3 Factors Key to RIA M&A Partnership Success

Partnership Criteria: Part II of III

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5 MIN READ

This is a Part 2 of a 3-part advice series dedicated to three factors that are critical to successful RIA M&A partnerships: Strategic Objections, Partnership Criteria & Firm Culture.

Part I of this RIA M&A advice series was dedicated to strategic objectives. Having a clear understanding of your goals, needs and time horizon are key in developing a M&A strategy. The next step is determining who you want to partner with.

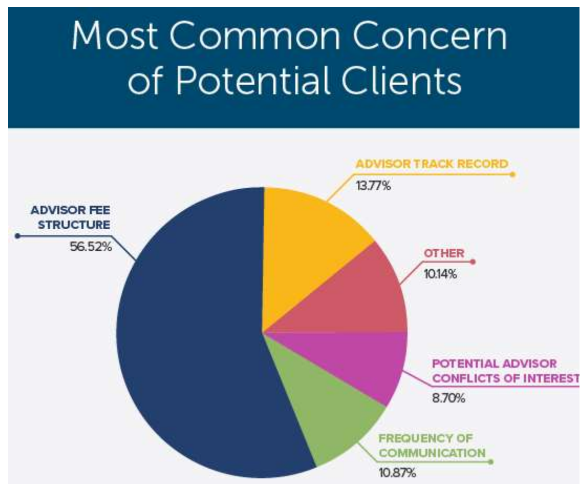
In the current super-charged M&A market, finding a buyer is not a major cause for concern. The difficulty is finding the *right* partner. If there is one common thread that binds RIAs, it is that every firm seems to do things a bit differently. The fact that no firm is exactly alike can make choosing the right partner challenging.

Firm culture is by far the most important determinant in best fit (we'll address culture in Part III of this series). But partnership criteria is vitally important too. This is where working with an M&A advisor with extensive industry experience and investor profiling expertise adds significant value. Key considerations include:

- Fee structure
- Service providers
- Firm size
- Service offering
- Client type(s)
- Geographic location
- Investment philosophy
- Fee-only vs Dually registered

Know Your Clients

When thinking about what is important to you, it is also crucial to consider what's important to your clients and prospects. Advisor fees rank highest in terms of most common concerns of potential clients, as shown in the SmartAsset survey below. Consequently, alignment and parity in fee structure are particularly important in M&A partnerships.



Increasing AUM through the addition of new clients is attractive and often reflected in what acquirers are willing to pay for firms. However, your ability to add new clients could be hampered post-transaction if you are required to adjust fees upwards to bring them in line with your new partner's fee structure.

If that is the case then it may well impact future performance, and thus the earnout portion of the deal. Most all acquirers will require an earnout as part of the overall deal structure. Earnouts are a way for buyers to "share the risk" with sellers.

Like with investment risk, there is an upside and a downside. The upside is that if you hit growth targets then you get rewarded for it. The downside is that if you don't hit your targets, or revenues decline, then it will likely result in a lower earnout.

The ability to add new clients is one concern. The other is losing existing clients over fees which is where attrition rates factor in. Your clients will be happy to hear that their fees will be coming down, but less than thrilled to learn that their fees will be going up. Significantly higher fees may cause clients to leave.

Service Providers

One thing that you want to avoid post-transaction is disruption. Clients typically expect the same level of service and embrace what they are used to. People are generally averse to change. Again, you do not want to give clients an excuse to leave. Subsequently, everyone is better off with a smooth transition.

Maintaining the same custodian is advisable as repapering can become more than just an irritant. The same goes for client-facing technology like portals and reporting. Try to keep it consistent for the benefit of your clients as well as your staff.

Size Matters

Larger RIAs often have the scale and access to capital necessary to make acquisitions. They are typically professionally managed and have an organizational structure that supports continued growth. Additionally, many of the prolific acquirers have a dedicated M&A team. These attributes help reduce risks to sellers and makes the post-transaction transition less disruptive and more efficient.

On the other hand, being "too big" can be a detriment. RIA owners are entrepreneurial, and many have left banks, B-Ds and wirehouses to start their own firm so they could move away from the constraints inherent in large corporate environments. In over decade working with advisors, I have yet to meet one that desires to return to that world. The right size ultimately boils down to personal and cultural preference.

