

## **SELL-SIDE TRENDS**

### **The Business Transition Tidal Wave**

*By Roger Winsby*

*Association for Corporate Growth Hub News - August 27, 2003*

Over the next several years, the U.S. economy will experience an unprecedented volume of wealth transfers. The result will be a glut of businesses for sale and downward price pressure for most privately owned companies.

To date, most analysts have focused on the inter-generational wealth transfer from the parents of baby-boomers to baby boomers – a transfer that is already well along. There is a second, less publicized and less understood transfer that also will take place over the next decade. The entrepreneurial explosion in the U.S. over the last 30 years has resulted in record numbers of well established small- to mid-size private businesses with annual revenues ranging from about \$1 million to \$50 million. For most of the private businesses started in the 1980s and early 1990s, the owner or owners are now 50 years old and over. Just as the baby boomer demographic bulge threatens the solvency of the Social Security system as boomers approach retirement, the private business owner demographic bulge will seriously strain and possibly overwhelm the available supply of buyers and the support infrastructure for business transition and transactions as these owners approach retirement. We call this the business transition tidal wave. It affords excellent opportunities for companies that learn how to effectively surf the wave.

#### **How big is this demographic segment of owners of established privately held businesses?**

Our best estimate is that there are approximately 7.5 million established businesses in the U.S.. Factoring in companies with multiple owners, that makes approximately 9.5 million owners. These businesses tend to have from two to 200 or more full-time employees beyond the owner; have been in business for at least three years; and have a work location outside of the owner's home.

These established businesses are in virtually every sector of the U.S. economy. Examples include dry cleaners, machine tool shops, insurance agencies, accounting firms, telemarketing firms, medical device manufacturers, landscaping firms, etc. Yet they are generally ignored in the media. Most of the attention on small businesses centers on either start-up firms with plans to grow rapidly and then go public, or on the SOHO (small office/home office) businesses with one or just a few employees that have also exploded in size to approximately 17 million in number.

From both quantitative surveys and through our frequent discussions with small business owners, we see the early stages of the transition tidal wave developing. A quantitative study by NFO in 2001 showed that among the affluent established business owners (48% of the 9.5 million owners are considered affluent), the numbers planning to retire show a sevenfold increase from 50,000 per year in 2001 to 350,000 in 2005.

#### **What are the transition plans of these owners?**

According to the NFO survey, one of three of these affluent owners plans to sell the business to an external buyer. Another one in three plans to sell to family members, while another 18% plan to sell in some manner to current employees. The rest say they will close the business.

What are the likely impacts of the business transition tidal wave? Based on estimates by Tom West in the 2002 Business Reference Guide, the total number of private businesses sold in the U.S. for the last few years has been around 250,000, out of a fairly steady number of businesses for sale of between 1.5 and 1.6 million. Businesses are for sale for many reasons, not just owner retirement, and ultimately many businesses for sale do not sell. These statistics cover all types of established businesses, not just those owned by well-off owners. Even with only one of three of the affluent owners planning a sale to an unrelated party, this means that by 2005 the number of high-quality businesses for sale is likely to increase significantly. If the supply of interested and qualified buyers of private businesses does not increase, the expansion of businesses for sale is

likely to depress the values for private businesses.

For the 80+% of these affluent owners who plan some form of transition, these activities will at a minimum involve substantial time involvement by CPAs, lawyers, and financial advisors. Most of the professional support network for small businesses consists of other small businesses -- mainly small accounting and legal firms, valuation consultants and business brokers, and independent financial advisors and insurance agents. Given the nature of their practices, most of these professional advisors have limited experience dealing with business transition issues, and the consequence is that many matters are overlooked until it is nearly time for the transition to occur. This is often too late. Moreover, the significant increase in demand for professionals with transition experience is likely to seriously strain the resources of the relatively select group.

#### **Have recent economic difficulties affected business owner plans?**

The 2001 NFO survey occurred before substantial economic weakness became apparent across the economy. Based on anecdotal evidence, many owners have temporarily deferred their retirement plans until their business prospects, and resulting firm value, improve. Now with the recent tax cuts, an improving stock market, and signs of an economic rebound, we expect to see many of these owners focusing again on the transition issue.

#### **What are the opportunities from this transition tidal wave?**

For companies that can offer high quality, cost-effective business transition solutions for business owners and buyers, there are tremendous opportunities. For example, the typical process for putting in place a business succession plan funded by insurance takes several months, involves a lawyer, a business valuation, an insurance agent or financial advisor, and costs several thousand dollars not including the cost of the insurance. A business succession plan for multiple owner firms should be a necessity; however, most firms do not have one in place or do not have their plan funded at the current value of the business. A few financial-services firms have started putting together teams of specialists to work on business succession plans. These teams have cut the time and cost of the process dramatically. Not surprisingly, their business owner clients are quick to take advantage of these new capabilities and become increasingly reliant upon the professionals who are part of the transition planning process.

Involvement in the transition advisory process should not merely be viewed as a fee-for-service activity. The advisors who successfully assist owners in the planning and, ultimately, execution of their transition plans will be rewarded many times over as they become the key advisors to the owner who has transformed a traditionally unmarketable business into a liquid asset. This entire process presents significant opportunities for investment banks and other financial institutions that develop cost-effective procedures for screening, valuing, marketing and, most importantly, closing the deal on the sales of private companies.

The use of technology, expert systems, and cross-functional teams revolutionized American manufacturing over the last 25 years. These same basic concepts must be applied to develop mass customized solutions to ensure that business owners and their businesses survive the fast approaching business transition tidal wave.

*Roger Winsby is president of Axiom Valuation Solutions, a privately held business valuation firm based in Lowell, Massachusetts. Roger, formerly an executive at DRI, can be reached at [roger@axiomvaluation.com](mailto:roger@axiomvaluation.com).*