TITLE:

Identification and inclusion of clients' sustainability preferences as a financially material factor when determining the value of your firm for exit-planning

CONTENT:

We believe identification and inclusion of your clients' sustainability preferences is a financially material factor when determining the value of your firm for exit planning.

A key risk for any firm wishing to sell is that the sale price can be eroded by discoveries made during the valuation process. Potential buyers will need to understand the nature of the firm's business, its liabilities and, critically, the quality of the compliance process.

In this article I will explain why embedding a robust and granular ESG & Sustainable Finance compliance framework now (oh, hello ESG Accord!) could help firms achieve a more solid/less negotiable sale price (or conversely - for acquisitions firms - help you negotiate a lower buying price!)

This is a complex area, but at a general level it is widely accepted that there are three ways to calculate the value of a business;

1 - as a multiple of ongoing advice fees/charges
2 - as a multiple of profit
3 - a percentage of AuA

Firms looking to sell will obviously be seeking the highest value exit price with minimal deductions or legacy liabilities. Acquisition firms will be looking at the purchase in terms of impact on their future profitability; the cost, the workload, staffing and ongoing revenues.

The next stage will be a more detailed valuations assessment, this is business quality, such as

a/ review of DB cases
b/ adequacy of PI
c/ any incoming regulatory shifts that may affect the business adversely
d/ likelihood of client retention: i.e., clients staying on the books long term and the level client engagement needed

c/ and d/ are clearly of relevance when looking at a firm's exposure to ESG and Sustainable Finance advice. A well informed, engaged client bank will have greater value for the seller. A client bank that has 'been asked the ESG question', with little evidence of client education, engagement or quality of fact finding in this area will allow potential buyers to reduce the value of the business.

The acquisition firm will be looking to see if they can reduce the current model costs so that profitability can be raised. So, they should be asking a raft of questions, which could include:

- How far does the selling firm engage with clients?
- Is the KYC complete? (ie more than one Fact Find question for ESG/SF/Responsible/Ethical/SDGs/Impact etc!)
- How has the selling firm categorised its target market/PROD for ESG and Sustainable Finance?
- How are client assets invested currently?
- What do annual reviews consist of? Does this fit with a long term 'sustainable/intergenerational/wealth shift business model?
- How much work will be required to embed ESG/SF into the back-office systems?
- How have ESG/SF processes been previously recorded throughout the advice process?

Sellers will be looking at the above from a compliance perspective. Firms who have already fully embedded an ESG & Sustainable Finance compliance framework will have an arguably more solid model for pricing. Those who have asked a single ESG question, can't document full client education and do not detailed files linking advice to client needs will struggle to achieve the values they are looking for.

Where weaknesses are identified in the area of ESG/Sustainable Finance, potential buyers will look to reduce purchase price, based on considerations such as:

- Wealth shift - clients may not be retained if the current firm's advice model does not support sustainability values preferences or does not fully embrace finance for a net zero economy. As older clients die, will inherited money stay with a firm that hasn't embraced ESG/Sustainability advice issues?
- The cost and timescale of embedding a full review process for all clients; educating clients, implementing full compliance processes for gathering sustainability preferences etc will be a considerable expense for the purchasing firm
- risk of inheriting back book of clients in funds that potentially do not match target market or client needs. Potential grounds for future complaints directed at the purchasing firm, based on the selling firm's compliance weaknesses in ESG/Sustainable preferences assessments.
- client retention may be lower. Clients used to a 'flexible' compliance process may react badly to the job being done properly!

I know what I'd do if I was exit planning. Or buying!