

THE DONNELLY REPORT

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The Coming Tsunami *for* America's Small Business Owners

THE 
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GROUP
It's Your Time



Over 6 million businesses will change hands over the next 10 years, according to recent estimates.¹

The impact of this 'Coming Tsunami' will be transformational, as America's small business owners look to cash out and use the proceeds from the sale of their businesses to fund the lion's share of their retirement. But, this is a cautionary tale: This surplus of businesses for sale is likely to cause business valuations to plummet, and owners to either remain at the helm longer to reap sufficient retirement income or accept much lower returns on their decade's long investment.

What are the implications for America's 23 million small businesses?² How can America's small business owners successfully navigate this perfect storm?

Experienced, educated, and older than the average U.S. population, many of today's small business owners have invested decades building and transforming their businesses.³ As a result, many small business owners are so invested and intertwined with their business, it's often difficult to embark on a well-planned succession and exit strategy, as 'five more years' gets pushed further and further out.

What happens though, when five more years suddenly becomes now? For some small business executives, staying on longer to get the business optimized for sale is not always an option. Health issues, economic influences, industry shifts, personal priorities, and more may further risk business values, and in extreme cases, force a liquidation event. In addition, these issues can wreak havoc on the business as successors grapple with the stress and uncertainty of their own futures with the company.

Without confident and trusted communications, uncertainty prevails. As the strongest performers at every level seek more reliable or lucrative growth opportunities, the weakest performers tread water, trying to hang on to their jobs. The consequence: This 'Coming Tsunami' potentially puts a lifetime of business success in freefall.

The Economic Impact of U.S. Small Businesses

Many in our communities still have not recovered from the recent recession. As U.S. businesses jockey for a sale, the subsequent churn in our local economies could spell trouble.

As key employees jockey for leadership positions and others worry about whether they will have a job, get along with the new owners, or if the business can survive and thrive under new management, they will carry their fears and

uncertainty into every aspect of their lives. The lion's share of our local economy will be exposed to this wave of change: According to the most recent U.S. Census Bureau statistics, over 98% of employer firms in the U.S. employ less than 100 people.⁴ Families may tighten their belts, be more cautious spending money, and seek opportunities offering security and stability.

It Can Be Tricky to Fund a Retirement Lifestyle for Small Business Owners

Whether a business owner is ready to exit a business or still wants to contribute in some capacity, most owners have the majority of their wealth – and retirement funding – tied up in the business.⁵ Without sufficient funding for retirement, the owner is either forced to stay on in the business, or potentially accept a reduced quality of lifestyle.

Owners can pursue a third-party-buyer cash sale, but they need to stand out in order to attract the serious attention of such buyers. Unfortunately, even in a balanced market, the majority of business owners want to sell their business, but only 20% actually do.⁶

Those who do sell risk a much lower return than expected. According to a Mass Mutual Business Owner Perspectives Study, 25% of owners who claim they have done a business valuation did it on their own, rather than hiring a credentialed valuation expert.⁷

If the owner sells the business to a family member or key employee, in most cases the owner will have to finance the sale since most family

members and key employees are not sitting on a pile of cash or a mountain of available equity to borrow against.

The owner needs to have confidence the business will grow and be profitable or he or she will see diminishing returns, and the investment that took a lifetime to build will die a painful death. At the same time, the incoming successor needs some flexibility and autonomy to exert leadership, establish credibility, and make changes that expand long-term growth potential.

Charlie*, a business owner in Greensboro, N.C. would like his key employees to own the business one day. They are young, talented professionals who have demonstrated a passion and knack for the business. He knows they do not have the cash to buy the business outright, nor do they have the resources to borrow enough to make much more than a good faith down payment on the business. Charlie doesn't need a cash sale to fund his retirement, but he wants a fair return on his equity and hard work.

Why do most succession plans fail to reach their potential?

It's not due to financial barriers. Most leaders can figure out the financials.

The biggest reason succession plans derail...

It's EMOTIONAL. It's the soft-side issues. This is...

The Unspoken Truth

Difficult Conversations

These negotiations can be very tricky; there are so many conflicting emotions and agendas involved. Incoming leaders can feel entitled to own the business, overly confident in their ability to run it, and underestimate the work and skills required to run a profitable business. They may be anxious to remove vestiges of the previous owner from the

workplace, or they may hesitate to make any change at all, afraid to step on toes, or upset the status quo.

