



Crossroads

Critical Decisions That Advance the Evolution
of an Advisory Firm

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The Crossroads

Crossroads are points in life that force us to make critical decisions, choosing among different paths. What should I do next? Should I go to college? What career should I pursue? Should I marry this person? Like people, firms experience crossroads that result in transformative progression—where it can be decided how the firm’s future will look compared to its past.

Over the past 20 years, success has lifted many firms in the advisory industry from early-stage startups to prominent Super Ensembles (multi-professional advisory firms with \$10M+ in annual revenue). The industry has averaged double-digit growth in the past 15 years. This means that an average firm will double in size about every seven years. This means more people, management and opportunity.

When faced with an unfamiliar path, it is wise to have a guide. Throughout the crossroads, leaders of successful advisory firms share examples on the decisions they made to transform their firm. Accompanying their expertise, each crossroad presents a key decision you need to make to traverse the path.

As your firm reaches higher levels of growth, the structure must change to keep growing. At the point you reach the ceiling for your firm’s evolutionary stage, an opportunity becomes available. These eight crossroads of opportunity will make you face critical decisions that lead your firm to the next evolutionary stage.

Firm size (assets)	The critical decisions—managing your organization structure
Approaching \$100M	1) Hiring the first support advisor; learning to leverage the owner(s)
	2) Hiring the first employee lead advisor
	3) Promoting an employee to partner
	4) Hiring the first full-time executive
Over \$1B	5) Creating a corporate governance model
Firm size (assets)	The critical decisions—managing your revenue growth
Over \$500M	6) Making the first acquisition or merger
Approaching \$1B	7) Branding the firm apart from the owners/founders
Over \$1B	8) Entering into another geographic market and opening a second office

Crossroad 1: Hiring the First Support Advisor

Many firms find that hiring their first support advisor can be both daunting and satisfying. It can be daunting because the solo advisor is now handing over tasks and responsibilities that were once his or hers. This takes a great amount of faith that the tasks will be handled in the same manner that you, as the owner/advisor, handled them—resulting in your business thriving and growing to the size it is today. This action can also be satisfying because now you, the advisor/owner, can spend more time handling the tasks that need to be your focus, which will grow your practice. The decision to add a support advisor is one of the first crossroads that an advisory firm will face in its business life cycle.

Definition: Support Advisor

Provides technical support for the lead advisor. Responsibilities may include:

- › Data gathering
- › Modeling
- › Case design
- › Scenario building
- › Plan development
- › Presentation development

Might participate in client meetings, but not in an advice capacity. The position has no decision-making authority on client matters

Why do you need a support advisor?

Simply stated, a one-advisor firm needs a support advisor to enable growth for the business. Numerous surveys have shown that an advisor working alone can work effectively with a finite number of clients (from 80 to 120). However, these same studies show that with the addition of one support advisor, an advisor can leverage his or her abilities and serve nearly twice as many clients.

What tasks can be delegated?

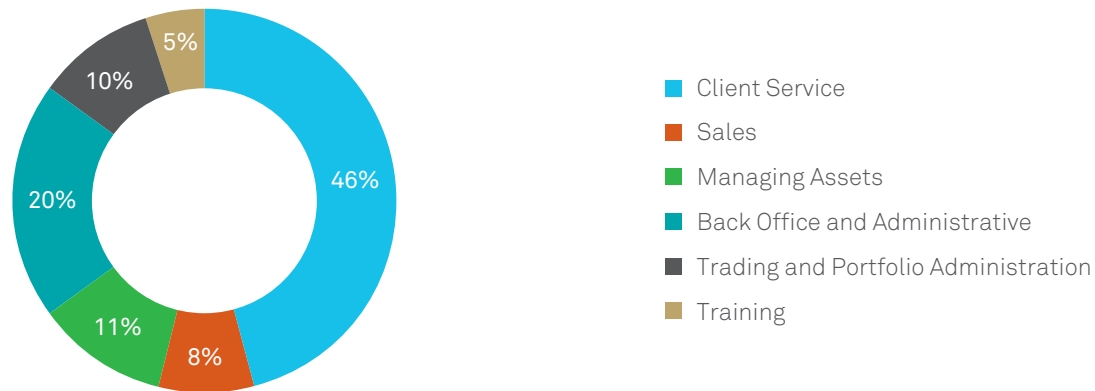
A support advisor typically manages existing client relationships with your assistance and will eventually be managing these relationships on his or her own. As your clients become more comfortable with the support advisor and accustomed to him or her handling requests, you will find that clients ask you fewer and fewer questions. This is a good thing. You want to encourage the support advisor to take on more and more tasks; tasks that no longer require your time. The support advisor will also be responsible for formulating plans and implementing advice. Initially this will be with your supervision but gradually relying on you less and less.

Support advisors are not typically tasked with driving new business development but serving and retaining the firm's existing clients. Their job is to maintain the current revenue for the firm while you build new revenue streams.

Cerulli Associates surveyed advisors to better understand how they manage their time. They found that most advisors spend only about 46% of their time serving their clients and 8% of their time in sales oriented tasks. The remaining time (46%) is spent on non-client facing, non-revenue producing tasks.* These tasks include training, asset management, back office and other administrative functions. All of them are vital for the success of the firm, but it is not the optimal use of an advisor's time.

* Source: Cerulli Associates, U.S. Advisor Metrics 2016

Percentage of time spent—typical lead advisor
Firm size: \$100M to < \$250M AUM



Source: Cerulli Associates, U.S. Advisor Metrics 2016

When do you add a support advisor?

	Annual Firm Revenue	
	<\$500K	\$500K–\$1M
Median AUM	\$ 40,950,000	\$ 92,300,000
Average Revenue	\$ 382,000	\$ 728,000
Median Pre-tax Income per Owner	\$ 173,000	\$ 329,000
Median # of Professionals	1.0	2.0

Source: 2016 *InvestmentNews* Financial Performance Study of Advisory Firms

Advisors are often troubled with the timing of adding this support advisor role. They hesitate because of the immediate impact on their take-home pay. They also hesitate because it can be a challenge to find the right person to fill the role. Data shows that solo firms with assets under management (AUM) of \$41 million typically operate with just the owner/advisor. However, by the time firms have over \$92 million in AUM, an additional professional has been brought on board. These same firms have pushed from average annual revenue of over \$382,000 with the solo advisor to over \$728,000.

Example Support Advisor Cost Analysis	
Average Profit Margin (all firms)*	25%
Average Cost of Support Analyst (comp, benefits, taxes)**	\$64,000
Additional Revenue Needed to Maintain Profit Margin	$\$64,000 \div (1-.25) = \$85,333$

*Source: 2016 *InvestmentNews* Financial Performance Study

**Source: 2015 *InvestmentNews* Compensation and Staffing Study

Finding the right time to add the support advisor may not be easy. Somewhere between \$400,000 and \$700,000 in revenue seems appropriate given the data. However, those who added the role can leverage the support advisor and focus their time on client-facing activities. This has led to increased AUM and revenue to generously cover the added expense.

Crossroad 2: Hiring the First Employee Lead Advisor

Definition: Lead Advisor

Primary managers of client relationships. Has responsibility for:

- › Formulating and implementing advice, but may rely on technical specialists to develop recommendations within the specialist's area of expertise
- › Typically expected to develop new client relationships
- › Work with, train and supervise other staff in client service delivery

When an owner/advisor hires his or her first employee lead advisor, it is a big step. Taking this step means you are moving from a practice to a true business. It means not only are you making a conscious effort to build your bench strength, but it also lays a foundation for the firm to flourish beyond you and your own future involvement in the firm. The crossroad for an owner to hire an employee to be a lead advisor proves he or she is on the road to growth.

Why add a lead advisor?

Adding a lead advisor is a natural evolution in the life cycle of your business. It is an indication that your practice is evolving. You have built the practice through hard work and dedication to your clients, but also through the development of a series of standardized processes that allow you and your employees to function in an efficient manner, delivering quality investment advice to your clients. Prior to this hire, the firm is solely dependent on your ability to retain clients and garner new ones.

To capitalize on these efficiencies and continue to grow, it is only natural that you need another lead advisor to carry the load. If you have more than one individual leading client engagements and driving new business to the firm, you can leverage the efficient processes and grow the profitability of the firm.

What does the lead advisor do?

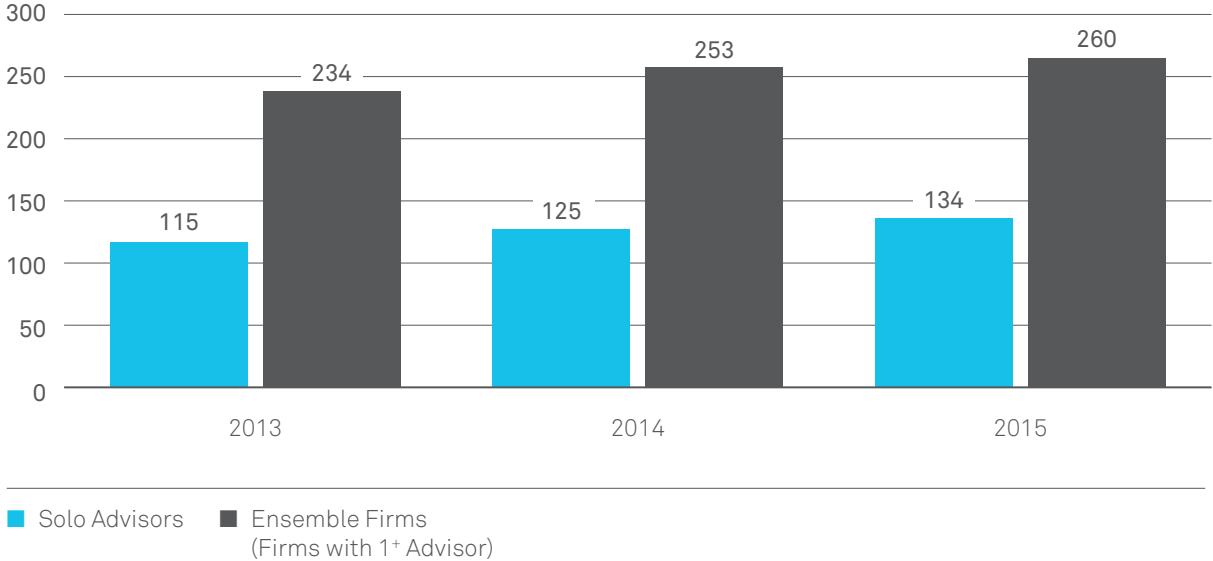
The role of a lead advisor is to be the primary relationship manager for a group of clients. A lead advisor is one of the most experienced individuals at the firm. Not only are lead advisors knowledgeable and can gain the trust of clients, but they can also train staff and direct the management of work flows. They own and manage the entire client relationship. Often times, the owner/advisor does not need to be involved with the clients of the employee advisor.

