Building a Business to Last

By Mark Tibergien

Most advisors are speeding toward retirement like distracted motorists with their noses in their smart phones. If they do not look up and start paying attention soon, they could be headed toward a major collision with reality. According to recent research, more than half of independent registered investment advisor (RIA) firm owners are within 12 years of retirement and 18 percent are planning to retire in seven years or less. Yet two-thirds have no succession plan at all, and nearly one-third offer no career path of any type to develop their employees into suitable heirs.‘

Many independent advisors seem to be cruising on vague, optimistic expectations about the future. At one family succession-planning meeting I attended, the elderly entrepreneur campaigned for the highest possible price for his practice. One of the sons turned to me and said: “Please tell Dad we don’t even want his business. We’re already collecting Social Security.” Such are the hazards of waiting too long to plan.

Another entrepreneur, running a very successful $400-million advisory practice as a sole practitioner with five support staff, requested help recruiting a partner to succeed him. The trouble was that he had delayed until he was two years away from retirement. Two years is hardly enough time for a solo flyer to learn to work with another professional—much less enough time to search for a candidate—to vet for a cultural fit, and then develop that candidate to serve clients and manage the business. Unfortunately, this is the dilemma many advisors create by failing to plan for succession.

Begin with the End in Mind

If you are interested enough in succession planning to read an article, you naturally want to take away at least one idea of immediate value. Probably the most important advice you can hear now is to start asking yourself the tough questions you may have been avoiding—the very types of questions you probably ask your clients:

How old will you be in 10 years?
That number may be a bit uncomfortable to contemplate, but it truly focuses your attention, especially since 10 years is a relatively short period of time.

What would you like to do?
Would you like to work as hard as you do today, partly cut back on your hours, or enjoy full retirement?

What will your business look like?
Most importantly, who will lead it? Is your successor already working in your firm today, or will you need to recruit one? How long will it take you to find and groom a suitable candidate?

Who will your clients be?
Your clients are probably your age or older— boomers, their elder siblings, and their parents. However, in 10 years the boomers will have shifted to the withdrawal stage of the investment life cycle. To remain viable, your firm will need to cultivate Gen X and Millennial clients. These two age groups bring a very different set of demands and expectations, and your firm will need employees who can meet them.

You also need to consider the impact of your choices on others. What if you die or become suddenly disabled? Who will tend to your clients? How will your family or staff react? Are they prepared for the shock?

Once you answer these questions, you will begin to understand how much importance you need to personally place on succession planning.

One of the big challenges for advisors confronted with the idea of succession is they view it as an end-of-life decision rather than an opportunity to reinvigorate their businesses. Succession planning is not the same as sale planning where you turn over the keys in return for a big check. Rather, it is an opportunity to build a business that will last way past your exit. Truth is, if you build a business to last, you also will be building a more-compelling business to sell.

But creating an enduring business requires work—just like preparing for retirement or striving for financial independence. Only you can decide whether it is worth the effort.

The Five Characteristics of a Lasting Business

If you do choose to build an enduring business, it is critical to know what such
an animal looks like. Businesses that last share five distinguishing characteristics:

**Consistent profitability.** Regardless of the measure you use—take-home, net profit, operating profit, or other metric—your profit must be consistent, and it must be growing as you evolve your business.

**Transferrable value.** Valuation is a function of the future, not the past. Someday you will need to convince a buyer that your business will retain value even after you retire. To do that, your business must generate recurring income without its founder’s presence.

**Loyal clients.** Affection alone is insufficient. Loyalty enhances value only when it is visible and measurable. How many referrals do your clients provide? How many of their friends have they introduced to you? Do they speak of your business to others, and what do they say?

**Opportunities for employee growth.** A lasting business is one that enables individuals to grow, whether they move up a hierarchy or simply develop personally and professionally. Growth is necessary to keep employees engaged, committed to your mission, and making a positive impact on your business. **Multigenerational appeal.** If your clients, principals, and employees are all baby boomers, then you can see how much of a future your business has simply by consulting the mortality tables. A lasting business must appeal to a new generation of clients as well as the next generation of advisors and owners.

**Headwinds That Will Impede Your Progress**

If your business is to endure, it must be ready to evolve. Tremendous change looms ahead for the entire retail financial services industry, and each advisor must decide how to respond.

**Regulatory reform.** Fast-changing regulation is the new reality. How will your business adapt to it? For example, will regulatory reform affect the kinds of people you hire or how you train them? Can you create a stronger culture of safety? How will your cost structure change?

**An acute talent shortage.** The scarcity of qualified personnel is well-known. Pershing (2012) anticipates 12,000–16,000 advisor retirements every year for the next 10 years. Cumulatively, those 160,000 advisors represent just more than half of the entire retail advice industry today. To cope with that retirement wave while meeting market demand, FA Insight (2011) projects that the industry will need to add 237,000 advisors over the next decade.

