Sustainability and the Future of the Profession

by David Grau Sr., J.D.

It seems that the one constant in the financial services industry is change. Over the past 20 years or so, the industry has been shifting away from product-based solutions to advice-based solutions. As a part of this trend, we have witnessed a change in the role of planning professionals from producers to advisers, and a change in revenue structures from transactional to recurring.

The one element that has been slow to change is the evolution from an industry of book builders to a profession of business owners. Rhetoric aside, the organizational, entity, and compensation structures often in use are designed around fragile, one-owner, one-generational book or practice models, leaving clients to fend for themselves at some point. From the clients' point of view, and even from that of the next generation of independent advisers, this is an unacceptable outcome.

FPA and Janus Henderson Investors recently conducted a survey on the issue of succession planning, titled *The Succession Challenge 2018: Why Financial Advisers Are Failing to Plan for the Inevitable.* This survey found that 73 percent of the respondents did not have a formal plan of action guiding their end-of-career strategy, be it an internal succession plan, a sale to a third party, or a merger with another practice or business. Everyone agrees that such a plan is important; it just isn't getting done in sufficient numbers—yet. The issue of building an enduring business and creating a seamless transition from one generation to the next isn't something that wins advisers any awards or recognition, yet it is arguably one of the most important duties they have.

Operating a one-owner practice that is centered on a single adviser's talent, drive, and success is not the same thing as building a sustainable business. If we define a business as a multi-owner, multi-generational operation with sufficient growth and profitability to attract and retain next-generation talent, I estimate that less than one in 10 independent advisers qualify. And if we are to assume that the fallback plan is to sell or merge at or near an adviser's career end, 20 years of data and observation suggests that only about one in 10 entrepreneurs will choose this route, leaving about 80 percent of the independent industry simply doing nothing (the term often applied is attrition, or just letting the books die out). The issue of sustainability is our Achilles' heel.

Why Sustainability Matters

In many professions and in most businesses, sustainability is not a pressing issue. Most people don't need a multi-generational dentist office, for instance. But in the financial services and wealth management industry, it is different. Advisory clients have a clear expectation of receiving continuing advice and plan management tailored to the length

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Current life expectancy data suggests that as many as one-third of a financial adviser's client base will live to be over 90 years of age (husband or wife). Simply put, many advisory clients are going to outlive their adviser's career length—and by a wide margin. Add to this the generally held belief that over the coming decades, the biggest and wealthiest generation in U.S. history will transfer close to $60 trillion in assets to the next generation based on a 2014 study by the Center on Wealth and Philanthropy at Boston College. Whether the issue is charitable gifting, estate planning, providing an inheritance, or navigating state and federal tax laws, people will need help managing this transfer.

There has never been a better time to build a sustainable, valuable, profitable business that can serve the founding generation (G1), launch the second and third generations (G2/G3) into ownership, provide for the clients for the length of their lives and wealth, and even look after the financial plans of their children and grandchildren.

Of the 27 percent of advisers surveyed by FPA who reported having a formal, documented transition plan, only 41 percent said their formal plan included information on the team transition process. This ignores the client's expectation to receive continuous, informed financial guidance from their chosen professional and overlooks the opportunity to build a truly sustainable business from within. This ongoing revenue stream and the attendant duties could be easily passed on (for example, sold, merged, or otherwise transitioned) to the next generation of advisers who already know the clients if a basic plan was put in place earlier in the process.

It only makes sense for independent advisers to design a wealth management cycle that addresses the client life cycle. To be clear, I'm not saying for one minute that independent advisers can't make a very good living—they can and are for the most part. Today's independent advisers are not failing in their work of providing professional, relevant, and much needed financial services advice to their clients; they are failing to sustain a business beyond their own careers, leaving their clients to do that portion of the planning on their own, and advisers (and their broker-dealers, custodians, and insurance companies) are leaving an incredible amount of money on the table as a result for no good reason.

Good Choices and Multiple Plans to Consider

Designing a business that can serve your clients for their lifetime and perhaps well beyond your career as a founding owner is not a matter of good luck or good genes, nor even hard work. Virtually all fee-based advisory practices have the capacity to become sustainable beyond the length of the founder's career, if they start soon enough and build effectively and efficiently. It takes a plan. Advisers have some good choices including the following:

A succession plan is a design for growth and endurance that builds on top of an existing practice or business and gradually and seamlessly transitions ownership and leadership internally to the next generation of advisers. These plans are typically executed over a period of five to 10 years or more with the assistance of the founding owner who maintains a presence in the office for the duration.

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 step—usually not suddenly, just completely. In many cases, at least in a sale to a third party, clients are transferred to a multi-owner, multi-generational business designed to serve them, their children, and grandchildren.

A continuity plan is a formal, written contract that assures a seamless transfer of control and responsibility in the event of a sudden departure from a practice or business of any of its owners for any reason, but usually focusing on death or disability. Continuity planning is a challenge for one-owner books and practices, leaving the clients on their own in many cases with little or no notice.