This addition, while a natural progression of the firm, enables the owner to leverage the infrastructure and efficiencies already in place to create value in the firm that is sustainable and transferrable in the future. It also begins to create a natural succession plan for the owner.

When do you add the lead advisor?

It is best to add a new lead advisor when the solo lead advisor is nearing capacity. Various studies have shown that there is a finite number of clients that one lead advisor can adequately serve. This number typically lies between 80 and 160 clients and varies by the service clients receive, although it is not uncommon for an advisor to have close to 200 clients. In the two-advisor models, the number of clients served by each will still be limited by each individual's capacity, as seen in the chart here.

Average number of clients

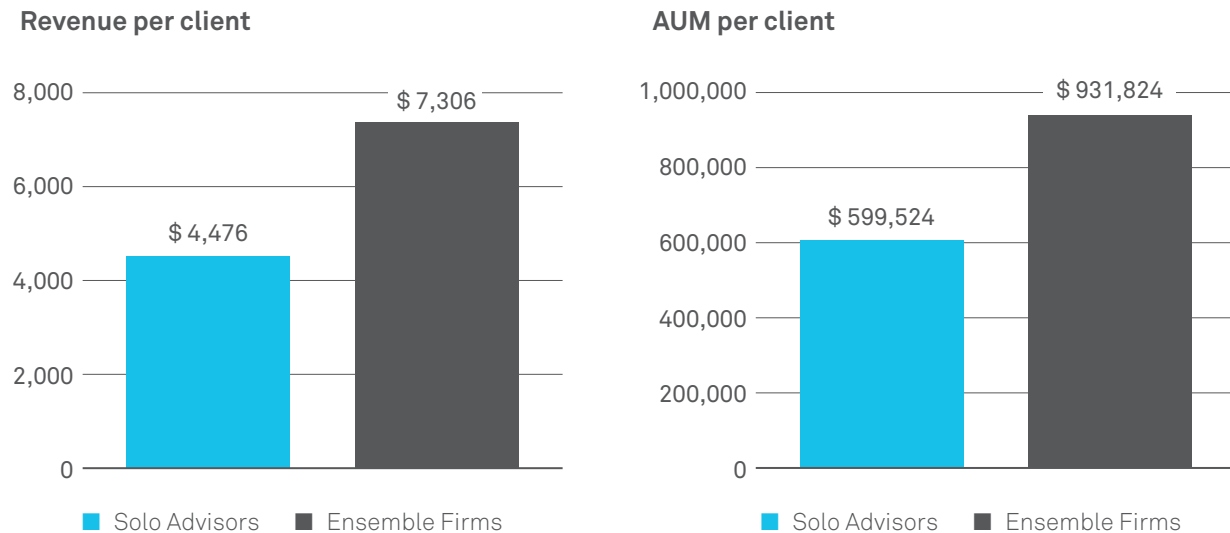


Source: 2016 *InvestmentNews* Financial Performance Study of Advisory Firms

What is the benefit of adding a lead advisor?

Adding this new lead advisor role is particularly evident when looking at the client size between a solo firm and an ensemble firm. The data from the Pershing sponsored, 2016 *InvestmentNews* Financial Performance Study of Advisory Firms shows a 63% increase in annual revenue per client when a firm has at least two lead advisors (becoming an Ensemble Firm).

When looking at the same data, it is evident that firms can attract larger clients when there is more than one lead advisor.



Crossroad 3: Promoting an Employee to Partner

The path has led your firm through the growth challenges of adding staff and building leverage, and now you approach a new crossroad. Your employees are becoming more valuable to the firm as they perform a majority of the client service and a growing portion of business development and management. The business is beginning to run independent of the owners and key employees are driving greater income to the firm. The employees are helping to push the firm toward the next level of organizational maturity where the departure of any key employee would not cause a disruption.

Promoting employees to new partners

Being a partner can mean many things in an advisory firm and it is possibly the best motivator for members of the firm, because it encompasses recognition for achievement, greater responsibility and reward. The term partner is synonymous with owner in our definition and equates to someone with ownership and elevated accountability in the organization. Ownership comes with a responsibility to be a leader and caretaker for the firm. In addition, it provides a level of personal prestige and status. Of course, ownership also contains the hopes for greater income and a share in the growing value of the firm. Ownership is coveted, which makes it valuable. Therefore, making it accessible to members of the firm may be the most constructive way to incentivize and retain talented staff.

Adding partners to the firm has the benefit of sharing the ownership and management responsibilities of the business. Leading a company takes a lot of commitment. Whether you have a team of leaders or a single owner responsible for making all decisions, the burden to manage staff, make payroll and ensure the future of your organization takes a lot of attention. As the saying goes, “Uneasy lies the head that wears a crown.” Sharing the weight of leadership and management with other owners has many advantages, and your next partner is perhaps already on the firm’s payroll.

What ownership has to do with firm growth

The rapid growth of the industry over the past five years has expanded the size of most firms in terms of revenue and staff. This has likely resulted in bigger budgets in your firm and an increase need to manage the people, processes and technology that those resources can afford. The growth also pushes the existing owners to be more deliberate about where they spend their time.

An advisory business needs to generate new business, serve clients and make strategic decisions about the future of the organization. For a solo practice, the owner is the primary business developer, lead advisor and CEO because there is no one else to fill these roles. An advisory firm is different than an advisory practice because a firm has people other than the sole practitioner who can fulfill the client and leadership needs of the business. Your challenge in an advisory firm is to leverage the organization. That means leverage the time and expertise of your people and the value of your ownership. While the details of leveraging the time and expertise of your people are discussed in later chapters, the ownership of the firm can also be leveraged.



As a firm grows, the annual income per owner increases as a result of ownership leverage. In other words, the owners make more when the firm brings in more money, even when more partners are added. The last part of that statement is important—*the owners make more money although the number of owners increases*. The simple math assumes that maximizing the profitability of the business without expanding ownership will result in the highest income to the owners. But the reality is more growth and more partners are interdependent. Businesses are impacted by growth, risk and enterprise value and getting to the next level of income requires a larger firm to generate more earnings and more management attention to grow efficiently. The firm needs more partners to keep up with the needs of a larger firm.

A firm that continues to grow can produce greater income to the owners as well as compensate and retain good employees. The enterprise value of the firm increases, which also enables the firm to add partners without impacting the income of existing owners and, in parallel, lowers the operating risks of the firm. Your people are the key component of the interdependent growth-ownership loop. You need good people for the future of your firm and it all starts with the growth you are experiencing.

Profile: Promoting an employee to partner at Sullivan, Bruyette, Speros & Blayney

The name *Sullivan, Bruyette, Speros & Blayney (SBSB)* introduces you to the firm's founders, but we must dig a little deeper to understand the value of the firm's employees. Today, SBSB is approaching \$3 billion in assets under management and has nearly 50 staff members. A growing group of owners started as employees in the firm.

The size of SBSB is recognition of the firm's success. The steps it took to promote key employees to partner can help us understand the importance of preparing for this crossroad. In 2003, the firm was sold to Bank of Montreal, which forced the firm to hire and retain employees without the availability of firm equity to incentivize key performers. This demanded a realignment of staff performance, culture and compensation. In early 2016, the firm returned to independent ownership.

Although providing a path to ownership may attract talented employees, the firm still must adeptly manage expectations and performance. Involving some employees in an ownership stake too early can give other employees the perception of unfairness, disrupting relationships and fomenting discouragement. Consistency is fair—this means managing expectations for each employee role in the firm, and compensating fairly based on performance. Without fairness, having equity available for staff is undermined as an incentive, because employee trust in the promotion process has been reduced.

Founder and Managing Director at SBSB, James Bruyette, maintains expectations of fairness by communicating the firm's values through the question, "Are we doing things better, faster or cheaper?" The firm's dedication to better, faster, cheaper (BFC) helped them create a culture of accountability that rewards individual contributions with career advancement and compensation.

