PITTSBURGH BUSINESS TIMES

# Why size matters to financial pros

## SUCCESSION ISSUES, RISING COSTS DRIVING SMALL FIRMS TO LARGER SUITORS

JENNAE BACKO

*Fragasso Financial Advisors CEO Robert Fragasso, second from left, and Jeanette White, seated at the head of the table, signed an agreement last May for Fragasso Financial to acquire White's The Grandview Group. Also on hand for the signing were Daniel Dingus, president of Fragasso Financial, and Melissa Richey, executive vice president, sales and marketing.*

BY PATTY TASCARELLA
ptascarella@bizjournals.com
412-208-3832, @PBT_Patty

Jeanette White likes to say Christmas came early in 2014. That's when she received the key to her company's future.

The Friday before the holiday, White had let her administrative staff go home early, so when the phone rang that afternoon at The Grandview Group's Zelienople office, she picked it up.

Robert Fragasso, founder and CEO of Fragasso Financial Advisors, was on the other end. They hadn't met, but Fragasso had heard through a mutual acquaintance that White was quietly exploring options for Grandview, which she'd launched more than a dozen years earlier. And White's husband had mentioned Fragasso as someone she should reach out to as the couple drove past a Fragasso Financial billboard.

"Bob and I talked for an hour and decided to get together in the new year," she recalled. "I was giddy through the holidays. I told my husband, 'I may have found the right fit.'"

White had no plans to retire in the short-term.

"I had been looking for a continuity plan for my clients," she said. "I'm in my 60s, like many advisers who aren't thinking about retirement right away, but wondering what happens to the client base."

Grandview's assets under advisory and management were at about $60 million. Its sole financial pro, White has worked in the industry for more than three decades. She had such close relationships with clients that one who recently passed away at age 92 left White her cat Harley.

Fragasso and White met and talked for several months, found their businesses and cultures were compatible and sealed the deal in May. It marked the first acquisition in Fragasso Financial's now-44-year history and the start of a new direction, as far as Fragasso's concerned.

The next wave of consolidation among financial professionals and wealth advisers is at hand. A combination of generational turnover, succession issues, regulatory pressures and rising costs are driving small firms to become part of larger enterprises.

"It's eat or be eaten," Fragasso said, and he intends to feast.

Fragasso Financial employs 45 and its assets under management top $1.1 billion.

Buyers increase assets under management, justifying their technology and staff investments. At least 80 percent of clients accompany their adviser, according to an oft-cited industry standard – and all of Grandview Group's clients transitioned to Fragasso Financial.

"This is not a one-time trend, it's not cyclical," Fragasso said. "Small business is the backbone of the economy, but it still has to reflect big business resources and you can't do it with a onesie-twosie-person shop."

Age is the biggest factor. Cerulli Associates Inc., a Boston-based research and consulting firm, said the head count nationally of registered investment advisers dropped by 32,000 over the past decade and forecasts more than 25,000 registered investment advisers will retire within the next two years. About 10 percent of advisers were over age 65 at the end of 2013.

"It's interesting. The status of markets does not drive attention to it," Fragasso said. "You'd think bad markets, people want out, or great market, they want to cash out. But it's where people are in their lives."

David Root, CEO of D.B. Root & Co., which is in the midst of its own acquisitions, put it another way.

"I've seen industry statistics that the average adviser's age is 53," he said. "This is an industry close to retirement and an enormous amount of advisers retire every day. This is a younger person's business.

Although you can work at it indefinitely, it's fast-moving. Witness the first week of January. Markets are volatile. To stay on top of that, to handle this kind of dynamic upheaval, you've got to have the energy."

Most financial pros, especially the independents, are not staring down retirement. But with a large number leading small or solo practices, it becomes an issue because of succession. In some cases there isn't just a lack of a clear-cut next-in-line, there simply isn't anyone else to take over.

Just how many financial advisory firms are in Pittsburgh is anyone's guess, but it is believed to be more than a thousand. It's tough to calculate because of industry fragmentation and the way the sector has lent itself to home-based businesses.

During the 2000s, large brokerages, also called wirehouses, established beachheads in cities like Pittsburgh by hiring a top performer from a regional firm – sometimes the head of a small group of advisers – and signing him or her to a multiyear contract with a bonus and marketing and backroom support.

Now, with more regulations kicking in from legislation passed to curtail financial meltdowns since the Great Recession, these larger firms are responsible for maintaining the same high levels of compliance across their wider empire.

