February 2023

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Advisor firm consolidations and acquisitions – learning from the UK experience

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In a recent article, we evaluated the health of the South African independent financial advisor (IFA) market post the Covid pandemic. We looked at statistics on the number and age distribution of IFAs active in South Africa, as well as the results from our 2021 IFA financial metrics review.

The article concluded that, despite the impact of the Covid disruptions, the investment advice market in South Africa appears to be vibrant and healthy. Some of the highlights were:

- The number of active investment-focused IFAs continued to grow at a rate of more than 3% p.a. since 2014, despite the pandemic.
- The overall age distribution of advisors in IFA firms appears healthy, with a strong cohort of younger advisors (age 25 to 45) coming through the ranks.
- Financially speaking, revenue lines remain robust despite cost pressures in IFA firms.

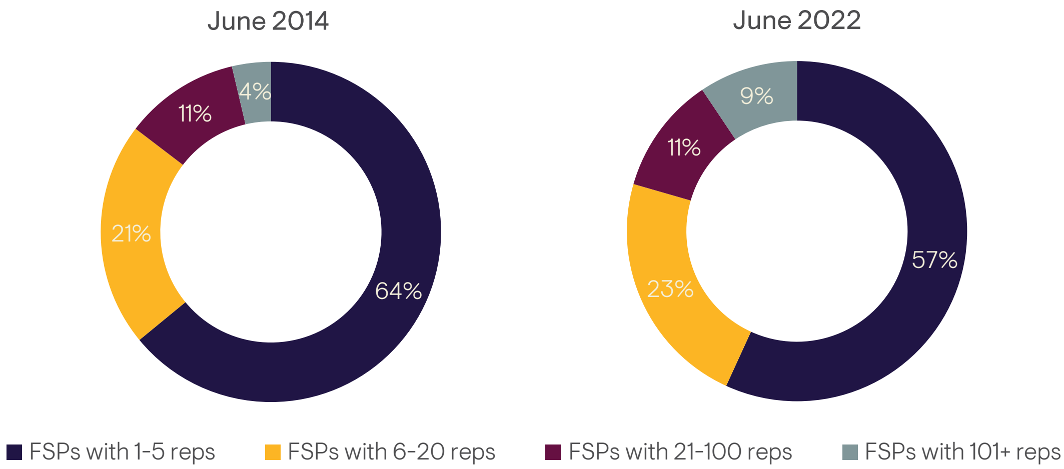
An industry experiencing consolidation?

After the publication of the above-mentioned article, we fielded a number of questions from SA advisors on the topic of consolidating with another IFA firm – to manage challenges around succession and advisor retirement plans.

We therefore did some further analysis on advisor FSCA licensing data[1] to investigate the structure of IFA firms in South Africa. Specifically, we looked at changes in the number of advisors working for small IFA firms versus those working for large firms.

The analysis of the approximately 13 000 IFAs with investment product categories on their FAIS licence[2] revealed some interesting results, as can be seen in the pie charts.

The SA IFA market remains strongly entrepreneurial



Source: Pi FSI 2022 database. FSP refers to an authorised financial services provider.

The main takeaways from these pie charts are:

- The vast majority (57%) of individual advisors work for IFA firms that have 5 or fewer advisors in the business. The SA IFA market remains strongly entrepreneurial, dominated by small firms.
- However, from 2014 to 2022 the number of advisors working for firms with 5 or fewer advisors declined from 64% to 57%, which is a meaningful reduction.
- Around 70% of the advisors who exited smaller IFA firms between 2014 and 2022 appear to have joined large corporate advice networks (firms with more than 100 advisors on their licence).
- The other 30% of advisors leaving small firms joined slightly larger firms employing 6-20 individual advisors.

1. Source: Pi FSI 2022 database. FSCA refers to the Financial Sector Conduct Authority.
2. The Financial Advisory and Intermediary Services (FAIS) Act requires that financial services providers (FSPs) be licensed.

From this data it seems that there has been some level of consolidation of smaller SA IFA firms over the past 8 years. This resonates with the increase in succession and acquisition conversations we have been having with advisors. The data also reflects the increased number of advisor practice acquisition transactions we have observed over the past 5 years.

The UK experience provides an interesting perspective

Consolidations and acquisitions remain a hot topic of discussion in the UK financial advisor industry. Particularly, as the UK market has seen UK and internationally based private equity (PE) investors funding large-scale consolidations in the financial advice industry over the past 5 years.

A search on UK financial services websites[3] and the Financial Conduct Authority's (FCA's) online portal yields several relevant articles on the topic of IFA consolidation. The FCA in the UK also publishes some useful reports[4] annually, highlighting key statistics about the state of the UK advisor market.