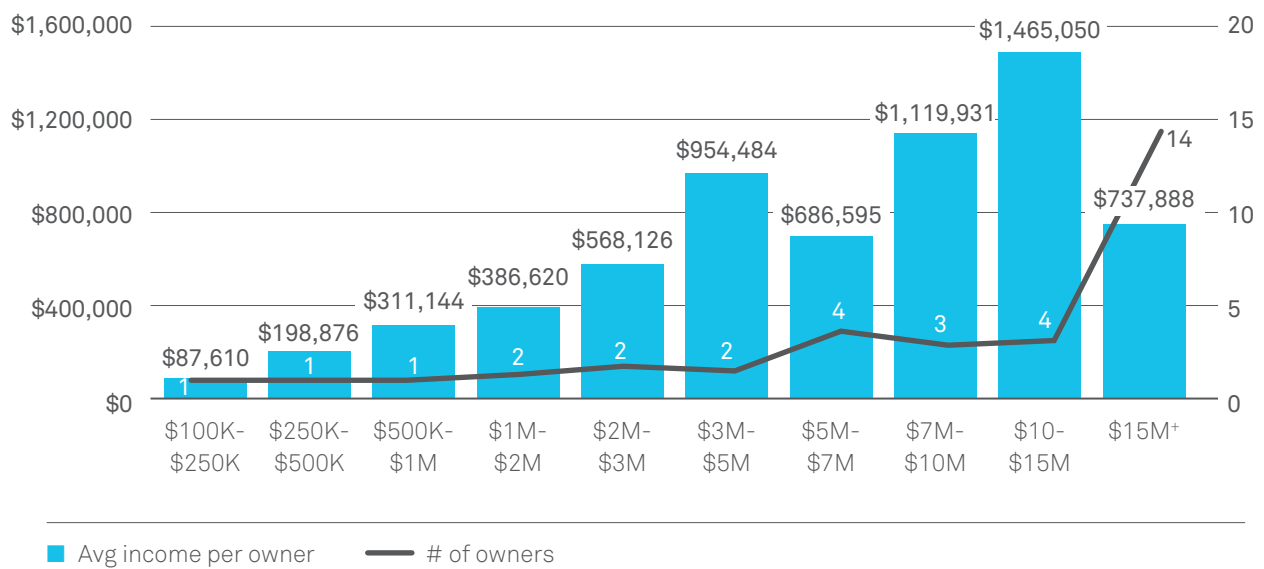
When the firm was acquired back from Bank of Montreal, the criteria of the BFC mantra was used to identify partner candidates. For example, one of the new partners is Chief Operating Officer, Martine Lellis. Despite not having client-facing responsibilities that are commonly associated with partner criteria, Martine strongly qualified for promotion because better, faster and cheaper is in large part measurable. As the COO, Martine helped SBSB operate more efficiently and she took responsibilities off of client-facing partners, freeing them to grow the business.

When do you add a new partner?

The timing around adding new partners is impacted by the financial ability of the firm, the managerial commitments and the opportunity. In other words, the new partners must either possess personal contributions that would create a material void in its absence, or fill a leadership need the firm developed with increased size and complexity. In both cases, we are valuing the contribution of the individual, but when the firm is smaller, excess managerial skills cannot be used like in larger firms, however, revenue and profit contribution are valued at every firm size. Revenue contribution adds available resources for staffing and improving the firm, as well as potentially greater income to the owners.

A key to partnerships is that the firm does not need another partner for every \$X of firm revenue. There is no linear link between revenue growth and added owners. There are, however, parameters that can be followed to manage equity and income dilution of the existing owners.

Median number of owners and average owner income vs. firm size



Source: 2016 *InvestmentNews* Financial Performance Study of Advisory Firms

Criteria for promoting partners

Even though we are discussing promoting your first partner, the criteria should apply to subsequent partners as well. The partnership is a commitment to one another and, like other large life relationships, it is supported by trust and fairness. Transparent criteria for new partners can uphold the fairness of the partnership when it is applied consistently.

The criteria for new partners must support the needs of the firm. When you are promoting an employee to partner, you are interested in growing the capacity and stability of the firm. A new partner should add to the collective capacity of the firm. Assessment of the contributions of the individual must be based on what the firm needs and not simply what the employee is doing well. For example, in the early stages of the firm, every partner contributes to serving clients, business development, management and general administration. In an advanced firm, such as SBSB (see page 11), there is adequate capacity provided by the other partners and staff for serving clients and business development, but Martine was made a partner because she contributed to the collective management need of the business.

Promotion criteria to “make partner” commonly includes:

- › **Productivity:** amount of revenue, assets or clients serviced as the lead advisor, or firm profitability managed by an administrative or operational leader
- › **New business development:** amount of annual new revenue, assets or clients generated
- › **Leadership:** contribution to the strategic initiatives of the company
- › **Management:** oversight of people and processes
- › **Culture:** adds to the firm’s culture even if their personal style is different
- › **Entrepreneurialism:** often called “thinking like an owner” and means an awareness and willingness to do what it takes to make the firm successful

Your job is to pick the appropriate criteria for your firm and then choose how to weigh each. For your first new partner, you may find that an equal importance/weight is given to all criteria, but as the firm matures it may become feasible for a majority of the emphasis to be placed on a single criterion. Be sure, however, to assess the deficiency along with the contributions. It is much easier to add a partner than to remove one, so be sure you can live with your decision.

First compensation, then equity

Income to partners must first come in the form of compensation for the role they serve and then distributions from the profits of the company. Most advisory firms are taxed under registration as a pass-through entity and so the profit in the firm is viewed as personal income to the owners. But this is not what we should call compensation. The dividend paid to the owner from the profits of the company is the return on investment owed for the capital the owner has risked investing in the firm.

Compensation is the return on labor the partner receives for working in the company and is typically comprised of a base wage and bonus. The dividend should not replace compensation for partners and promoting an employee to partner will help to demonstrate why this is the case.

Employees are paid compensation for responsibilities specific to their role. For a lead advisor this includes serving clients and closing new business. That same lead advisor as a partner will still serve clients and develop new business, but may also have extended responsibilities to lead or manage. In effect, the partner is an employee and an owner. The portion of his or her duties that serve the company should be compensated consistent with other employees. A partner should be an advanced version of the lead advisor and, therefore, higher compensation is expected, but the mechanics of establishing the compensation do not need to change.

A well-designed compensation plan upholds fairness and encourages promotion. Take a moment to evaluate compensation in your firm. Are partners compensated for the labor they contribute to the firm? A great way to assess compensation in your firm is to benchmark against industry standard compensation as found in the Pershing sponsored, 2015 *InvestmentNews* Compensation and Staffing Study of Advisory Firms.

Ownership is always purchased

Ownership equity is the most valuable possession of the firm. Equity holds the value of the firm's profitability today as well as additional value for the potential growth of the firm in the future. It is important to make sure your new owners meet the criteria you desire in a partner, and that they buy their shares.

Your promoted employee to partner will enforce a precedent for the internal value of the firm's shares. If the ownership transfer is gifted instead of purchased, then the last internal price for shares is \$0. But we just said that equity was the most valued possession of the firm, so a price of \$0 dissolves the perceived value and allure of becoming a partner. (Note: this can be different when owners are brought in from outside the firm, as equity can be exchanged for the value of the incoming book of business.)

Promoted employees do not necessarily need to purchase shares with cash. Although cash is the most common vehicle of purchase, the firm may allow for shares to be earned through performance, where compensation is issued in shares in lieu of cash.

Creating a partnership culture

The partnership is often the pinnacle of the career path for employees or, in a reduced population of firms, ownership is available to employees and dissociated with the career path. Since the equity of an advisory business is fairly illiquid, the gateway to ownership should be narrow and the desirability should be high.

Ideally the aspiration of your most valued employees is to commit themselves to the firm and become a partner someday. Possibly the best promotional marketing for your partnership is to create a culture that embraces the prominence and success of those who achieve the role of partner. Celebrate employees that become partner as a deserved achievement.

A founder transformed

If you are the founder of your firm, then promoting your first employee to partner will be one of the more difficult things you will do for your business. The challenge is to trust an employee that you have worked closely with to be your partner. After all, this is someone you have watched develop in the profession and the strength of your mentorship will be tested. The emotion of the decision and commanding presence you impose may hide a worthy candidate.

You may find it easier to assess the results of an advisor of another firm. As it is said, you can't be a prophet in your own town. The appeal of an advisor developed outside of your firm is partially attributed to a clearer evaluation of proven results, but mostly relates to the hope he or she gives you for great things to come. Since you know your employee, the sense of hope for the future is often discounted by the lasting perception you have of him or her when they began.

To be a transformed founder, assess your employees based on what they contribute today and not on where they have come from in the past. As the founder, the firm is your baby and may feel like a personal representation of who you are. However, like a baby, the firm grows up and is less dependent on the founder. It is often the goal to create a firm that will last beyond the founder. Find good people to fulfill this vision and trust you have done a good job.

Crossroad 4: Hiring the First Full-Time Executive

There comes a time when complex, unfamiliar situations lead us to seek guidance; to use the expertise of someone who will help us reach our goal. Most of us will not hike a mountain or raft a white-water river without a guide. We could try to take on such adventures on our own, but why risk a disastrous outcome?

For many advisory firms, the leader or guide for the organization is an advisor. Typically it is the founder or a partner who is primarily trained as an advisor, but assumes the role of CEO. The need for an executive is not full-time in the early stages of growth, but there may be a point when the moving parts in the company dictate full-time attention. Growth adds more people to the organization: more owners, bigger clients and an increased need for management. The crossroad is committing to the development of a full-time executive role to act as the guide for your firm.

