

# INVESTMENTS & WEALTH MONITOR

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## RIA Consolidation: Addressing a Competitive Yet Expanding Market Opportunity

*By Stephen Caruso*



**INVESTMENTS & WEALTH INSTITUTE®**

# RIA Consolidation

## ADDRESSING A COMPETITIVE YET EXPANDING MARKET OPPORTUNITY

By Stephen Caruso

Following a tumultuous 2020, registered investment advisor (RIA) merger and acquisition (M&A) activity will continue to increase as more players enter the market. With a suitably vast market opportunity, consolidators are adjusting their affiliation models to appeal to different types of advisors with specific needs. Established consolidators such as Focus Financial, Dynasty, and Hightower are now joined by an ever-growing pool of emerging consolidators that have put their own spins on the idea of consolidation. The addressable market for RIA acquisitions continues to expand, and Cerulli Associates expects it to reach \$2.8 trillion during the next five to 10 years.<sup>1</sup> Much of this market potential is tied to advisor retirements, representing \$1.8 trillion in acquisition opportunity. Growth-challenged RIAs (\$461 billion) and breakaway advisors (\$529 billion) account for the remaining \$1 trillion. Encouraged by recent growth and increased activity, private equity dollars are pouring in, upending valuation multiples and tightening competition for the top firms. Consolidators are getting more creative with their offerings to continue to win market share. This approach's ongoing success will be determined by the ability to continue growing in a market with new entrants increasing competition for the largest firms.

### ADVISOR RETIREMENTS

Advisor retirements present the largest consolidation opportunity for RIAs. Succession planning remains an ongoing concern across the industry as more

### KEY POINTS

- The market for RIA M&A is expected to grow to \$2.8 trillion during the next 5-10 years. This growth will be driven by advisor retirements, migration to the independent model, and existing growth-challenged RIAs.
- Growth-challenged RIAs represent a significant opportunity for RIA consolidators that can provide operational efficiencies and support. These firms are run by high-achieving advisors who are overwhelmed operationally and need middle- and back-office support to thrive.
- RIA consolidators are competing in an increasingly homogenous market where firms are presenting multiple affiliation models that can appeal to a broader range of advisors. To stay ahead of the curve, consolidators will need to be conscious of the tools advisors are missing and allocate resources to deliver them efficiently.

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founders and partners approach retirement. Independent advisors often lack the tools and resources to implement a quick succession plan that can transition a business to the next generation. However, more firms are actively engaging the next generation of advisors and assessing their interest and readiness to take on larger roles, with the eventual goal of passing the reins to them.

According to practice management professionals, these plans often take several years to develop, and advisors may encounter numerous pitfalls along the way, including managing successor expectations and adequately financing the deal. Retiring advisors who have not formed or considered their succession plans will find themselves at a disadvantage each year they delay putting a plan in place. As best said by one succession-planning professional, "Succession planning doesn't have to be retirement, but if you wait too long, it is retirement." An M&A transaction can propel the founding generation toward retirement by providing a liquidity event and empowering next-generation advisors to take greater ownership in the firm's success.

### BREAKAWAY ADVISORS

During the next decade, breakaway advisors moving to the independent

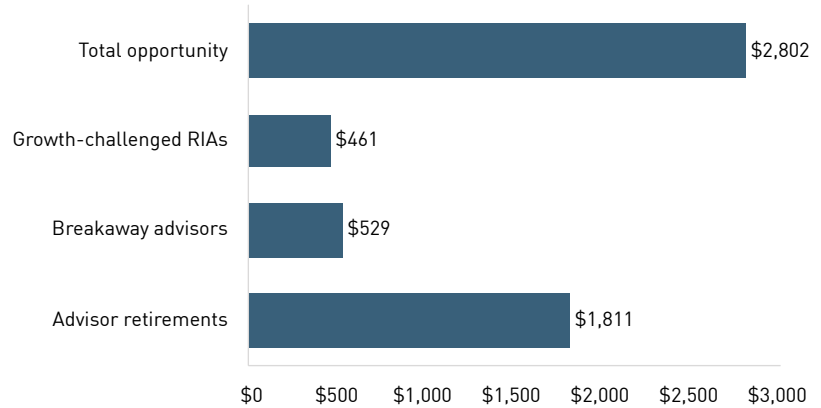
channels are expected to represent \$529 billion in acquisition opportunity (see figure 1). Although they tend to focus more on acquiring existing independent firms, several RIA consolidators have built affiliation models designed to attract breakaway advisors. However, they face an ongoing challenge: developing a landing pad that balances these advisors' desire for independence while providing them with all the resources they need to be successful. A highly centralized, top-down infrastructure may reduce retention due to a perceived lack of freedom.