However, retiring advisors will find very few understudies waiting in the wings. On average, there is an 11-year experience gap between lead advisors and their juniors. Only 22 percent of financial professionals today are younger than age 40, and a mere 5 percent are younger than 30. Worse, quit rates—finance and insurance workers leaving the business—are back on the rise (U.S. Bureau of Labor Statistics 2011). It is ironic that an industry that manages clients so well does such a poor job of managing and developing its employees. If you do not master this task quickly, you will not be able to transfer the value of your business, and it will not outlast you.

**Margin compression.** Current trends will continue squeezing profitability. Gross profit margin—revenue minus direct expenses, which are the costs involved in generating revenue and serving clients—has dropped to 50 percent in many cases. At the same time, overhead expenses such as rent, utilities, and administration have risen to 45 percent, leaving the average advisory firm with a measly 5-percent operating margin, barely above that of a grocery store. Obviously, declining profit is not good for any business, but it’s especially not good for one looking to build transferrable value. The good news is that solutions are readily available. Many practices are rife with inefficiencies that are easy to minimize. Custodians can help convert fixed costs to variable costs that scale with revenue. Many pricing models are ripe for updating, so fees more accurately reflect the value that clients receive. However, many advisors have little interest in fixing these problems, especially if they feel their own compensation is adequate.

None of these headwinds is insurmountable, but they remain forces of resistance that advisors must navigate if they hope to build enduring businesses.

**Tailwinds That Could Propel Your Growth**

In addition to all these challenges, new opportunities also are rising. There are many ways to capture momentum from these industry trends if you structure your business correctly to take advantage of them.

**Women investors.** Women, who represent 51 percent of the population, are not a niche market; they are the market. More than one-half of women with business degrees out-earn their husbands. Eighty percent of women will make the financial decisions for their families at some point in their lives. There are 8 million women-owned businesses within the United States, and their total revenue is greater than the gross domestic product of France, the United Kingdom, and Italy combined. Obviously this segment is

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of tremendous importance—and yet, 90 percent of them fire their advisors after they are divorced or widowed. Why? Women’s chief complaint is that their advisors fail to help them become smarter investors, educate them about risk and reward, and teach them to make critical financial decisions. Many advisors seem to either ignore women clients in favor of the husbands, or they try to target and sell to them. Tremendous economic opportunity awaits advisors who learn how to listen, teach, and communicate with respect.

The next generations. Gen X investors and Millennials will replace boomers as the core market for advice over the next several decades, and no advisory business can survive without them. As with women investors, the task is not to target or sell to these investors but to find new ways to interact and connect with them. Surveys show that 90 percent of this demographic plans to fire their parents’ advisors. One reason cited is a concern about the longevity of a firm led by advisors who are as old as their parents, making the need to recruit and develop younger advisors all the more acute. The other cause for this attrition is a radically different set of expectations and styles of communication compared with previous generations. Boomers use communal words such as “we,” “team,” and “group,” and serving them starts with building a trusted relationship. Cynical Gen X investors think in terms of “I” and “me,” and they expect advisors to prove their worth before starting a relationship. The Millennials are technology-driven, and their business will be won by advisors who learn to create completely new kinds of interactions that are largely virtual and built around anytime, anywhere electronic access.

Where Will Your Business Be in 10 Years?
The next 10 years will go by in a snap. Over that time, we will see dramatic transformations across the industry, whether they take the form of market pressures, regulatory reform, more-demanding clients, or new competition from online providers or super-regional organizations. Whatever specific changes may come, the fact is that your business strategy may simply no longer be relevant 10 years from now.

However, most advisors still are cruising toward retirement without pausing to look where they are going. They need to pay attention now, before it is too late. Advisors in their 50s still have time to build a business that lasts—if they are willing to do the work. That work starts with a change in attitude. You will need to transform your practice into a business and start viewing people as an investment from which you hope to earn a return instead of a cost to be managed. You will have to answer tough questions about your goals and vision and equip your business to navigate the headwinds and tailwinds that the future will bring. You must invent new ways to connect with a new breed of client and develop younger advisors who can do the job.

If advisors want to build transferable value in their businesses—enduring engines of growth that will continue running long after they are gone—they can’t speed through the next 10 years like distracted drivers. They must start paying attention to the road ahead right now or they are very likely to miss their exits.

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Endnote

1. This research is being published in a forthcoming study by Pershing Advisor Solutions and developed by research firm FA Insight, “The Advisor of the Future II: Building a Business to Last.” To obtain a copy of this research, contact pasinformation@pershing.com.

References