MassMutual

2018 Business Owner Perspectives Study

Insights from America's Economic Engine

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"Whenever you see a successful business, someone once made a courageous decision."

– PETER F. DRUCKER

Business owners are the engine that drives the U.S. economy. The small business community in the U.S. is the fifth largest economy in the world[1], represents a total buying power of $2 trillion[2], and employs nearly 50% of the country's entire working population[3]. They are also your peers.

The *2018 MassMutual Business Owner Perspectives Study* takes the pulse of today's business owners. Conducted by HawkPartners for Massachusetts Mutual Life Insurance Company (MassMutual), the results reveal that today's business owners are spending the majority of their time working in their businesses instead of on their businesses. The reality for today's business owner is that long-term planning is not always top of mind, even though many feel protecting the business is important. In addition, most business owners prefer to keep their business and personal finances separate, but often find the two inextricably linked.

We recommend that you review the study with your family members, business partners, key employees and centers of influence. Then use the findings to begin a meaningful dialogue about how you can best position your business for long-term success and financial stability.

At the same time, consider the impact not planning could have on your business and on those who depend on it most. Evaluate what's important, keep those critical items top of mind, and seek guidance from professionals who are best equipped to meet the needs of you and your business. After all, your business is vital to the livelihoods of your family, your employees, and your community. Shouldn't you spend the same amount of effort protecting it, as you did building it?

[1] CIA World Fact Book, 2017

[2] SMB Insights, The Business Journals, 2014

[3] Small Business Administration, Small Business Profile, 2016

The personal side of business ownership

The decision to become a business owner is both a brave and noble one. When asked about the ideals and values upon which business owners started their businesses, words like excellence, integrity, customer-centric, and respect all rise to the top. And, while business owners have undoubtedly spent a great deal of time building a successful business that reflects these ideals, there may be a lack of emphasis on some other just as important key words, such as employees, value, exit, and legacy.

A majority of business owners say they prefer to keep their business and personal financial well-being separate and prioritize their personal financial planning over their business planning. But, if your business is your largest asset, the provider of income for you and your family, and the source of wealth you wish to pass on to the next generation, shouldn't the two be viewed with equal importance?

In an effort to understand how business owners think and feel about protecting their businesses, this study examines seven core planning pillars and how important, top of mind and capable of addressing each one is:

- Keeping key employees loyal to the business
- Knowing what the business is worth
- Protecting the business from the death of an owner or a key employee
- Protecting the business from the disability of an owner or a key employee
- Choosing who will take over the business if an owner leaves, becomes disabled, or dies
- Transitioning ownership and/or finding a buyer upon retirement
- Being fair and equitable regarding distribution of the business and assets from the owner's estate

The results show that business owners are not ready or too busy to address all of the core pillars, emphasize the need for education and awareness around the planning areas that could leave a business exposed, and reinforce that taking action involves protecting whom and what matters most.

TOP REASONS for NOT having agreements/ plans in place:

1. I don't feel like I need to think about these issues yet.
2. Nobody ever approached me to talk about these issues.
3. I am too busy with the day-to-day management of the business.
4. I wasn't aware these were important issues for my business.
5. It's an uncomfortable conversation for my family and me.
6. I don't have extra money to put towards paying for help.

TOP REASONS FOR having agreements/ plans in place:

1. I wanted to protect my family.
2. I wanted to protect my business.
3. I was doing personal planning and it prompted me to think about business planning.
4. I wanted to protect my employees.
5. A trusted source brought it up to me.
6. I witnessed a difficult life event.

The core pillars at-a-glance

The following chart provides an overview of how business owners rank each core pillar. Keeping key employees loyal is viewed as the most important, most top of mind, and most solvable. Knowing what the business is worth is also very much top of mind and continues to rise in terms of its importance. Finally, what happens to the business, and the business assets, upon the death of an owner is another critical area of concern.