In response, RIA consolidators are developing multiple affiliation options that enable advisors to dictate the levels of independence and service offering that suit their needs. This multi-faceted approach can appeal to advisors with differing preferences. For example, Dynasty and Mariner Wealth Advisors recently partnered on a new affiliation offering, Mariner Platform Solutions. This option is aimed at RIAs that want

Figure 1

### TOTAL ADDRESSABLE MARKET FOR RIA ACQUISITIONS, 2019 (\$ BILLIONS)

The addressable market for RIA acquisitions continues to grow at a rapid pace. Firms currently engaging in consolidation will need to build an affiliation offering that reflects advisors' needs for both services and independence.



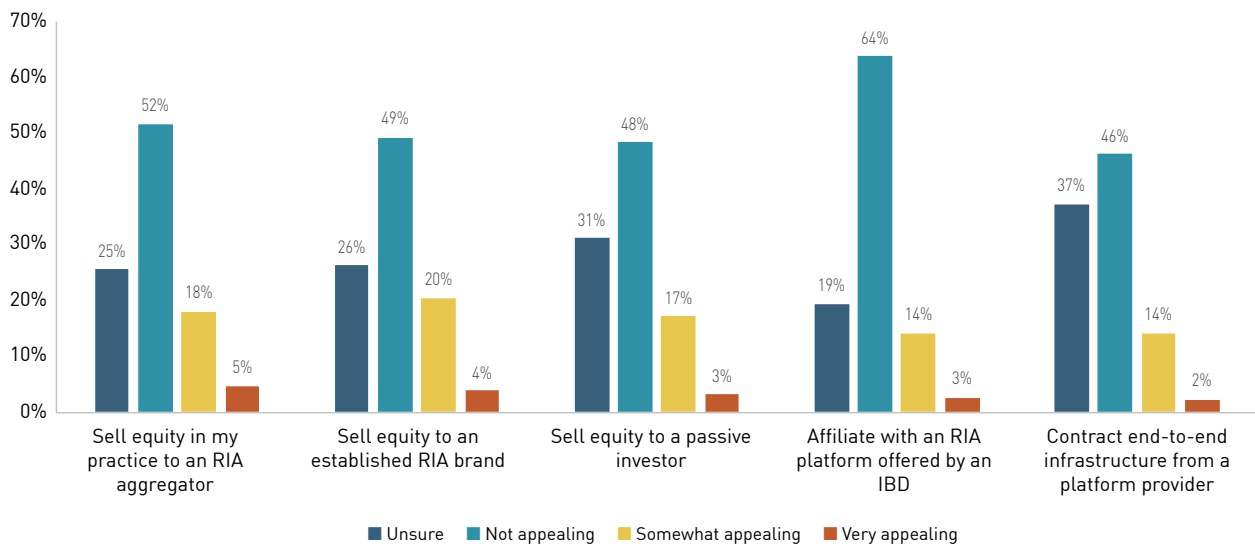
*Analyst Note: The acquisition opportunity from breakaway advisors is based on estimated advisor movement for wirehouse, national/regional broker-dealer (B/D), insurance B/D, and retail bank B/D advisors, excluding independent B/D advisors and intra-channel RIA transitions. Projections for advisor movement are based on historical movement of advisors among channels, average movement rates, and advisor channel preferences for the future. Movement reflects only advisors with three or more years of experience and does not reflect asset changes resulting from advisor retirements or the hiring or failures of rookie advisors. The acquisition opportunity from advisor retirements is based on the assets in transition model, which segments advisors based on the number of years until they expect to retire. It includes the age 60+ lifer category (advisors who are older than age 60 and indicate an expected retirement in 10 or more years), advisors who are unsure of their retirement dates, and those who plan an external sale. Growth-challenged RIAs report major challenges related to technology, compliance, operational responsibilities, lack of practice management support, limited home-office support for product due diligence, or limited time to run a business.*

Source: Cerulli Associates

Figure 2

### APPEAL OF RIA AFFILIATION MODELS, 2020

Generally, advisors have yet to identify their ideal consolidator affiliation models, there is very little consensus across existing models.