Owners can be overly controlling, uncomfortable with changes in strategy or structure, undervalue their key employees' contributions or capabilities, and send mixed messages about the transitional role they want to play in the business. Both sides may have very different ideas of what the business is worth and a timeline for payout, so these details often have to be negotiated and renegotiated throughout a transition.

Often, what successors are not prepared for is the realization that 'owner financing' will usually mean 'owner involvement' as owners not only need to ensure business growth and viability to ensure they get paid out, they also have a strong emotional tie to their business. It's been a part of their identity for many years and trusting that to someone else can take time and a lot of good, frequent, and transparent communications.

The Leadership & Legacy Group works with executives on the soft-side issues of Succession Planning and Exit Strategy. Our mission is twofold: To develop the executives on the senior management teams to profitably run and grow the business through an ownership change, and to help the business owner transition to a compelling 'what's next.'

Critical Success Factors: Business' 'Soft-Side'

The hard truth is that the soft-side of business will make or break the bottom line and the viability of a business' future. To minimize the risk of business derailment, *the Leadership & Legacy Group* has identified imperatives related to successfully navigating soft-side business issues:

Build Leadership Bench Strength: Building a strong leadership team positions an owner to command a premium in a third party sale, and dramatically increases confidence in a full payout

in the case of an internal sale. These high level leaders are soft assets that command a tremendous return on investment (ROI). They set business strategy, put management systems in place, and ensure the profitable implementation of the business plan.

Business owners must assess their strategies for growth and profitability and define the key competencies that are needed to deliver against them. The Chally Group Worldwide Third Annual Global Leadership Research Project, 2013 Report: Best Companies For Leaders, identified the top critical skills for small businesses.⁸

Armed with this critical understanding, owners can assess their key leaders and create a plan to close any gaps. This process is often quite illuminating and provides a powerful snapshot of the work to be done.

Formal assessments are very effective because they provide objective data against a set of criteria, and equally as important, they open the door to crucial conversations about succession. They can serve as a starting point for informal assessment, presuming the owner and key employees can start with a common understanding of the business needs, and each is willing to be open to feedback and input from the other.

The Leadership & Legacy Group has developed proprietary assessment tools and development methodology to build capability and capacity. While this process can take three to five years, the value is tremendous, as it instills strong leadership at the top and creates a solid foundation of trusted relationships and confidence throughout the organization. A powerful side benefit, it enables the owner to reap the rewards of a stronger leadership team long before a sale and a greater purchase price when the time is right to sell.

Manage Internal Risk: Every business faces risk, but in the case of an owner nearing ‘traditional retirement age,’ whether or not there are health issues, or the owner is showing up less frequently, or he is making noise about moving on, fear and speculation about the future of the business will begin to take on more and more of the employees’ time and energy.

Proactively managing this uncertainty and ensuring open communications appropriate for each level in the organization will provide business stability, and create opportunities for employees to contribute even more as roles and responsibilities evolve. Owners and successors need to be acutely aware of changes in their body language, work habits, and communication patterns as their transition plans begin to take shape.

Where there is tension, uncertainty or stress, employees will see it – and feel it – long before any formal communications. This can have direct impact on the organization’s results – revenue, turnover, productivity, effectiveness and more.

Manage External Risk:

Nobody has a crystal ball to predict the future, but we can be certain that over time, industry dynamics and economic conditions will change, and business opportunities will come and go. A strong forward-looking leadership team with deep bench strength can anticipate and mitigate risk and be agile enough to respond quickly when unanticipated issues arise.

Critical Success Factors: Emotional ‘Soft-Side’

While few business owners will admit it, most are uncomfortable – if not downright stressed out – with the dual challenge of turning their business over to someone else AND facing the looming prospect of 20+ years of ...who knows what?

Uncertainty: Because there is no clear roadmap for this soft-side of succession planning, owners are often surprised and irritated by the emotional challenges they face. From acknowledging the need for a succession plan and exit strategy, to identifying the right successor(s), to preparing them to lead the organization (in exactly the way the owner wants them to), to defining and crafting a graceful exit or a new value-added role for themselves, it can be unexpectedly difficult and uncomfortable. Finding others to commiserate with is difficult, and opening up to the wrong person can be painful. As a result, 60% have delayed their exit plan.⁹

“I could tell he was slowing down, but I didn’t see any indication that anyone else was stepping in to take up the slack.”

