mean the business will last forever. It is a distinct possibility that the second or third generation of ownership (which came to pass through a succession plan) will choose to merge the business or sell it when the time is right. For this purpose, they will need an exit plan.

A sale of an advisor's book or practice results from the inability or failure to build a sustainable business. That's not bad, just reality. An airplane flight isn't a failure because it doesn't achieve orbit—that isn't what that vessel was designed to do. An exit plan should be required of almost every independent advisor who is not building an enduring business model.

The exit plans and succession plans discussed up to this point generally presume that the founder or primary owner(s) is alive, well, and capable of choosing what comes next—that isn't always the case, especially in an aging industry dominated by single owners. Sometimes life intervenes and the next

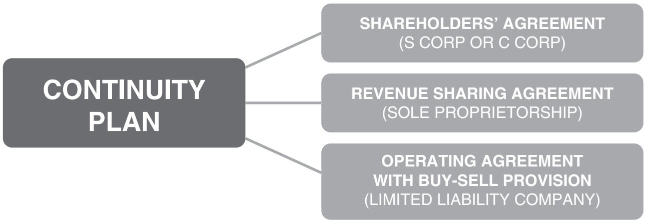

FIGURE 1.9 A Continuity Plan

step is a bit more sudden. Addressing death or disability is the role of a continuity plan, actually a subset of an exit plan or a succession plan for those who own a business or firm.

Continuity Plan

A **continuity plan** is usually a formal, written contract that assures a seamless transfer of control and responsibility in the event of a *sudden* departure from the practice or business of any of its owners, young or old, and whether by choice or through termination of employment, a partnership dispute, and certainly death or disability (Figure 1.9). The common terms applied to a continuity agreement are a shareholders' agreement (as with a corporation), a buy-sell agreement, or even an operating agreement (for use in an LLC). The event triggering a continuity agreement may be unplanned, but the solution should never be.

It is a bit of a misnomer to think of providing a "continuity plan" for a single-owner book or practice. Legally, when a one-owner model is transferred by a revenue sharing arrangement or an asset sale, it comes to an end. In reality, the continuity plan triggers a sale, which is a perfectly fine outcome regardless of the means. The clients, assets, obligations, and such may continue to be handled by a new advisor, but that advisor is not continuing what the former advisor built, at least in the sense of an ongoing enterprise. That is an important distinction and part of what separates books and practices from businesses and firms.

If you've already built a multigenerational business or are on the road to doing so, your continuity plan will derive from your succession plan. An internal ownership track, once implemented and in place, is the single best continuity plan available as clients' needs are addressed by the other principals who are invested in the same business. For the vast majority of advisors, it works the other way around—continuity is the first planning problem to solve because it poses the most immediate and serious threat to a lifetime of work, value, and the clients' well-being. For this reason, continuity planning is best thought of as a dress rehearsal for the exit planning or succession planning process.

Job/book owners and practice owners, groups dominated by a single advisor or single owner, often tend to enter into a very basic, even rudimentary, continuity agreement to address what happens to their clients and their value in the event of sudden death or disability. The solution set often exists in the form of a simple two- or three-page revenue sharing agreement provided by the practice management personnel at an independent broker-dealer or custodian. In the event of an owner's death or disability, the "buyer" or continuity partner will typically pay a percentage of every dollar received for three to five years and the "seller" or the seller's family/estate suffers the same disadvantages we discussed earlier under revenue sharing agreements: nothing down, all ordinary income tax rates, no guarantees. Sometimes, many times, this can be better than nothing, but that is setting the bar pretty low.

The bigger problem is that the IBDs and custodians often add "retirement" to the list of triggering events (in addition to the basic "death and disability" provisions), making this simple document set an *exit* plan as well and taking the book or practice off the market. If you're a willing continuity partner/buyer, good for you—you've just reduced a 50:1 buyer-to-seller ratio to 1:1 and now you can dictate price and terms to an eventual seller. That's smart, at least in the near term. If you're a prospective seller of a job/book or a small practice, this *might* be a good course of action, as your choices are limited, but do so with your eyes wide open. Remember, what's in your broker-dealer/custodian's best interest may or may not be in yours.