Service Offering

Size is often dictated by client type so there should be synergies around who your firm serves. RIAs catering to HNW clients are usually higher touch than those serving the mass affluent, for instance. That makes the service delivery model between the two quite different in most cases.

The same goes for varying types of institutional clients. Sub-advisory relationships are quite different than a retirement plan focus, for example.

Location, location, location?

Geographic location is a partnership consideration, although arguably it is not as important as it was prior to Covid-19. The industry adapted exceptionally well to the pandemic by working remotely and quickly adopting technologies like video conferencing.

Industry research shows that proximity rarely registers in the Top 10 reasons why clients choose a particular advisory firm. While it may be beneficial to have mutual connections and know the area, it does not appear to be an overriding decision point for most clients or prospects so long as communication is frequent.

Investment Philosophy

Investment philosophy is often a major sticking point in partnership discussions. There is active, passive, tactical and countless other strategies which are incompatible with each other. Talks will almost certainly breakdown if the gap is too wide. It is therefore imperative to address the similarities and differences early on to determine fit.

Another major philosophical difference is between fee-only versus dually registered RIAs. Fee-only RIAs tend to avoid partnering with dually registered firms due to perceived conflicts of interest associated with hybrids having a Broker-Dealer affiliation. Sales of insurance products can cause discord too.

Conclusion

Finding a partner that checks all these boxes can be a challenge. It is important prioritize each of these factors based on your own individual circumstances. If it makes it more practical, separate the "must have" from the "nice to have". And whether you are exploring a sale or merger, always be mindful that a partnership should make strategic sense.

About Nunnally International, Inc.

Nunnally International, Inc. provides strategic M&A services to RIA firms that are looking to buy, sell or merge their business. The company was founded by Tyler D. Nunnally.

Prior to entering M&A, Tyler served as a strategist to leading advisor technology providers – including FinaMetrica, which was acquired by Morningstar. He began his wealth management career as an executive at Oxford University spin-off consultancy Oxford Risk. During his career he has consulted hundreds of RIAs on matters of risk as a frequent speaker at industry conferences, host of countless webinars and proficient author of journal articles. Tyler has been a key relationship manager to strategic partners at prominent institutions including SEI Investments, TD Ameritrade, LPL, Fidelity and Schwab, as well as leading advisor technology companies such as Redtail, Orion Advisor Services, eMoney, MoneyGuidePro and Fi360. As an industry thought-leader, he has been interviewed extensively by The Wall Street Journal, Bloomberg, CNBC, Smart Money, Kiplinger and InvestmentNews. Tyler holds a B.A. from the University of Georgia and a Master's in International Business with Distinction from the University of St Andrews in Scotland.

How We Work With RIAs

Nunnally International, Inc. works with RIAs in two ways. You can choose whichever option best suits your unique circumstances.

Option #1 – Referral Partnership

Nunnally International, Inc. can introduce your firm to prospective buyers through our existing referral partnerships. Our referral partners pay our fees, so it won't cost you anything. We work with a select number of referral partners that are all differentiated in terms of what they bring to the table. We do not partner with anyone that we wouldn't have manage our own money. We employ our expertise in investor profiling to find the best fit based on your strategic objectives, partnership criteria and firm culture. Naturally, this is done in consultation with you. If you decide that you would like to pursue a conversation with a group that we recommend, then we make the initial introduction and help facilitate the talks.

Option #2 – Engagement Agreement

RIA firms that want to sell or merge retain Nunnally International, Inc. through an engagement agreement. We lead the M&A process all the way from initial introduction to close. Our fees consist of a monthly retainer for six months, plus a success fee based on the closing price. This is a standard M&A advisor model for buy-side and sell-side engagements. We guide you through the M&A process by:

- Help define your strategic objectives.
- Identify the right prospective acquisition partners.
- Make introductions to prospective acquirers and solicit bids.
- Assist in preparation of necessary documentation.
- Facilitate conversations and information flow.
- Conduct due diligence on prospective acquirers.
- Negotiating terms of sale and maximize valuation.
- Successfully close sale.

For more information call us at 404.492.2152 or send an email to tnunnally@NunnallyInternational.com