PILLAR	IMPORTANCE	TOP OF MIND	CAPABLE TO SOLVE	2015 RANK
Keeping key employees loyal				1
Knowing what the business is worth				4
Being fair and equitable regarding distribution of the business and assets from the owner's estate				7*
How the business would be affected by the death of an owner of key employee				3
Who will take over the business if an owner leaves, dies or becomes disabled				6
How the business would be affected by the disability of an owner of key employee				2
Transition ownership/finding a buyer when the owner retires				5

* Estate planning results in 2015 MassMutual Business Owner Perspectives Study focused on estate taxes versus distribution of assets.

The findings also indicate that business owners leverage many different resources for support in addressing the core pillars. Most often, the resource is either themselves, their business partner, or their family members. This shows that business owners may not always be turning to the most informed resources for help. In the instances when business owners do look to experienced professionals for guidance, they say it's a financial professional, attorney or accountant they turn to most.

> "I feel like our business and our personal [finances] are very interconnected because everything we do comes in through the business. I mean that's how we survive, that's what we live, so I don't know that I could separate the two because one doesn't operate without the other."
>
> — FEMALE, PROFESSIONAL SERVICES

A closer look at the core pillars

Keeping key employees loyal to the business

Keeping key employees loyal to the business tops the list in terms of importance and 79% of respondents say they either frequently or often think about the issue. However, the gap lies in what the respondents are offering in terms of benefits and to whom. There appears to be no difference in what is offered to all employees and what is offered to those who are most critical to the success of the business. In fact, nearly one-third report not offering any additional benefits to their key employees.

There may be individuals who are valuable assets to the company because of what they bring to the table everyday — creative genius, sales acumen, or relationship building to name a few. Business owners should ask themselves this question: If you were to leave your current business to start a new business, who would you take with you? Those are your key employees and should be taken care of.

The good news is over 90% report offering some kind of benefits to their employees with health insurance, generous salaries, and flexible work arrangements as the most common benefits offered. But, are these the right benefits?

Not all employee benefits are created equal and certain ones are more valued by employees than others. Some of the most desired employee benefits aren't what you might think. Competitive pay is only the beginning. Retirement savings plans, preventative health and wellness incentives, and financial education programs are popular elements of today's compensation packages. In addition, bonuses used to pay life insurance premiums, employer-paid disability income insurance, or non-qualified deferred compensation programs can help keep your most valuable employees in place.

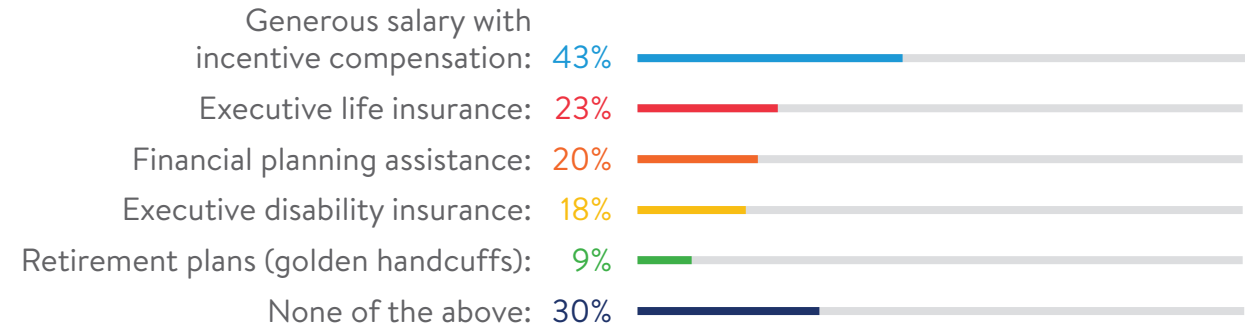
Considering the employee benefits that the workforce desires most will help you develop a benefit package that will help keep your current employees loyal and attract the best new talent in the future. Business owners could benefit greatly from speaking with a knowledgeable professional outside of the business or the family for information on the many types of benefits that may be of value to their key employees.

