2013 Northeast Ohio Chapter of the Exit Planning Institute

"State of Owner Readiness" Survey

Full Report

Prepared by

Chris Cooper, Ohio Employee Ownership Center, Kent State University

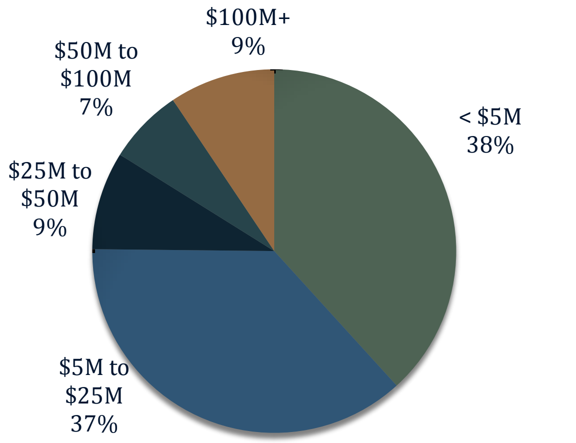
Introduction

The Exit Planning Institute's Northeast Ohio Chapter partnered with Grant Thornton, PNC Bank, and the Ohio Employee Ownership Center at Kent State University in 2013 to conduct a survey of business owners. The goal of the survey was to ask business owners a set of questions around a broader and larger issue: how effectively (if at all) have you planned for the inevitable exit from your business?

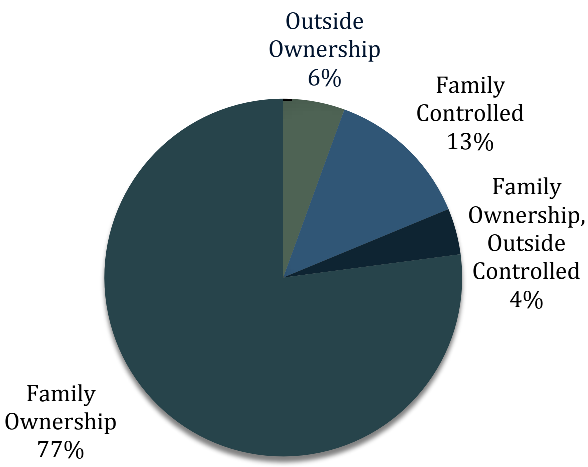
The purpose of the survey fits closely with the core mission of the Exit Planning Institute, namely the creation of an all-inclusive, proactive process for accomplishing the objectives and goals of the exiting business owner. In order to do that, it was important to find out where the average business owner was in the process.

The Plan of this Report

This report is composed of three major parts: 1) a discussion of the major demographic data of the respondents; 2) an overview of the major findings from the data, and; 3) recommendations for the exit planning community, based on the data from the survey, to ensure the best results for their business owner clients.



Annual Revenues



Percentage of Family Ownership

Key Demographics of Survey Respondents

The survey was sent to over 900 business owners nationally, 175 business owners responded, with 128 business owners completing the survey in its entirety. The respondents were generally slightly older and had a larger percentage of males than the general demographic for business owners in the United States:

- **73% WERE BETWEEN THE AGES 50 TO 70 (THE DEMOGRAPHIC IS REPRESENTATIVE OF THE BABY BOOMER POPULATION FOR THE US).**
- **78% WERE 50 YEARS OF AGE OR OLDER (US AVERAGE, 51 YEARS OLD, US CENSUS 2010).**
- **87% WERE MALE (71%, US CENSUS 2010).**

The companies represented a good cross-section in regards to sales, and skewed larger than general Census numbers:

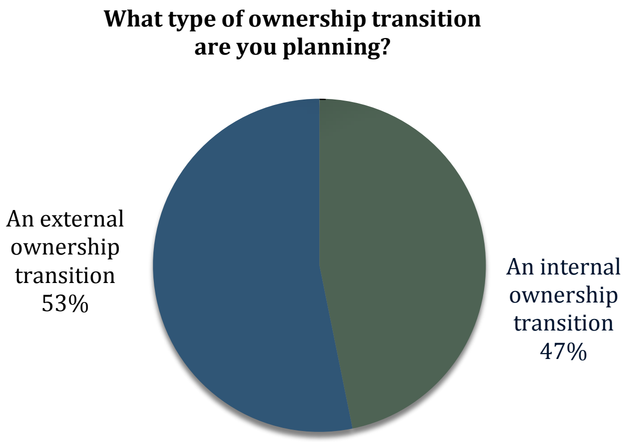
- **75% OF THE SAMPLE WERE COMPANIES WITH ANNUAL REVENUE UNDER $25 MILLION, WITH 35% UNDER $5 MILLION (US CENSUS DATA = 93%), 40% BETWEEN $5-25 MILLION, 15% BETWEEN $25-100 MILLION AND 10% OVER $100 MILLION (US CENSUS DATA = .3%).**

Evidence of some form of family ownership remains strong in the sample:

- **77% OF THE COMPANIES ARE 100% FAMILY-OWNED, WITH AN ADDITIONAL 17% HAVING SOME FORM OF FAMILY OWNERSHIP INVOLVED.**
- **57.5% OF FAMILY-OWNED COMPANIES WERE UNDER FIRST GENERATION OWNERSHIP.**

The trend towards S-Corporations as a structure also remains strong:

- **69% OF THE COMPANIES ARE S-CORPORATIONS, WITH THE REMAINDER SPLIT VIRTUALLY EVENLY BETWEEN C-CORPORATIONS AND LLCS.**

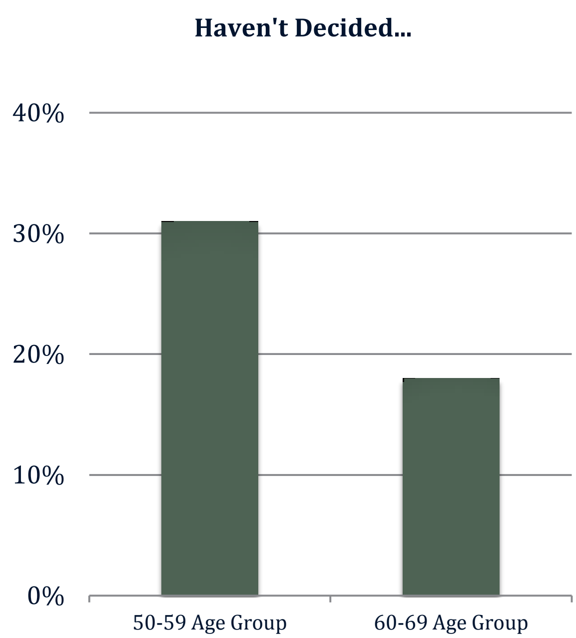


Previous surveys on the topic have identified that a large number of business owners in the Boomer generation plan to transition out of the business over the next 10 years. The respondents to the EPI Survey are no different:

- **76% OF RESPONDENTS PLAN TO TRANSITION WITHIN 10 YEARS; NEARLY 50% WITHIN THREE YEARS.**

Although most owners admit they do not understand all of their exit options, a broad range of options are available, and being considered, by the respondents:

- **47% EXPECT TO TRANSITION TO SOME FORM OF AN INTERNAL BUYER (FAMILY MEMBER, EMPLOYEES, MANAGEMENT, OR PARTNER(S)/SHAREHOLDERS), 53% TO SOME FORM OF AN EXTERNAL BUYER (SALE TO A THIRD PARTY SUCH AS A PRIVATE EQUITY FIRM OR STRATEGIC BUYER).**
- **18% OF RESPONDENTS IN THE 60-69 AGE BRACKET, AND 31% IN THE 50-59 AGE BRACKET, WERE STILL UNSURE OF WHETHER THEY WERE IMPLEMENTING AN INTERNAL OR EXTERNAL TRANSITION. ALL OF THE RESPONDENTS IN THE 70+ AGE BRACKET HAD MADE UP THEIR MINDS ON THIS ISSUE.**



Confirming the overall trend in the general populace towards working during retirement, a number of business owners expect to continue working in the business, even after "exiting":

- **58% EXPECT TO HAVE SOME TYPE OF CONTINUING ROLE IN THE BUSINESS AFTER THEY EXIT.**

Key Findings

Overall the survey results reinforce commonly held perspectives on owner readiness, but also reveal a few surprises as well. When analyzing the findings, it is important to remember that the survey relies on self-reporting from the business owners themselves (rather than objective "facts"), and therefore needs to be judged (at least on some questions) by that standard. Even by that standard, the survey uncovers important details about where the owners see themselves in relation to exit planning.