Let's shift gears and get back to what you can do to improve your endgame strategy. Whether you're considering an exit plan, a succession plan, or a continuity plan, the operative term is this: *planning*. We're not talking about an idea, or a developing thought in the back of your mind or, worse, an impulsive decision after a bad day or bad economic news report. Take the time to lay out a formal plan, do the math, and decide years beforehand what makes the most sense for you and your clients and your staff. Gather the information and expertise to evaluate your options and develop your best strategy going forward. Then execute that plan in a professional manner and adjust once a year or as needed.

A formal plan under any one or more of these umbrellas should include these fundamentals, all committed to writing and back-tested with a spreadsheet that assesses the plan on an after-tax basis tied to what you've built and how you've built it:

- A formal, annual valuation to assess and monitor equity value (and any decline in that value)

- A complete benchmarking analysis based on reliable data
- A review of current organization and entity structures and the impact on an eventual sale
- An assessment of the most likely payment structure and best tax strategy
- A review of the bank financing element and its possible application to your situation (covered in depth in Chapter 7)
- A plan for finding the "best match" and a determination of whether that is likely to be within the same broker-dealer network or not (for RIAs, the best choice or addition of a custodian)
- Preparation and retention of key staff members before the sale and after the sale
- A continuity plan to protect everyone's interests in the event of the death or disability of the owner before a sale or the readiness of an internal team of successors

I used to work for a curmudgeonly senior judge back in my law school days and one of his favorite expressions, especially to young lawyers who tended to overthink everything, was "This ain't rocket science!" Well, the combined legal, tax, regulatory, and cash flow structures that underlie an exit plan, a succession plan, and/or a continuity plan for a practice or business or firm worth a million dollars or more structured within an S corporation, a C corporation, or an LLC in this highly regulated industry—this *is* rocket science. It takes some real work, education, thinking, and planning to develop a sound and practical strategy. Give yourself time to do the job right. Don't be afraid to ask for help. And, above all else, do not expect to solve all of this with a three-page do-it-yourself form. Your clients deserve better, and so do you.

THE PLANNING CONTINUUM

So where to start? Begin with an accurate assessment of what you've built. Do you own a job or a book, a practice, a business, or a firm? Depending on what you've built to date, what is your goal for the future? Do you want to grow? Do you want to build your practice into a business? Do you simply want to earn a good living and sustain your current income as a book or practice owner for another 5 to 10 years without the complexities of taking on partners or new employees? Or do you want to retire on the job and make your business work for you? There is no wrong answer, only questions that go unasked. You can fix that.

For everyone not settling for the attrition route, let's put the planning process into context. In a perfect world, starting at about age 50, follow these steps to determine the best and safest path forward—steps that apply to both buyers and sellers:

Build or adjust supporting infrastructure (entity structure, organization, staffing, compensation, profitability) to support your goals

- Obtain a formal valuation (don't guess)
- Perform an annual benchmarking exercise to assess strengths and weaknesses
- Track your annual revenue growth rates on a five-year compounded basis
- Reassess your compensation structure if your profitability level is below 15% of gross revenue
- Assess regulatory environment/IBD status. Would a standalone RIA be a better model now, or in the future?

Protect what you've built

- Create a continuity plan
- Do not tie the buy-out valuation formula to a multiple of anything
- Don't settle for "better than nothing" as a solution to your continuity plan
- Provide for an adequate funding mechanism (life insurance/lump sum disability insurance/bank financing) to support your continuity plan
- Consider methods for improving the reliability and efficacy of your continuity plan (i.e., an internal ownership track)

Plan for transition of ownership and/or leadership

- Consider internal options (succession planning)
- Consider external options (exit planning)
- Consider a merger (an enormous field of possibilities, as you'll read further on)
- Consider advantages/detriments of an attrition strategy

Make a plan to realize value

- Attrition (cash flow only)
- Sale (equity only)
- Succession (cash flow + equity)
- Realize value at long-term capital gains tax rates at all levels of ownership

Learn how to utilize bank financing and strategic debt in a professional manner to support your planning process

- Fuel growth and support continuity planning with a working capital loan
- Utilize buy-in capital to support succession planning
- Consider acceleration options as soon as your team is ready

It is okay if you start the planning process later, maybe much later, than age 50. The takeaway is to start planning in a formal manner. Some exit plans can be laid out and implemented in 90 days, and some take five years or more. Just start planning and commit the process to paper based on accurate information as soon as you're able. Most advisors plan to work well past the traditional retirement age anyway, so start when you're ready. Just remember that the earlier you begin the planning process, the more choices you'll have when the time comes.