Business owners should ask themselves:
If you were to leave your current business to start a new business, who would you take with you?

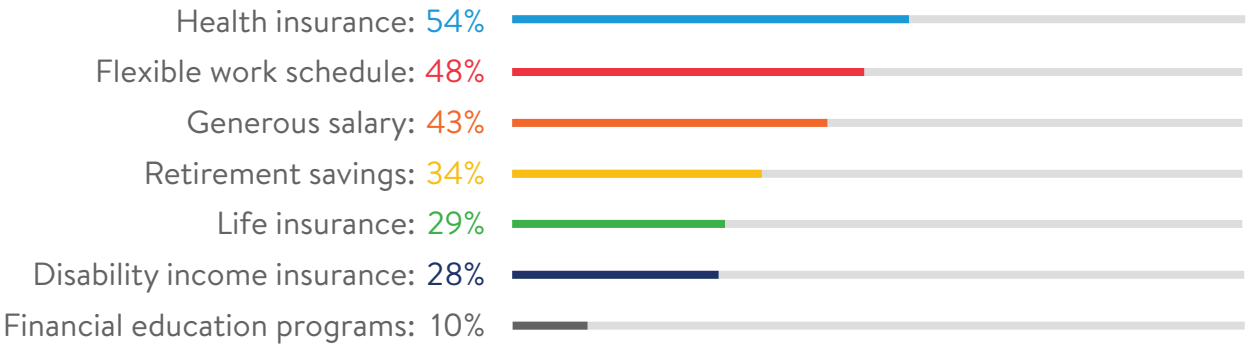
"Happy employees are more productive employees. We want to make sure they know we're looking after them...give them more financial bonuses and incentives, raises from time to time. Just make sure they know that their work is not going unnoticed."

— MALE, CONSTRUCTION

BENEFITS OFFERED TO KEY EMPLOYEES



BENEFITS OFFERED TO ALL EMPLOYEES



Knowing what the business is worth

Knowing what the business is worth is of increasing importance as evidenced by its jump up to number two in this year's study (it was ranked 4th in 2015). In addition, it is very much top of mind with 70% saying they frequently or often think about their business value.

The reasons given for wanting to know the value tend to focus more on business KPIs rather than on strategies to protect the business and the wealth it generates. Some business owners also stated they would only need to know its value when they are ready to sell.

There are critical milestones in the life cycle of a business when an owner needs to have an accurate valuation and these appear to be under-represented. For example:

- Only 13% of respondents considered a valuation to know if the value of the business will be a sufficient component of their **retirement** income plans.
- Only 10% considered a valuation to set the value of the business for the purposes of establishing a **buy-sell agreement** between partners.
- And, only 9% considered a valuation for the purposes of creating an equitable distribution of the owner's business and assets as part of an **estate plan**.

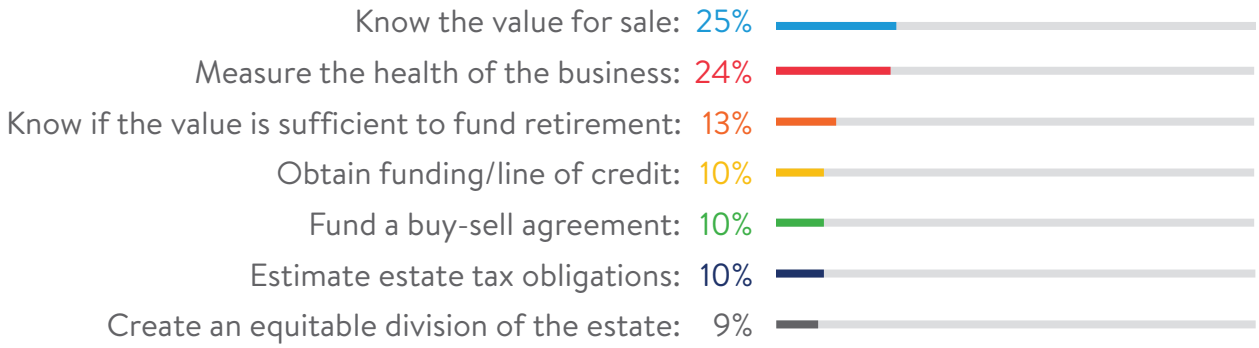
In addition, the study indicates that business owners may not know what their true business value actually is. Nearly two-thirds claim to have done a formal valuation in the last three years and many site their CPAs as the go-to resource. But, one out of four say they did it themselves, and when business owners value their businesses themselves, they can over or under value it by a significant amount.

