RIA M&A Advice Series (Part II of II)

Behavioral Finance in M&A: Focus on Things That Really Matter

By Tyler D. Nunnally

This 2-part RIA M&A Advice Series is centered on behavioral finance. Part II introduces a decision framework called The 3 Fs that helps our clients make rational and deliberate decisions by focusing on the things that really matter.

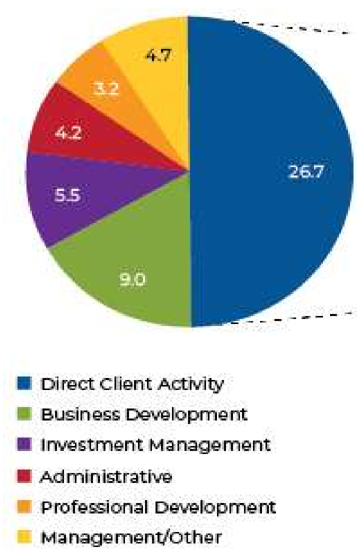
Part I detailed how emotions and bias lead to costly M&A decisions. Below is a summary of the topics:

FOMO	Fear is often a primary emotional driver in M&A decisions. The fear of missing out (FOMO) precipitates a strong desire to make a quick decision before an opportunity slips away. Making hasty decisions causes haphazard due diligence that leads to conflicts and regrets post-sale.
Fear of Change	Uncertainty around change incites fear that causes indecision and inaction. The succession dilemma plaguing the RIA industry is a perfect example of that. While kicking the can down the road indefinitely is the easy option, procrastinating carries grave personal and business risks.
Anchoring	Everyone has a number. If an offer comes in at - or above – a seller's valuation expectations, then they jump on it, which is a mistake. A firm's value is established by receiving and comparing multiple offers. Using competing offers to negotiate the best deal possible yields a much higher valuation.
Time discounting	When the thought of large sums of money starts swirling in the brain, people start dreaming about how they're going to spend it, and all the cool stuff they can buy. Suddenly fit and future become secondary or all but forgotten – sacrificing long-term interests for short-term gain.
Overconfidence	The goal of most sellers is to arrive at the best deal with the best fit. RIA owners leave millions on the table by doing a deal on their own instead of working with a professional M&A Advisor thinking it saves money. Owners working with a pro make around 15% more on deals than ones that don't.

Filtering Through the Noise

M&A is ultimately a process of elimination. Evaluating prospective M&A partners is a lot like dating. Filtering through the noise can be exasperating. There are continuous conversations with multiple people all at the same time. There are constant meetings, emails and calls with the M&A teams from all the prospective partner firms. There are also a host of communications with executives, investments, compliance, and operations teams. A ton of data is exchanged throughout the process.

On top of that, there's the day-to-day duties of running the business and a multitude of other distractions. The Kitces graph to the right shows the hours spent by advisors across various weekly tasks. With all the delirium going on it is easy to get caught-up in the hoopla. If RIA owners are not cognizant of it, then emotions and bias can easily creep into M&A partnership decisions.



Source: www.kitces.com/blog/how-do-financial-advisors-spend-time-research-study-productivity-capacity-efficiency/

Arriving at the Best Deal with the Best Fit

Having worked with RIAs for the better part of twenty years – the last several as an M&A Advisor – I understand these issues all too well. It is hard for people to focus on the things that really matter when being pulled in so many different directions. Our job is to help clients make rational and deliberate choices. To do that, Nunnally International employs a decision framework called The 3 Fs.

The 3 Fs stand for: Fit. Financials. Future. The objective of the decision framework is to arrive at the best deal with the best fit. The devil, of course, is in the details. Decision frameworks are very useful in M&A because they give conversations structure and set clear parameters around offers.

The 3 F's ensures that all suitors are on equal footing. It provides an apples-to-apples comparison to make sure biases like favoritism do not factor into our clients' decisions – or the advice we offer our clients; it would be disingenuous not to admit we have our own bias towards particular people and firms we like.

The decision framework's design is based my years of experience as an M&A Advisor together with the behavioral finance training that I received at Oxford University earlier in my career. My role in Oxford (and later with risk profiler FinaMetrica) was to help make behavioral finance useful for financial advisors. The 3Fs is essentially a continuation of that work.

We carry the load by coordinating meetings, leading the discussions, and keeping the conversations on track to get to the answers we're after. There are people in this line of work that could sell Bitcoin to Warren Buffet, so it's not always easy. We're looking for comparative answers, therefore the key is to ask the right questions.

The 3 F's Decision Framework: Fit. Financials. Future.

