Scott Brewster, ümlaut

Scott Brewster is a co-founder and director at ümlaut. With over 18 years' experience in IT-focused management and professional services, he brings an extensive knowledge of data applications and ecosystems to deliver tailored business solutions to help improve clients' business procedures, fix data disorders, more easily meet compliance requirements and add value.

Selling a financial planning practice

Tips for a successful transition

Scott Brewster

Due to tighter compliance requirements and changing personal priorities, many financial advisers are beginning to think of selling their practice.

However, selling a practice is not like listing a products store for sale. Its client base is the main asset, and the ownership transition needs to be managed carefully to keep clients' confidence and trust.

Getting record-keeping systems in order is one way to increase the perceived value of a business and make the transition smoother. This and other steps to help create a stress-free, successful sale are examined in this paper.

Your clients are your biggest asset

An adviser may have spent years building up their business, but maybe the time to sell the financial planning practice is drawing near. Do you just slap a 'for sale' sign out the front and hope for the best?

Selling a financial planning practice is not like selling most other businesses. Customers buying from Widgets 'R' Us generally do not know–or care–who owns the store. However, customers using the services of a qualified professional–like a doctor or a financial planner–do care.

Consider

If the doctor you have been seeing since childhood retired tomorrow, would you feel comfortable seeing a brand new doctor at their practice out of the blue? Or would you feel better if your existing doctor introduced you to the new one, and handed over your notes with care before you saw them completely on their own?

So, if you were in your clients' shoes, you would most likely want the same consideration from your financial adviser.

Adviser-client rapport is often built up over many years. Thus, clients deserve to be treated with respect, which means planning the sale carefully and transitioning them smoothly through to the new owners.

Reasons for selling a financial planning practice

While everyone has their own motivations for wanting to sell, here are some common reasons for deciding to take the step.

Retirement
With a sizeable number of Australian financial advisers in their mid-50s, many will be looking to retire in the next few years, particularly as a result of industry changes.

Education requirements
As a result of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) findings and Financial Adviser Standards and Ethics Authority standards, advisers are now required to meet more stringent education criteria.

In many cases, this means advisers have to become degree-qualified within the next four to five years. This has seen more experienced advisers deciding to bring forward their retirement. Others who are not prepared to spend the time and money on an additional qualification are also thinking about leaving the industry.

Adviser Ratings predicted in 2018 that more than 14,000 advisers would exit the financial advice industry over the next five years. That is more than 50%.

Changes in grandfathering commissions
Additionally, changes in grandfathering commissions and trails have drastically diminished the value of many advisory businesses. Multipliers have dropped from 3.5 to as low as 1 or 1.5. It is easy to imagine the impact this will have on the standard financial planning firm business model.

Other reasons
Other common causes for choosing to sell a financial planning business include:
- relocating
- personal circumstances (e.g. ill health)
- the need for a change.

Whatever the reason for selling, with so many advisers looking to sell up in the next few years, it is worth starting to plan the sale now. Not only will there be less competition and more time to find the right buyer, but it may be feasible to increase the selling price significantly.

Ways to sell a financial planning practice

How an owner sells their financial planning practice may depend on their licensee.

For instance, a buyer of last resort agreement means a financial planning practice owner can sell their client book back to the licensee/dealer group. However, depending on the terms, sellers may end up with a lower price than they would like.

Some firms let the owner sell within their licensee network and possibly even outside of the network with permission.

Other than this, the selling options basically boil down to two methods.

1. Selling internally
Selling a business internally means selling to either a family member or an employee.

> **Tip**
> If the new owner is a current junior member of your business, you may want to implement a transition over an extended period of time to make sure they are ready to take on running the business.
>
> If they are not already on your team, look at hiring someone now with the view to them purchasing your business when the time is right.

2. Selling externally
Selling a business externally involves selling to another business or person with no connection to the owner. However, this option can be very time-consuming and complex.

> **Tip**
> It may be worth using a broker to help take the hassle out of the process of selling externally. However, make sure you check they are reputable before you engage their services.

How to prepare a business for sale

What do buyers look for in a financial planning business?
Anyone who is looking at buying a financial planning practice will want to carry out the necessary due diligence. They will want to see that the business has been running profitably, and that it has a sustainable future.

As part of the process, they will want to examine several things, such as:
- **previous financial records** to assess a business's profitability and any money owing
- **client records** to see the mix of client base and products
- **asset lists** to determine what assets the business owns.

Potential buyers are also likely to be particularly interested in aspects of a business that were affected by the Future of Financial Advice (FoFA) reforms introduced in 2013.

> **Tip**
> To help them prospective buyers, be prepared to answer questions such as:
> - How many new clients have you brought on board since July 2013?
> - Which clients are grandfathered under FoFA?