A disaster plan seeks to address how the clients will continue to be served in the event of a natural disaster (earthquake, flood, hurricane, tornado, tsunami, etc.), a local incident (power outage, building fire, etc.), even a terrorist event. Regulators are now requiring

A merger or a tax-free exchange is the joining together of two previously separate practices or businesses into a single, economic enterprise. It is a statutory combination of two or more corporations (or LLCs), in which one of the corporations survives and the other corporation(s) ceases to exist. The goal of a merger usually is focused on the synergistic effects of the transaction that strengthen all the merger participants and provides a wider array of planning solutions in the end.

No one plan is right for every independent adviser. Some of these plans require you to build a business with a strong foundation. Other plans allow you to enjoy the lifestyle practice you've built and then to merge into, or sell to, a larger and stronger business model. Some of these plans are dictated by time, others by an adviser's business acumen, and most by the quality and quantity of next generation talent available to step-in, step-up, buy-in, buy-out, invest, or otherwise to take over the operations and responsibilities.

If your goal is to build a sustainable business to serve the needs and goals of all involved, you will need next-generation talent at some point to get the job done. This completes the circle back to the working definition of a "business" as a multi-owner, multi-generational operation.

Recruit, Retain, Reward

Building a sustainable business usually means that growth is an ever-present challenge, and opportunity. A practice will need to grow in terms of size and strength over the coming years. Simply pursuing additional clients and assets under management (AUM) might seem obvious, but adding and retaining the key personnel necessary to sustain the business and serve more complex clientele over time is essential. Add in the need to develop continuity and succession plans, which will derive from the next-generation talent pool, and we're talking about a succession team in most cases. Handled over a decade or more, this is a very manageable task.

To develop this team, independent advisers will need to master the three Rs: (1) recruit qualified talent; (2) retain the most talented of the next generation advisers by… (3) rewarding that talent using both compensation and equity.

The overwhelming majority of team members surveyed by FPA (88 percent) recognized that the owner's transition plan had an impact on their careers. Even more (96 percent) said there is a risk associated with not having a transition plan in place. At the other end of the spectrum, evidence from my work at FP Transitions suggests that nine out of 10 of the 30-something-year-old next-gen advisers who are offered an opportunity to become an equity partner, buying in, and committing their careers to the process, say yes to the opportunity.

The problem is that the opportunity to become an equity partner, to buy-in to ownership, and to earn a place as a potential successor needs to be considered and presented much more often. Creating equity pathways helps recruit and retain next-generation advisers.

In terms of creating an adequate reward system to retain the best of the next generation of talent, equity is the key. Equity is a powerful business-building tool and is what advisers actually invest in. A total compensation package for a younger adviser that includes equity creates myriad opportunities to attract, retain, and reward key employees, who, in turn, can succeed the founding generation. Wages typically support an at-will relationship that is easy to set up and easy to walk away from; equity requires a longer-term investment with a longer-term payout and is much more effective in retaining and rewarding next-gen talent.

Defining Your Goals

It is important to have an industry-wide perspective as you develop your own business plan, but it is equally important to build an enterprise that works for you. As you contemplate transforming your practice into a sustainable business, start with an eye on the horizon. What do you want your business to look like 10 years from now?

Retirement is certainly one option, but if your goal is to continue to grow in the meantime, it is likely that the size, value, and scope of your enterprise may very well double, making it a

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demand more of your time, additional capital, and more personnel. In fact, as you succeed in creating this model, necessity will drive you to assemble many of the pieces of a sustainable business.

FPA's succession planning survey showed that a majority of firms with more than $500M in AUM have a transition plan, yet creating a sustainable business is possible with far more modest resources. Practices with $100M in AUM, for example, can move beyond good intentions when they truly evaluate their practice and their future goals and successfully implement one of the plans listed earlier.

As you think about the next 10 years of your career, carefully consider your answers to these questions:

- What do you want the business to do for you and your family?
- How many hours do you want to be working each week?
- What will your primary role be in the larger business—that of producer, leader, mentor?
- What will the business be worth, and how will you realize that value?
- How will you attract, retain, and reward the key people it will take to build and operate such a business?
- Do you have the correct organizational, entity, and compensation structures to support such growth?

The answers to these questions will be different for every adviser, but building with a clear set of goals in mind will help you figure out what is important to you, and what you need to accomplish on the journey. This usually isn't a do-it-yourself process. FPA's succession survey showed that most advisers with formal plans used an outside expert to formulate and implement their plans. There are many paths and several good planning options for most advisers. Having the assistance of an experienced team to help on everything from a formal valuation, to plan strategies, to cash flow analysis, to legal documentation, can expose opportunities as well as blind spots that must be considered.

Conclusion

Take the time, now, to lay the foundations for a strong, sustainable business, or make plans to merge into such a business before your own career winds down. Consider the options that are available. Ask yourself the hard questions and commit the answers to paper. Be sure you're working with accurate information and not myths or stories that have been retold over and over without all the facts.

The good news is that the tools are there to help you succeed. It is time that, as a group, we live up to the level of a profession and finish the work that we promised to do.

David Grau Sr., J.D., is founder and president of FP Transitions. As author of two industry best-selling books and a nationally recognized speaker, he is known as one of the most influential leaders in transition and sustainability strategies for financial advisers.