A proper business valuation is not a "rule of thumb" or a figure agreed to with a handshake; it's thoughtfully crafted by a credentialed

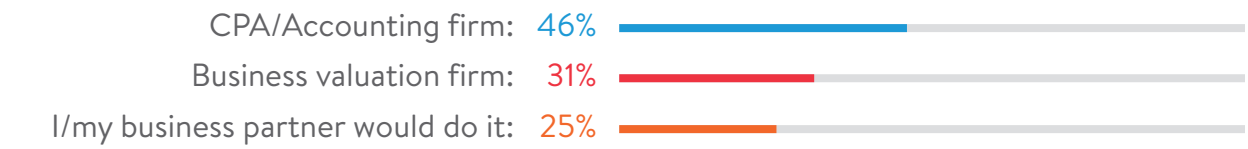
appraiser after thorough research and is documented in writing. Be sure that any firm or individual you hire to value your business has the proper credentials, such as: Certified Valuation Analyst (CVA), Accredited Valuation Analysis (AVA), Accredited Senior Appraiser (ASA), or Accredited in Business Valuation (ABV). You don't want your succession, retirement, or estate plan derailed due to an unsubstantiated business valuation.

> "An outside person would have to present us with what they think it's worth, and then we would say that makes sense or it doesn't make sense based on other companies that are our size and in our industry"
>
> — MALE, HVAC

REASONS FOR HAVING THE BUSINESS VALUED:



WHO DO BUSINESS OWNERS TURN TO FOR BUSINESS VALUATIONS?



Protecting the business from the disability and death of an owner or key employee

The next pillars are protecting the business from the death and disability of an owner or key employee. These two concerns are on par with each other in terms of how important and top of mind. However, relative to the previous two pillars, they lag behind. In fact, over half of the respondents rarely or never think about it, and only about 40% say they have a buy-sell agreement in place.

Business owners should ask themselves this important question: If you died 90 days ago, what would your business be worth today? For some, it could be pennies on the dollar. Without a current, funded, and signed buy-sell agreement in place, a forced liquidation of the business could be the reality should an unfortunate event occur.

A buy-sell agreement should be drafted to protect the business from the five D's — death, disability, divorce, departure and disqualification. When properly executed, a buy-sell agreement can help ensure the continuity of the business when ownership needs to change hands for any reason. It is a legally binding agreement that requires one party to sell and another party to buy ownership interest in a business when a triggering event occurs.

A buy-sell agreement must also be properly funded in accordance with the current value of the business. Funding buy-sell agreements with insurance products, specifically life insurance and disability buy-out insurance, is often the most effective method. Otherwise, remaining owners may be forced to liquidate

Business owners should ask themselves:
If you died 90 days ago, what would your business be worth today?

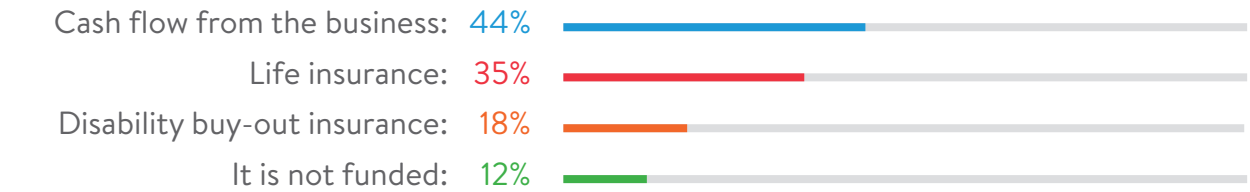
business assets or take operating cash out of the business to purchase the ownership interest of the departing owner or his/her family.