The quote

Buyers can see the value of a business more easily if the owner has good record-keeping systems in place.

Getting records in order

Buyers can see the value of a business more easily if the owner has good record-keeping systems in place.

Keeping accurate records is also a requirement of both your licensee (if you have one) and the Australian Securities and Investments Commission. This includes client records and business processes.

Client records

Client records need to be in good order within a proper system of record [that is, an information storage and retrieval system]. Licensees also generally require that an owner digitises a business's records within a relevant system before they leave the business.

Additionally, storing records properly within a system of record allows an owner to quickly generate reports for buyers. This means that revenue numbers, client demographics, client retention rates and any other information needed to carry out due diligence can be readily provided.

Tip

Think about engaging a software business solutions provider to help get your systems in order, and then build reports and dashboards to help track relevant metrics.

Business processes

Many business owners keep all their processes in their heads. However, if they are thinking of selling, they need to have everything formalised 'on paper' to enable a smooth transition.

Laying out clear, formalised staff procedures gives any prospective buyer more confidence in a business. It shows that the practice is running well, and that it does not just rely on the owner to survive.

Further, well-documented procedures will also improve business efficiency while readying for sale.

Consider

If you are trying to get your business ready to sell without 'tipping off' your clients or team, sorting out your record-keeping can just look like 'meeting the requirements'. It does not have to be a red flag.

Work out a business's value

As mentioned earlier, selling a financial planning practice is not like selling a shop or a factory. Its main asset is not stock or equipment; it is the client list. And that can be hard to value.

However, the business value of a financial planning practice can be calculated in different ways.

Multiple method

One rule-of-thumb valuation method—*the multiple method*—is based comparing the quality of a business with that of similar businesses.

This method calculates value as either *multiples of revenue or multiples of cash flow.*

For *multiples of revenue*, apply a multiplier to a firm's trailing 12-month revenue. In previous years, this multiplier has been between two and three times a business's recurring revenue.

However, since 2018 and the Royal Commission, prices being offered for advisory businesses have declined. This is partly due to stricter compliance regulations, partly because finance is growing more difficult to obtain, and partly because more businesses are coming onto the market.

RiskInfo data from May 2019 found that it is now a buyers' market. In this market, "higher-quality advice businesses are now selling for between 1.5x and 2x recurring revenue, while conventional advice businesses are selling for between 0.5x and 1x recurring revenue multiples".

The multiple method can also be used with *multiples of cash flow*. This allows the valuation to account for expenses rather than just revenue. It is often calculated using earnings before interest and tax (EBIT).

Income approach

Rather than comparing a financial planning practice with other such businesses, the income approach bases its valuations on actual income estimates. Again, valuations can use two approaches:

- The *discounted cash flow* method uses a business's cash flow forecast, then applies a discount to bring the value back to the current time. While this method is accurate, it is also complicated, given the need to predict future cash flow, growth and market.
- There is also a less complicated income approach that assumes a normalised growth rate, called the *single period capitialisation* method.

Fine tune with research

Consider

Whichever method you use to value your business, it pays to fine tune your price by conducting market research. It is worth researching what similar businesses are selling for in your area.

However, the end price can be influenced by many factors, for instance:

- business location
- mix of clients and demographics (e.g. age and net worth)
- earnings potential
- profitability
- future growth potential.

Consider

Every business is unique, so it can pay to seek the advice of experts like business valuators to help work out a fair price for a business.

What to do during and after the sale

Just as you would like to smoothly transition to seeing a new doctor, make sure you transition your clients to their new financial adviser proceeds in a similar fashion.

Tip

It is a good idea to create a takeover strategy as a roadmap to ensure the transition goes smoothly and nothing is forgotten. This should be a 'living' document that you update as things change or progress.

As a strategy is created, the following points need to be kept mind.

Communicate clearly and often
Contact your clients to let them know about the sale and any impact it may have on them. The more you communicate with your clients, the greater their chance of staying with your firm during and after the transition.

Introduce your clients to the new owner
It may be helpful for both you and the new owner to meet with clients to go over their portfolios and answer any questions. This can improve their chances of remaining with the business, and increase their confidence in the new adviser.

Be available after the sale
Be willing to answer any questions from the new owner, or help with any issues for a period of time after the sale.

Enjoy your new life
Move on to the next stage of your life—whether that is retirement or a new direction— knowing that you have done your best to ease the transition for your clients.

Conclusion

According to Business Health, only 30% of firms have documented succession plans. This leaves them completely vulnerable if the unexpected happens.

Even if an owner is only thinking about selling their practice and has not decided whether to take the leap, a succession plan helps disaster-proof the business. Moreover, it provides security for the practice which the owner would have most likely spent a significant part of their life building up. FS