

# Financial Service Needs of Established Business Owners

The Size and Demographics of a  
Wealthy Underserved Market

**By**

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## **Purpose and Objective of Study**

The role of small business owners in the US economy has been well documented by the Small Business Administration among other organizations. The vibrancy and growth potential of this group has been especially dynamic over the last two decades. While this research has been revealing, it has not focused on a number of important segments that make up the small business population. The focus of this research is to better understand the financial needs of perhaps the wealthiest, most dynamic and diverse group within this larger population. These are owners of established businesses (i.e., those with two to five hundred full-time employees in addition to a full-time owner).

This study measures the size of this group as well as the degree of their affluence. The affluence measures are determined by income and wealth excluding the value of their residence. Beyond this, we identify various segments within these broader categories and the extent business owners in each category are prepared to seriously address what we have termed business life events. Business life events are critical moments in the life of a business owner that trigger a series of actions that influence the future direction and success of the firm and its owners. The table defines five business life event categories.

<b>Business Life Events</b>	<b>Typical Issues</b>
Ownership Structure	Bringing key employees into ownership through stock options/purchases; Buy-outs of co-owners; Valuing ownership positions for divorce settlements
Business Transition	Selling the business to partners; Selling the business to a “roll-up” group; Selling to or buying a competitor; Establishing an ESOP; Taking the company public
Retirement Planning	Determining the optimal owner portfolio across business and other retirement assets; Use of deferred compensation plans
Estate Planning	Estimating potential estate tax liabilities; Evaluating alternative tax minimization strategies; Picking the right trust vehicle; Charitable giving options
Income and Equity Protection	Putting in place owner/key employee disability insurance and key person or business succession insurance

Baby boomers are the dominant segment of the wealthy owner marketplace. Given their age and wealth, they will need to address critical business life events over the next fifteen years. In two of these business life events, retirement planning and estate planning, a majority of wealthy business owners indicate that they have addressed these issues to varying degrees. The others, those tied to the value of their business, remain a mystery. As well, it is not clear that business owners with estate plans have updated those plans for gains in business value over the last decade. A primary objective of this study is to measure the degree to which owners are prepared to address business valuation related issues.

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## Implications of the Study's Results

### **1. The productivity of the small business economic engine that has driven much of the U.S. economy's growth over the last twenty years is likely to slow down if business owners cannot unlock the value of their private businesses.**

The wealth of affluent business owners excluding their primary residence exceeds \$2 trillion. The bulk of this wealth is tied up in their private businesses. To put their wealth in perspective, consider the following. Affluent business owner wealth comprises over 40% of household equity holdings in public firms and over 6% of total household net worth<sup>1</sup>. Unlike stock market wealth, the bulk of these assets cannot be easily and cost-effectively bought and sold. Owners and managers of publicly held businesses who can check the value of their companies at any time during trading hours, most private business owners do not have reliable information on the current value of their businesses.

Private business owners are caught between a rock and a hard place when it comes to valuing their businesses. On the one hand, they can use free, but generally inaccurate "valuation multiples" for their industry to estimate the current value of their business. While saying for example that in this industry firms sell for 1 times current revenue is a convenient communication vehicle, the fact remains that there is a very wide dispersion around any industry norm making its use, as a practical matter, problematic. Business owners have an alternative. They can spend \$5,000 to \$25,000 to have an expert complete a business valuation that is only useful for a short period of time.

The high costs of valuing and selling private businesses means that ownership change occurs less frequently than desirable. This lack of redeployment follows from the fact that ownership is entrenched. Since there is nobody knocking down the door to buy the business, the entrenched owner is not motivated to do anything really different. The saying, "if it ain't broke, don't fix it" is certainly the motto of the entrenched business owner. The upshot is that assets of private businesses are less frequently redeployed to more productive purposes than they should be. Since assets are not used optimally, economy-wide productivity growth is lower than it could be.

The expense of valuing a private business also limits the ability of the business owner to alter the capital structure and raise capital through the issue of debt. The proceeds of this loan could then be used to invest in other worthwhile and productive activities. Since funding new investment projects raises productivity growth, it follows that any thing that limits this funding will moderate the growth in productivity for the economy as a whole.

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<sup>1</sup> *Flow of Funds Accounts of the United States*, Table B. 100: Balance Sheet of Households and Nonprofit Organizations, Federal Reserve Statistical Release, June 8, 2001.