Scanning through those articles and comparing the UK experience to the SA experience, a few observations stand out for us:

- The UK advice market also has a large number of smaller advice practices, although not as much as South Africa:
    i. The FCA 2021 report lists approximately 36 000 individual investment-focused financial advisors in the UK working for around 5 000 firms across tied, restricted and independent categories (an average of 7.2 advisors per firm).
    ii. In June 2022, the SA market had around 25 000 investment-focused advisors (both tied and IFA) working for 4 700 firms (an average of 5.3 advisors per firm).[5]
- The UK market has had a higher rate of IFA consolidation transactions than South Africa. International law firm Mayer Brown recently reported that there have been around 400 financial advisor firm consolidation transactions in the UK every year for the past 3 years. This represents almost 9% of the number of registered advice firms every year!
- Because of this growing interest, valuations of UK investment advice firms have been very attractive. In the UK, the norm would be for investment advice firms to be valued between 3 and 5 times their annual revenue.

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3. See www.ftadvisor.com
4. See www.fca.org.uk/data/retail-intermediary-market-2021
5. Source: Pi FSI 2022 database

- Besides attractive valuations, market commentators in the UK list a range of factors that are driving the UK consolidation trend. These will all be familiar to SA advisors:

  i. Implementing succession plans – one article quoted 2022 data from the FCA stating that a third of authorised advisors in the UK were older than 50 years.
  ii. Regulatory compliance burden – this is a major driver in the UK where the overhead costs and regulatory requirements imposed on advisors are higher than in South Africa.
  iii. Significant investments in technology are required to build an advice firm that can serve the financial advice client of the future – smaller firms struggle with this transition.
  iv. Lower market returns are shaking out firms with flimsy advice propositions.

The relevance of the UK experience to South Africa

Given the huge amount of publicity of the UK experience, it is easy to get caught up in the frenzy and assume that consolidation should follow a similar path in South Africa.

While some consolidation is to be expected in South Africa, we believe that smaller, well-organised SA advice practices are in a better position than their UK counterparts. This is predominantly because of the less intrusive regulatory framework in South Africa compared to the UK, as well as the strong support local IFAs receive from outsourced local compliance providers, discretionary fund managers and investment platforms.

There are also some structural differences between the two markets:

- The private equity (PE) market has been the driving force of the UK consolidation trend. In South Africa, PE plays a much smaller role – advisor firms here have largely either merged with another advice firm or joined a large advice network owned by a product manufacturer.
- A combination of low interest rates in the UK since 2008 and the availability of significant capital targeting the advice industry there, has resulted in generous valuations for practices. This has supported advisor consolidations in the UK.
- In South Africa, we must factor in that we are an emerging market with higher interest rates and less private equity and international investor interest in the financial advice market. It is therefore not surprising that SA investment advice firms are generally valued at lower revenue multiples – typically between 2 and 2.75 times annual revenue.

In conversation with UK PE consolidators, the endgame strategy for PE investors remains unclear. We know that most PE investors typically sell out 5-10 years after the initial investment to liquidate their position. Given the large number of recent PE deals in the UK advice market, we should therefore expect many of these consolidated advice entities to be up for sale over the next 10 years.

But who will be buying them? When asking this question to UK market commentators, most expect that UK banks, insurance companies and asset managers, eyeing distribution for their in-house products, will be the likely buyers. Time will tell how that outcome will sit with UK advisors who have sold their firms to consolidators.

Conclusion

Reflecting on the learnings from the UK advisor market and understanding the drivers behind the advisor consolidation trend there, will help SA advisors navigate the trade-offs inherent in different succession options. Ultimately, this should lead to better succession decisions.

What can SA IFA firms take away from the UK experience?

- There are significant parallels between the UK and the SA advisor market.
- Both markets are experiencing increasing regulatory scrutiny of their advice industries and higher compliance costs, leading to some consolidation in advice channels. These factors are unlikely to change soon.
- But there are also significant differences between the two markets, which affect the way these markets respond to their operating environments.
- Most importantly, South Africa does not have the same large asset pools available to fund advisor consolidation as the UK has.
- It is therefore likely that the structure of consolidation deals in SA advice firms will be different from the UK and that amalgamations of like-minded, smaller IFA firms might be more popular here.
- The final chapter in the UK consolidator network story still needs to be written. Specifically, how the exit of PE investors will be funded and what that means for advisors in a network, remain open questions.

At Ninety One, we frequently speak to advisors keen on either buying or selling practices as part of succession plans. Based on anecdotal feedback from these conversations, it seems that the SA market currently has more buyers than sellers. After the spike in IFA buying activity in South Africa between 2017 and 2021, potential sellers are now more circumspect and are evaluating offers and succession options more carefully.

We are always keen to hear your views on consolidation and succession planning. Please contact your Ninety One Sales Manager if you would like to share your thoughts with us.

Contact information

Please visit our website at www.ninetyone.com for more information on our range of funds and portfolio products. You'll also find application forms and other relevant documentation for offshore investing on the website.

For more information and assistance with investing, call the Advisor Service Centre Tel 0860 444 487.

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