According to the study, of those with a buy-sell agreement in place, only 35% say its funded with life insurance, and only 18% say its funded with disability buy-out insurance. The rest are funded with cash flow from the business or not funded at all. In addition, the number of buy-sell agreements funded with cash increased 17% since 2015.

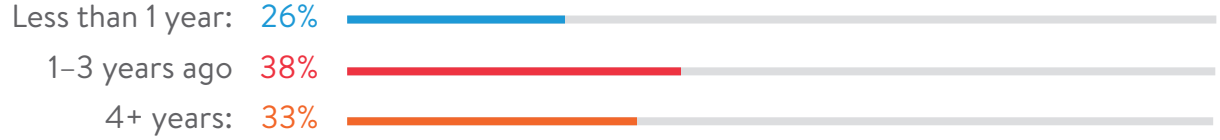
It is also recommended that a buy-sell agreement be reviewed at least every three years to reflect any changes, such as business value, family relationships, and ownership interest. The study shows that one out of every three buy-sell agreements may be stale.

> "If I had died three months ago, [our product] would have gone to the highest bidder and sold as fast as possible to obligate the equity. At this point, if we took fifty cents on the dollar, we would still be able to pay people off."
>
> — MALE, TECHNOLOGY

HOW IS YOUR BUY-SELL FUNDED?



HOW LONG AGO WAS YOUR BUY-SELL REVIEWED?



Choosing who will take over the business if an owner dies, becomes disabled or leaves

This pillar ties directly in with the previous pillar. You could have a well-drafted and properly funded buy-sell agreement in place, but if you haven't chosen (or trained) the right person to take over the business when the times comes, your succession plan may not work out as intended.

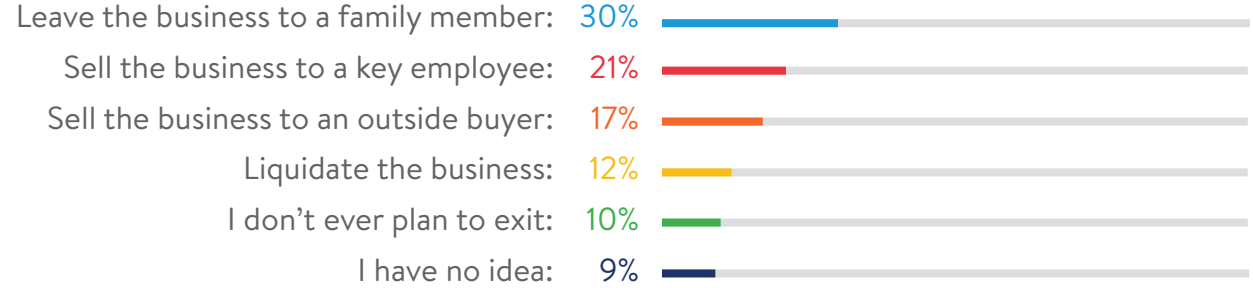
Most business owners say they have chosen a successor, but only about half claim to have a written succession plan in place. This might explain why one of out four say their successor is not aware they are the chosen successor.

Choosing the right successor, and then properly communicating that decision, is critical to the long-term success of the business. The one stat that doesn't need research to prove: 100% of business owners will exit their business someday—either by design or by default. That's why business owners must begin their succession planning, and successor development, as early as possible.