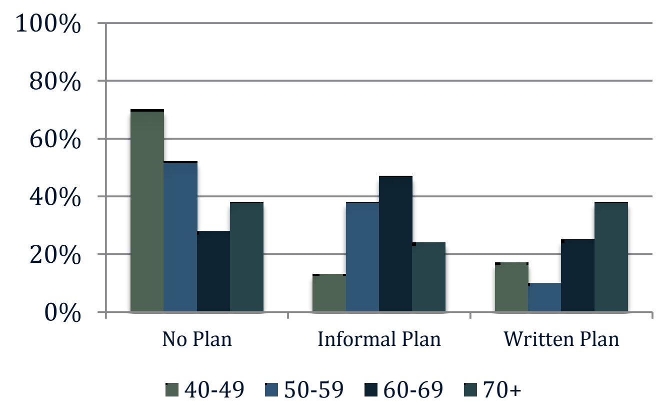
83% do not have a plan, or have not documented or communicated their plan

Lack of Planning, and Communication

Though a large amount of general (and industry) focus has been placed on the need for effective exit planning, the rate of planning for that transition on the part of surveyed business owners remains low:

- **83% EITHER DO NOT HAVE A TRANSITION PLAN (49%) OR "HAVE" A PLAN THAT HAS NOT BEEN DOCUMENTED OR COMMUNICATED (34%). OF THOSE THAT DO HAVE A PLAN:**
  - **13% HAVE COMPLETED STRATEGIC ANALYSIS AND VALUE ENHANCEMENT PLANNING ONLY.**
  - **ONLY 13% HAVE DETAILED ACTION PLANS.**
  - **50% DO NOT DIFFERENTIATE BETWEEN MANAGEMENT AND OWNERSHIP TRANSITION.**
- **14% OF RESPONDENTS IN THE 60-69 AND 70+ AGE BRACKETS HAVE NO PLANS TO TRANSITION THEIR BUSINESS**
- **40% OF RESPONDENTS DO NOT HAVE A PLAN THAT COVERS A "FORCED" EXIT (ILLNESS, DEATH, ETC.).**
- **81% OF RESPONDENTS HAVE NO WRITTEN STRATEGIC PLAN, YET 67% EXPECT TO MAKE STRATEGIC DECISIONS REGARDING THE COMPANY AS PART OF THEIR EXIT STRATEGY.**

% of business owners, by age group, who have completed steps in the exit planning process.



These results generally are in line with those from other surveys on the issue, and provide a humbling reality check as to the effectiveness of "status quo" models of client advisory services.

It is to be expected that business owners in their 40s and 50s are less likely to have settled on a transition plan, and our survey bears that out. What is disturbing is that too many business owners between 50 and 70+ years of age still do not have a viable plan in place.

Continuing the theme of a lack of communication to stakeholders (whether in the business or not) about their exit plans, too many business owners neglect to share their plans with the most important people in their life:

- **35% OF RESPONDENTS STATED THAT THEIR FAMILY IS NOT AWARE OF THEIR MANAGERIAL AND OWNERSHIP TRANSITION PLANS.**

Timeline for Exiting Business, by Age Bracket

40-49	
< 5 years	17%
< 10 years	38%
No plans to transition	62%
50-59	
< 5 years	41%
< 10 years	83%
No plans to transition	17%
60-69	
< 5 years	69%
< 10 years	89%
No plans to transition	11%
70+	
< 5 years	63%
< 10 years	0%
No plans to transition	25%
No answer	12%

Timeline for Affecting an Exit

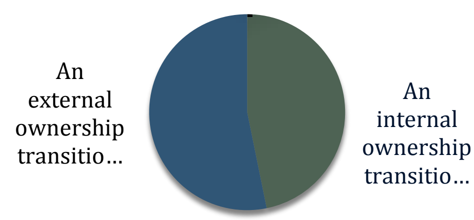
As is to be expected (at least in most cases), when asked to provide a time frame for exiting the business, proximity to retirement age clearly affected the respondents' timeline for exiting.

