TWIN CITIES METRO AREA

2017

Exit Planning Institute

A LOCAL MARKET STUDY:

The State of Owner Readiness

BENCHMARKING LOWER MIDDLE MARKET BUSINESSES AND EDUCATING OWNERS ON THE DIFFERENCES OF “ATTRACTIVENESS” VERSUS “READINESS”

VISIT WWW.OWNERREADINESS.COM

Minnesota's business climate is among the best in the nation, according to *Forbes*. We came in 15th on the magazine's "Best States for Business" list, which is no surprise. Known as a land of entrepreneurs, the state boasts a highly educated work force and a strong work ethic.

Minnesota business owners are leaders and tone setters. Many of our local leaders have built their companies into lucrative assets. Frankly, though, many more have not. Even more ironic is the fact that many of those same highly successful owners are unaware of how nontransferable their companies really are. And, like it or not, on the horizon is a wave of companies coming up for transition in the next ten years. Statistics show that most business owners will be unable to sell and will not transition. As a result, the negative impact that wave will have on us, our families, our employees and our economy will be far-reaching.

The good news is that we have the knowledge and tools to prevent that from happening. For both owners and advisors, the time is now to take massive and immediate action. And step one is to pull your head out of the sand and get educated in exit planning.

The 2017 *Twin Cities Metro Area State of Owner Readiness™ Survey* is a powerful research study that not only illustrates the current readiness levels of local owners but also brings awareness to you with the insights necessary to effect change, encouraging readers to take steps to implement a solid business transition plan. The Exit Planning Institute has teamed up with the Twin Cities' top advisors and firms to bring this knowledge directly to the fingertips of the Twin Cities market.

The results of the survey prove to us that the Minnesota business owner community desperately needs competent transition guidance and advice. As you explore this report, you will certainly see a disparity between what you'd expect from "the best business climate in the nation" and the actual strategic readiness of the owner sample.

Do not let this discourage you! Before any positive and lasting change can occur, we must first become aware that we need it. This survey does just that. Knowing what steps to take and who should get involved is just the beginning. The successful leadership and entrepreneurialism that made the Minnesota market so remarkable can once again be harnessed to change the outcome and the future business landscape. In fact, if you are reading this report, you've already started down the path to making a positive impact on your business success.

In my travels as a business advisor, coach, and exit planner, I have seen many successes and failures; many situations went south because of lack of planning. I cannot overstate how vitally important this step is in any business endeavor, especially one that affects the most important financial event of your life!

As you read the information in this report, I challenge you to ask yourself:

- Do I know the actual value of my business?
- Have I built a business that has transferable value and owner independence?
- What can I do today to ensure that my business has value in the future?

For most owners, you have one shot at doing your transition right. Exit planning is something you do now. Don't risk your legacy and hard work in hopes that you will beat the odds and sell for a high multiple someday. Plan now and have the assurance that you will exit on top.

As local advisors and exit planners, it's our job to eliminate the confusion, familiarize you with your exit options, and educate you on what drives business value and what depletes it. As an owner, it's your job to work on your business and build a team of trusted advisors that will provide you with peace of mind, assuring you that your outcome will be on your terms, not someone else's. It is time to take control of your own destiny.

Julie Keyes, CEPA
EPI Chapter President, Twin Cities Metro Area
Founder and President, KeyeStrategies

THE STATE OF OWNER READINESS
2017 TWIN CITIES METRO AREA REPORT

SURVEYED BY: The Exit Planning Institute
SPONSORED BY: The Twin Cities Owners Forum Council
FOREWORD BY: Julie Keyes, CEPA
AUTHORED BY: Christopher M. Snider, CEPA

Table of Contents

Survey Overview

In 2017, the Exit Planning Institute (EPI), in partnership with a collaborative network of partnering firms and organizations, conducted a survey of business owners in the Twin Cities region to determine their state of readiness to transition their businesses and unlock the wealth accumulated in those businesses. We also wanted to compare the Twin Cities results to those in EPI's national survey and other regional surveys EPI has conducted over the previous four years. Finally, we wanted to point out specific things that successful owners do and offer suggestions to business owners and business advisors for improving the probability of a successful transition and unlocking this vast wealth.

Roughly six million privately held companies currently operate in the United States, representing approximately $30 trillion in sales. Per US census data, 63 percent of these are owned by baby boomers, who currently range in age from 53 to 71. Although baby boomers are holding on to their businesses for longer, all boomers will reach the age of 70 or older within 17 years. That represents nearly four million baby boomer businesses poised to transition. Assuming a business valuation of 50 percent of sales, reasonable by most standards, that further represents $10 trillion of wealth poised to transition.

Unlocking this wealth in a business is or should be of paramount importance to all business owners if for no other reason than that **80–90 percent of most owners' financial assets are bound up in the business itself**. Given the significance of this asset in the owner's wealth portfolio, the ability to monetize this wealth at some point will have a significant impact on the owner's financial security and lifestyle once he or she exits the business.

The significance of the business asset transition spans beyond the owner and owner's family. Failure to provide for the continuity of the business affects not only the owner's personal wealth and that of his or her family, but that of all other stakeholders who depend on the business's successful transition. "The business owner is the giver of life," wrote Leon Danco, a legendary expert on family businesses, in his book *Beyond Survival: A Guide for Business Owners and Their Families*. With roughly six million privately held companies operating in the United States, representing around $30 trillion in sales and $15 trillion in wealth, the continuity of an owner's business matters not just to his or her family but also to the business's employees, vendors, customers, and supported charities as well as the economic and social well-being of the community where the business is located.

What happens if the business does not successfully transition? The alternative is that the business shuts down. People lose their jobs. Families suffer. Communities suffer. And in many cases an owner's life's work is liquidated for pennies on the dollar.

Previous surveys conducted by the Exit Planning Institute (EPI); Pricewaterhouse Coopers (PwC); the Alliance of Mergers and Acquisitions (AM&AA); Tom West, founder of Business

Broker Press; and the Family Firm Institute (FFI) have determined that **historical transition success rates range from only 20 percent to 30 percent nationally**.

The mission of the Exit Planning Institute and all Certified Exit Planning Advisors (CEPA) worldwide is to change this outcome. The good news is that we have models (20–30 percent do successfully transition) that can be emulated by business owners who decide that a successful business transition is in their future.

The significance of this potential outcome is increasing in urgency as baby boomers, who own nearly two-thirds of all privately held businesses, face the inevitable condition of aging. Although boomers are holding on to their businesses longer than previous generations, they must face the reality that **preparing for their business transition is now an urgent imperative**.

The community of owners must realize that transitioning a business is a high-stakes and, for many, once-in-a-lifetime endeavor whose successful execution requires significant focus, action, and time.

Doing it right has significant benefits. For many owners, their businesses represent the vast majority of their wealth. For the average middle market business, which we define as those with sales between $5 and $100 million and that hold a market value of $8.5 million, successfully transitioning the business means the difference between having $10.6 million in pre-tax wealth at transition and having $2.1 million in wealth. Even at an aggressive 6 percent yearly return rate, the difference in pre-tax income is $510,000 ($637,000 vs. $127,000) per year.

The consequences are even more significant for the micro market, which we define as those businesses that do less than $5 million in sales per year, with an average business value of just over $300,000. Most of these businesses are owner operated, and the owner derives almost all his or her income from the business. Roughly 5.7 million (94 percent) of those 6 million privately held businesses fall into this category. If 80 percent of an owner's wealth is locked up in the business, successfully monetizing the business asset represents the difference between having $400,000 at transition and having $100,000.

To successfully transition, an owner must address three things: (1) maximizing transferable business value for as long as he or she holds the business while positioning it to successfully transfer upon exit so that he or she can harvest the wealth locked in the business, (2) preparing financially for a lifestyle without the income from the business, and (3) planning personally for what comes next (the third act) after exiting the business.

To understand a business's present level of readiness to harvest this wealth and the current financial preparedness outside the business, as well as understand how well owners have prepared personally, EPI, with the help of its many strategic partners, has been conducting surveys of business owners since 2013. EPI completed national surveys in 2013 and 2014, conducted two regional surveys in 2016, and has planned several more regional and industry surveys for 2017.

The survey results continue to demonstrate many business owners' lack of readiness to transition, which explains why most transitions fail. The reports also demonstrate the need for massive education of business owners and business advisors on successfully transitioning.

The reader should note that **the survey answers reflect the owner's *perception***. Although the owner's answers may be factual, they are not based on proven fact. This can be accomplished only by completing a thorough personal, financial, and business assessment conducted by an independent credentialed advisor, such as a CEPA.

Nevertheless, the data are useful at least for assessing the owner's *state of mind* as it relates to his or her readiness to transition from a business, personal, and financial standpoint. Owners would be wise to consider completing personal, financial, and business assessments to support their current perceptions and their business valuation and to avoid surprises when the time comes to actually complete the transition of their businesses. This is also necessary for proper estate and personal financial planning.

What we know from past studies is that success rates in the United States are in the range of 20–30 percent—far below what they should be from an economic and social standpoint. Some owners' responses provide good reasons as to why that is. Others may reflect an owner's misunderstanding or underestimation of what it takes to successfully transition. In other words, it may be a situation in which business **owners don't know what they don't know**. Certainly, the lack of formal exit strategy education demonstrates that they are not sufficiently well-informed.

