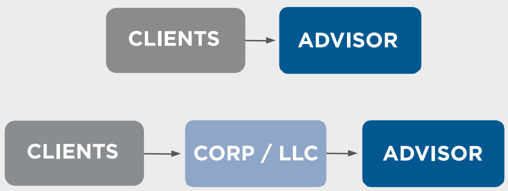
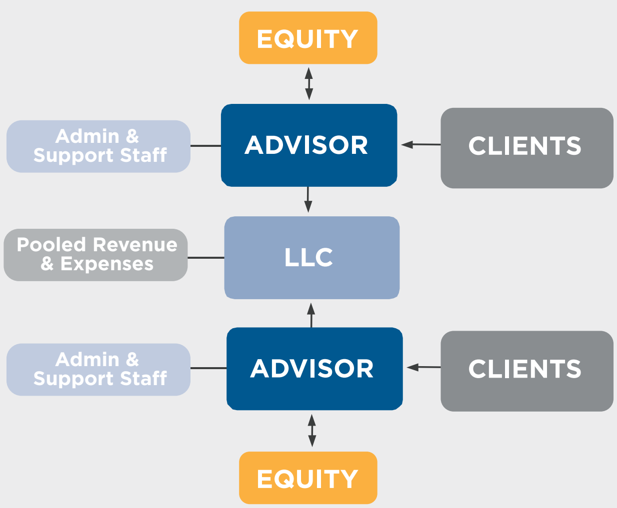
SHIP VS. LIFERAFT

WHICH ORGANIZATIONAL STRUCTURE DO YOU HAVE?

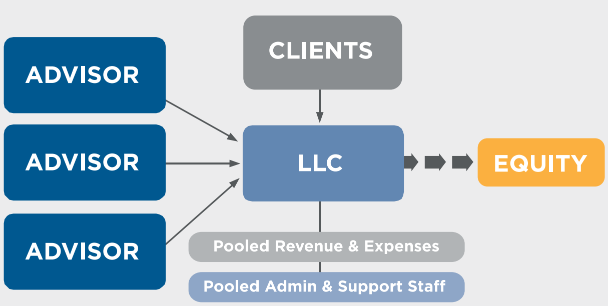
EAT-WHAT-YOU-KILL MODEL (LIFE RAFT)



SILO-BASED MODEL (FLOTILLA)



EQUITY-CENTRIC ENSEMBLE MODEL (SHIP)



The concept of an equity-centric business model can be difficult to grasp. Consider this parable to better understand the problem most independent financial advisors face when trying to progress from a job to a practice, and ultimately to a business of enduring value over the course of a career:

Picture a bright orange life-raft floating on a dark blue, storm- tossed ocean. In this durable, well-built small craft sits an independent financial advisor. Our advisor has a paddle for propulsion – the means by which to move the raft to safer or more prosperous waters. Our advisor has the means to collect and store rain water for drinking, and fishing tackle to bring in food for survival – the craft literally is floating on a sea of food and fuel to sustain and propel its lone occupant. Our advisor also has a compass for navigation to guide forward progress along a chosen route.

Over time, though the sea is vast, there are many financial advisors and our advisor encounters other life-rafts and other peers. Most of the time, they just pass by and co-exist, easily and effortlessly competing for the same food supplies without much thought or concern. But in time, when the skies grow dark and the seas inevitably become more challenging and dangerous, behaviors tend to change. Instead of passing by each other, advisors come together and form a group. Under the right circumstances, they'll lash their life-rafts together for safety and support and form a flotilla of three or four, each sitting in a separate craft, but inextricably linked together for the duration of the event.

During this time together, our financial advisors can explore various opportunities. Synergies may develop from the group as the paddles are placed in the hands of the strongest advisors, whose task it will be to propel the group to safety. The advisor best qualified to lead and navigate will take the compass and direct the group with a single vision and set of actions. And the advisor best suited for "hunting and gathering" will be in charge of collecting water and catching fish to sustain the efforts of his or her crewmates – each doing what they do best, contributing to the success of the group. But it is just as likely that each independent advisor continues to function as a separate unit, each "eating *what they kill" and each reserving the right to cut the ropes and paddle off at any time and in a direction of their own choosing.*

One of the biggest mistakes that financial advisors continue to make is to view this group of life-rafts as the pinnacle of business growth and organization, or even as the goal. The mistake is to think of this loose assembly of individuals and producers as a "ship" when in fact it is nothing more than a flotilla, quick and easy to assemble, and equally quick and easy to disassemble. The old wirehouse model or the traditional OSJ models are poor blueprints for building a valuable and enduring advisory business. Even RIAs are susceptible to these assembly errors.

In terms of organizational structure, the common starting point for most financial advisors is a sole proprietorship model – a single advisor compensated on the basis of some form of revenue split or eat-what-you-kill system.

To its credit, this basic production-based or advisor-driven model is extremely adaptable and simple to establish and operate. Unfortunately, this starting point is often mistaken as a building block for larger, more sustainable business models, resulting in a very common, still predominant, business structure in the independent financial services industry.

Another structure, generically described as a "silo-based model," does present one common business name and structure to the advisor's clients and to the public, but the nucleus of the business model, the corporation or LLC, has little to no value because only expenses are paid through its bank account. The value, or equity, is actually split between two or more separate advisors, each a separate "production unit" or "book of business" capable of taking their clients with them at any time. From a buyer's perspective, the business as a whole has no value. Adding more and more advisors to this model does not change the resulting value of the founder's overall practice.

The most valuable and enduring business models now emerging in the independent financial services industry are "Equity-Centric" Ensembles.

A properly constructed "Equity-Centric Ensemble Model" relies on a strong, centralized entity structure which collects all incoming revenue, pays out compensation for work performed, and pays operating expenses. The net result is a stronger business that generates a higher quality and more predictable cash flow. This fuels profit distributions – and these profits, in turn, provide advisor/investors with two essential results: 1) a return on their investment, and; 2) the means by which to pay for that continuing investment.

One of the most powerful growth strategies available to independent financial professionals is to use a combination of compensation elements (e.g., wages or paychecks for work performed) and equity value (i.e., an internal ownership track) throughout a business's lifetime. Adding an ongoing equity component to a firm's compensation structure allows the business to create a shared-risk/shared-reward relationship between employers and employees – a connection between the generations, providing both the means and the rewards of ownership. This is often accomplished by assembling a team organized around a formal entity structure such as an LLC or a corporation.

For a more indepth look at how the proper organizational sturcture is key to long-term growth, download our white paper, ***Building a Business of Enduring and Transferable Value*** here.

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

Since opening its doors in 1999, FP Transitions has completed more financial service transactions than any investment banker or business-broker in the country. FP Transitions' expertise also includes continuity planning, practice benchmarking, compensation studies, entity formation, mergers and acquisitions, and equity compensation strategies.

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