12 QUESTIONS TO ASK BEFORE BUYING A PRACTICE

THE OECHSLI INSTITUTE

SUMMIT BROKERAGE SERVICES, INC.

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INTRODUCTION

Buying or merging with a practice can be one of the most efficient ways to grow your business while adding scale and efficiency to your client services. But just like buying a larger home, the benefits come with costs. Sorting out the pluses and minuses doesn't have to be complicated if you have answers to these 12 essential questions from Matt Oechsli.

The considerations in this guide are appropriate whether you are looking to buy a practice outright or merge with one as part of that firm's succession plan. Finding the right fit when it comes to client mix, culture and service philosophy can make the difference between unqualified success and buyer's remorse.

In the first section, Matt explains what to ask about the most valuable asset to any practice: the clients. Next, he'll help you uncover whether your target acquisition's service model is compatible with yours. In the last section, Matt will focus on important considerations about the sale itself.

When reading over the questions, ask them about your own practice: your answers will be a solid first step to evaluating your potential purchase.


1?

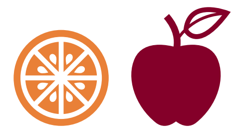
ASK ABOUT THE CLIENTS

1 IS THE PRACTICE COMPATIBLE WITH MY PRACTICE MANAGEMENT PHILOSOPHY?

This is a critical question—maybe the most critical since it likely affects to some degree the answers to the other 11. The client "handoff," or transition process, is a major consideration whether you're buying or merging, and warrants a detailed action plan. If clients don't fully understand your value proposition and how it relates to the services they are accustomed to, they may be tempted to leave—ultimately leaving you with a fraction of the practice you purchased.

Consider ways to limit the impact of the transition on clients, and help them feel in control of the process. Buyer and seller should have similar philosophies on:

- How to interact with clients
- The frequency of communication and personal interaction
- How to handle staff
- The investment recommendations
- The overall operational standards



2 WHAT IS THE MAKEUP OF THE CLIENT BASE?

Size and age of the target book are important considerations. Buying a small book of 60 wealthy families allows you to offer more focused service, and puts you in contact with affluent centers of influence (COIs) who can in turn help you find more A-list clients. A firm with 400 smaller clients likely reverses the situation, requiring a heavy workload and less COI potential.

As for client age, if the majority of revenue-generating clients are octogenarians, you are targeting a fading practice. On the other end of the spectrum, a firm that specializes in thirty-somethings may be a challenging purchase if your client base is in their fifties and sixties. You should also consider whether the seller has developed strong professional relationships with the children of wealthy clients—it could help keep their assets under your management after intergenerational transfer. Otherwise, and all other things being equal, the more affluent and local (see question 3) the client base, the more desirable the practice.

3 WHERE ARE THE CLIENTS LOCATED?

Ideally, you want to purchase a book that is local, or at least without any clients more than a few hours' drive away. This gives you the chance for some face-to-face interaction as you transition into the role of primary financial advisor. Proximity not only makes it easier for you to develop strong relationships with clients and COIs, it also increases the likelihood that you are building on their already strong relationships with the seller.

Of course, if your current business consists of clients across the country and you are confident in your process for ongoing contact, location may be less of an issue. But if this is not your current business model, be forewarned that it can be very challenging.

4 WHAT PERCENTAGE OF THE ANNUAL REVENUE IS FEE-BASED?

Not only is an annuitized client base—75 percent or more is preferred—more valuable, it leads to a much smoother transition for you, since annuitized books tend to be more stable, lowering your risk premium. Strengthening these ongoing relationships can be considerably easier instead of pitching transactions in those critical first months of the transition. It is not uncommon for advisors to buy a largely transactional book, try to turn it fee-based very quickly, and pay the price with client defections.

5 WHAT PERCENTAGE OF CLIENTS IS GENERATING THE MAJORITY OF THE SELLER'S REVENUE?

Typically, you'll find there are 20-30 clients generating the majority of your target firm's revenue, which is perfectly reasonable. (If there are only two or three clients propping up the firm, be careful.)

These 20-30 clients are most in need of relationship building and a smooth handoff. What involvement will the seller have in the transition? Is the seller going to participate in meetings with you and each top client at least twice in the first 12 months? Is there an opportunity to host client events with the seller to get to know everyone socially? Ensure the seller is willing to go the extra mile with you to ensure a smooth and personal transition experience for top clients.

ASK ABOUT THE SERVICES

6 WHAT IS THE SERVICE MODEL?

In many instances, the more accurate question is "Is there a service model?" If there isn't a systematized client communication process in place, it could indicate weak client relationships. That could be a great opportunity for you if your existing service model is robust—clients are less likely to defect if they notice improvements right away.

In cases where your target firm does deliver solid service, the critical question to ask is whether it is compatible with your model. If there are differences, are there steps you can take to transition into a unified service model? Keep in mind that having different service models for different tiers of clients—A and B, Platinum and Gold—is common practice and may be a way to integrate the capabilities of your current practices and those of your target.