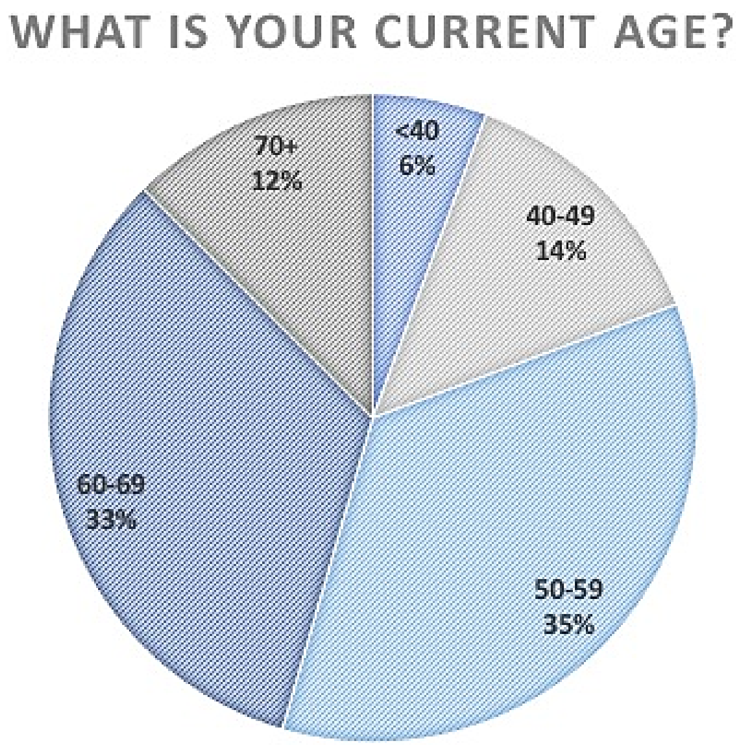
This data should be used as a business tool for discussing transition with owners and identifying areas where education and assistance are necessary. At a minimum, the results should be reviewed with business owners to begin the process of validating their particular situation, educating them on critical success factors, examining their options, and determining the probability of a successful transition.

This report is divided into three sections. In Section 1, we make general observations about the data collected from the Twin Cities survey and how they compare to the national surveys conducted by EPI in 2013 and 2014. In Section 2, we provide our analysis of the data and make observations regarding their implications for business owners. In Section 3, we outline recommended actions that business owners and business advisors should take to improve the probability of a successful transition and capture this hard-earned wealth.

Over 5,000 surveys were distributed with approximately 280 responses (5% percent). The survey included 44 questions organized as follows:

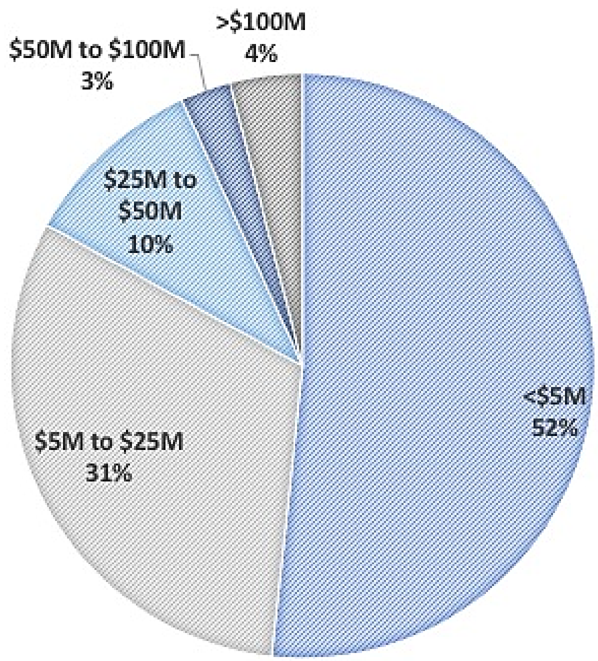
- demographic information (age, gender, annual revenue, legal structure, industry, most trusted advisor, etc.);
- current transition plans and thoughts;
- owner, shareholder, and family readiness to transition and company readiness to transition.

Section 1 – Demographic Data



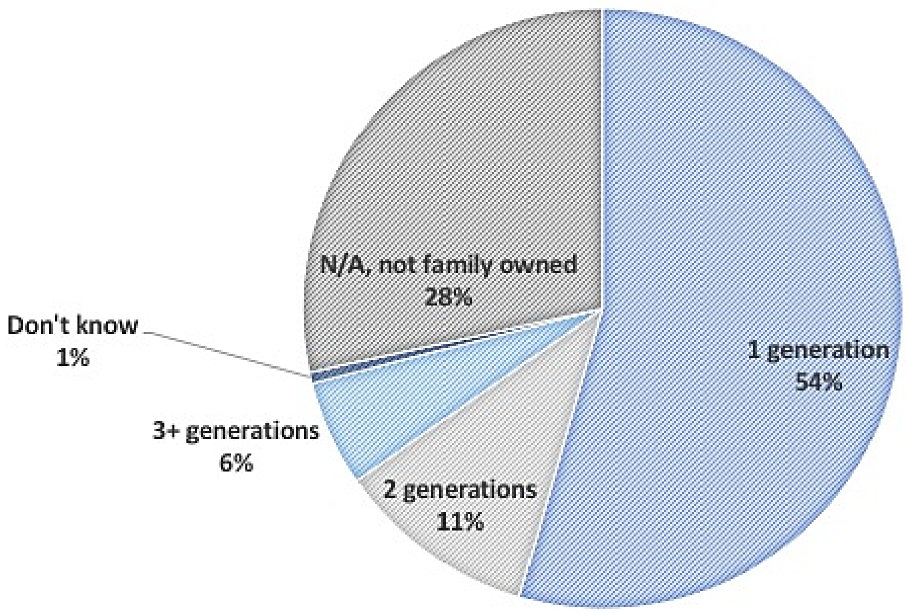
OWNER AGE: Sixty-eight percent of the respondents were baby boomers. This aligns with the US Census data indicating that baby boomers own 63 percent of privately held businesses. *Eighty percent of owners in the Twin Cities sample were 50 years of age or older*. The importance of transitioning rises significantly as the owner ages, meaning that it is highly likely that the successful conversion of the owner's most valuable asset, the business, will be a high priority for at least 80 percent of the owners surveyed.

WHAT IS YOUR COMPANY'S ANNUAL REVENUE?

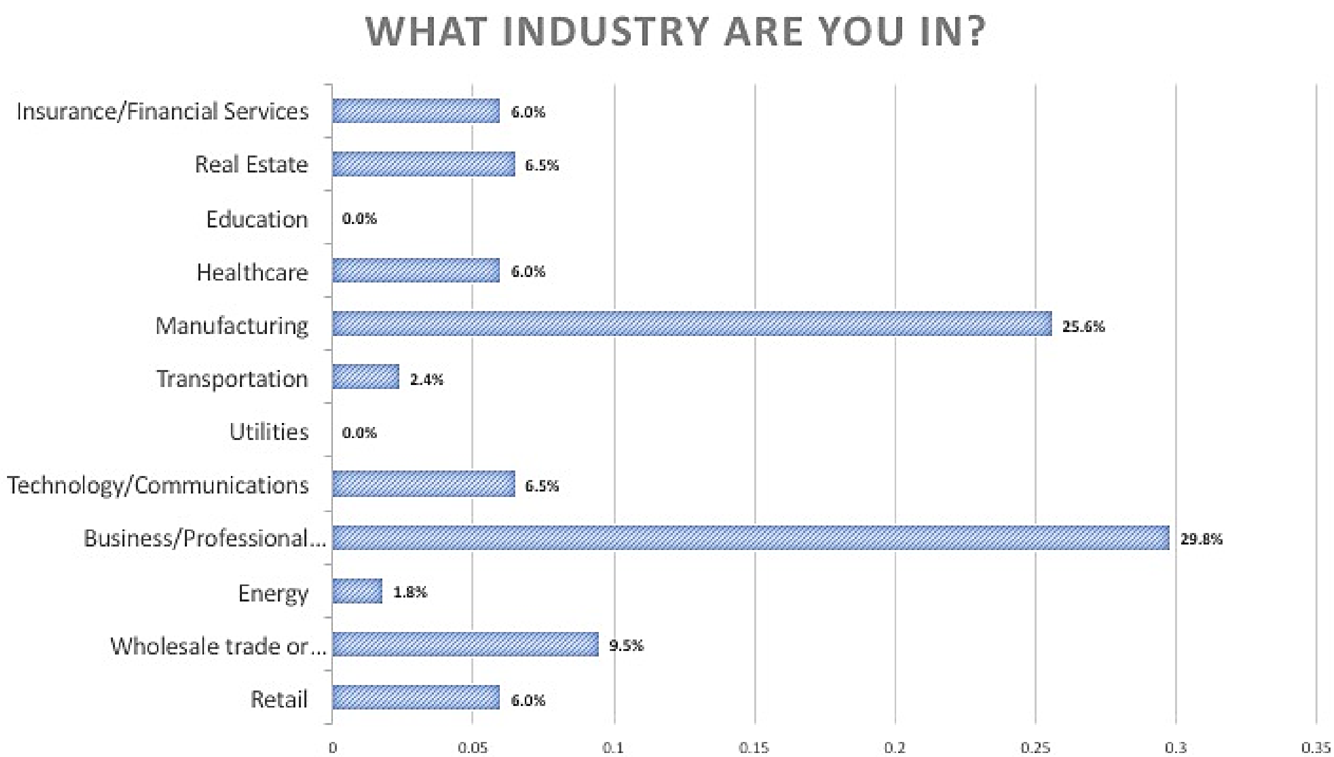


BUSINESS SIZE: Fifty-two percent had annual sales of less than $5 million, 44 percent had sales in the range of $5 million–100 million, and 4 percent had sales of $100 million or more. The Twin Cities data represents a strong middle market focus that represents a greater share of businesses over $5 million in sales than that found by the national US Census data, which indicate that, of the six million privately held operating companies, 94 percent do $5 million in sales or less, 5.8 percent do between $5 million and $100 million, and only 0.2 percent do over $100 million in sales.

IF FAMILY OWNED, HOW LONG HAS YOUR COMPANY BEEN OWNED BY THE FAMILY?