~Julie, employee

Loss of Identity: After years of living the ‘American Dream’ and creating a successful business, most business owners’ identities are inextricably linked to their business. It’s difficult to imagine letting the business go because it’s so much a part of who they are. Transitioning it to a family member or key employee – or even a done deal sale to a third party can be gut-wrenching as the new owner stakes their claim, and makes changes in strategy, staffing, systems and culture. It’s further compounded if the owner is concerned these changes may not produce the growth and profitability required to fund their payout.

Social Expectations: Because ‘Retirement’ is coveted in our country, the traditional response to

hearing of an impending retirement is excitement for the retiree – and possibly a hint of jealousy for what this stage of life will offer. Retirees, after all, are free to enjoy life with no business demands or the stress of day to day business responsibilities. Friends and business associates covet the time and opportunity to pursue new interests, to sleep in, and to tackle hobbies that have lain dormant for many years. But in reality, most hard charging business owners are incredibly uncomfortable with the idea of ‘retirement’ and are terrified of the long days of nothing to do but travel and play golf. They fear boredom, lack of meaningful ‘work’, loss of relationships and community, and becoming obsolete.

It’s hard to get much sympathy for the stress of ‘retirement.’ Business owners are seen as financially independent leaders, people who ‘have it all’ and have earned the right to ‘retire.’ If they do happen to get some sympathy, they may find themselves roped into doing volunteer work or other projects on a much more aggressive schedule than planned, or end up putting their energy into someone else’s long-standing priorities and goals, rather than investing in their own.

Health Concerns: Research indicates there is a sharp rise in depression, alcoholism, and obesity after retirement because these fears become manifest. According to the Harvard School of Public Health research, rates of heart attack and stroke among men and women who had retired were 40% higher than among those still working.¹⁰ The increase was more pronounced during the first year after retirement, and leveled off after that.¹⁰ The reality for most business owners is that the shock of moving from a full-time business leader to the uncertainty of what’s next is very unsettling. They may not want the level of responsibility they used to have, but they

want something meaningful, which keeps them engaged and with purpose.

Breaking new ground: Today’s business owners are the first generation to enjoy 20+ healthy years of life after age 65. There is no clear roadmap for this generation defining what life looks like after age 65, and in fact, many are rejecting the term retirement because they are finding a second lease on life and rewriting what is possible.

If business owners do not proactively address the soft-side, the emotional issues that come with a transition of this magnitude, business owners risk not just an adequate selling price, they risk the very foundation of their business.

A Meaningful ‘What’s Next’:

This generation of business owners has the blessing of time and the curse of figuring out what will keep them engaged in life and in community in a meaningful way. Companies are taking notice as AARP launches a new web site called Life Reimagined and Encore.org (formerly Civic Ventures) launches a book and model to encourage ‘Encore Careers’ of meaningful giving back.

Business owners can work with CEO Succession Coaches, through *The Leadership & Legacy Group* who specialize in this kind of a transition. CEO Succession Coaches help owners prepare their key leaders to run the business profitably and sustainably, and guide the owner through a process of defining and creating a powerful and rewarding next phase of life.

The High Cost of Avoidance

This is tough stuff. It’s easier to put off than it is to address and many owners are putting it off – for years, until one day it’s imminent. Patrick Ungashick, author of *Dance in the End Zone*, shared the phrase “The Rolling Ten” at a Vistage presentation in Greensboro, NC. He asks owners, “When do you plan to exit your business?” They

say, “Five to 10 years.” As years go by, he asks them again. The answer, “Five to 10 years.” Before long, 15 years have passed, the owner is 75, no action has been taken, and the business is at risk.

Over 30% of owners have no plans to retire¹¹, but 100% of them will exit their business due to health issues or ultimately, death. Even for those 40% who plan to exit within the next 10 years, the majority have not selected a successor.¹¹ Of those who claim they have, over 80% say their successor is aware they have been selected, but 17% of the successors don't know.¹²

Failing to properly prepare for a leadership transition, or appropriately deal with the soft-side emotional and personal issues associated with retirement and a business sale can thwart chances for success far more than poor economic conditions. While this work cannot be accomplished overnight, and it may take three to five years for planning and implementation, it's invaluable to the business owner and business.

The Roadmap for Business and Owner Success

If you've made the decision to buck the trend and seize the opportunity to do this transition right, we recommend the following steps:

ASSESS YOUR ORGANIZATION

- Know the human resource assets you have to work with and the value they can bring your business. Assess your leadership team against the key competencies required for success of your strategic growth plan. At The Leadership & Legacy Group, we have a proprietary set of assessments in our *Executive Suite Toolkit* designed specifically for the purpose of assessing leadership for critical competencies and readiness for transition. Whatever tools you use to assess your organization, the intent must be to understand where the gaps are and how to best close them for the benefit of the business.

