Commonwealth

How to Create a Robust Succession Plan for Your Firm

Planning for the future of your financial advisory business is a crucial step in ensuring its continued success. Having a well–thought–out succession plan is essential to maintaining the legacy you've built over the years. In this guide, we outline four strategies to help you prepare for a seamless transition when you decide it's time to pass the torch.

Document Your Intentions

To successfully transition your business, you have to understand your drivers and quantify what you're working toward. Setting goals can help you get started. Begin by asking yourself these questions.

- **When do you want to transition?**
  Determine how much longer you'd like to run your business and what you'd like your next phase to look like. Then work backward to ensure you make your deadline.

- **How involved do you want to be?**
  There are multiple ways to transition depending on the intended outcome. You could stay with your firm and transition out gradually over a predetermined amount of time, or you could retire and sell your business to a suitable buyer.

Once you've answered those questions, you can start creating your transition plan. According to studies conducted by the Small Business Administration and others, having a written business plan improves a business owner's ability to successfully pursue their goals.

Follow these steps to create a focused plan:

- Articulate your personal vision.
- Establish your business mission based on your personal vision and set strategic directives to get there (such as pace of growth, service model, business niche, succession outlook, and financial performance of the firm).
- Make your goals SMART (specific, measurable, achievable, relevant, and time-bound) and set up a task calendar for accomplishing them.
- Set a budget to help you make focused financial decisions.
- Monitor implementation by establishing check-in meetings for you and your staff and creating a goal dashboard to hold everyone accountable on goal progress.

Check Your Transition Readiness

Preparing a practice for a transition begins years before the actual process. Does anything need to be addressed now to ensure your business transition goes smoothly when you're ready? Consider the current state of your client base, financial data, and other work-dependent details of your business to make sure it's organized and ready to move.

- Quantify details of your clients such as location, age, services provided, and duration of relationship.
- Catalog your financial data and revenue sources, including types and frequency of revenue.
- Document your employee records, income structure, property details and asset agreements, and necessary licensing and regulatory information.

Identify Potential Buyers and Successors

Selecting the right path for your business transition is pivotal. Whether you're looking for a successor or a buyer, it's crucial to identify candidates that align with your vision and values.

— **Successor.** This is generally an advisor you're familiar with, someone who works with the same philosophy, style, and level of client service. If no one in your circle meets these criteria, you can make these connections through events, conferences, or networking platforms.

— **Institutional buyer.** This is usually a larger firm that can manage a transaction with access to more capital. But it might take more time to find a match with your firm's culture and philosophical approach.

To focus your search, you should also consider the characteristics of your ideal successor or buyer. Factors to think about include:

- Experience
- Production
- Compatibility with practice model (e.g., advisory practice vs. commission-based)
- Geographical proximity
- Flexibility to service additional clients
- Ability to retain staff

You can also use outside vendors or service providers that provide classifieds and networking platforms, or dedicated teams, to support your search or provide potential matches.

Once you've identified potential successor or buyer profiles, you can weigh their compatibility with your business. Consider these four criteria:

— **Continuity of philosophy:** Is their financial planning approach similar to your practice's?

— **Chemistry with clients:** Is their client service philosophy comparable to yours?

— **Capacity to purchase:** Do they have the ability to fund the purchase (depending on the structure of the sale)?

— **Compliance and legal details:** Do they have the correct state licenses and insurance coverage? Are there any noncompete agreements in place or pertinent legal disputes to be aware of?

Value Your Practice

Once you have your goals set, with next steps and transition readiness aligned, you can develop a detailed valuation of your practice. Take a holistic look at your business to value it both practically and financially; both aspects bring quantifiable assets to a valuation process.

There are several common approaches to putting a price value on your practice. One such approach uses the multiples of revenue method, which determines a business's value by comparing its key statistics with those of similar businesses that were recently sold. Although this method can be a helpful way to determine a starting point for negotiations, it's limited in that it doesn't forecast future cash flows. In addition, there's often a lack of accurate information available on the sale of other advisory practices to use for comparison.

A more sophisticated solution uses the income approach, which is based on estimates of the income that the practice will actually produce. The most common version of this approach is the discounted cash flow analysis. In this method, cash flows are forecast for a certain period of time and discounted back to the present day using a discount factor. A terminal value is calculated as well, using an assumed long-term growth rate. The parties involved are able to account for future internal and external risk, and they can predict what will be produced by the business going forward.

When you've detailed the value of your practice, you can work on terms that would fit your valuation and meet your personal goals. There are three typical payment structures for transitioning a business:

- **Down payment:** A cash payment typically made on the date of the sale.
- **Promissory note:** A fixed amount paid over time, based on an agreed upon amortization schedule. Payment terms can be adjustable depending on the structure of the deal.
- **Earn-out:** Percentage of the actual revenue paid to the seller over a predetermined period.

Consider the compensation structure that fits your transition goals and then pursue what works for you. Know what you're willing to negotiate on—and what you're not.

Keep in mind that a valuation is not meant to be a fair or firm price. Buyers and sellers will have various motivations for accepting a higher or lower price. For example, a buyer who is looking to relocate to a certain area may be willing to pay a premium price, whereas a seller who is facing a health issue may accept a lower price. The purchase and sale of a practice should be seen as a negotiation between two parties, each with the ability to make their own sound business decisions.

Time flies when you're having fun—don't let the next phase of your journey sneak up on you. Planning for your legacy takes coordination, organization, and a thoughtful approach. Commonwealth has the experience and the tools to help make your succession successful and easy, so reach out to our Business Development team today at businessdevelopment@commonwealth.com to learn more about how we can help.

Commonwealth

Your Firm Partner Established in 1979

Commonwealth Financial Network®, Member FINRA/SIPC, a Registered Investment Adviser, provides financial advisors with holistic, integrated solutions that support business evolution, growth acceleration, and operational efficiency. Privately held since 1979, the firm has headquarters in Waltham, Massachusetts, and San Diego, California. Learn more about how Commonwealth partners with more than 2,100 independent financial advisors overseeing more than $242.9 billion* in assets nationwide by visiting www.commonwealth.com.

*As of 12/31/2022

Waltham
29 Sawyer Road
Waltham, MA 02453-3483
Toll-Free: 866.462.3638
Phone: 781.736.0700

San Diego
600 West Broadway, Suite 3200
San Diego, CA 92101-3398
Toll-Free: 866.462.3638
Phone: 619.471.9700