OWNERSHIP STRUCTURE: Seventy-one percent of businesses were family owned, with 78% of those structured with family controlling interests. *77 percent of the family-owned companies were first-generation businesses started primarily by the owner.* Most of the businesses in the sample were S corporations (60 percent), followed by LLCs (27 percent) and C corporations (12 percent); one percent of businesses reported being Family Limited Partnerships.



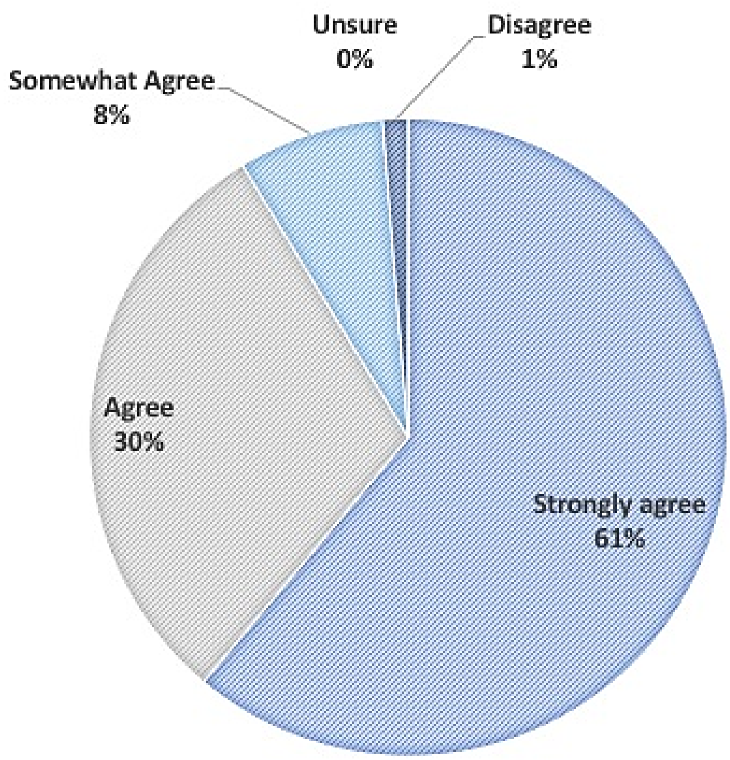
INDUSTRY BREAKDOWN: The surveyed business owner sample included a diverse cross-section of industries. Manufacturing (26 percent) and business/professional services (30 percent) were the largest industries represented.

Section 2 – Analysis and Relevant Observations

Given the general lack of family and business transition readiness evidenced in the survey results, it is not surprising that 70–80 percent of transitions fail.

As you read through the rest of this report, bear in mind the following statement:

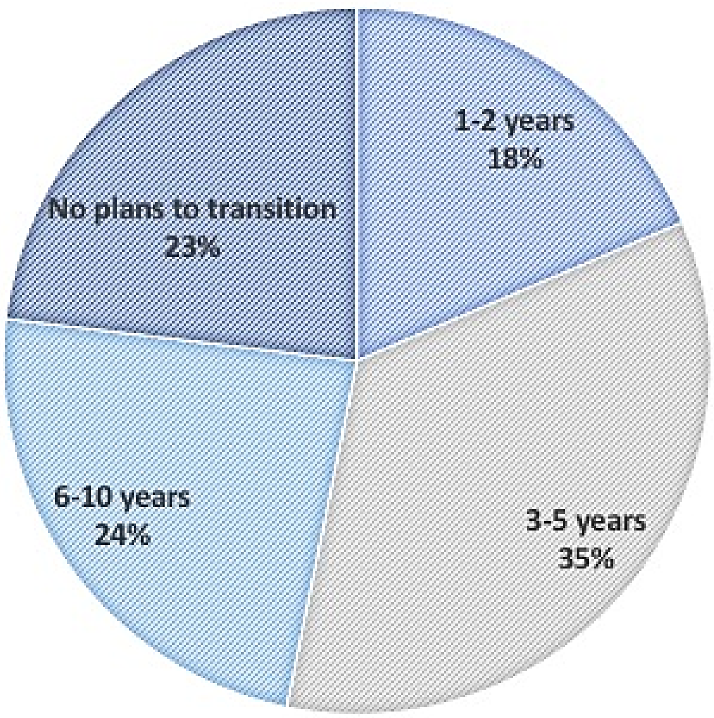
Ninety-nine percent of the business owners who completed the survey in the Twin Cities region indicated that they *agreed* with this statement: **"Having a transition strategy is important both for my future and for the future of the business."**



Despite 99 percent of the business owners indicating that they agreed with this statement (and almost 61 percent indicating they strongly agreed), the following information was indicated:

- 79 percent had **no written business transition plan**
- **48 percent had done "no planning at all"**
- 94 percent had **no written personal plan**

The state of transition planning is very weak, although a large segment of business owners also indicated that they would like to transition their business within 5–10 years.

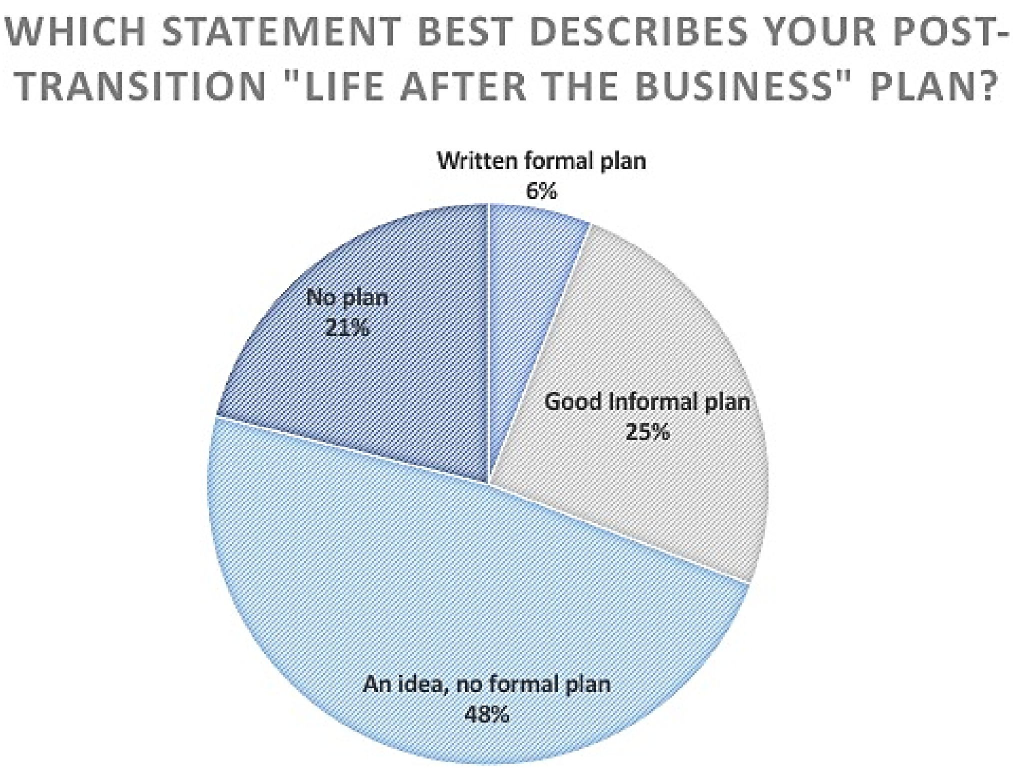


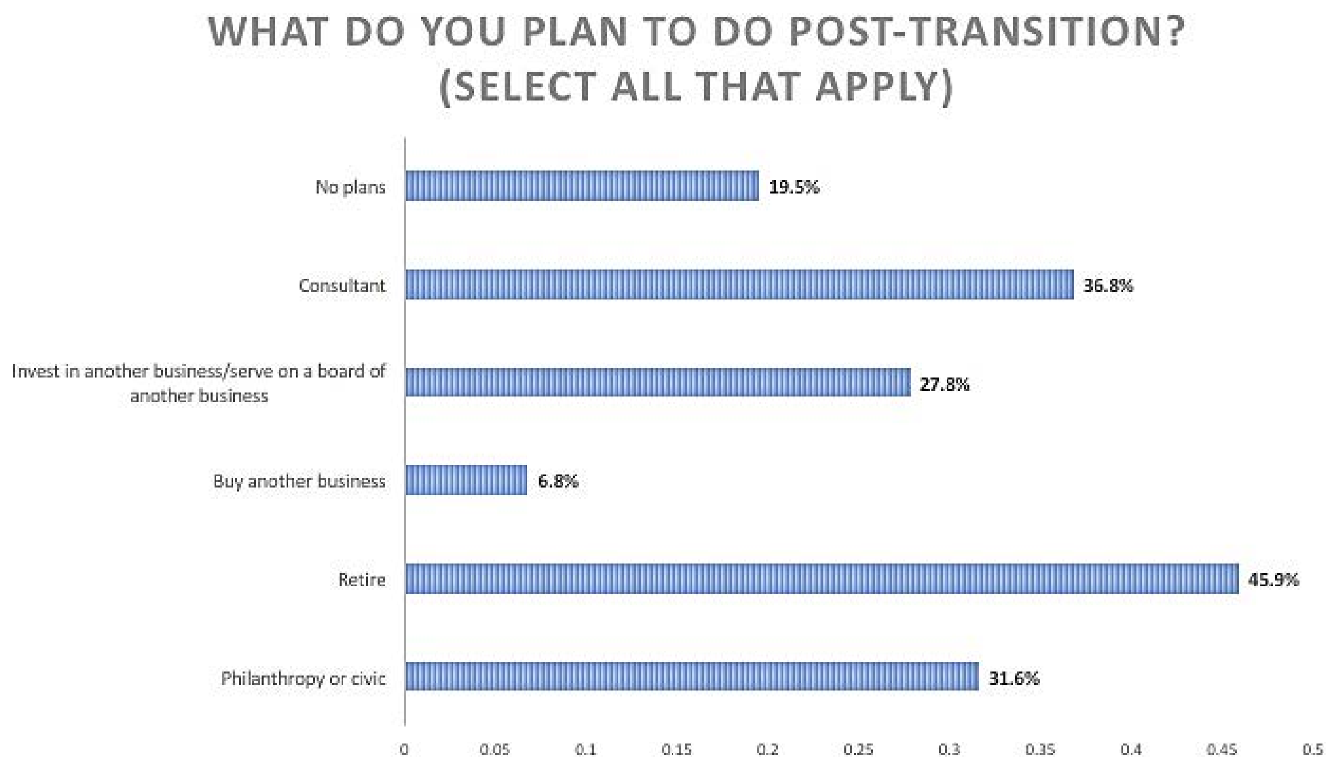
The previous statistics are alarming, considering that **more than half (53 percent) of the sample indicated that they would like to transition in 5 years or less** and more than three-quarters (77 percent) would like to transition in 10 years or less.