"If those commissioned people are not uniform in the way they do their practice, well, I couldn't sleep if I was responsible for their compliance to regulations," Fragasso said. "The broker/dealers are putting a lot of pressure on those shops and it's another burden."

Erica Snyder, president and CEO of Hunter Associates Inc., described it as "the flip side of the prior 10 years." Now these solo practices and small team groups are increasingly pressed to find potential economies of scale.

New fiduciary standards also are looming.

"A much higher level of regulatory and compliance costs have taken place over the last seven years and it's really hard for smaller organizations to absorb," said Craig Wolfanger, president and executive managing director at Raptor Partners LLC, the North Shore-based investment banking firm. "The need to get larger and spread costs over a bigger organization is a fundamental driver of M&A activity. I don't expect that to diminish at all. It stops new businesses from starting and it drives the smaller ones that can't operate with all those regulatory costs. Inevitably, what that does is increase the average size of the participants within the investment management sector."

So being part of a larger firm provides more resources as the industry becomes more complex, Snyder said. Those include additional human capital, technology and compliance resources.

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>
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> CEO, D.B. Root & Co.

"Those are key," she said. "If you're on your own island, it helps to have company."

Although Hunter Associates added a practice in Ohio a few years ago, it has yet to do a local deal, though Snyder is open to it, provided the fit is right.

"Small firms must do what's necessary to meet the standards and you can't do it all," Fragasso said. "You can't be the mastermind for the portfolio, chief marketing officer, administrative manager and compliance officer and work a 60- to 70-hour week, especially if you're over 60. That's a recipe for merger."

Fragasso is currently in what he termed serious discussions with three different firms – two locally based and another split between Pittsburgh and another city – and has had talks with six during the past year.

Word of mouth is just one of the ways companies hook up. Deals are also brokered by consultants, lawyers and accountants, and investment banking firms.

D.B. Root, based downtown, partnered last fall with New York-based Dynasty Financial Partners to provide an integrated technology platform, and because of that relationship has been approached by four firms, all outside southwestern Pennsylvania. It only had been approached once in the previous 18 years.

"We're actively in talks with three," Root said. "It's beyond polite introductions. We're in due diligence with two."

Root did not identify the firms, but two are based in the Philadelphia area, he said. One has $160 million in assets under management, the other counts more than $200 million. Talks are at an earlier stage with the third candidate.

It's lucrative – and efficient – for firms like Dynasty to serve as matchmaker.

"If they do a deal, basically an investment banking function, they're compensated by taking an upfront fee based on assets under management and receive a small percentage of the ongoing revenue because we use their platform," Root explained. "If we double or triple in size, they're dealing with one client, but a much larger one, so it's in their interest to help us grow. We're better off if we have fewer bigger clients; they're better off the same way."

Several Pittsburgh-region independent firms said they are likely to buy. None said they were seeking an acquirer.

"A firm should have assets under management of more than $500 million before they should think about selling, and at over $1 billion, you become a player," said Rick Pierchalski, chairman of Medallion Wealth Management Inc. "You need to put numbers on the books."

Pierchalski's firm, launched in 2013, is still too young to do transactions of that size, he said.

One local who did opt to be acquired by a larger firm is Jack Abriola, who in November sold his Carnegie-based money management firm, Select Financial Group LLC, to California-based United Capital Financial Advisers, which has $15 billion of assets under management.

Abriola launched his company back in 1992, the year his daughter Diana was born, and she had recently joined Select. But the industry was changing and he said he wanted to provide a secure future for her and his other employees. So when United Capital approached him last spring, he was ready to listen.

"The financial regulatory environment is tough and, not only that, in the years to come, the whole industry has been changing a lot," he said. "You need scale, you need more regulatory oversight and you need to keep up with technology."

To be nimble and remain competitive, Abriola said it made sense to become part of a larger organization.

Count Abriola among those who believe many other small independents will make similar decisions.

"Things like the Department of Labor's new issuances for fiduciary responsibility are just speeding up what I think is inevitable," he said.

Meanwhile, White said she no longer feels bogged down by the multiple demands of running her own company. Fragasso Financial added another adviser to White's practice and moved her office to its Wexford space.

"Bob told me, 'You're going to get reignited, I can see you have the passion,' and he was right," she said.

Fragasso, by the way, is no stranger to offers. Search firms have approached him as well.

"I had a call last week," he said. "But I turn them around. I say, 'No, and here's why. But we're looking to acquire. We'll pay you a finder's fee if you find a good fit.'"