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**2. Business owners need to diversify their wealth but they have few alternatives to do so.**

For most business owners, their wealth is tied up in their businesses. The need to diversify their overall portfolio was less of an issue earlier in the business' life cycle. Now, as a large number of owners are well into their 50s, and as they look to retire or change the pace of their business life, the need to diversify has become more critical to the long run viability of their retirement plans. The question they face is how can the diversification objective be met in the least costly manner possible? One way to meet the diversification objective of course is to borrow against the value of the firm and then use the proceeds to invest in stocks and bonds of firms in industries unrelated to the industry the firm is in. But given the traditional high costs of valuing private firms, borrowing against their values is generally not a realistic option for owners.

**3. Financial service firms are not really prepared to address business owner diversification needs until the owner has sold the business but this is often too late.**

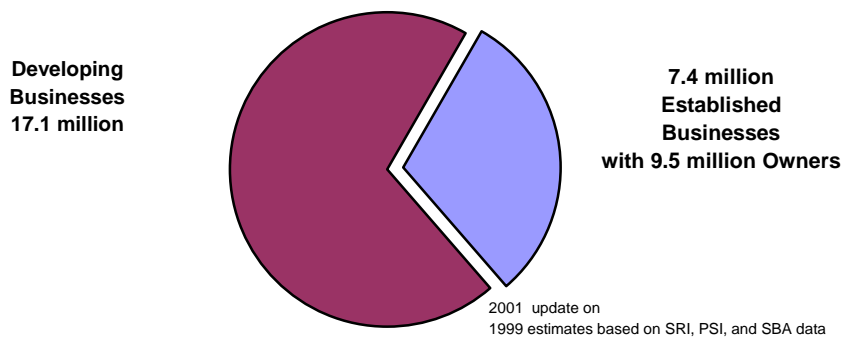
Financial service firms for the most part focus on retirement planning and portfolio construction to meet the retirement requirements of their client base. The assumption is that new money is being set aside each year to fund the client's retirement. In the case of the business owner this is often not the case. While money is available on an annual basis, the bulk of what is set aside is small in comparison to cash that is locked up in the business. Our surveys indicate that business owners believe that investment banks and private banks generally treat them as low priority customers. However, after an owner sells his/her business, the business owner is likely to become a higher priority client resulting in the emergence of a fierce competition between financial service firms and independent financial planners to help the former owner manage his/her newly liquid assets.

***Financial service firms are leaving money on the table and are not optimally servicing their client base.*** Once a credible value is established for a private firm, the financial service company the owner is doing business with is in a position to develop two lucrative incremental revenue streams. The first relates to loaning the business money as part of a strategic refinancing plan if the firm can afford to take on more debt. The second results from reinvesting the proceeds of the loan in stocks and bonds thereby helping the owner achieve his/her diversification objectives. The loan generates interest income and the larger asset base yields incremental management fees. Secondly, when the owner is ready to sell the business, the financial service firm is in the best position to facilitate this transaction thus limiting the possibility that the proceeds of the sale will find its way to a competitor. The problem with executing this strategy is that the costs of valuing the firm are high. Thus financial service firms only deal with issues of valuation, refinancing and facilitating sales when the client firm is large. This need not be the case, however, if there were a low cost high value-added credible alternative to valuing a private business.

## The Size and Financial Demographics of the Established Business Owner Market

**The established business owner market is large and growing.** Chart 1 shows a detailed segmentation of the business owner market. In total there are over 24.5 million businesses in the US. We have subdivided this into two categories- developing and established businesses. There are 17.1 million developing businesses the bulk of which are sole proprietorships. Most of the business births and deaths are in this segment.

Chart 1 - The Size of the U.S. Market of Business Owners



The established business segment is made up of 7.4 million businesses that encompass 9.5 million owners. This segment has grown very rapidly over the last decade. This growth is related to four factors.

- ❑ Robust economic growth that has characterized the US economy over the last decade.
- ❑ The downsizing of corporate America resulting in the freeing up of talented labor to pursue novel ways to produce goods and services at lower cost and higher quality. These employees initially financed their activities by selling their goods and services to their former large corporate employers. This activity provided a profit base that allowed these expatriate corporate employees to expand and grow their businesses.
- ❑ A renewed entrepreneurial spirit that was both a product of significant scientific developments and the emergence of large amounts of financial capital seeking investments with large expected returns.
- ❑ A category shift resulting from **developing businesses** moving into the **established business** category.