7 WHAT ARE THE WEALTH MANAGEMENT SERVICES BEING PROVIDED?

It's important to assess both the nature of services offered by the firm you are looking to buy, and the investment management philosophy that guides them. Ask:

- Do top clients have a financial plan that is current and comprehensive?
- Is it compatible with your planning process?
- How is it being executed?
- Does each client have their financial plan reviewed annually?
- Has the seller involved the CPA of these clients in the planning process?
- Do they use third-party money managers? Who and how many?
- Is internal asset management compatible with the third-party managers being used?

You may also discover opportunities through more comprehensive service offerings, such as estate planning, tax planning, or insurance, whether you or your target firm offers them. You might leverage your target's strategic partnerships to enhance your offerings to your current book, draw on your own services to deliver an expanded suite to your target's book, or a combination of both.

8 WHAT IS THE POTENTIAL OF TRANSITIONING COMMISSION ASSETS TO FEES?

While the ideal target would have about 75 percent of their practice annuitized, The Oechsli Institute has found that for the average veteran advisor getting ready to retire, it's more like 50 percent. If that's the case, you should determine how many of these clients can be transitioned into a fee-based relationship, what process and timeline will be associated with this transition, and what role the seller can play. Your target firm may have a number of wealthy clients, but if they are mostly in buy-and-hold positions and unlikely to transition to a fee-based model, they won't do much for your bottom line.

9 WHAT IS THE STATUS OF THE SUPPORT TEAM (ASSISTANTS, JUNIOR ADVISORS, ETC.)?

Clients—especially top clients—often have a very good relationship with the support team of the selling advisor. It is important that these team members stay involved throughout the transition, and that you and the seller communicate consistently with your respective teams—they may be worried about their jobs.

If you do have to make cuts, you will have to determine who has the right core competencies to stay. Those without significant tenure or strong ties to top clients should receive lowest priority. If you are in a position to keep all or part of the support team, it's important that their compensation is in-line with the seller's current compensation model.

ASK ABOUT THE SALE

10 WHY IS THE PRACTICE FOR SALE?

Many sales are triggered by the selling advisor's impending retirement. This is perfectly normal, but it doesn't mean you shouldn't start your due diligence process with the question "Why?" If the seller is using the sale to actually fund his or her retirement, the strong monetary incentive makes it a good idea for you to take extra care in researching the details of the health of the practice. And if the seller is in legal or financial trouble, don't expect him or her to reveal everything; conduct reconnaissance online and with key stakeholders.

If you are part of the seller's succession plan, you will need to clarify the terms, roles and responsibilities across the entire timeline. The obvious upside to such an arrangement is that the clients will experience the buyout gradually, and have time to get to know you while still having contact—or at least access to—their current advisor.

11 WHAT ARE THE TERMS OF THE SALE?

There are two common practices for structuring the sale. If it's a straight sale to a third party, a three-part payout is fairly standard. It consists of an up-front down payment, seller or bank loan financing, and earn-out—some percentage of profits from the business over a defined future period. The selling advisor may stay on with the practice for some time, which allows a warm client handoff, or sell and walk away, which is not an ideal situation for you with respect to building or fostering client relationships.

When the selling financial advisor is looking to retire a few years in the offing, you may agree to structure a gradual buy-in, or partial-book sale. The selling advisor segments his or her client base and sells a portion at a time. This allows you to either work side by side or in separate practices, or a junior member of your team could buy the practice to build his or her own book over time.

12 WHY ARE YOU CONSIDERING BUYING ANOTHER PRACTICE?

Buying a practice can be an excellent growth strategy for your business, doubling or tripling your book and revenues in a year or two instead of a decade or two. But it is not the only growth strategy, and it may not be the best for everyone. The devil is truly in the details, and there are a lot to consider. Add to that the fact that there are many more potential buyers of practices than there are sellers, and you have all the more reason for financial advisors to adhere to the caveat of buyer beware.

The poor satisfaction level of advisors who have purchased financial practices should serve as an additional pre-flight check. The Oechsli Institute estimates that fewer than 30 percent thought the purchase was actually worth it. Be careful when analyzing your profits and projected increase in the scale of your practice. Be honest about what you can and cannot manage with respect to the increased workload, both with the expanded book and the transition period. Understand the quality-of-life trade-offs you may be making, both long- and short-term.

You should know that buying another firm is a good idea before it happens, rather than roll the dice and hope to be pleased with the result.

The rewards of buying a practice are typically easy to envision. Growing your client base, adding scale and efficiency to your work flow and generating more income make it seem like an obvious choice. But even with adequate pre-sale due diligence, you should expect challenges along the way. You aren't likely to be able to predict every contingency, but if you have thoughtfully sought the answers to the questions within this guide, you should find yourself among the 30 percent of advisors who felt the purchase was worth it.

ASK YOUR BROKER-DEALER

Your first resource for growing your practice should be your broker-dealer. They may offer services to help you with your purchase, from identifying potential targets for acquisition to delivering advice on how to structure or close the sale. They may also have a list of affiliated advisors in your area looking to retire and in need of a succession plan, or be able to put you in contact with other advisors who have acquired practices and who can offer you advice based on their own experiences. Before you start shopping, talk with your current firm to find out what kind of support they can give you to make the process easier.

For additional ideas on the support that might be available to you, or for more ideas on how to grow your business, we can help. Contact us at 800.354.5528 or visit joinsummit.com.

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