Here are a few tips for properly preparing an individual for assuming leadership responsibilities in the business:

- Establish an employment policy that includes guidelines for family member involvement in the business and how the next leader of the business will be selected
- Develop a written career path for the successor that includes time spent working in all facets of the business — from the "shop floor" to the "corner office."
- Help the successor find and utilize a mentor outside the business
- Recommended the successor spend time working outside the business, perhaps even in other industries, so they gain valuable experience and prove they want to come back.
- Communicate the timeline for exit and successor development plan with family members and key managers so they can participate as appropriate

WHAT IS YOUR IDEAL EXIT STRATEGY?



Being fair and equitable regarding distribution of the business and assets from the owner's estate

Estate planning is of much higher importance when it is positioned in terms of a fair and equitable distribution of assets as opposed to the handling of estate taxes. In fact, 60% of business owners frequently or often think about how the assets in their estates will be divided up as opposed to only 28% concerned with handling estate taxes.* Moreover, 64% say the business is their largest asset. So, when the question of dividing up assets in an estate is mentioned, it is often the business that will be at the forefront of that discussion.

Remember, when it comes to dividing up ownership in the family business, fair does not always mean equal. Nearly 60% of business owners say they plan to divide the ownership in the business equally among all children regardless of their individual roles in the business. That means children who are working in the business day in and day out will have to share in the decision making, and the profits, of the business with siblings who have no involvement. That may be equal, but it certainly is not fair.

Estate equalization is a strategy to help resolve this issue. It involves equalizing the estates of those working in the business with those not working in the business by using other assets, such as real property, cash, or a life insurance death benefit. To begin putting together an estate equalization plan that is both equal and fair, an owner must ask a few very important questions:

- Should the business be divided equally between children working in the business and those not involved in the business?
- If the children not involved in the business do not receive ownership, what other assets can they receive that are of equal value?
- Are you comfortable with children outside the business potentially receiving liquid assets versus those working in the business receiving an illiquid asset?
- Are you comfortable with those working in the business receiving their inheritances today in the form of ownership, whereas those not involved must wait until your death to receive theirs?

Finally, paying estate taxes and fees is still an issue that may need to be addressed. Only 55% of business owners have life insurance in place for estate tax purposes, meaning many families may end up liquidating business and/or personal assets to cover these potential obligations.

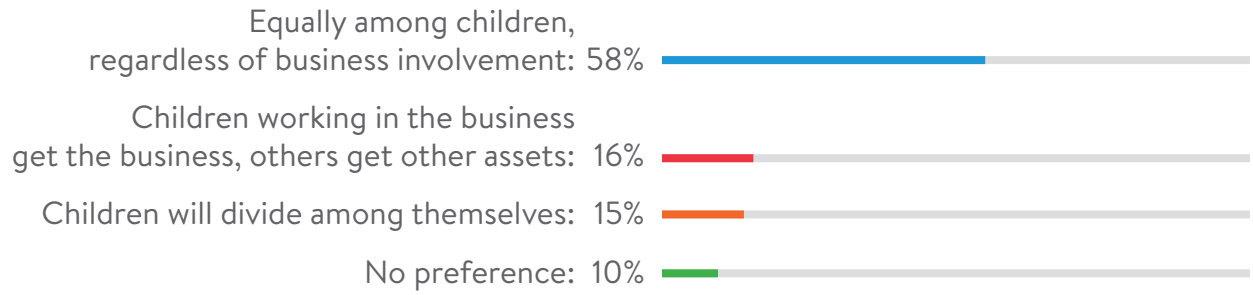
Business owners should remember:
When it comes to dividing up ownership in the family business, fair does not always mean equal.

* Data point on how often business owners think about estate taxes is from the 2015 MassMutual Business Owner Perspectives study conducted by HawkPartners.