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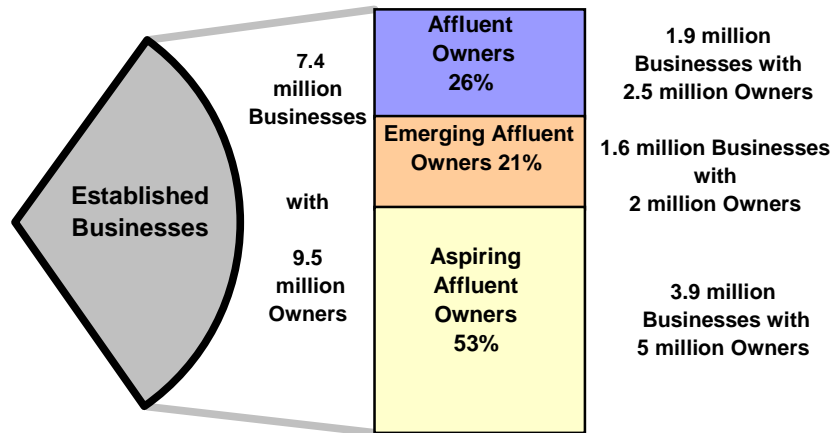
**Established business owners earn high incomes and have significant wealth beyond their principle residence.** We have categorized established business owners into three wealth segments- affluent, emerging affluent, and aspiring affluent. Table 1 shows the income and wealth criteria used to develop these three unique segments.

Table 1 - Income and Net Worth Definitions of Targeted Segments

Segmentation Structure	Net Worth (Not Including Principal Residence-NIPR)		
Annual Income	Under \$300K	\$300K - \$1M	Above \$1M
Under \$100k	Aspiring Affluent	Aspiring Affluent	Affluent
\$100k and above	Aspiring Affluent	Emerging Affluent	Affluent

Emerging affluent owners earn at least \$100,000 but they have not earned it long enough to build sufficient wealth to be considered affluent. The affluent, on the other hand, may have incomes below the \$100,000 threshold, although most do not, but they are individuals that have accumulated wealth in excess of a million dollars. Chart 2 shows the numbers of established business owners in each category.

Chart 2 – The Very Attractive Established Business Owner Segment



2001 update of  
1999 estimates based on SRI, PSI, and SBA data

The chart indicates that 47% of the established business owner market is made up of owners that are affluent (26%) or emerging affluent (21%). There are 2.5 million established business owners whose wealth, in addition to their primary residence, exceeds a million dollars.

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## Segmenting Owners of Established Businesses by Business Life Profiles

Our research indicates that established business owners know they need a great deal of help addressing issues around business life events in general and business transition related issues in particular. Based on this research, we have developed business life event profiles that reflect different degrees of business owner confidence in their own ability to manage business life events, and owner willingness to rely upon professional advisors for help in managing business life events.

Our Business Life Events' Profile segments are:

- **BLE Planners:** This segment of owners indicated that their needs for solving business life events were spread evenly across retirement planning, business succession planning, disability protection, and other business life events. However, this group split into two important sub-segments based upon their advisor preferences and their sense of financial self-confidence.
  - **Expert Dependent:** These owners are less confident and more easily overwhelmed by the number of financial choices they face. They place a high degree of importance on working with an expert who takes a leadership role.
  - **Expert Independent:** Owners in this sub-segment are confident about managing their finances. They are open to working with an expert but only if the owner has close involvement in the business life event solution planning. Although they have similar business life events needs to the first group, members of this second segment should be approached and managed in a very different manner.
- **Business Succession:** This group places a very high priority on implementing a comprehensive approach to business succession. They want to have business succession insurance in place to ensure that the business has adequate capital through any transition. They also want to have a clear strategy for how the next owner or owners will fill their shoes.
- **Golden Years:** This group wants to maximize the resources they have available for retirement. Over half are sole proprietors and at least a quarter expect to close the business upon retirement. They are looking to put the most money away on a tax-free basis rather than to expect some large payout from selling the business.
- **Needs Being Met – Expert Dependent:** This group is the most advanced in already purchasing and/or implementing business life event solutions. Almost half have 3 or more solutions in place. This group places the highest priority on getting on-going support from their advisor team.

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- ❑ **Limited Needs’ Skeptics:** This group does not see the need for doing much about business life events. Many expect to close their business upon retirement. These people are generally mistrustful of advisors, agents, business brokers, and consultants.

## Business Life Event Profiles Can Help Advisors Customize their Approach to Owners

Table 2 shows the distribution of the business owner marketplace by business life event profile and gender. The data have important implications for financial service firms focusing on the established business owner marketplace. For example, women who own established businesses now constitute 30% of the overall market.