Owners must realize that a successful transition requires that they start planning well in advance of their exit to maximize the business's value and have an appropriate amount of time to prepare financially and personally.

The biggest regrets many owners face include the following:

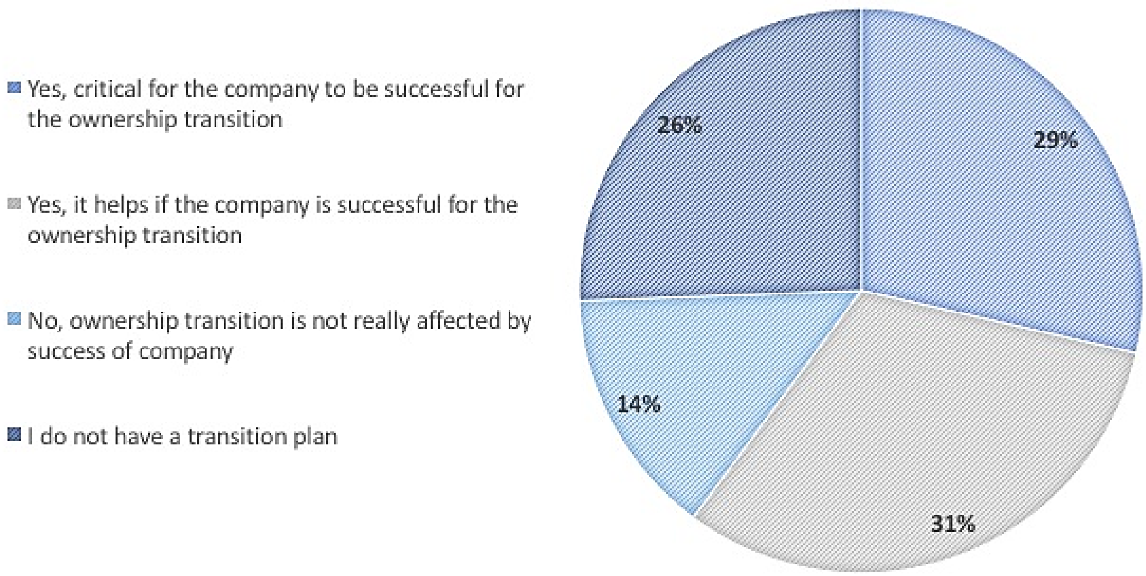
1. They realize that they should have integrated a value acceleration process to prepare themselves and their business much earlier.
2. They realize after the fact that they left money on the table by not maximizing the value of the business at the time of exit.
3. They are miserable because they did not prepare a personal plan to fill their time and develop a fulfilling experience post transition.





Ironically, although 94 percent indicated that they had no written personal plan and **almost half indicated that they had done "no planning at all,"** most owners gave an answer regarding their ideal lifestyle post transition. The most popular answer was "retire" (47 percent). Other popular answers were "consult" (37 percent) and "invest/sit on a board" (28 percent). On a positive note, that demonstrates business owners' philanthropic inclinations, almost one-third (32 percent) indicated that their ideal lifestyle post transition would involve a philanthropic venture.

DOES YOUR OWNERSHIP TRANSITION PLAN REQUIRE THE COMPANY REMAIN PROFITABLE FOR YOUR PLAN TO BE PROPERLY EXECUTED?

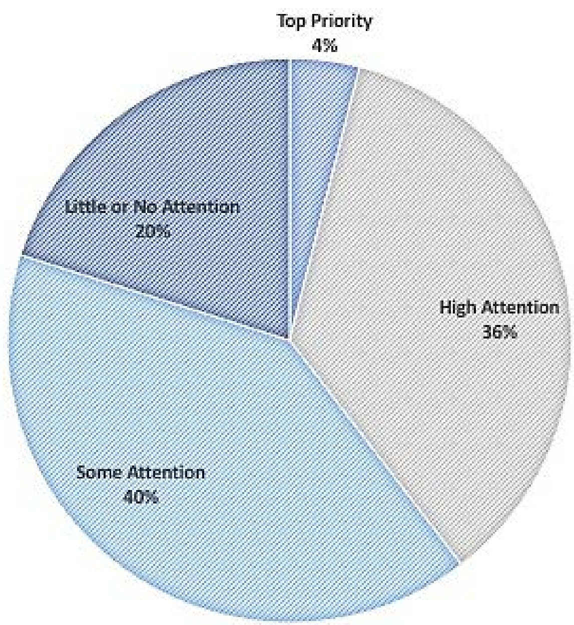


To execute their transition plans properly, **most business owners need their companies to *remain* profitable.**

Eighty-one percent of owners who said they had a plan indicated that, to properly execute their transition plans, it would at least be “helpful” for their **companies to remain profitable**; 29 percent said it was “critical.” Many owners need their businesses to remain profitable because they do not get all their money out until many years after the actual transition because of seller financing, holdbacks, and earn-outs.

Continued profitability is especially important for inside exit options such as ESOPs, family transitions, and management and partner buy-outs. In such situations, the owner does not usually achieve a windfall at closing. Rather, he or she must finance the inside buy-out and depend on the next generation of management to carry the day without them at the helm.

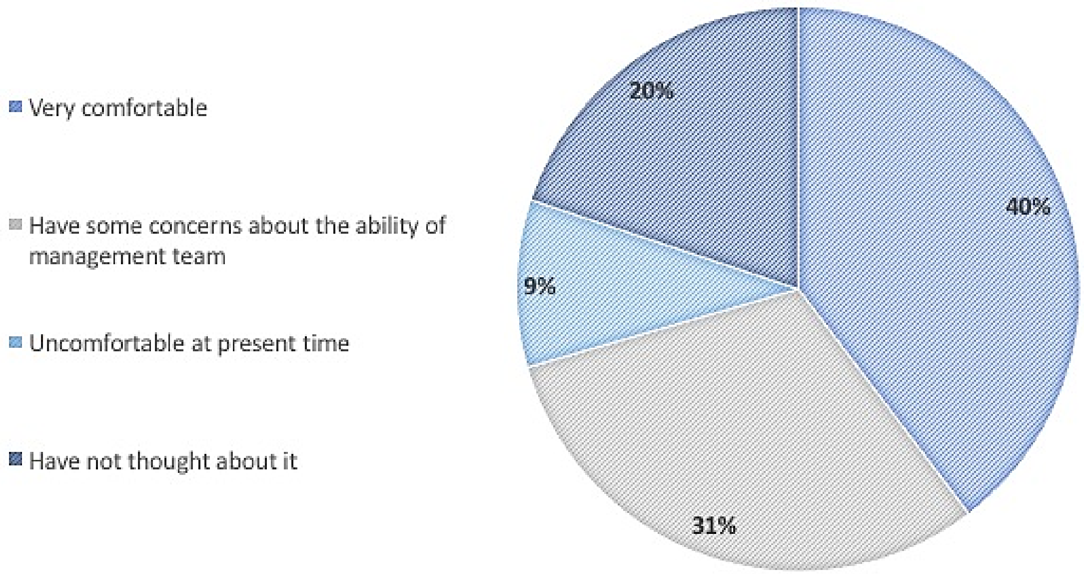
HOW WOULD YOU DESCRIBE THE ATTENTION YOU HAVE GIVEN TO YOUR EXIT UP TO THIS POINT?



When asked, **"How would you describe the attention you have given to your exit up to this point?"** 80 percent of the business owners indicated that they had given at least **some attention** to their transitions. In fact, 40 percent indicated that they had given the transition process **high to top priority**. This would appear to be good news.

However, this statistic conflicts with previous statements in which 48 percent of business owners indicated that they had "no transition plan at all" and 94 percent indicated that they had no written personal transition plan.

IF YOU ARE NOT GOING TO BE INVOLVED WITH THE BUSINESS POST TRANSITION, HOW COMFORTABLE ARE YOU THAT YOUR MANAGERIAL TEAM WILL BE SUCCESSFUL.