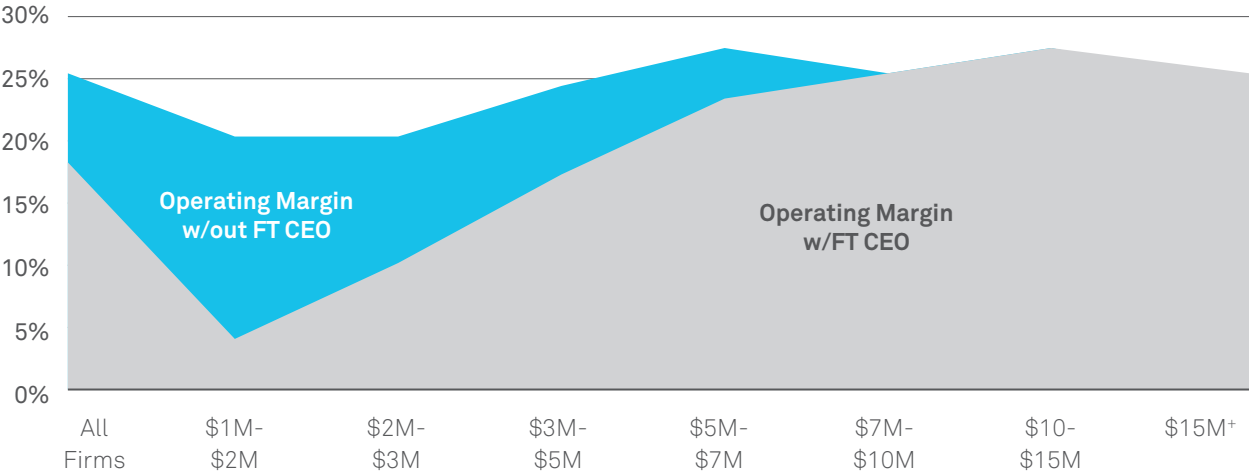
When to hire a full-time executive

A firm is ready to hire a full-time CEO when it produces enough revenue to support the strategic contribution of the executive. For instance, if the firm has a strategic focus to aggressively acquire other firms to grow, the CEO will lead the search for acquisition opportunities and decide whether the deal is worth executing. The CEO's contribution directly increases the top-line revenue and is easily measured. Alternatively, a firm strategically focused on organic growth will use a CEO to create a firm that has high quality talent working with the best clients and is competitively superior in their market.

Timing for hiring a CEO differs for these two scenarios:

- › A CEO making contributions via M&A will have a very active role in growing revenue, like a practicing partner or lead advisor. The time to hire may be as early as the firm has funds available to use in M&A.
- › The CEO's contribution to an organic growth strategy is generally indirect to firm growth and is measured on a comprehensive scale. Typically a firm is approaching \$1B AUM (or \$7M in revenue) and growing to afford and use a full-time executive. Before about \$7M in firm revenue the additional compensation of a full-time CEO greatly impairs operating profit.

Impact of hiring CEO on firm profitability



Source: 2016 *InvestmentNews* Financial Performance Study of Advisory Firms

Profile: The first full-time executive at Baldwin Brothers, Inc.

The need for a CEO is often driven by the rising complexity in an advisory firm. They say a frog placed into hot water will jump out because it knows it is in danger, but a frog in water that is slowly heated doesn't realize that it is ultimately in hot water. The same is true for advisory firm management; the next dollar of revenue and growth is the core focus most of the time, and the need for management builds like the frog in slowly heated water. At Baldwin Brothers, Inc. in Marion, Massachusetts, the firm lived both scenarios, but recognized the need for a CEO to help them.

Michael Baldwin founded Baldwin Brothers more than 40 years ago. Over the years, the firm grew—steadily adding more clients and more employees to serve those clients and support the firm's growing infrastructure. Over the last decade, Michael recognized that “the waters were heating up” and that the very factors that were fueling the firm's growth—strong company culture, client-service philosophy, execution excellence—needed professional management as the firm evolved into a large, complex business.

Moreover, Michael also realized that a strong leadership pipeline was needed to ensure management continuity. However, the firm struggled for several years to find the right framework to structure a leadership transition plan amongst the existing partners. By 2015, the firm had grown to \$1BN in AUM and a “passing of the baton” of leadership was business-critical. John Mannix, a 25-year industry veteran and a former Managing Director at Baldwin, rejoined the firm as CEO to work with Michael and COO Taylor Baldwin to structure and implement a much-needed succession plan.

The CEO position at Baldwin Brothers is well-defined and has full support from the founder. John works closely with Taylor to fulfill the executive functions. The CEO, along with the COO, are both focused on business development, marketing and the 1-, 3-, and 5-year plan for maintaining and growing the firm. The COO leads operational efficiency and day-to-day back office functions.

Baldwin Brothers understands the role of management in their future success. Over the past year, the executive team has financed the buyout of several partners, built a long-term incentive plan for key employees and streamlined the investment process. The firm is in the beginning phases of a long-term plan that focuses on responsible growth, client satisfaction, operational efficiency, employee engagement and community partnership.

As part of their succession plan, John acknowledged that Baldwin will need to recruit more advisors, but they also need to continue to focus on retention of talent. John acknowledged this twofold strategy as important to their success, and John credits Michael's unwavering commitment to build the firm's legacy for the years to come.

CEO responsibilities may include:

- › Prepare and execute the firm's strategic vision
- › Delegate and empower parts of the firm's governance structure (e.g., committees)
- › Manage firm culture and enforce accountability
- › Service client relationships and develop new business (0–20% of time)
- › Represent the firm in the advice industry and the in the larger community

Who should you hire as an executive?

The experience of your CEO must be applicable to your firm. In other words, do not hire a deal-maker and only grow organically. Structure the CEO position first with expectations for the role and then find the best candidate for the position as described. A CEO is arguably the most valuable position in your firm. The position is responsible for executing a plan that will grow the value of your ownership in the firm. It also requires a specific set of skills that are gained through education and experience.

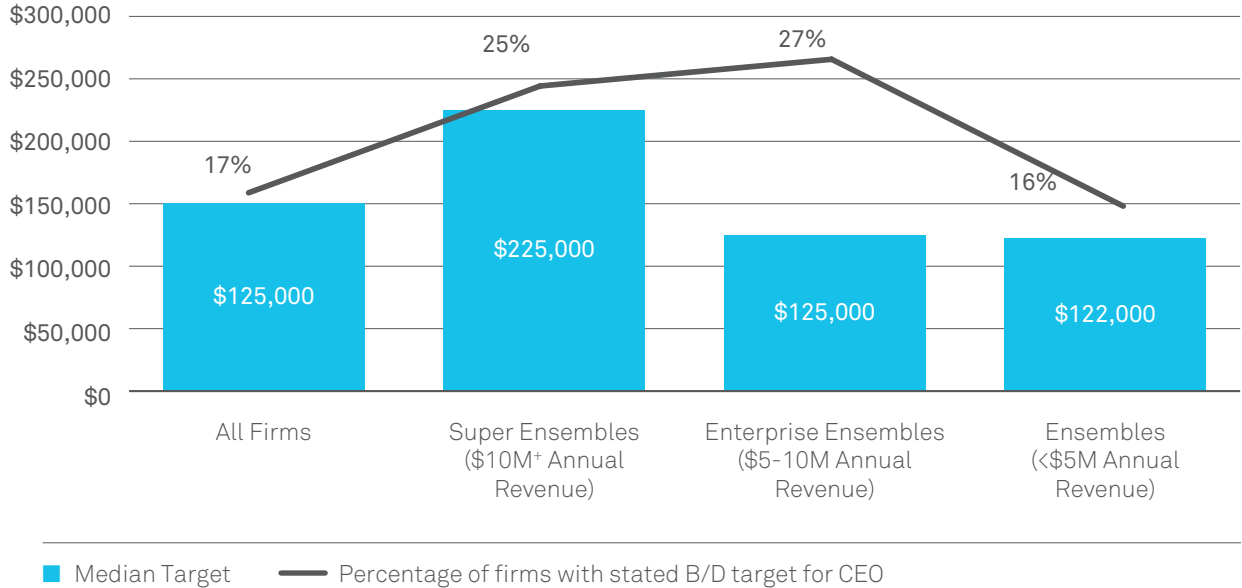
The CEO position is not specifically a promotional role for one of your advisors or partners. Since it is an important role, your search for a CEO should include candidates from outside of your firm. Some firms focused on M&A have had success hiring a CEO with deal-making experience from outside of the industry. Most firms, however, benefit from a candidate with familiarity to the intricacies of the advisory industry. For example, John Mannix at Baldwin Brothers (see page 16) had 25 years of industry experience outside of the firm before he was hired.

After comparing candidates from outside and within your firm against your position requirements, you should have a better understanding of the type of CEO that can lead the owners and the firm.

Structuring the CEO position

When the CEO is not one of the original owners of the firm, it is often difficult for owners to follow an individual hired to lead as the CEO. This can be helped by clearly defining the CEO position and expectations. The office of the CEO should also be given authority to execute initiatives. CEO responsibilities typically include traditional executive functions and many firms also require a small amount of client interaction. This requirement is intended to keep the CEO in touch with the firms' concerns for clients. The level of involvement with clients ranges from casual social interaction to full client service.

Business development targets for CEO



Source: 2016 *InvestmentNews* Financial Performance Study of Advisory Firms

Does the CEO have to be an owner?

A full-time CEO will attempt to add to the firm’s growth, profitability and long-term value. His or her concentrated attention to preserving the value of owner equity most commonly results in CEOs being owners.

The benchmark for CEO performance is firm results. As an owner the CEO is directly impacted by decisions that influence firm results. CEOs can also be paid a bonus for firm performance, but a bonus is an option that benefits the CEO. There is no downside to the bonus below \$0, whereas your ownership can decrease in value.

Preparing the firm for the CEO

Void of an explicit structure, culture will dictate behavior. Before hiring a full-time CEO, the firm has to address the current cultural climate in the firm for leadership. You see this in firms where the founder is still prominent and a de-facto leader simply because of the long-standing influence on the company. As John Mannix shared, internal communication to the staff from the owners and framing the message for why the firm was hiring a CEO was important.

The message to your employees should:

- › Share your strategic vision for the company
- › Inform them of the reason for hiring a CEO and what the role entails
- › Address how this will impact the employees
- › Demonstrate the owner’s submission to the office of the CEO

Avoid being a helicopter partner

If you deny the CEO full control of the role, you will sabotage the relationship, as well as the firm success, more than any other outside factor. The owners of the firm have a lot of responsibility for the success of a hired CEO. It begins with a foundation of trust in the structure you have built in your firm.

The firm itself is built on the trust that each partner, advisor and employee will work to benefit the firm. Not every member of the firm does the same thing. Everyone works as a team performing his or her designated tasks to benefit the firm. The CEO has the same goal with distinct responsibilities.