*Analyst Note: Employee advisors work in wirehouse, national and regional B/D, insurance B/D, or retail bank B/D channels and would prefer to transition to the independent B/D, independent RIA, or hybrid RIA channels if they switched firms. Respondents include only those who are not currently affiliated with a consolidator model. Data in figure 2 represents the percentage of respondents who consider the RIA affiliation model somewhat or very appealing.*

Sources: Cerulli Associates, in partnership with Investments & Wealth Institute® and the Financial Planning Association®

to maintain their independence and brands while accessing resources that are usually beyond the reach of small-scale firms.

### GROWTH-CHALLENGED RIAs

Increasingly, consolidators are recruiting from a pool of smaller firms led by successful advisors who are unable to achieve the next stage of growth. Although independence presents the ideal option for advisors who want to be unencumbered by the rules of broker-dealers or limited product menus, many advisors find themselves underprepared to run an RIA and have trouble achieving scale. As a hybrid RIA platform executive notes, “Advisors need to wear two hats, financial advisor and business owner.” Independent advisors, on average, spend 41 percent of their time on investment management and administrative responsibilities. Overly burdened by the operational needs of their businesses, growth-challenged advisors are unable to achieve the success they desired in independence.

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A senior consolidator executive suggests that much of their deal flow comes from “sub-scale advisors who want to strategically align themselves with a bigger firm. They might do this for access to better products and services. They’re aligning themselves with bigger firms and in that process securing the future of the RIA.”

Oftentimes, these advisors are unwilling to sell their firms in their entirety and become employees of the consolidator. In most cases, they sell a minority stake to the consolidator, which preserves upside in their business. As one consolidator executive said, “By sharing equity, advisors still feel their compensation rising when they win a big account. ... I’m not coming in to operate a firm, we’re investing in management teams.” By allowing firms to retain equity, affiliation with a consolidator becomes less about selling out and more about an injection of strategic capital and access to resources that enable growth that the RIAs could not achieve alone.

### CAPTURING ASSETS IN TRANSITION

Consolidators’ spectrum of services makes them capable of appealing to each of these groups of advisors in different ways. Independent advisors currently do not have a clear preference for an affiliation model (see figure 2). Almost one-fourth (24 percent) of independent advisors find it appealing to sell equity to an established RIA brand, compared with 23 percent that find it attractive to sell equity to an RIA aggregator. The largest consolidators are revising their value propositions frequently in a continuous quest to appeal to a wider swath of advisors. For example, Focus Financial is expanding its affiliation model through partner firm Connecticut Wealth Advisors to attract advisors who need more services. Connecticut is a wholly owned subsidiary that acquires RIAs that are seeking to leverage a support network and centralized services. Although Connecticut represents a developing opportunity for Focus, it continues to be most active in acquiring large RIAs and supporting those firms’ synergistic acquisitions.

Most consolidators offer solutions that leverage centralized middle- and back-office services to reduce the strain on

advisors and enable them to focus on revenue-generating activities. Further enhancing their offerings, consolidators are building technology platforms that represent best-of-breed tools. More than half of advisors consider the high associated costs (57 percent) and a lack of support staff (54 percent) a challenge to implementing technology in their practices. Consolidators delivering these tools to advisors can increase operational support and contribute to a firm’s overall success and efficiency. Notably, Carson Group recently moved to cover its partners’ technology costs, thereby growing their value proposition and further streamlining advisors’ operations.

Although uncertainty likely will linger, Cerulli Associates expects interest in M&A to accelerate as RIAs both large and small re-evaluate long-term goals and paths to achieve them. Although the market seems suitably vast, several consolidators have sounded early alarms that valuations have reached new highs amid fierce competition. Firms increasingly are competing in a more homogeneous market as offerings proliferate and omnichannel approaches become the norm. As consolidation continues to reshape the industry, Cerulli Associates expects that firms will identify key growth areas and shift resources to focus on them. ●

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### ENDNOTE

1. Related research: “The Cerulli Report—U.S. RIA Marketplace 2020: Exploring Drivers of Change,” <https://www.cerulli.com/reports/us-ria-marketplace-2020>.



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