FP TRANSITIONS®

JUMPSTARTING THE OWNERSHIP CONVERSATION

SESSION Q&A - SEPT 16 2020

Define G1, G2, and G3.

G1 owners are majority owners, often this means they are founders who built the business from scratch, but G1s can also be owners who have acquired the firm or have gone through internal succession and now hold majority stake. **G2 owners** have a minority share of equity and are leaders in the business. Key employees who are leaders in the business and make a significant contribution are sometimes referred to as G2s even if they have not yet acquired equity. The G2 ownership level is often two or more advisors. And as G2 owners step through their buy-in milestones and acquire more ownership, it can be a good time bring on a **G3 ownership team** using a similar track, typically, with a smaller share of ownership and control.

How should an ownership conversation strategy differ when a G3 is asking a G2 for ownership? G2 owners seem to have a different relationship with the organization than the one that G1 has or had. How would a G3 start this conversation, and with who?

The perception that G2 has a different relationship is just that, a perception. This is due the where G1 and G2 are in their life cycle and where the business is in its cycle. It also has to do with each of the generation's journeys to ownership. While a founding owner made different investments to build a business from scratch, the G2 certainly has taken a significant debt load, and as such may have a greater concern with the wallet share, and potentially making existing debt payments. Understand, though, that once a generation of owners team acquires majority share in the business and/or the founder exits, that team becomes the G1s and the minority owners, like yourself, become G2s.

As far as who to ask, starting the conversation with an owner you're comfortable with is a good way to go, but remember you'll have to convince all of the owners. Broaching the subject of ownership with a G2 minority owner, or even with majority owner who has taken the same path as you're embarking on, is not much different than if you were speaking to a founder. The only differences might be that you don't have to convince them of the benefits of multi-generational ownership or do as much legwork researching the process, but you will still need to consider their unique ownership journey–the work they did convincing the G1 and improving the business as well as the debt they still carry.

If our founders are open the conversation, what should we do now? What questions should we be asking? How do we propose the succession structure?

If you've got conceptual agreement, you're heading in the right direction. This is a good time to leverage experienced guidance to keep going. For example, the FP Transitions team asks questions like: what's the overall timeline, what's your business value, how many G1s and G2s are involved and how much can the participants afford? We continue the process by understanding your goals for the succession plan and assessing the resources available. The structure will depend on the answers to these questions. We keep everybody on track by guiding the process and providing input as the plan evolves.

What happens if you get to the conversation and your G1 says no? Or even if your G1 is dragging their feet about pulling the trigger and are stalled in moving forward in the process? What advice do you have for these next generation owners where their situation seems to be going nowhere?

One, if this is the case, you need to assess whether this is even a conversation worth pursuing any further. If the conversation leads to a definitive "No, this is a lifestyle practice and it's going to stay that way," you have your answer and it's time to pursue other paths to reach your career goals.

However, if the answer is more ambiguous, or your existing ownership is hesitant and/or avoiding the issue, this may not be the firm for you if you're looking to be part of a team and ultimately want to participate in the ownership structure. This is the time to be forward in your questioning and make sure communication is happening. What's the hang up? how can we work through it? is this really something you still want to do? Can we bring in outside help to get us going again and help us figure out our options and next steps?

If hesitation comes from the complexity and the uncertainty on how to take the next steps, that's where leveraging experts can help significantly. Having an intermediary who's not representing the buying side or the sell side but rather is coming in as a disinterested 3rd party and helping facilitate the conversations can provide information so that both parties can make informed decisions. Having someone to help you identify your priorities, help you stay on track, moderate any challenges, and encourage you to keep your eyes on the long-term goal can make the process much easier for everyone. That's just the importance of getting a guide in that has experience so that you're not trying to build it on your own and win every battle without someone to help you figure out what's going to work.

Based on these difficult discussions and the behavior of the generation of owners ahead of you will be a good indicator as to whether this is a good fit and whether this process is something you're interested in participating in with these particular partners. You always have the option to move on to another firm (there are always businesses looking for talented folks) or to start your own practice. The good news is that the work you've put in preparing yourself to think and act like an owner is growth that moves with you and your journey.

What about ESOPs and other options? Why is this tranche strategy the go to for FP Transitions?

Employee Stock Ownership Plans (ESOPs) are DOL-regulated ownership plans that have strict rules and give the founder less control over who participates. We find that most financial practice owners don't want to take on another layer of regulation. Further, ESOPs are extremely expensive to set up and have ongoing compliance requirements with annual expenses exceeding $20,000. The gradual tranche strategy that FP Transitions employs allows the founder(s) or existing ownership team to have more control over not only who participates, but they have more control over the terms of the buy-in and have the room to assess and adjust as needed.

What should be considered when gifting ownership rather than selling it?

When stock is granted to an employee the value the stock/units being granted is treated as ordinary income to that employee that is due in the year the grant is made. Depending on the size of the grant this may create a tax liability the recipient cannot afford.

What is a good strategy for businesses who are considering acquiring others that don't have succession plans in order to become successors?

If you're looking at being a successor as the acquiring firm, you'll want to present yourself and your business from a position of strength. We would recommend that you solve for your own sustainability first so that you can present all of those business benefits of succession planning: the deeper bench, the diversity of service, the greater scale and structure that comes with having a multi-generational team. Create that within your business before you begin courting advisors that don't have a succession plan.

We've seen a substantial increase in advisors who are looking for a transaction that allows them to sell and stick around. And you can fold that retiring advisor into your firm with a short-term employment agreement; 3-5 years, potentially longer, but you need to create a business that has a foundation for that structure and for that scalability in order to make that kind of transaction work. Being able to communicate that you provide sustainability and continuity for those clients post-acquisition is going to be a very strong selling point according to what we hear from advisors who are out there on the fence right now.

Alternatively, what about the strategy of selling to become a successor in a larger firm?

This is definitely a viable strategy that we've seen employed before, and it can work as long as everyone is aligned. We have seen many advisors, especially recently, looking, not necessarily to sell and walk away, but to sell and become part of a bigger team. If a firm is looking for successors, participating in the marketplace looking for acquisition opportunities could solve their succession needs and provide a solution if they don't have an internal team already.

In this case, we might come into a conversation around what does a merger look like for these situations. There are a couple of different ways you could approach it, and that's definitely a strategy to pursue for a G1 that's earlier in their career. These advisors might even have more success approaching younger advisors that are a good match for the business and presenting the opportunity not as an acquisition, but as a merger and to join forces. A next-generation advisor looking to sell as a successor could also reach out and propose the same opportunity to successful businesses that are a good match for you and your existing client base.

How do advisors sell into a bigger team and still take an equity/ownership stake?

This depends on how the deal the structured, and there's opportunity to customize the arrangement based on each situation. Commonly, acquiring firms make a down payment in cash and the balance of the purchase price is paid for with an equity interest in the acquiring firm. In essence, the seller is trading their book of business for some cash and stock in the firm by which they are being acquired.

Explore our curated collection of succession and next-gen resources at fptransitions.com/jumpstart to learn more about the process and the impact a next-generation team can have on the long-term success of a business.

If you have additional questions, you can contact our team at 800.934.3303, questions@fptransitions.com, or visit fptransitions.com/schedule to book time with one of our experts.

FP Transitions is the nation's leading provider of equity management, valuation, succession planning, and sustainability building services for the financial services industry. Based in Portland, Oregon, FP Transitions operates the largest open market for buying and selling financial service practices in the U.S.

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