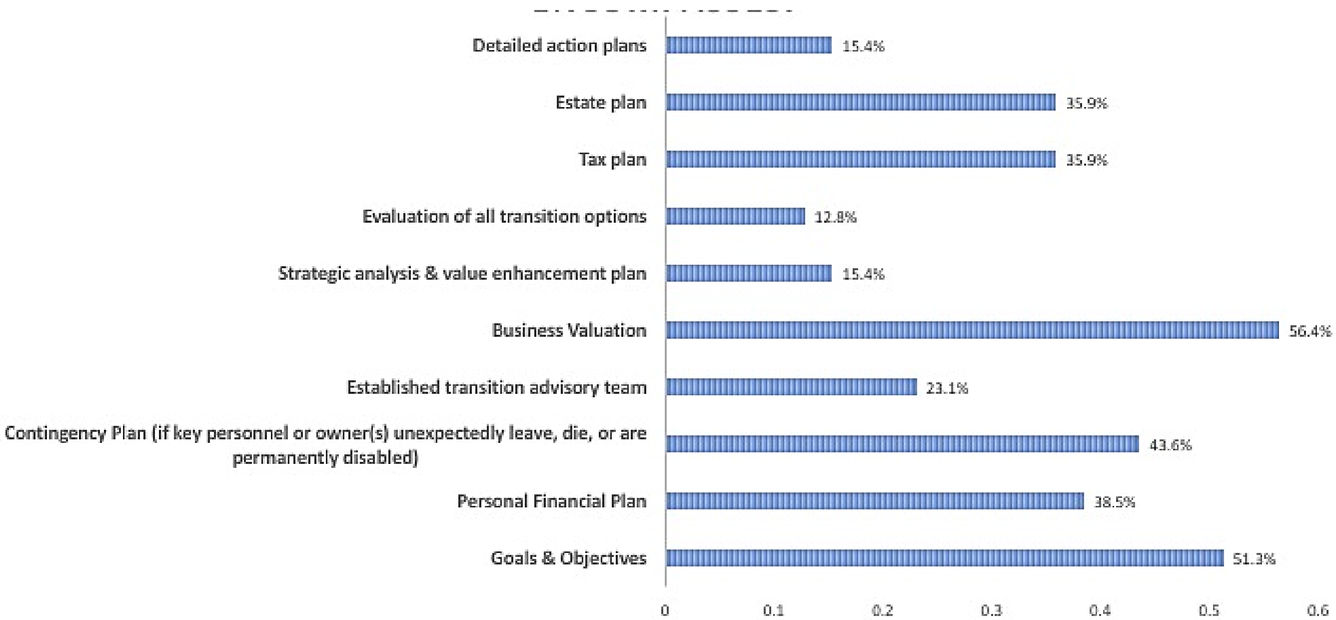


Another answer demonstrating a high degree of **misguided confidence** was that **71 percent indicated that they were at least somewhat comfortable that the managerial team** would be successful if they themselves were not involved with the business post transition; 40 percent said they were very comfortable. This would be critical in a situation where the owner depended on the company's remaining profitable after he or she stepped down.

The conflicting data points above clearly point to confusion. Owners are saying that they have done "no planning," yet at the same time they have given it at least "some attention" and have a high degree of confidence in management succession.

Owners don’t know what they don’t know.

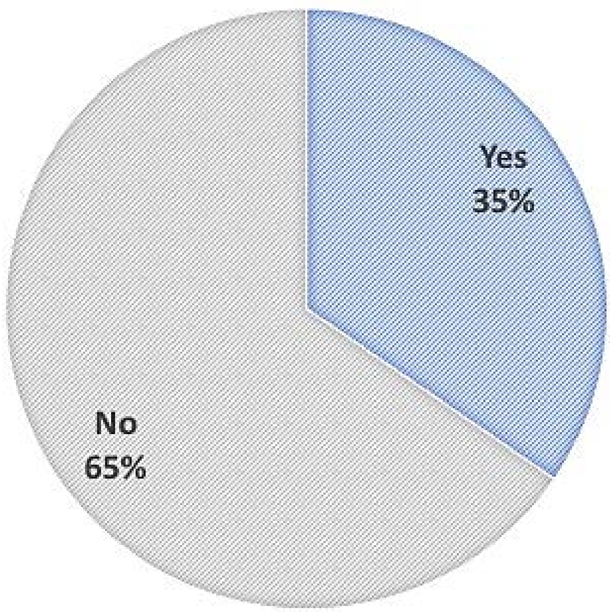
Even for those owners who said they had a plan, we question whether this is misguided confidence that is not based on fact. We asked those owners who said they had a plan, **“What do your plans include?”**



- Only about half indicated that their plans included a business valuation, goals and objectives, or contingency planning.
- Less than 40 percent said that their plans included tax and estate planning or personal financial planning and less than 20 percent said that their plans included an analysis of exit options or action plans.
- Only 15 percent indicated that their plans included a strategic analysis and value enhancement plan that took maximizing value *off the table*.

Thus, if many of the owners’ transition plans do not include business valuation, goals and objectives, contingency planning, personal financial planning, tax and estate planning, exit options analysis, action plans, strategic analysis, or value enhancement, **what *do* they include?**

HAVE YOU COMPLETED ANY FORMAL EDUCATION RELATED TO TRANSITIONING A BUSINESS?



That owners **don't know what they don't know** is concerning. This lack of education is further evident in that **65 percent of the owners who completed the survey indicated that they had not completed <u>any</u> formal transition planning education**.

The danger here is that business owners significantly underestimate what exiting successfully requires. Owners *think* (perceive) that both they and their businesses are prepared because they have given "some" attention to their transitions. However, successful transition requires much more than thought. It requires solid, long-term business, personal, and financial plans grounded in action, with specific deliverables complete along the journey.

Unsurprisingly, successful transition rates are very low nationwide. And this national statistic is likely to be very similar to that for businesses in the Twin Cities region.

How would the middle market business owner benefit from transition planning?

Transition planning and value acceleration address several potential problems that prevent owners from achieving better transition success rates. Typically, we see the following issues:

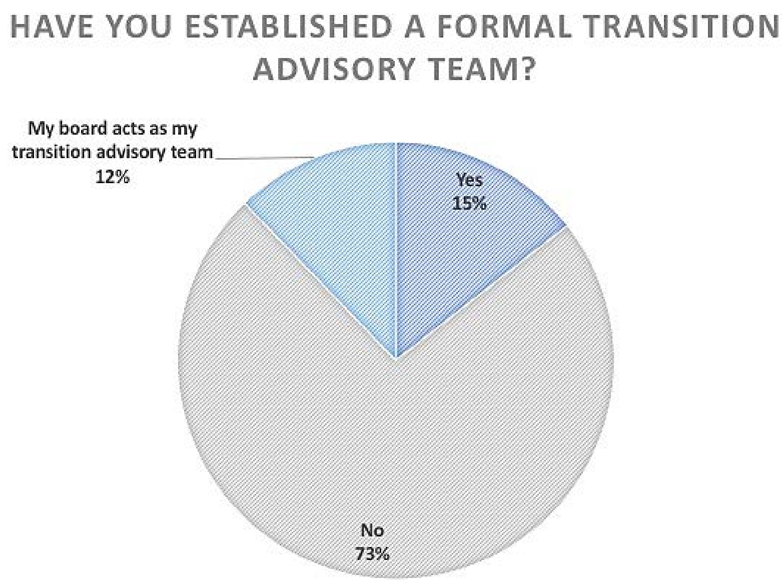
- **First,** when owners decide to exit, they realize that they have not allowed themselves enough time to position the business for transition, minimize taxes, and maximize net proceeds. Thus, they achieve significantly lower net proceeds.

- **Second,** they are unprepared for the possibility that an unplanned event (the likelihood of which is 50 percent) will force them into an exit that is not on their terms or timeline. Or they are fortunate to receive an unsolicited offer from a buyer, but because they are not ready, they are unable to harvest the value of their business in either situation.

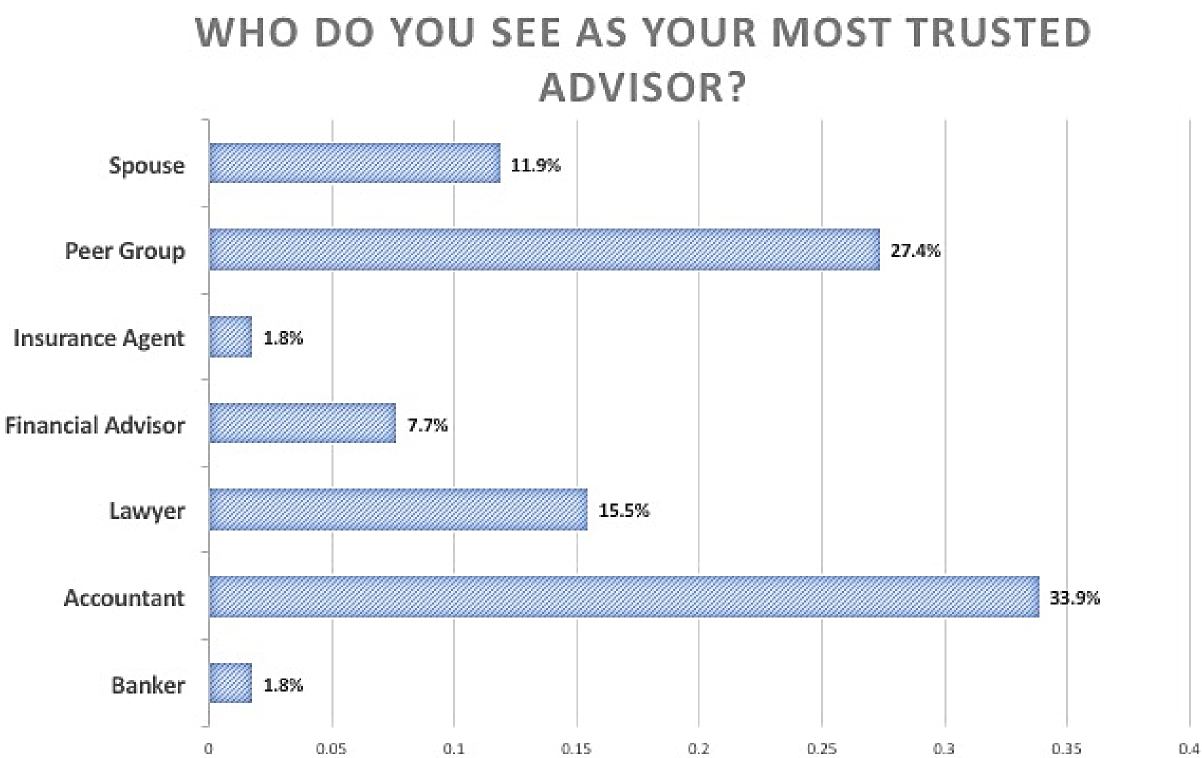
- **Third,** when the time comes and they decide it is time to get out but have not planned for a transition to a family member, employee or management group, or partner, they are unable to pass the test and achieve a sale, even a partial sale, to a third party. Private equity and strategic buyers are very seasoned and selective.