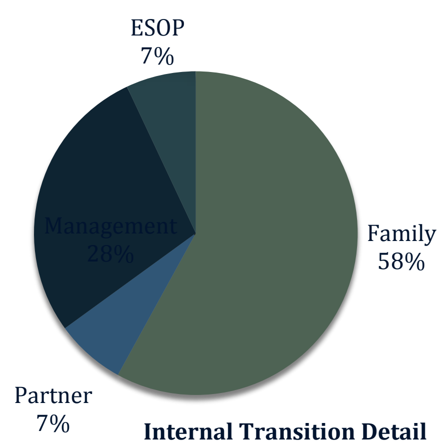
- **83% OF THOSE IN THE 50-59 AGE GROUP AND 89% OF THOSE IN THE 60-69 AGE GROUP PLAN TO TRANSITION THEIR BUSINESS IN THE NEXT 10 YEARS.**
- **41% OF THOSE IN THE 50-59 AGE GROUP, 69% OF THOSE IN THE 60-69 AGE GROUP PLAN TO TRANSITION THEIR BUSINESS IN THE NEXT 5 YEARS.**

Internal or External?

The fundamental choice facing business owners as they plan their exit is, at its core, binary: an internal sale (Family member, employees, management, or partner(s) and/or shareholders), and external sale/transfer (a third party such as a private equity firm or strategic buyer).

- **WHEN FORCED TO CHOOSE, 47% EXPECT TO TRANSITION TO SOME FORM OF AN INTERNAL BUYER 53% TO SOME FORM OF AN EXTERNAL BUYER.**
- **WHEN GIVEN THE OPPORTUNITY TO NOT SPECIFY ONE OR THE OTHER, 31% OF THE 50-59 AGE GROUP AND 18% OF THE 60-69 AGE GROUP CHOOSE THE AMBIVELANCE OF "NOT SURE".**
- **48% OF THE 50-59 AGE GROUP THAT WILL LIKELY TRANSITION EXTERNALLY WILL DO SO IN THE NEXT 5 YEARS, WITH 38% IN 6-10 YEARS. CONVERSELY, 19% OF THE 50-59 AGE GROUP THAT WILL LIKELY TRANSITION INTERNALLY WILL TRANSITION IN THE NEXT 5 YEARS, WITH 69% IN 6-10 YEARS.**





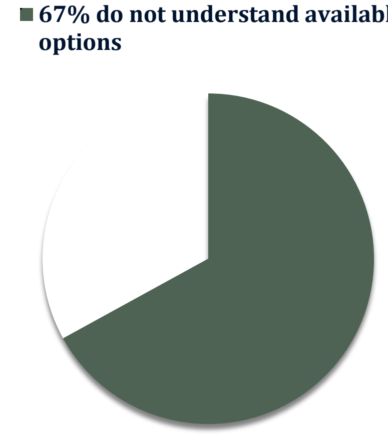
Internal Transition Detail

Type of Ownership Transition, by age group, when given option of Not Sure

Age	External	Internal	Not sure
40-49	17%	22%	61%
50-59	40%	29%	31%
60-69	26%	56%	18%
70+	63%	37%	0%

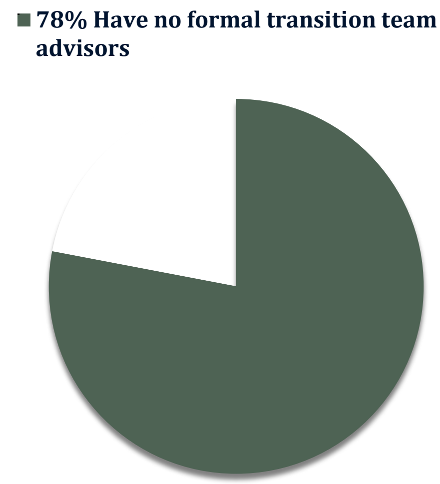
How well do business owners understand the various exit options? The answer is they often have a partial view of the choices available to them for exiting their business. This definitely was the case with our group of business owners:

- **Two-thirds of respondents feel they are not familiar with all exit options.**