Table 2: Business Life Event Profiles by Market Size and Gender

Segment Name	Segment Description	Market Size	Gender	
			Male	Female
BLE Planners- Expert Dependent	Younger, emerging affluent, and more likely to be female	20%	54%	46%
BLE Planners-Expert Independent	High income, very involved in business life events planning	25%	80%	20%
Business Succession	Very high net worth, focused on business succession issues	10%	80%	20%
Golden Years	Lower net worth, focused on building retirement assets	20%	82%	18%
Needs Being Met – Expert Dependent	High net worth, likely female	17%	55%	45%
Limited Needs’ Skeptics	Higher net worth, do not trust advisors, mostly sole proprietors	8%	71%	29%
<b>Affluent and Emerging Affluent Market Total</b>		<b>100%</b>	<b>70%</b>	<b>30%</b>

Among our additional findings from this segmentation analysis:

- ❑ Only 17% of the established business owner market, the Needs Being Met – Expert Dependent segment, has implemented solutions to three or more business life events’ areas. The areas where the most work has been done are retirement planning and estate planning, and in these areas most owners have done only basic activities, for example:
  - Few owners have updated their estate plans for the likely growth in the value of their business over the last decade.
  - Most owners have done little to diversify their retirement investment portfolio, as the single largest asset in this portfolio is the value of their business.
- ❑ Less than 40% of business owners are willing to manage their business life events in close partnership with professional advisors. Women business

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owners are much more likely to want to rely extensively on an advisor or a team of advisors.

- ❑ The remaining 60+% of established business owners are not willing to work in close partnership with financial experts and other professional advisors. Most of these owners are willing to pay for information and advice from professionals, but they want to retain control, make the final decisions, and in essence, become experts in these areas.

Beyond the important findings by Business Life Event Profile segments, we also found these areas of agreement among most established business owners:

- ❑ Most owners believe that their current professional advisors cannot really help them with their most important asset, their business. In this regard, they feel that advisors are either not qualified to help them devise strategies to extract cash from the business through refinancing or selling the business in part or in total.
- ❑ Most owners do not like getting a standardized sales pitch from representatives from large financial institutions. These owners are looking for advisors who will listen to their immediate business life events' concerns, and then offer constructive, objective, and customized solutions.
- ❑ Most owners believe that advisor fees for solving business life event problems are too high. Owners wonder why the technological efficiencies that they have used to reduce costs and improve service for their customers are not being widely used in the professional advisor communities to provide business owner customers with similar benefits.
- ❑ Most owners are skeptical of the advice they receive from professionals whose compensation is tied to the products he/she sells to the owner.

The bottom line is that over 80% of this very attractive, established business owner marketplace are not adequately being served in the management of their business life events. The result is that business owners put off addressing these challenges until circumstances emerge that force them to act. This is often too late, and generally does not result in the optimal course of action. There is a significant *Solutions Gap* that exists between owners that need help and an efficient professional infrastructure that can offer high value-added solutions at the "right price". There will be a tremendous reward for organizations that develop more cost effective, objective, and customized solutions for the established business owner market.



Axiom Valuation Solutions provides expert solutions empowering business owners to manage important business life events. Its solutions are targeted at owners, advisors, and financial services firms. The company was founded two years ago and is privately owned.

[www.axiomvaluation.com](http://www.axiomvaluation.com) is Internet headquarters for cost-effective expert solutions to strategic issues that we call “business life events” facing the owners of (and advisors to) privately held businesses and professional practices in the United States. Business life events are “high stakes” issues, such as selling a business, managing owner risks, and planning for retirement and estate taxes. How these events are managed typically has a major impact on an owner’s financial success; most are one-time events, and thus are outside an owner’s experience.

Valuation of a business is a central activity to managing most business life events. Our first expert system, the Valuation GURU™, provides a sophisticated and reliable set of business valuation briefings, including Axiom’s Valuation Snapshot, Value Maximizer, and 50+ page Business Valuation Report for as little as \$1,300. The Axiom Valuation staff carefully reviews company financial data and key valuation assumptions, typically with the owner or advisor by phone. A discussion of the final results and Q&A session with the owner or advisor, conducted by a senior Axiom Valuation staff member completes the service.

The information and advice in the briefings and report generated by the Valuation GURU provide an objective and reliable foundation to begin the process of effectively considering their business life event options. For owners, we bring them up the learning curve, so they are more comfortable in working with the professional advisors they will need to engage to implement various business life event solutions. For professional advisors, we provide an objective and reliable source of valuation advice to help educate their owner clients about the importance of planning for business life events. Our role is limited to providing this objective and reliable foundation of information and advice through our expert systems.

The co-founders of Axiom Valuation Solutions are Dr. Stanley Feldman and Roger Winsby. Stan is an expert in business financial and valuation issues and in industry forecasting. He is an Associate Professor of Finance at Bentley University, Waltham, MA. He has a Ph.D. in economics from New York University. Roger conducted extensive market research studies on business owners’ needs, while serving as Chief Operating Officer at Chadwick Martin Bailey, a Boston-based market research firm. Dr. Feldman and Mr. Winsby worked together previously as senior executives at DRI/McGraw-Hill in Lexington, MA.

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