- **Fourth,** they may be unaware that they have eliminated their inside options as well, including transitioning to family members, because they have a business that cannot operate without them and is potentially undercapitalized or has insufficient cash flow to succeed with an inside option.

Improving the use of outside resources, in particular, a board of advisors that includes non-family members, would likely increase the rate of successful transitions and higher valuations. From previous surveys, we have observed that using outsides resources and an active board of advisors that includes non-family members on the board are two characteristics associated with better planning and preparation and a greater focus on maximizing value. The Twin Cities business owners scored low in both categories.

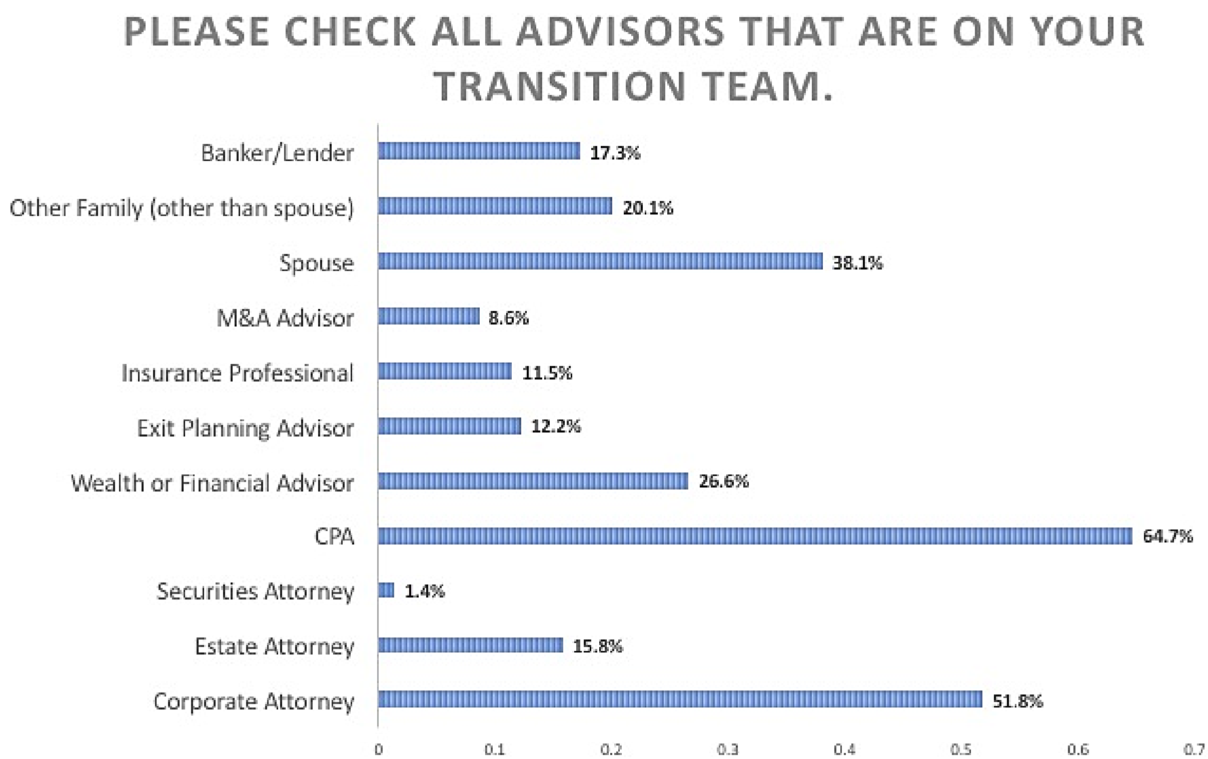


- *Eighty-five percent of the business owners surveyed indicated that they had NOT set up a formal transition team.* Twelve percent indicated that they use their board of advisors as their transition team. This is usually a mistake. Most advisors and many owners should realize that the skillsets required to transition a business can be much different from those of the members who sit on the owner's advisory board.
- Even for the 15 percent of the owners who said they had a transition team, we found that their teams were missing key advisors. The owner's core transition team needs, at minimum, consist of an attorney, CPA, wealth manager/financial planner, and exit planning advisor (such as a CEPA).



The CPA is the most trusted advisor. The spouse is number four.

Thirty-four percent of the owners indicated that their CPA was their most trusted advisor, followed by their peer group (27 percent), attorney (15 percent), and spouse (12 percent). These statistics were similar to those of our national survey.



According the owners who said they had a formal transition team, however,

- only two out of three (65 percent) teams included a CPA,
- only one out of two (52 percent) included an attorney,
- only one out of four (26 percent) included a wealth manager, and
- only one out of ten (12 percent) included an exit advisor.

In most situations, the core team should include the owner's spouse and/or other family member. Here, only 38 percent of the owners indicated that their transition teams included the owner's spouse, and only 20 percent included another family member.

Other advisors who often also play a key role in a successful transition include the owner's commercial banker, insurance advisor, and estate attorney; if the business is to be sold to a third party, a mergers and acquisitions advisor should also be included.

- Only 17 percent of the transition teams included a commercial banker, 11 percent included an insurance provider, 16 percent included an estate planning attorney, and 9 percent included an M&A advisor.

- The commercial banker and insurance advisors are key members who would be beneficial to the transition to the new owners, whether family or outside ownership. For example, the bank that is currently supporting a business is likely to be the first to step up to provide financing because it already knows the business and would benefit from the transition from the present relationship to the new owners, assuming the owners and banker have already developed a strong business relationship.

- Almost one-third (30 percent) of the respondents indicated that they were considering an outside exit option via some form of sale to a third party. Yet only **one in ten** of the owners who said they had formed a transition team indicated that had actively included an M&A advisor.

A few concerns should be noted:

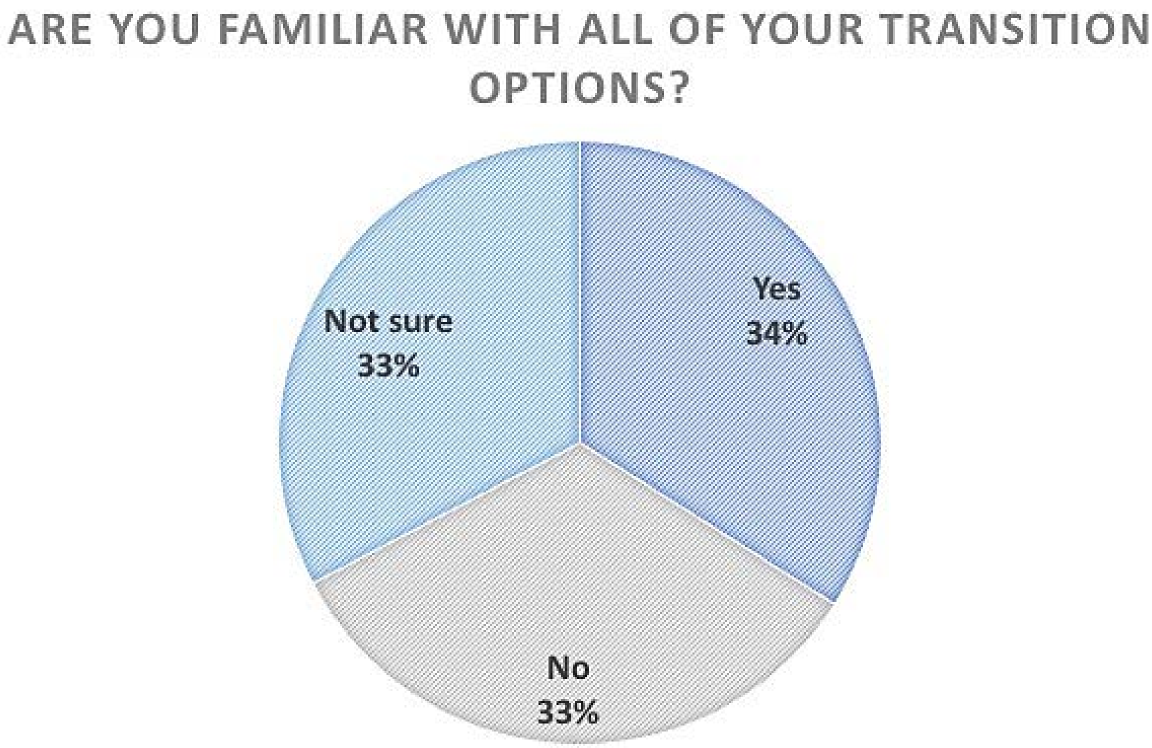
Although 26 percent of the owners indicated that the wealth manager/financial planner should be or is on the transition team, **only 8 percent considered the wealth manager/financial planner their most trusted advisor**.

> This is surprising and, I believe, a huge opportunity for the financial planning industry. It is clearly a best practice to have a wealth manager or financial planner involved in the transition process as early as possible. I don't even know how it's possible to design a transition strategy without involving the financial planner, who plays a critical role in determining the owner's financial needs before, during, and after the exit. The planner's role in evaluating options to optimize the owner's post-business lifestyle is vital and often dictates the available exit options and the structure of the exit transaction, whether that be an internal or external option. The financial planning industry and the owners themselves would benefit tremendously if the financial planning industry did a better job of educating owners on the roles of financial planners and wealth managers in the transition process.

Additionally, **only 2 percent of the owners considered their banker their most trusted advisor**. Perhaps, except for the CPA, no other advisor *should be* as familiar with the business as the banker. We have consistently observed opportunities for improvement in this relationship. This certainly is a two-way street. Given the potential significant role of the banker in the transition process, however, both owners and commercial bankers would benefit from an enhanced relationship.