There exists a growing trend in the advisory community of recommending proactive strategies (outside board members, advisory boards, and team-based approaches); despite this, business owners are not utilizing these tools and strategies of business support and expertise efficiently:

- **72% of respondents do not have a board; 93% of those who do have no outside members on board.**
- **Only 28% of respondents have what they consider to be an engaged Board of Directors, with only 8% having engaged outsiders on the Board.**
- **78% have no formal transition team of advisors in place.**
- **Only 14% of the owners have completed in the last two years (or have underway presently) a formal, pre-transition value enhancement and/or preliminary due diligence project to de-risk the business, maximize its value, minimize taxes upon transition.**
- **The respondents chose accountants (33%) as their "most trusted advisor", followed in order by their spouse (16%) and attorney (12%).**



The survey provides support for the aforementioned proactive approach to planning; an example is in the area of understanding the range of available exit planning options (an important early step in planning). The data clearly points to a correlation:

- **Two factors increase the likelihood of the business owner understanding all of their transfer options: formal education about the exit planning process (57% understand all their options vs. 26% that don't) and having a professional team of advisors in place (47% understand all their options vs. 31% that don't).**

Smaller Companies Less Likely to Have Boards of Advisors

	<$50M Sales	>$50M Sales
No Board	73%	53%
Yes Board	27%	47%
Outside Directors	6%	10%

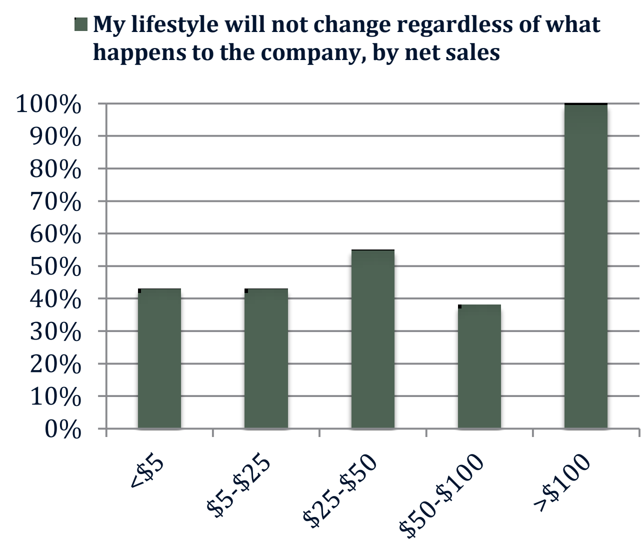
The Third Act - After the Transition

One of the most commonly neglected (and predictably enough most important) aspects of the exit planning process is what happens after the transition. This area covers many different components, some financial, some emotional, but all very personal in nature.

Financial Planning – The survey data reveals a number of interesting points worth exploring, and illustrates the incomplete nature of much of this type of planning.

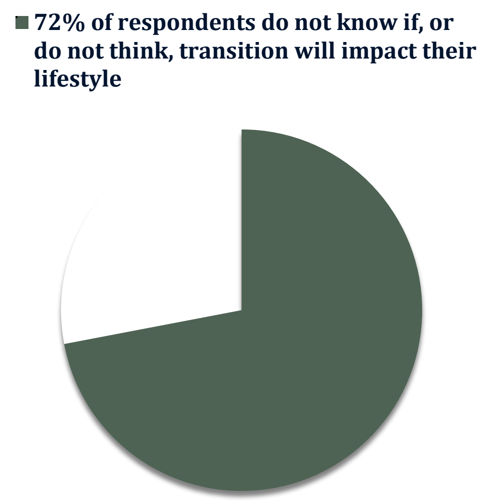
- **ONLY 39% OF RESPONDENTS FEEL THE TRANSITION WILL BE "ABOVE AVERAGE" EMOTIONALLY.**
- **RESPONDENTS LOOKING TO SELL TO AN OUTSIDE BUYER CHOSE "MAXIMIZING AFTER TAX PROCEEDS" AS THE FACTOR MOST IMPORTANT TO THEM IN VALUING THE SUCCESS OF THEIR TRANSITION; HOWEVER, 36% OF THE SAME SEGMENT STATED THAT THEY HAVE NO FINANCIAL OR ESTATE PLAN.**
- **63% OF RESPONDENTS LOOKING TO SELL TO AN INSIDE BUYER, AND ONLY 27% OF RESPONDENTS LOOKING TO SELL TO AN OUTSIDE BUYER, HAVE INCORPORATED THEIR EXIT PLAN INTO THEIR ESTATE AND FINANCIAL PLANS.**
- **57% OF ALL RESPONDENTS STATED THAT LIFESTYLE IS NOT DEPENDENT ON TRANSFER OF OWNERSHIP OF THE BUSINESS, SUGGESTING SIGNIFICANT (OR A PERCEPTION OF SIGNIFICANT) SOURCES OF OTHER WEALTH.**
- **72% OF RESPONDENTS DO NOT KNOW IF, OR DO NOT THINK, THE TRANSITION WILL IMPACT THEIR LIFESTYLE.**