Crossroad 5: Creating a Corporate Governance Model

What is a corporate governance model and why is it needed in an advisory firm? Most advisory firms are technically small businesses with closely-held, private ownership and a governance model can seem like a reason to hold unnecessary meetings. Not to say the owners do not know each other or communicate. On the other hand, unlike the early days, management has more responsibilities and partners are former advisors. It is too time-consuming to have all the partners lead by committee. The crossroad is to address the growth needs of the firm and assess how a corporate governance structure, with dedicated leaders, can represent all of the owners.

Role of corporate governance in your firm

Most of us travel frequently by plane. We share a few hours at 35,000 feet with myriad people, including the pilots, who share the same objective: get to the destination safely and on time. Inside the cockpit the pilot is monitored by a team assisting the flight.

In corporate governance, the pilot is the CEO, the co-pilots are the Board of Directors (BOD) or the Executive Committee (EC) and the passengers are the other owners of the firm. All owners of the firm have a vested interest in preserving the value of their ownership, like all people on the plane want to travel safely, but appointed figures who best allow us to achieve our objectives are put in charge to govern the progress.

The purpose of corporate governance is to preserve and sustain the value and integrity of the firm for the owners. The role of the corporate governance model is to provide a consistent leadership structure, regardless of changes to the CEO or partnership.

A good corporate governance model creates accountability for the CEO, and organizes the owners.

- › Governance is an active, continuous process intended to oversee decisions and actions pertaining to strategic management and the health of the firm. The CEO is responsible for executing strategic decisions; however, the owners hold this position accountable for good judgment using an active governance model.
- › The necessary oversight is handled by the owners and is usually represented by an elected group who meet with the executives regularly, on behalf of all of the owners.

Governance does not require a BOD or EC. All owners could represent themselves; however, once the firm exceeds five partners, the task of all partners governing the actions of the firm is arduous. While all partners should have input on items addressed in the operating agreement (e.g., the sale of the company or the admission of a new partner), all other decisions should only be a concern to the elected board members to work with the executives hired to handle such items.

Profile: Creating a corporate governance model at Waldron Private Wealth

As a firm grows, its owners bring on support staff, then employee advisors and, finally, leadership. A corporate governance model guides the executive management in maximizing the quality and efficiency of this leadership.

Twenty years ago, John Waldron founded Waldron Private Wealth, in Bridgeville, Pennsylvania. Under John's leadership throughout the years, Waldron grew into a very successful firm with a solid team of professionals. John is still the CEO today. Six years ago, John recognized the need to incorporate a more formal leadership structure to be able to continue to drive success for the firm. An Executive Committee (EC) was formed to govern the firm's leadership, and it is led by Matt Helfrich, President of Waldron. The EC serves multiple purposes:

- › Alleviate the risk of having leadership concentrated in only one person, the CEO
- › Increase transparency and ensure leadership alignment toward well-defined objectives
- › Solicit unique points of view, since EC members lead different parts of the organization
- › Act as a training ground for future firm leaders

Matt maintains that a role-diverse Executive Committee has led to success. Members of the EC represent client service, operations and investments in addition to executive management. The group is very democratic and everyone brings ideas. These executives from all corners of the business contribute perspective and address concerns while promoting team cohesion.

Board of directors versus an executive committee

Board of Directors (BOD) and Executive Committee (EC) are practically interchangeable terms in advisory firms. The two terms have become synonymous to refer to a representative body of the ownership group that has frequent involvement with the executives and the strategic decisions being made. The strict definitions do diverge and are used by the largest advisory firms to represent two separate functions.

The Board of Directors (BOD) represents the ownership group to oversee the management and direction of the firm. The primary objective is to monitor the firm's management for financial decisions, compliance, hiring practices, legal and ethical activity.

The Executive Committee (EC) is often composed of firm owners. However, the core function of this body is execution instead of oversight. The members of the committee provide feedback to the CEO on initiatives and may be accountable for completing other initiatives.

Few advisory firms not owned by an institution have a Board of Directors and an Executive Committee. Firms above \$1B in assets and more than five owners will typically elect members from the partnership to serve on the Executive Committee and represent all owners.

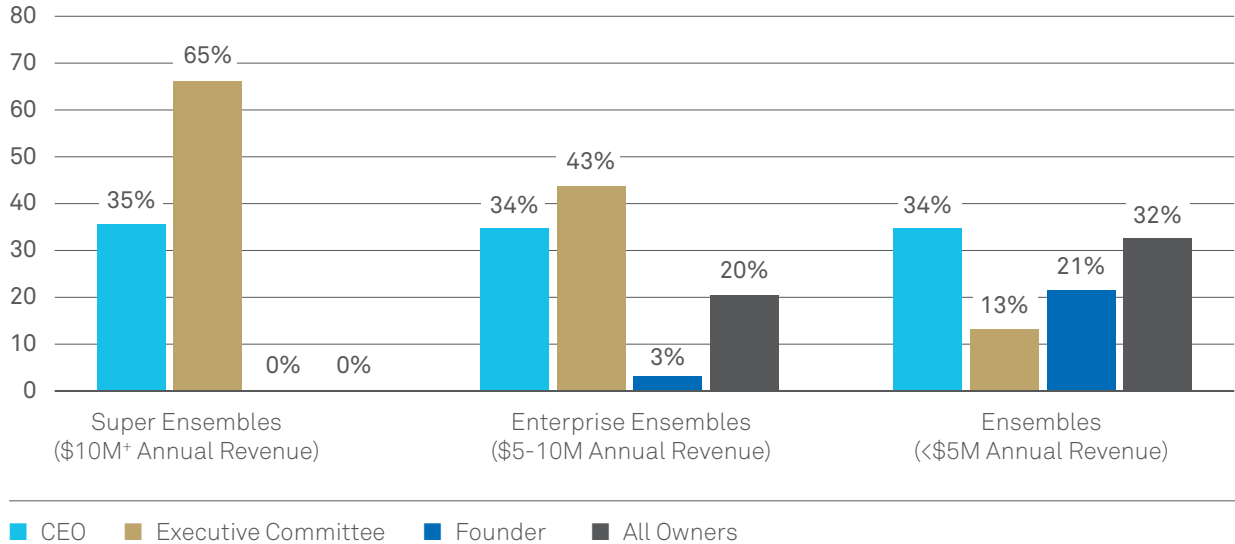
Should you have a Board of Directors?

Probably not. Unless you are beginning to look like a public company, with highly liquid firm stock and frequent changes additions to the owner's group, then the representation of a BOD is not necessary. Outside of the large ownership situation, the members of a BOD, EC and the CEO often overlap and create unnecessary structure.

Should you have an Executive Committee?

Probably, if you have more than five owners. It is more efficient for an EC of three to five members, including the CEO, to meet frequently versus involving all partners. The use of ECs grows steadily by firm evolution and is represented in 65% of Super Ensembles.

Leader for strategic decision-making



Source: 2016 InvestmentNews Financial Performance Study of Advisory Firms

Executive committee day-to-day functions

The typical role of an Executive Committee may include:

- › Defining a vision for the long-term future of the firm
- › Defining and executing a strategic planning process
- › Identifying the top priorities for the firm
- › Reviewing and making critical strategic decisions such as merger and acquisition opportunities, change in strategic contracts, and significant changes in pricing or other impactful decisions to firm value
- › Interviewing candidates for executive positions and review the appointment of key executives, including CEO, COO, CIO
- › Evaluating the performance of each executive and provide feedback
- › Reviewing and approving executive compensation, including the compensation of the CEO
- › Approving a budget each year and monitor its execution at a high level

Executive committee term limits

A role of the EC is a responsibility, but it is not the primary job of the incumbent and should not be treated the same way. The members of the EC need to change periodically to gain different perspectives from new members and train more potential leaders. Firms commonly stagger seats on the committee to rotate only one or two seats at a time. For example, if the EC has five seats, the CEO may always be on the committee and two of the seats could be up for re-election by the partners every year or every other year. Staggering the election of seats is not required, but it is preferred by many firms because the existing members know the reasons behind past decisions and stabilize the process without the new members creating a jarring shift in strategic direction.

Election of EC members is typically done by vote of the ownership group. Often the vote is based on a per-capita representation of the owners. In other words, each owner gets one vote versus the owner's vote being weighted by their ownership percentage.

Crossroad 6: Making the First Merger or Acquisition

Any major company with some level of merger and acquisition (M&A) activity has grown as a result. Your firm's success attracts the attention of others and may present opportunities to acquire or merge with other firms. Your firm has managed a familiar staff structure, evolved from a community of clients and referral sources, resulting from organic growth. Transferring the success of organic growth to an opportunity to buy or join another business introduces new territory. The crossroad is making a case to venture into this new territory for strategic purposes and build on the firm's organic growth with a merger or acquisition.

The strategy of mergers or acquisitions

The opportunity to merge or acquire another firm or advisor, while incredibly appealing, requires careful assessment of all involved. When both parties know what is coming through understanding of the work needed for a successful M&A, both sides are more cautious vetting a good opportunity from a bad deal.

There are many types of buyers ranging from single-office, independent RIAs to network firms and large, national institutions. For our purposes we will focus on M&A that continue operations as a single firm; including a single, ownership group, management structure and a single brand.

Mergers and acquisitions can advance your firm strategy, but they risk failure if the motive of the buyer is only focused on the financials from the culture of the firms involved and the deal structure. A successful M&A transaction should liquidate the seller, transfer the value of the entity to the buyer, combine cultures and produce perpetual revenue. The deal should contribute to the strategic vision of the firm by adding resources that move the firm closer to its objectives.

The discipline to assess right and wrong M&A opportunities is guided by the firm's strategy followed closely by its finances. Many transactions feature the size of the deal in terms of assets or revenue, but the key criterion is the management of successful buyers interested in the continuity of the firm using M&A to achieve this goal.