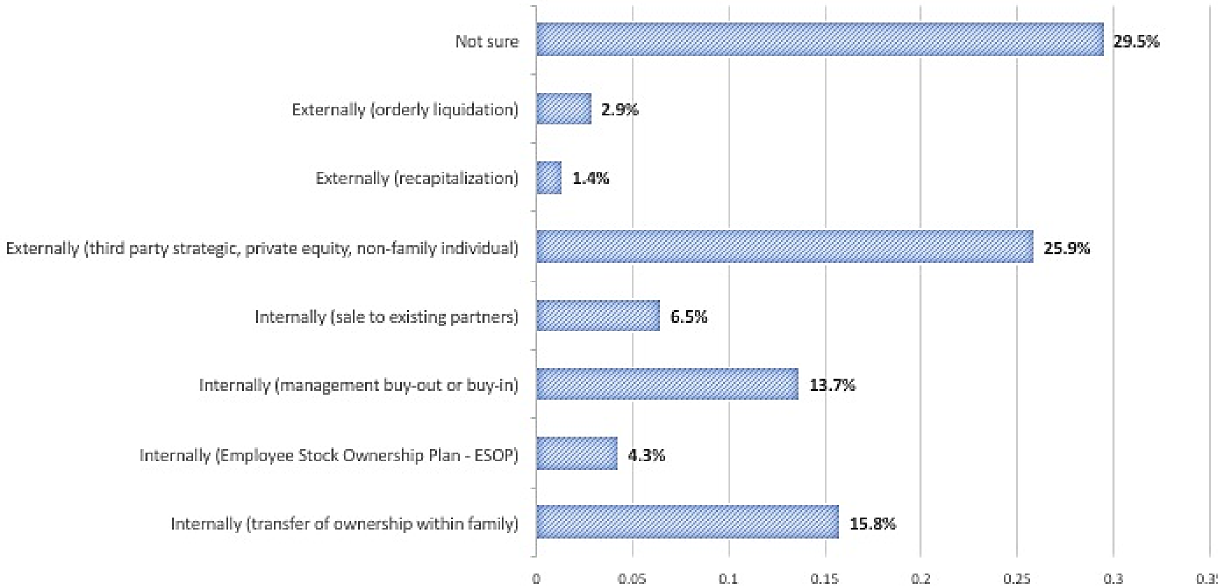
More than half of the businesses do not have a board of advisors. Only 45 percent of the respondents had an outside board of advisors. Of those who did, only 25 percent indicated that their board of advisors included non-family members.

Owners are not aware of and thus are not spending enough time analyzing all exit options.



Sixty-six percent of the business owners said "no" or "not sure" (which means "no") when asked if they were aware of all their exit options. Not being aware of all their exit options means that owners risk leaving money on the table when they exit or structuring an exit that is not ideal for their situation. This statistic is consistent with all previously conducted research.

WHAT BEST DESCRIBES HOW YOU ARE PLANNING TO TRANSITION?



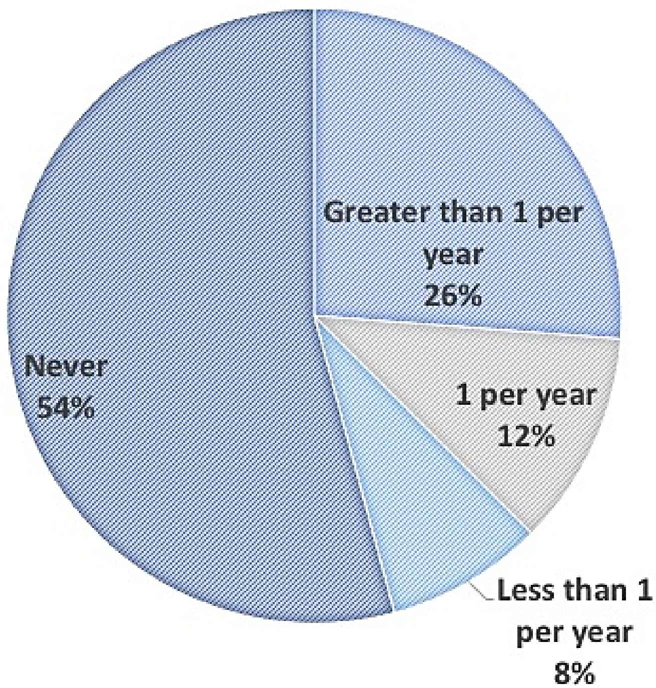
The most popular inside option was to transition the business to a family member (16 percent), followed by management (14 percent), partners (6 percent), and employees (4 percent).

The Twin Cities region had percentages consistent with national stats related to family transitions. However, in contrast to national data, **Twin Cities owners appear more inclined to management transitions (14 percent); overall, their strongest inclination (40 percent) is toward inside options, greater than in any other survey completed previously.**

The most popular outside option was to sell to a third party, such as a strategic or private equity buyer or non-family member (26 percent), followed by orderly liquidation (3 percent) and recapitalization (1 percent).

We are disappointed to see so few business owners considering recapitalization as an exit option. Our educated guess is that this is once more due to lack of education. Recapitalization is an excellent way for an owner to take some money off the table while at the same time bringing in capital and talent to accelerate growth.

HOW OFTEN DO YOU HAVE FORMAL FAMILY MEETINGS WITH REGARD TO THE BUSINESS?

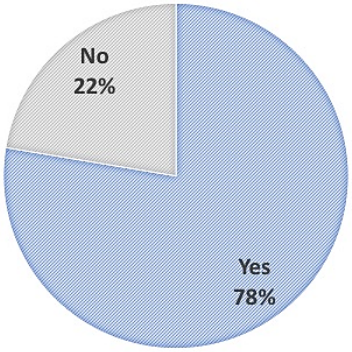


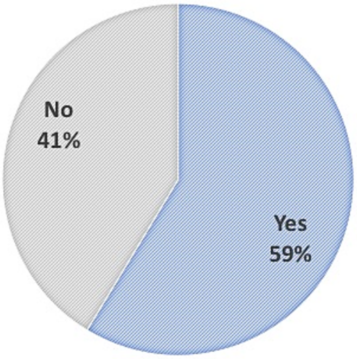
Oddly, despite this tendency toward inside options, especially family ones, **54 percent have never had a family meeting about the business** and 26 percent say they hold family meetings less frequently than once a year. Only 19 percent hold family meetings concerning the business at least once a year.

Use of buy–sell agreements is stronger in the Twin Cities region—but can they be executed?

"IF THERE ARE MULTIPLE OWNERS/PARTNERS IN YOUR BUSINESS, DO YOU HAVE A FORMAL, WRITTEN BUY-SELL AGREEMENT?"

Of those businesses survey (that have multiple partners), **78 percent have a buy–sell agreement**...the highest we have seen thus far.



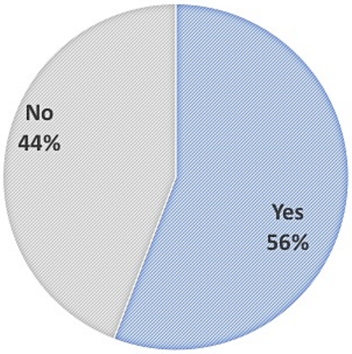


"HAS YOUR BUY-SELL AGREEMENT BEEN REVIEWED AND UPDATED IN THE LAST 3 YEARS?"

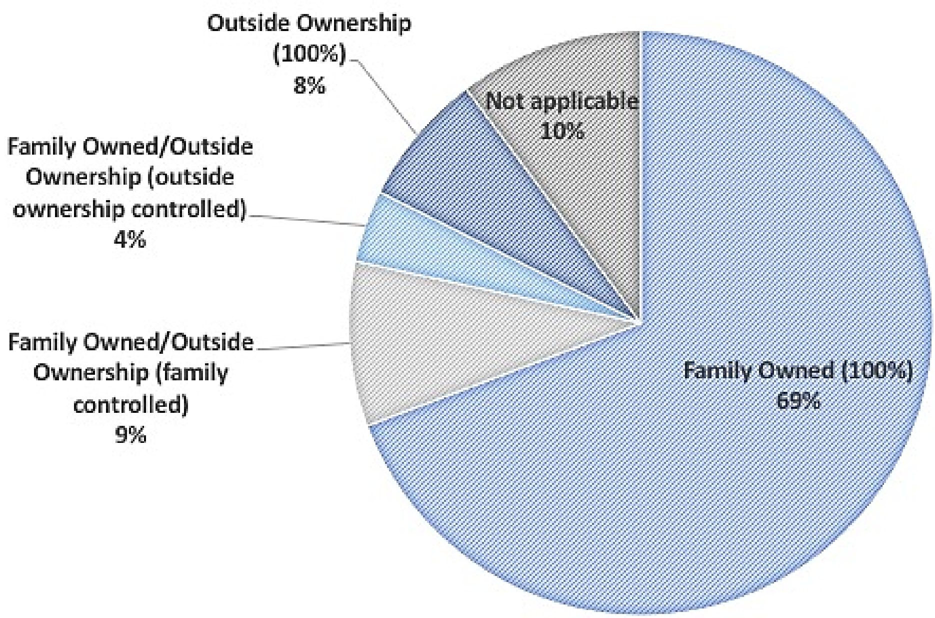
59 percent of those who do have a buy–sell agreement have had it reviewed and updated within the last three years.

"IS YOUR BUY-SELL AGREEMENT FUNDED BY A LIFE INSURANCE AND/OR DISABILITY POLICY?"

Only 57 percent are funded by life insurance. A buy–sell is like a valuation: it should be revisited annually even if it requires no changes. And making sure that the buy–sell is funded is key to ensuring, should the buy–sell need to be invoked, that terms can be met.



IF YOUR COMPANY IS PRIVATELY HELD, WHAT IS THE OWNERSHIP STRUCTURE?



Family is still important, but is the family ready for the transition of the business and potential change in lifestyle?