BUILD YOUR BENCH STRENGTH

- Strong leaders create business growth, opportunity and profitability. Invest in your team, and engage them in the future of the business by being intentional about development for each high potential leader. The Leadership & Legacy Group's *5 Level Leadership Model* provides a path for development and certification. We use traditional methodologies such as 1-1 coaching and classroom training, as well as non-traditional methodologies such as strategic investments in benchmarking visits, serving on a non-profit board work, or experiencing a day in the life of your customer. Whatever approach you choose for your business, ensure your bench is strong and deep.

REDUCE UNCERTAINTY

- Admit to what you know and what you don't know. Acknowledge the stress and uncertainty – at least to yourself and a trusted advisor. Manage your emotions at work. If you don't have a trusted advisor, hire one. There are many resources including CEO groups such as Vistage and The Alternative Board (TAB), as well as executive coaches and other trusted advisors who can provide important support.
- Ask for help. Hire resources with experience and wisdom to share. Wealth advisors, brokers, business attorneys, estate planning attorneys, CPA's, investment bankers, and insurance agents can provide critical advice and guidance.

GET 'SALE READY' NOW

- The beauty of being an owner is you get to decide when to sell. Prepare emotionally to let the business go when the right opportunity comes. By being 'sale ready' any time – both emotionally and financially, you can reap the benefits of a good ROI now AND in the future. You never know what and when opportunities might emerge.

DEFINE ‘WHAT’S NEXT’ FOR YOU

- When you have something compelling to move to, it’s easier to leave the past behind. Take some time to examine what you are passionate about, what you are best at, and what lifestyle priorities resonate with you at this point in your career. For a framework and resources to help you discover ‘what’s next’, take a look at our [Develop Your Future](#) model.
- Be aware of your emotions and acknowledge them to a trusted friend or advisor. Work through them in a safe and productive environment so you don’t derail your sale. Follow the steps outlined above to ensure a stronger financial and emotional return. Knowing you proactively and intentionally built the foundation for your successor’s ongoing success, they will grow and flourish with confidence.

This boomer generation is charting new ground –again. It will take a few brave souls on the front end of this ‘Coming Tsunami’ to recognize the importance of early and proactive planning.

Those who proactively seize the opportunity to do this right will meet with success, and blaze the trail for tomorrow’s business owners.

The Donnelly Report is based on comprehensive research including over 45 interviews of business owners and CEO’s, and more than 50 articles, white papers, books and research studies. We understand the challenges and complexities that business leaders face as they plan for succession. At The Leadership & Legacy Group, we are committed to providing a roadmap for business owners and CEOs who are ready to tackle their plan for succession.

You’ve invested in your business. Now invest in your future.

>> It’s your time. <<

SOURCES

¹ From Robert Avery, Cornell University Study; calculated from statistics cited p. 11, in *Exiting Your Business, Protecting Your Wealth: A Strategic Guide for Owners and Their Advisors*, John M. Leonetti, John Wiley & Sons, Inc., 2008.

² *Small Business Administration, Small Business Trends.* <http://www.sba.gov/content/small-business-trends>

³ SBSI Survey sponsored by Network Solutions.

⁴ According to most recent U.S. Census Bureau statistics, of the 5,885,784 employer firms in the U.S., 5,782,199 firms employed less than 100 people.

⁵ *Exiting Your Business, Protecting Your Wealth: A Strategic Guide for Owners and Their Advisors*, Leonetti, p. 9.

⁶ *Exiting Your Business, Protecting Your Wealth: A Strategic Guide for Owners and Their Advisors*, Leonetti, p. 32.

⁷ *Mass Mutual Business Owner Perspectives Study: 2011 Insights in an Uncertain Economy.* p. 9.

⁸ *Chally Group Worldwide Third Annual Global Leadership Research Project, 2012/2013 Best Companies For Leaders,* p. 23.

⁹ *Research done in 2010 by Strategic Advisors, LLC, Greensboro, NC.*

¹⁰ *Harvard School of Public Health looked at rates of heart attack and stroke among men and women in the ongoing U.S. Health and Retirement Study.* <http://www.health.harvard.edu/blog/is-retirement-good-for-health-or-bad-for-it-201212105625>.

¹¹ *MassMutual, American Family Business Survey, 2007,* p. 6 and 6.

¹² *Mass Mutual Business Owner Perspectives Study: 2011 Insights in an Uncertain Economy.* p. 10.