Envision the M&A opportunity approach in two distinct phases: the first is what the firm will be like after the deal, working backward to the deal. The second is a reflection on the value once the deal closes. What is the effort and cost required to develop new business and service clients to make the deal additive to your firm value? Applying the analysis of the implementation costs to your firm, what are fair terms for the transaction?

Reasons to Merge or Acquire

- › Further the goals and vision of the firm
- › Increase liquidity among internal owners
- › Add talented advisors and staff
- › Gain access to clients or niche markets
- › Add resources to continue growth
- › Enter a new market or geographic region

Mergers, acquisitions and tuck-ins

Strategically, mergers and acquisitions are almost interchangeable terms, when the stock of two firms is combined into one firm. It can be difficult to tell whether the two firms are merging and creating a new entity or if one is acquiring the other, absorbing its structure. This description is intentionally oversimplified to remove tax considerations and focus on the strategic impact of different transaction types.

For our purposes, we will define a merger as a new vision and strategic direction for a combined entity determined by the management of the two firms joining; whereas, we will define an acquisition as a combined entity where the vision and strategic direction is set by the management of the buying firm. Most deals fall somewhere in the middle where the acquired firm has input on leadership decisions in the new firm, but may not hold an executive management position.

There are three common entity structures the buyer is purchasing in an M&A transaction: operating business, practice tuck-in and book of business. These entity structures vary in the degree to which the buyer can leverage the existing structure of the purchased firm to produce profits.

Operating business

An operating business is a standalone firm that continues to operate after a change in ownership. These firms typically have an ensemble structure to service clients. The firm is independently capable of all operations needed to service and retain clients, grow the business and generate profits. In other words, this entity type could sustain on its own without entering an M&A transaction.

The buyer of an operating business is usually interested in purchasing this structure because of the firm's demonstrated ability to produce profits. That means there are people and processes that have relationships with their clients and know how to service them, which could result in greater retention of clients and revenue after the deal closes.

Buyer Considerations for a Successful Deal

Fulfilling Firm Strategy

- › Cultures are similar or complementary
- › Additional revenue will augment resources
- › Professionals and staff from absorbed firm will add revenue, production, capabilities or may fill a management need
- › Clients inherited from the seller are a good fit for the service capabilities and geographic market the firm hopes to dominate
- › Growth will be stimulated by access to new clients, centers of influence and markets
- › More options for ownership —go to market as a larger firm? Internal successor options?

Boosting Firm Finances

- › Fair purchase price that is expected to be repaid within a reasonable timeline
- › Clients and revenue from the seller will transfer to the buyer without material attrition
- › Costs of operations during- and-post transition do not impair the firm's long-term profitability

Tuck-in

A practice tuck-in is a transaction type and not specifically a descriptor of an entity structure. It denotes the purchase of a small practice where the advisors and the clients of the practice join your firm and use your operations and processes. The acquired practice is *tucked-in* to your firm.

Because the buyer is interested in acquiring the talent of the advisor and the clients they manage, this transaction is sometimes also called an “acqui-hire” to mean an acquisition and hiring of an advisor.

Book of business

A book of business is the simplest of the three structures because it is merely the purchase of rights to a list of clients and, hopefully, the evident revenue they will produce. There is not an entity purchased aside from the efforts of the seller to help transition the clients to the buyer’s firm. Typically the seller is required to assist the transition of clients to the buyer for a period from three months to more than 12 months. The buyer’s professionals and staff typically service the acquired clients without adding personnel from the seller’s practice.

Profile: M&A of an operating business at Private Vista

Since Private Vista began operations (as *Financial Strategy Network [FSN]*), the firm's focus was organic growth, but when an opportunity to merge with a firm in the Chicago suburbs presented itself to this downtown Chicago-based firm, it had to consider the role of an inorganic M&A transaction in their firm's growth strategy.

As described by FSN partners, Jim Weil and Steve Merdinger, they knew the prospective firm for 10 years prior to the transaction, but it still took over a year of due diligence and planning to set the deal up for success. The leaders of FSN cautiously verified that the deal would support their long-developed strategy. The objective of the transaction for FSN was founded in the firm's strategic objective to create a firm that lasts beyond the founding partners, and to grow the firm to continue to attract and retain really high level talent.

Since adding talented people in an M&A transaction is as important to FSN as adding assets, a merger with an operating business was a better fit than a practice tuck-in or purchase of a book of business. The merger of an operating business with FSN created a larger firm with more resources and ability to attract talented employees, and it contributed to the talents and abilities of the members of the merging firm.

To make the deal a success, Jim and Steve recall how the two firms compared their visions for the future and evaluated the cultures of each firm. FSN looked at how employees and operations were handled and hosted social events for staff of both firms to engage with each other.

In the end, the firms merged and formed the new company and brand: Private Vista. The transaction enabled FSN to add a partner from the merged firm, retire one of its partners, add an office and staff and incorporate a prior FSN firm initiative to rebrand. The transaction was a success because the firm aligned the M&A opportunity with as many as three of its strategic initiatives.

Profile: M&A at Wescott Financial Advisory Group LLC

Mergers and acquisitions are a viable path to growth, and in some firms they are a primary strategy. Firms that have executed one M&A transaction will tell you that success requires a lot of time and attention. To repeatedly execute successful transactions, it takes dedicated management of a well-crafted inorganic growth strategy.

Representing Wescott Financial Advisory Group, founder and CEO Grant Rawdin shared with us how his firm successfully grew through executing multiple transactions. The firm was founded in Pennsylvania and has expanded to five offices throughout the country, using acquisitions to build four of them. Grant recalls how the firm opened offices in markets where they saw competitive opportunities and had strategies to invest, leading them to become a super-regional firm.

Wescott's strategy is to open and operate an office with its staff first and then acquire firms to add. This order of events is distinctive in acquisition first, then building upon the acquired firm's office presence in the new location. The difference between the two orders is control and culture. Wescott is able to create a new office in a desired location with its look and feel and, importantly, the new office can be developed with the Wescott firm culture. In contrast, it would be more difficult for the firm to manage multiple locations if each retained the processes and cultures of acquired firms.

Acquisitions allow Wescott to build its regional offices with advisors, clients and referral sources in the local market. Grant uses the term "acqui-hire" to describe the tuck-in advisors they view as revenue acquisitions and professional hires for the local office. The firm has also acquired operating businesses that further the supply of talent and revenue to the office. However, every acquisition opportunity is evaluated for culture.

Wescott has developed a 15-page brochure and a dedicated acquisition team to introduce themselves to potential opportunities. The team assesses the fit of the culture and business plan for the acquisition target.

As a firm that has completed multiple transactions, Wescott had opportunities to improve its M&A process along the way. Its financial commitment to dedicate resources to ensure cultural alignment of an acquisition is indicative of its importance.

Making the purchase

A purchase cannot be completed unless the firm understands what it is buying or merging and is confident in the price. A deal could be structured to buy the clients of an advisor or to purchase a firm that pays a dividend from the produced profits. The valuation method used to generate the price should be confirmed by an industry expert. Depending on what you are buying, a mix of sale price, earnout bonuses, clawback provisions or salary can be part of the deal. What is being sold determines the purchase approach.

Recommended Purchase Considerations			
	Operating Business	Tuck-In	Book of Business
Purchase valuation (consult a valuation expert for an appropriate multiple)	Multiple of EBITDA (earnings before interest, taxes, depreciation and amortization)	Multiple of revenue	Multiple of revenue
Earnout or clawback provision	Earnouts are common to encourage continued growth in an acquisition	Earnouts are common to encourage continued growth in an acquisition	Either earnout or clawback provisions may be used based on the actual clients and revenue that transfer to the buyer
Compensation	May reflect the existing structure of the selling firm or change to the acquiring firm structure	Changed to the acquiring firm compensation structure	No compensation—the seller does not work in the acquirer’s firm
Ownership offered	Possibly offered to owner or key employee of selling firm	Not offered until the advisor is proven as a member of your firm	Not offered
Deal type	Merger or acquisition	Acquisition	Acquisition

The deal will likely have other considerations including tax registrations of both firms and whether the transaction is an asset purchase, stock purchase or consulting agreement.

When to use your equity

Equity is the most valuable resource of your company. It possesses the enterprise value of the investment, time and risk the owner has put into the firm. You want your equity to preserve its value by always selling it versus granting it and using it cautiously in transactions.

Firm equity is a tool for the owners, but for employees aspiring to be partners, it is also a motivator. Grant Rawdin of Wescott Financial Advisory Group (see page 28) stated that his firm will not make a tuck-in advisor a partner until the firm can observe the advisor working in the company. If your employees sense they are not given fair opportunity to be an owner, their motivation and engagement is gone. The risk of offering equity is a lack of demonstrated same level contribution expected of existing advisors and staff.

Navigating the transition

People are the most important part of a transaction. The deal requires a successful transition of clients and the assimilation of staff. Change can create a sense of unease and uncertainty. Before the deal closes it is best to prepare and establish relationships throughout the transition.

The fundamental requirements of clients and staff acquired or merged are relationships; understanding what is expected of them and what can they expect from others. Communication to new clients on what is changing, from a familiar point of contact, can help ease anxiety. A message coming from the client's existing advisor carries the credibility of a trusted relationship.

The people of both firms in an M&A transaction are uncertain about what the future will look like as well as how the change will affect their work. Jim Weil and Steve Merdinger of Private Vista (see page 27) worked to prepare their staff and the newly merged staff on building interpersonal relationships. Before the deal was closed, the staff of both firms spent time with each other in the office and at social events. Private Vista also made a conscious decision to place firm leaders in both office locations, so both firms would have access to leadership during the merger and leaders could observe the assimilation of cultures.

Managing a combined firm

The objective of the combined firm is to create an efficient structure that benefits from the best parts of both entities. The combined firm will likely require more time and attention of leadership to manage the company. Processes will also require structure and communication throughout to ensure consistency.