1. Fit

Making certain there is a good fit is not a trivial matter. Choosing a bad fit has serious implications. It means a disenchanted you, a dejected team, and unhappy clients that may no longer wish to stick around. On the other hand, a good fit will feel like home and give your clients peace of mind. Fit is tricky because it involves feelings as much as it does data. In that regard there has two distinct aspects:

- Quantitative Fit

A good fit is determined by compatibly and strategic alignment. Examples include:

- Is there alignment around investment philosophy?
- Who is their custodian(s)?
- What type of client do they serve (HNW, UHNW, mass affluent)?
- What is the fee structure and is it vastly different?
- What services do they offer clients?
- How would joining forces benefit your firm's clients?
- What tech stack are they using?
- Fee-only versus dually registered?
- What geographic markets are they in?

- Qualitative Fit

While compatibility is obviously important, the significance of culture cannot be overstated. The people factor is perhaps the single most important consideration in M&A partnership success. As the saying goes, "culture is king." A good cultural fit is determined by getting to know each other and employing a multifaceted due diligence approach for verification purposes. Discovery questions include:

- Do you like them?
- How do they compare to other groups?
- How do they treat their clients?
- Is putting clients' best interest first in words only?
- Will you and the team feel like you belong?
- Will you continue to enjoy what you do or dread it?
- How will they treat your staff? Will your staff want to stick around?
- Will they provide autonomy or be looking over your back all the time?
- Can you maintain your current lifestyle?

2. Financials

All prospective buyers are asked to follow our The 3 F's guidelines when presenting proposals and Letters of Intent (LOI). We are looking for consistency and uniformity to draw comparative conclusions. There can be obscurity in some offers that are confusing or downright misleading. Deal structure is vital will include aspects of the transaction listed below. A great deal will accommodate the preferred cash/equity split of each individual shareholder.

- Total valuation
- Valuation metrics
- Valuation multiple
- Upfront payment (cash)
- Upfront payment (equity)
- Earnout period
- Growth earnout (cash/equity split)
- Retention earnout (cash/equity split)

Please note: If the earnout portion of the deal is unobtainable then that typically implies that it is a not such a "great" deal. Earnouts are tricky. Sellers leave tons of money on the table if they don't know what they're doing.

3. Future

It is easy to get caught up in the financials for the reasons discussed earlier; we are human. But what comes after the deal closes is the key to a successful transition. These items need to be worked out and agreed in advance to avoid problems down the road – like client attrition. They include:

- Ongoing compensation
- Employment contracts
- Benefits
- Bonuses/Incentives
- Roles
- Fee structures
- Operations and compliance
- Restrictive covenants
- Leases
- Marketing budgets

Conclusion

The key to successfully implementing the 3 Fs is collaboration with our clients. Successfully closing an M&A deal is a total team effort. The process can be intense and stressful at times. As a result, you get to know the people you work with exceptionally well. We have been very fortunate to have had amazing clients that have become lifelong friends. Those relationships and the bonds that are formed are immensely rewarding, and by far the best part of the job.

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

About Nunnally International, Inc.

Nunnally International, Inc. provides strategic M&A services to RIA firms that are looking to buy, sell or merge their business. The company was founded in 2020 by Tyler D. Nunnally.

Prior to entering M&A, Tyler served as a strategist to leading advisor technology providers – including FinaMetrica, which was acquired by Morningstar. He began his wealth management career in England as an executive at Oxford Risk, a spin-off of Oxford University that specializes in behavioral finance.

Tyler has consulted hundreds of RIAs on matters of mergers, acquisitions, and risk as a frequent speaker at industry conferences, host of countless webinars and proficient author of journal articles. He has been a key relationship manager to strategic partners including Schwab, Fidelity, Redtail, Orion, eMoney, Fi360, MoneyGuidePro and SEI.

As an industry thought-leader, Tyler has been interviewed extensively by The Wall Street Journal, Bloomberg, CNBC, Smart Money, Kiplinger and InvestmentNews. He holds a B.A. from the University of Georgia and a Master's in International Business with Distinction from the University of St Andrews in Scotland.

How We Work with Clients

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

Option A – Seller Representation

RIA firms that want to sell or merge engage Nunnally International, Inc. through a Sale and Fee Agreement. We lead the M&A process all the way from initial introductions to close. Our fees consist of a success fee based on the closing price. We guide you through the M&A process by:

- Help define your strategic objectives.
- Identify shortlist of prospective M&A partners.
- Market your firm to prospective acquirers.
- Coordinate calls and meeting.
- Facilitate conversations and information flow.
- Solicit initial offers.
- Negotiate terms of sale and maximize valuation.
- Assist in preparation of necessary documentation.
- Conduct due diligence on prospective acquirers.
- Successfully close sale

Option B – Referral Partner Network

Nunnally International, Inc. can introduce your firm to prospective buyers through our referral partner network. Our referral partners pay our fees, so there is no cost to you. We work with around 22 referral partners that are all differentiated in terms of what they bring to the table.

We employ our expertise in investor profiling to find the best fit based on your strategic objectives, partnership criteria and firm culture. Naturally, this is done in consultation with you. If you decide that you would like to pursue a conversation with a group that we recommend, then we make the initial introduction and help facilitate talks.

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