Sixty-nine percent of the sample included businesses that were 100 percent family owned; of these, **78 percent were at least family controlled**. Transition to family was the number-one inside transition option. Yet only 23 percent of the owners said that a family member would fill a key position post transition.

When asked to rank family readiness for the business to transition, **61 percent of the owners said their families were ready.** However, does that make sense considering the following?

- Only about one of two owners (55 percent) said family members were aware of both their management and ownership transition plans. Nearly one out of four (23 percent) indicated they were not aware of either management or ownership transition plans.
- Only 38 percent of the owners indicated the "spouse" and only 20 percent indicated another family member (20 percent) were on their transition team if they had one. Only **12 percent indicated their spouse was their most trusted advisor—number four on the list of most trusted.**
- Finally, over half (55 percent) of the business owners have never had a family meeting about the business.

The danger here is that business owners tend to do less transition planning when a decision has been made to transfer the business to family. **The family should approach the transition with the same vigor as if they were planning to sell it a third party** even if they have decided on an intergenerational transfer. What makes a business valuable to a third party are the same characteristics that make it valuable to the next generation. One major reason that we don't see much higher success rates for family transitions than for selling to a third party is that some owners do not approach the family transition in the same way that they would approach a third-party sale; thus, they end up transitioning a business to a less experienced family member (son or daughter) who is undercapitalized and has not appropriately mitigated risk.

So, at the end of the day, are you ready?

Our second-to-last question asked owners, "How ready do you consider yourself to transition your business?" **Fifty-seven percent scored themselves below average,** and 43 percent scored themselves above average. We expected this scoring to be much worse given what we learned from the survey. Is this misguided confidence?

We think so. Here's why:

- **Eighty percent of the Twin Cities sample were 50 years of age or older, and** more than three-quarters (77 percent) were planning to exit in 10 years or less.
- Seventy-nine percent had **no written business transition plan.**
- Forty-eight percent had done **"no planning at all."**
- Ninety-four percent had **no written personal plan.**
- Sixty-five percent of the owners who completed the survey indicated that they had **not accomplished <u>any</u> formal transition planning education**.
- Only 15 percent indicated the transition plan included a strategic analysis and value enhancement plan, **virtually taking maximizing value off the table**.
- Eighty-five percent of the business owners indicated that they had **no formal transition team**.
- Sixty-six percent of the business owners were **not aware of all their exit options**.
- Over half (55 percent) of the business owners have **never had a family meeting** about the business.
- More than half of the businesses **do not have a board of advisors.**

Yet 99 percent of the business owners who completed the survey in the Twin Cities region indicated, **"Having a transition strategy is important for my future as well as the future of the business."** Hmmm...

Section 3 – Recommended Actions

Owners of businesses of all sizes must become much more proactive if they are to improve successful transition rates and harvest their most significant financial asset. Success rates are not likely to improve as long as exit planning is viewed as "something I can do down the road" rather than as an imperative integrated into the business's current operations. With $10 trillion of wealth at stake from an aging generation of business owners (remember that 80 percent of our survey respondents were 50 or older), a greater sense of urgency is necessary.

Advice to Business Owners

When asked how ready the owners felt regarding their businesses' readiness to transition, 57 percent of them answered "below average."

> "Exit planning is nothing more than *good* business strategy."

Owners need to realize that they must redefine their present paradigm of exit planning. Until they do, progress will be limited. They must realize that exit planning is nothing more than good business strategy. Their best practice is to integrate the actions of a successful transition into the way they run their businesses every day. Owners accomplish this by following the principles of the five stages of value maturity: identifying what they have now, taking risk-mitigating actions to protect their wealth, building value consistently over time, positioning the business to have multiple exit options and perhaps multiple exit events, and actively managing their wealth (including the business wealth) before, during, and after the exit event.

Clearly, this is not happening today.

> "Most accounting and management systems today do not provide feedback on the value of the business."

Eighty to ninety percent of an owner's net worth is likely to be in the business. And 70–80 percent of that business wealth is tied to intangible assets. To check this, owners need only look at their present income statements and balance sheets. Does the income produced on the income statement (for tax purposes) really reflect the true cash flow benefit assumed by the owner or future owner? Not often, when the owner considers normalized income and expenses, discretionary expenses charged to the business, and one-time nonrecurring charges. Does the owner's present balance sheet reflect the business's true "market value"? Again, not often. The balance sheet (again for tax purposes) reflects the book value of the business assets the owner has written down, not the true market value, which would include the value of the business's intangible assets.

Management systems must be adapted to provide the owner with strategy and feedback on the value of intangible assets, including human, customer, structural, and social (the four Cs), and on a regular basis. Most accounting and management systems today do not provide feedback on the value of the business. Focusing on value first drives all other positive outcomes, including increases in sales and profit. Integrating personal and financial goals and plans with business planning prepares the business owner for all possible events from a personal, financial, and business standpoint (a concept called the "three legs" or "master planning"). Owners must realize that 50 percent of all exits are not voluntary—not on the owner's terms or timeline—because of one of the five Ds: death, disability, divorce, distress, and disagreement.

By focusing on regular and relentless execution of actions to protect, build, and harvest business value (which again is likely to be 80–90 percent of an owner's net worth), owners position themselves to be able to harvest that wealth in good times or bad.

Although 99 percent of the respondents indicated that a transition strategy was important for their future and the future of their businesses, the survey results clearly indicate the vast education needed by business owners. **Sixty-five percent of the survey respondents indicated that they had "no education" on the subject of exit planning**. Owners can start taking control of their own business and transition plans by educating themselves.

Today, a vast number of resources are available within business owners' peer groups, advisors, universities and economic development organizations, and available literature. A good place to start would be to read *Walking to Destiny: 11 Actions an Owner Must Take to Rapidly Grow Value & Unlock Wealth* (which recently won the 2017 Middle Market Thought Leader of the Year Award from the Alliance of Mergers and Acquisitions). You can claim a copy by visiting www.SniderValueIndex.com.

Advice to Advisors

The "most trusted advisor" status continues to go to the CPA (34 percent of owners indicated that their CPA was their most trusted advisor). Of all an owner's outside advisors, the CPA is most likely to have the best insight into the business's financials and operations. Going beyond self-imposed boundaries and proactively providing more advice to the owner regarding managing the value of the business and exit options is an opportunity that would benefit both the CPA and the business owner.

Surprisingly, only 8 percent of the owners indicated that their wealth advisors were their most trusted advisors. This is surprising, given that the wealth manager is the one advisor (besides, perhaps, the business attorney) who is with the owner through the entire process, not only leading up to the transition event but thereafter, charged with managing the owner's windfall after the exit. Wealth advisors are also vital in helping owners select and structure an appropriate exit option. This is another indication that owners misunderstand the value that wealth advisors provide before, during, and after the exit event and their lack of education related to all their exit options.

> "...their (owners) lack of education related to all their exit options."

We didn't even put "exit advisor" on the list of choices for "most trusted advisor." The exit advisor community is growing, but it is a blue ocean, a new profession driven by the wave of four million baby boomer business owners who will be exiting their businesses over the next 10–20 years. Most owners are not even aware of a professional group of advisors who focus on helping them unlock the wealth trapped in their businesses. Only 12 percent of owners who had a transition team had an "exit advisor" on their team. We in the exit advisory community would clearly like to see that number climb with education. Personally, I have had dozens of owners who have exited tell me that they wish they had known about exit advisory services before they exited.

Thank you to our contributors.

This report was prepared and written by Christopher Snider and the Exit Planning Institute. The author wishes to thank and recognize the work of Julie Keyes of KeyeStrategies and President of the EPI Twin Cities Metro Area Chapter, and the Twin Cities Owners Forum Council, including Liam Higgins of BMO Harris Bank, Jeff Servais and Craig Arends of CliftonLarsonAllen, Todd Ganos of IWC Family Offices, Chris Cuneo and Dillon White of Lindquist & Vennum, Robert Kingsbury of MCM Capital Partners, Matt Kusilek and the editorial team at Minnesota Business Magazine, Peter Pricco of Prudential Capital Group, Rob Gales and John Harrison of Vercor, Michelle Bonahoom of VisionOne Performance.

This research was a collaborative effort of many partners and organizations in the Twin Cities market. Thank you to the Minneapolis Chapter of the Alliance of Mergers & Acquisitions Advisors (AM&AA), the Minnesota Chapter of the Association for Corporate Growth (ACG), and the many supporting firms in the EPI Twin Cities Metro Area Chapter, including Exit Planning Strategies, LLC; Simma Flottemesch & Orenstein, Ltd.; Oxford Financial Group, Ltd.; Olsen Thielen & Co., Ltd.; Engel Professional Association; Trust Point Inc.; AllianceBernstein LP; Aaron D. Hasler & Professional Services Marketing, LLC; and the Minnesota Precision Manufacturing Association.

Moreover, thank you to the respondents in the Minnesota market for their contribution by participating in this study, created to educate and empower middle market owners nationwide.

About the Exit Planning Institute

The Exit Planning Institute (EPI) delivers innovative learning experiences, performance-enhancing resources and strategic tools designed to enhance the exit planning profession. Formed in 2005 to serve the needs of CPAs, financial planners and wealth managers, attorneys, commercial bankers, management consultants, M&A advisors, ESOP and family business advisors, the Exit Planning Institute is considered the standard trendsetter in the field of exit planning across the globe. It is the only organization that offers the Certified Exit Planning Advisor (CEPA) Program and qualifies for continuing educational credits with eleven major professional associations, making it the most widely accepted and endorsed professional exit planning program in the world. For more information, please visit www.exit-planning-instutute.org.

For more information regarding the key stakeholders and individual partners of the State of Owner Readiness Survey conducted in this region, visit **www.OwnerReadiness.com**.

IN COLLABORATION WITH LEADING FIRMS & ORGANIZATIONS