The challenge of management is to maintain equality and fairness in the combined firm. As often as possible, deconstruct legacy structures and affiliations that existed in the old firms. Give all employees the opportunity to contribute to the company, develop in a career path and grow their compensation. The combined firm needs more management than your firm may have needed before a merger or acquisition. Allocate the necessary time to properly manage this investment.

Crossroad 7: Creating a Firm Brand

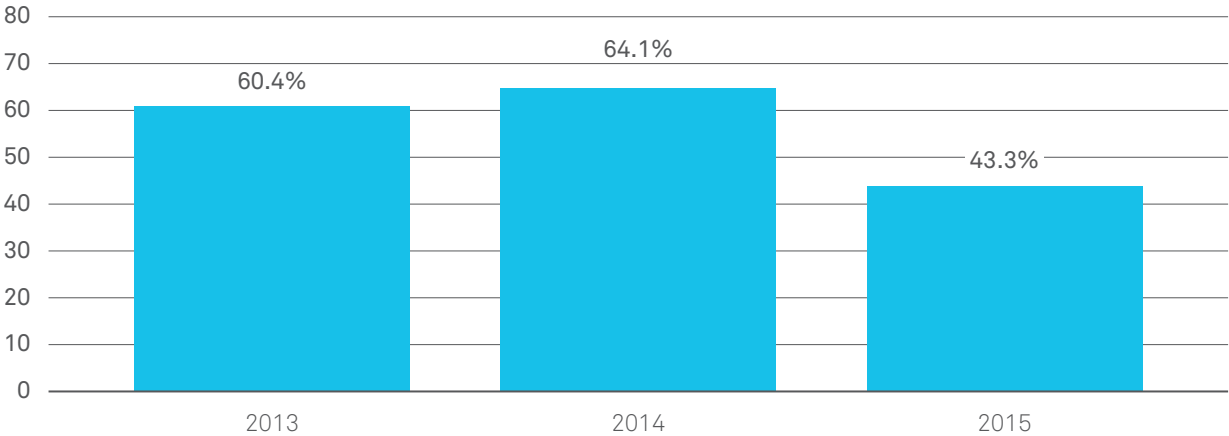
For many companies, the name on the office door represents their brand. This may also be true for many advisory firms, but only when the company is named after the founders. When you think of large companies, like Apple, General Electric and KPMG, quality is recognized for the products produced by the entire company and not simply the CEO. Conversely, at an advisory firm, the individual reputation of the advisor is often viewed as the product. A brand tied to an individual is finite, but a brand tied to a firm is potentially eternal. The crossroad is repositioning client perception of the company away from any one individual and vesting the relationship in an associated firm brand.

Why a brand matters

Every firm has a brand, but few have a brand strong enough to project in a community. Brands are typically associated with a product, and in advisory firms the product is client service. More specifically, the product should be the entirety of services a client receives, but often the client associates the product as the relationship with his or her advisor. After all, the client typically receives all services through a single source, the advisor, and therefore not always aware of the team of specialists involved.

The association of brand matters because the majority of new business for advisory firms originates from referrals.

Referrals as a percent of net new assets (excluding market performance)



Source: 2016 *InvestmentNews* Financial Performance Study of Advisory Firms

What product is being referred when the brand is the advisor and not the firm? If the answer is the advisor, then capacity and marketing conflicts are likely. A single advisor does not have enough capacity to see endless new clients. The return on investment of developing marketing for one advisor is lower and more limited than marketing for a team.

Profile: Creating a brand at SignatureFD

A brand must be relatable to clients, evoke a firm's unique features and communicate what the firm represents. For SignatureFD, based in Atlanta, Georgia, branding has been a vehicle for strategic growth. The firm currently manages approximately \$2.5 billion in client assets and employs more than 60 people. Based on the concept of "building communities," the firm identifies key client segments and the services they require, in order to create multiple brand offerings.

Heather Robertson Fortner, Partner at SignatureFD, shared how their growing firm realized that it would be too difficult to achieve consistent growth via traditional business development methods. However, it found success by employing a systematic approach that leveraged the collective expertise of the SignatureFD team to maximize interaction with prospective clients. The firm set a goal of reaching out to 10,000 people, recognizing that most new business was generated from client referrals, and that the more people the firm interacted with, the higher the probability of more high-quality referrals.

SignatureFD created communities to exponentially increase the number of people advisors meet. The firm started by forming a growth strategy, factoring in target clients and marketable services. It then created a message about how the firm best services the client base, and used its communities to distribute this message. Note that communicating its value, and its brand, happened after a strategy was formed and target clients identified.

As demonstrated by SignatureFD, a firm can have more than one brand, and the general firm brand is not necessarily the most important one. SignatureFD works with a general population of high-net-worth individuals, but the firm is creating brands based on common communities to which its clients already belong. Communities have many characteristics with which your firm can align and communicate distinguished offerings. The community should comprise a group of people with genuine and unique service needs.

The way Heather and SignatureFD approach brand is a leading example of management that is not yet common among advisory firms. By messaging the value that firm resources provide and investing in community development, the business efforts of this firm's advisors built on the recognition of the firm brands, instead of the many small, individual brands for each advisor. SignatureFD is advancing through the growth crossroads by creating brands that set the firm, and its advisors, up for success.

Marketing versus sales

Business development has two complementary parts: marketing and sales, but they are not synonymous. Too often, marketing is neglected by a firm and considered to be the responsibility of the advisor. Leaving the responsibility to the advisor confuses the role of marketing with the role of sales.

Marketing is the communication of firm services, reputation, differentiation and people distributed to a targeted audience. On the other hand, sales is the direct, person-to-person relationship built between a prospective client and an advisor.

Most firms lead with sales instead of marketing. The firm relies on the personal relationships of the advisors to generate new clients. This places the entire responsibility of business development on the advisor's ability to sell with the potential of referrals to follow.

The issue with a sales-first approach is that it does not attempt to leverage value from parts of the organization beyond the advisor's ability to relate to clients. Marketing, on the other hand, communicates the value of the firm and what differentiates it from the competition. Branding is a subcategory of marketing which packages the services tailored for a target audience into a single communication strategy. An advisor that communicates the firm's brand, even if immediately unsuccessful in generating a client, builds on the establishment of that brand in the community. The continued familiarity of the firm's brand potentially results in a source of new business for advisors that is more likely than relying on sales to create referral opportunities.

How a firm develops a brand

A brand is a unique story about the firm delivered to a target audience. Both parts of the equation must be satisfied to actually create a brand. If your story is not unique, relatable and easily understood by the audience, or if the story is not curated and delivered to a target audience, then it is difficult for the brand to succeed.

In our profile example, from SignatureFD (see page 32), the firm is developing unique stories for target audiences, or communities, to develop their brands. The firm itself is not the brand; instead, the firm manages a portfolio of brands. Each offers unique and competitive services to a distinct group of target clients.

The brand story is made up of the firm's unique characteristics, separating it from the competition, and highlights your firm's professional relationship. Begin by taking inventory of your firm and noting specific qualities of your people. What functions and processes do you have in your organization? For example, asset management, financial planning, tax preparation, estate law, trading, other operations and client service administration. Also, what qualities do your teams of people have, including: expertise, designations, talent, experience, personal interests and social involvement?

Equally important to the brand story is the brand distribution. Who is the brand intended for and what are the characteristics of the group? The target audience should have a common attribute to which your brand story relates. The group does not have to be as specific as a market niche.

You can choose to work forward or backward to create a brand. In the case of SignatureFD, it identified a target client profile and worked backward to develop the services and story to fit a community. In some cases, you may find the collection of expertise on your team allows for a compelling offering of services and, therefore, it is best to work forward and identify potential clients to benefit.

Building your brand

Develop your firm story	Deliver your brand to the target audience
<ul style="list-style-type: none">› A culture of understanding and empathy for client needs› Services that solve client problems (e.g., financial planning for large families)› Processes that benefit the client (e.g., risk management, convenient communication options)› The expertise, education and commitment of the people in your firm› The reliability and continuity of your organization› Individual involvement in the community associated with the target client› Cases of the firm's impact and contribution to the target client	<ul style="list-style-type: none">› Brand must be administered in close proximity to the target client› First build the reputation of the brand, then that of the firm, then the individuals› Be part of the community› Stay current on issues influencing the target client› Network with other centers of influence (COI) to the target client› Make the brand clear to the client and COIs so they understand how to refer you› Leverage the power of communal sharing to encourage referrals (e.g., target marketing, sponsor or host community events)

Can brands be transferred into new geographic markets?

The strategic advantage of a developed brand is its ability to leverage the promotion of business development. For professional services firms, like advisory businesses, we argue that a brand must be administered in proximity to the target client. As a firm explores the possibility of entering new geographic markets, the challenge is to build the same brand recognition you established in your current location.

Before you get too far ahead, you have to research the geographic market to confirm that your brand will be accepted. If, for example, your brand focuses on farmers in Texas, do the same factors that influence these clients affect farmers in the Northwest? After extensive market research about client needs, the focus for a new geographic market may lead to the distribution of a new message.

The law of probability suggests that the most efficient means of delivering your story is to first connect with influential groups in the community, followed by individuals. Centers of influence already have connections in your target community and can communicate your brand, provide introductions and help your firm understand the sentiments and values of the people in the community.

Managing the brand's reputation

Building a brand takes a lot of time and involvement to gain momentum, but only few mistakes to dissolve it. Cultivating a brand with emotional appeal makes it hard to tangibly measure its impact on business development. The growth of business from brand management usually materializes slowly at first and hopefully accumulates into a sizeable, recognizable source. The prerequisite for growth is the brand's reputation.