Generally, most financial planners estimate that 85-90% of the net worth of the average business owner is tied up in the business; the question becomes how to reconcile this generally accepted rule of thumb with the perception of overall financial well-being expressed by the respondents. This may be due to owners being unrealistic about their financial needs post transition.



The Soft Underbelly - The emotional side of exiting a business is usually trickier than even the financial planning aspects. The scope of this area covers a number of touchy subjects, including family relationships; personal self worth; decisions on what to do with a sudden influx of wealth (or a sudden glut of free time); and even health, wellness and end of life issues.

- **48% of all respondents stated that they have either "No Plans," or state a rather general goal of "retire" post-transition.**
- **Only 4% of respondents have a formal, written "life after business" plan.**
- **27% of respondents plan to either buy another business or invest in and/or serve on the board of another business.**
- **28% plan on devoting themselves to civic or philanthropic activities. Internal sellers are more philanthropic than those considering an external sale by a 4 to 1 margin.**



General surveys of business owners post-transition claim that 75% of business owners become dissatisfied with the result post-transition. A common term for this dissatisfaction is "seller's remorse." This remorse may be the result of believing they were underpaid for the business or perhaps they believe they sold it at the wrong time in the business cycle. Commonly, many owners are not prepared for the emotional impact of selling their business. This can hit home, for example, when the family name is removed from the sign in front of the building. In our survey, however,

- **64% of respondents feel that exiting their business will not be emotional.**

It remains to be seen (perhaps in a future survey) as to whether this number holds up, post-transition, for our set of owners.

Conclusion and Recommendations

A number of clear conclusions can be drawn from the survey, as well as a number of equally clear courses of future action for the advisory community.

- Business owners are not doing enough to successfully manage the "last, great test of entrepreneurship," transitioning their business.
- Despite the focus on exit planning awareness by the business advisory community, the survey makes clear that we need to do a better job defining best practices, collaborating with other advisors, and educating business owners.
- The survey reinforces previous surveys on the topic.

The survey does provide a number of areas for concrete action to improve outcomes for business owners.

- It is vital that we move business owners to a more concrete version of an exit plan. In other words, the plan needs to be documented and communicated to all relevant stakeholders.
- The exit strategy needs to be integrated into the business strategy and internalized as a method for operating the business on a day-to-day basis.
- An education and outreach program to business owners (and family) is important to allow a business owner to understand and evaluate all available options.
- It is highly unlikely that in the next 10 years there will be enough capital to enable the number of outside transitions (sale to a third party such as private equity or strategic buyer) preferred by business owners. As such, owners will need to take a more serious look at inside transition options such as ESOP, management buyouts, and family or be forced to substantially discount the sale of the business to a third party.
- It is vitally important that the exit plan and estate plan be considered two sides of the same coin. It serves no purpose to have these two important aspects of a business owner's retirement plan not be in sync, or worse yet, actively working against one another.
- Additionally (and related to the previous point), it is important to look beyond the financial aspects of the planning process to encompass the personal aspects of post-transition life for the business owner. Far too many of the survey respondents do not have a clear plan for this period of their life. When we ask why more entrepreneurs don't properly plan for exiting their business, often the reason is that they have not been able to answer the following question: "What do I do next?"
- Finally, based on all of the above, it is very clear that advisors should strive to achieve a comprehensive, team-based approach. No one advisor is capable of handling all of the above areas to optimal effectiveness.

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