Reputation is something we manage personally with etiquette and controlled behavior. In regards to a brand, the firm must manage the collective perception with a target audience in conversations, marketing and service. That means that all advisors and staff supporting the brand communicate in a way that makes the brand easily recognizable to the client. There is a reason why retail stores will send in secret shoppers to test the quality of their customer service. Managing the brand's reputation takes vigilance.

Crossroad 8: Opening an Office in a New Geographic Market

Your firm's market is primarily determined by its location. Many advisory firms have clients outside of their immediate locations, but all of these have an affiliation story to the firm's community. While connections within an advisory firm's community result in subsequent growth, there may be new opportunities for growth in new geographic markets. Perhaps growth in your current market is slowing, your firm has developed a competitive expertise or you have ambitions of being a regional or national firm. The crossroad is whether or not to expand the firm by entering into another geographic market and open an office or maximize your current location.

Why enter into another geographic market?

Expanding your firm to a new geographic market may increase management complexities, so why add an office in a new location? The reasons must justify the strategy of your firm and produce a return on investment for the owners of the business. In general, a business will choose a second location for better access to clients or access to talent and cost of operations. For advisory firms, cost savings in operations is not as impactful on firm value as access to clients and access to talented professionals.

Opening a second office relies as heavily as it does on good management as much as it does on skillful advice. Many advisory firms are led by a CEO who spends most of his or her time as an advisor. The skillset needed to enter a new geographic market is more heavily reliant on the CEO's management to devise and execute a strategy transferring the reputation and success as a single office firm to new locations.

The primary reason management of multi-office firms open secondary offices is access to clients. Your firm should be near the clients you wish to attract. Proximity to clients has been noted by leaders of many leading advisory firms as the most important factor in growth. Physically being near clients allows the firm to make connections to open up referral networks, be seen as a contributing member of the community and build trust.

A secondary reason may be the access to talent. Commonly, this strategy is used by a suburban or rural-based firm to add an urban office. The design of the strategy is to promote recruiting and have a location desirable for young professionals to live.

Ultimately, the firm strategy has to justify the expansion to a new location. You cannot simply follow clients to their second home and open shop. You need to build a brand and reputation surrounded by new opportunities. Your access point to a new geographic market should be evaluated against your expertise to service a client need or niche and an operating efficiency to manage expansion of the firm without impacting firm profitability.

Profile: Entering into another geographic market at Silvercrest Asset Management

Expansion into new markets is a way to derive greater value from the services and expertise you have built in your firm. If your firm's message and faculties test well with clients in your home market, you can potentially do well in another. This form of operating leverage is great if it works, but requires a higher level of management activity and strategic decision-making than running a single location firm.

Silvercrest Asset Management, headquartered in New York, decided to expand to new locations and succeeded under the guidance of Rick Hough, CEO. The firm has five additional office locations today, using its expertise as asset managers to identify office locations that support its target clients. Rick commented that it was always part of the firm strategy to expand geographically, but first they realized the primary management concerns of running a business.

Rick and his team worked through core management initiatives in the firm. This included personnel development plans, identification of target clients, competitive differentiation, succession planning and organic versus inorganic growth objectives. All the time, multiple offices were part of the strategic plan.

The locations for office expansion were chosen based on markets that had potential to generate the largest number of relationships leading to referrals. As Rick shared, to foster these connections the advisors have to be in proximity to the clients to build good relationships through social interaction.

Each new office has been created via acquisition in the local market. Silvercrest aims to acquire firms that are compatible and enable them to add to the brand the acquired firm has already built in the local community.

Compatibility with the acquired firm is the key to entry. The local firm possesses knowledge of a specific marketplace that would be unknown to an outsider. From past deals, Rick has learned that you don't need to get to know the various markets fully, but you need to know the people with whom you'll work within that marketplace.

Profile: Entering into another geographic market at Summit Trail Advisors

A shared hobby or interest can bring people together. We get together to discuss books and drink wine, watch a football game and drink beer—or sometimes just to share a drink with no pretext at all. Shared interests and activities build strong interpersonal relationships, at home and in business.

At Summit Trail Advisors (STA), COO Tom Harms expressed how common elements of working with large high-net-worth clients exceeding \$10 million in assets and working as a team helped found the firm as well as establish four office locations. The four offices were all former Barclays Wealth teams that transitioned to form the independent RIA. So, unlike most firm expansions that begin with the reputation and resources of a single office location, Summit Trail has operated multiple office locations since its inception in mid-2015. Its history provides us with an interesting view of the core elements that would entice advisors to work together in different locations without the certainty of an established firm.

Advisors at STA know who their target client is and what their role is on the team. These two critical elements are interlaced with expectations, culture and responsibility. Any advisor who joins STA is likely to have confidence that he or she can succeed in generating and servicing clients with wealth of \$10 million or more. Each also must understand that the local office works as a team.

Tom also shared that the emphasis for multiple office locations is client contact. The execution and completion of client interaction happens at the branch level. While the home office centralizes approval for client acquisition and other investment and operational support, the branch office is the unit that carries the vision and the brand to the client.

Summit Trail Advisors plans to keep expanding to as many as 10 cities, according to Tom. They intend to recruit advisors as a means to achieving its growth. Its challenge for the next phase of the firm, as for most firms, is to articulate the core elements into a simple list that attracts like-minded advisors.

Get your house right, first

Organize your initiatives in a single location before expanding. Rich Hough at Silvercrest Asset Management (see page 37) has had success at growing the firm to multiple office locations, but he didn't expand until he had tested and improved the firm's management processes as a single office firm first.

- › **Strategy:** vision, competitive differentiation
- › **Growth:** business development and marketing plan, target client identification
- › **Human Capital:** career tracks, performance evaluations, compensation
- › **Equity Management:** new partner admission, M&A, succession planning

Management is a skill. Instilling the firm's plans and expectations in the office prior to establishing a second location can increase management skills and develop a culture in the firm that lends it to be replicated in the new offices you add.

How to create a foothold in a new location

- › Reinvest in your company to fund your growth
- › Develop your competitive strategy and note which features of your differentiation are transferable to a new location versus location-specific
- › Evaluate your target client, niche or service need in the new market
- › Find a local professional (advisor or center of influence) to validate your business plan for the new office
- › Assess and attract local talent to populate your office
- › Manage the office and staff equitably to all other staff in other locations
- › Centralize as many administrative and operational functions as possible
- › Use a centralized brand and sales training, but rely on localized knowledge for business development

Analyzing the opportunities and threats of a new market

A new market must have strategic and brand purpose. Access to clients and staff is typically noted as the reason for opening a subsequent office, but opportunities have to be qualified against their support of the strategic plan.

Analysis of a new market will be difficult to fully assess without a local guide. Find someone who does what you do in the local market, someone who knows the clients you are targeting and understands the affiliated networks in the community.

For illustration, we'll compare the benefits of two strategic options for a firm. For comparison, we will look at how many new clients or new advisors a firm needs to add to create the same economic value from a second location versus those running very lean and efficient in a single location. Both options have the potential to produce greater value for the owners of the firm.

Analyzing the opportunity of opening another office

Assume the cost savings of running an efficient firm will decrease overhead from the industry average for all firms to the average for top performing firms.

Advisory Firm Average*	All Firms	Top Performing Firms
Overhead Expense	37.2% of revenue	29.0% of revenue

For illustration purposes, we will use an example valuation multiple of six times EBITDA (earnings before interest, taxes, depreciation and amortization) and assume the firm begins with \$1M EBITDA prior to opening a second office.

This valuation method and multiple is purely for illustration, and is not a recommendation for your firm.

Comparison of Objectives for Opening a Second Office	Analysis*	Result (Change in value at 6× EBITDA)
Option 1: Cost of operations savings	Assume: decreased overhead expense from 37.2% to 29.0%	One-time Increase: \$1.9M increase in firm value
Option 2: Access to clients	Assume: higher, 37.2% overhead and industry average revenue/client of \$7,600	Repeatable Increase: 160 new clients to reach \$1.9M in increased firm value
Option 3: Access to talent	Assume: higher, 37.2% overhead and average revenue/professional of \$430,000	Repeatable Increase: Three new advisors to reach \$1.9M in increased firm value

*Source: 2016 *InvestmentNews* Financial Performance Study of Advisory Firms

The result of this illustrative analysis indicates that it takes 160 new clients, or three new advisors, to produce a similar impact to increasing cost savings. A second office location can add more than 160 new clients, or add more productive advisors, to continually increase the value of the firm, whereas the cost saving strategy will reach a point where it cannot produce any further results. The analysis does not include factors such as the time each strategy will take, but it does demonstrate a framework for evaluation.

Conclusion

The crossroads you will face as a firm grow in complexity and risk. Each subsequent step of your evolutionary progress creates a larger firm structure that depends on keen leadership, but that also might be the definition for a firm instead of a practice. It's an entity, set apart from ourselves, that will continue to exist without our presence and supports the many stakeholders it is created to serve.

Whether you decide to take the opportunity of the crossroad and push to grow your firm should almost be a decision you don't have to make. The firm's vision and strategy maps out your course and the crossroads are merely requisite steps toward a greater outcome. Be honest with the ambitions for your firm and willing to do what it takes to realize your goals.

Each juncture is a call to action to change the way you've done things in the past to prepare for the future. It is so important to work with good people who thrive in times of change. The leader of a future management initiative or branding strategy may very well be a talented member of your team. Embrace the skills of your team and invite them into the decisions and direction the firm is taking.

There are many specific decisions required to traverse each crossroad that are introduced, but can't be captured in this paper alone. Luckily, there are numerous firms and industry experts that have answers to many questions. Pershing Advisor Solutions has consultants, research and experience working with firms at every crossroad stage. Start with your Relationship Manager to access these resources and solutions for your firm.

If you are approaching any of the crossroads, then you have already had success creating momentum toward your strategic goals. Don't let the momentum stop. Use the good people around you and the resources of the firm to reach the next crossroads on the way to becoming the firm you envision.

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