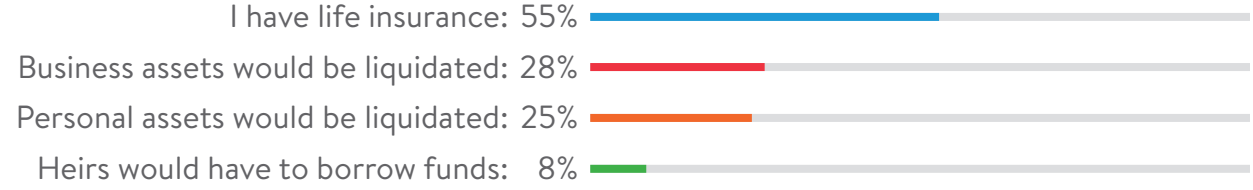
"I would say whatever I've built up over the years would have to be split equally between my kids, and the one kid who wanted to be part of the business, he will have to work his way into it properly. Whatever I have, I would have to divide up four ways."

– MALE, PROFESSIONAL SERVICES

HOW WILL YOU DIVIDE THE BUSINESS ASSETS AS PART OF YOUR ESTATE?



HOW WILL ESTATE TAXES AND FEES BE RESOLVED AT YOUR DEATH?



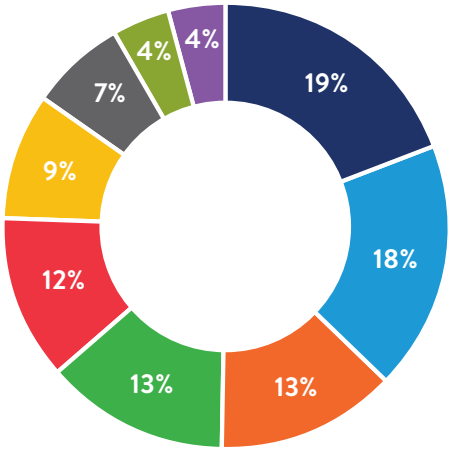
Transitioning ownership and/or finding a buyer upon retirement

Transitioning ownership when the business owner is ready to retire is ranked last in terms of importance and priority. This is not surprising when you consider that nearly half of the business owners surveyed don't think about retirement or can't imagine ever retiring.

However, more important than **when** business owners will retire is **how** business owners will fund that retirement when the time comes. More than half (56%) of business owners are extremely or very confident regarding their estimates on sources of retirement income, and they claim to have a diverse picture of where that income will come from.

WHERE WILL YOUR RETIREMENT INCOME COME FROM?

- Personal savings and investments
- Retirement accounts
- Social Security
- Income from the business
- Sale of the business
- Real estate
- Pension plan
- Work outside the business
- Non-qualified deferred compensation



However, reality paints a different picture. Three out of four business owners have less than $500,000 saved in their retirement accounts. That means business owners are underestimating their financial reliance on the business post-retirement. Many may be forced to rely on the proceeds from the sale of the business or continue to receive income from the business to fund their retirements.

This lack of financial independence may also lead to a business owner never truly exiting the business. To put in context how a business owner's lack of adequate retirement income planning can impact his/her exit from the business, consider the following "Business Owner Hierarchy of Involvement" and the percentage of business owners who expect to fall into each category:

- **Exit with no ties:** This strategy is generally best because the owner exits all day-to-day ownership and management of the business and allows the next generation of leadership to take over with full autonomy. It implies that the outgoing owner is financially solvent and not reliant on the business for income whatsoever.
- **Act as a "silent partner":** This strategy can be effective in many situations because it allows the outgoing ownership to gradually phase out of the business by staying involved for a predetermined period of time (no more than 3 years) serving as a mentor to the new ownership team. In return, they are compensated reasonably for the continued value they bring and the seamless transition they are helping to facilitate.
- **Exit but still earn a "consulting fee":** This strategy is generally better for the outgoing owners because they hand the reins of the business to the new ownership team, but due to a continued financial reliance on the business, never truly let go. They continue to receive income from the business in perpetuity, and the compensation is tied more to their financial needs in retirement rather than to the value they bring to the business.
- **Stay active indefinitely:** This is not an ideal strategy for the owners or the business. There is no plan in place for ownership to change hands, meaning the business may never realize an infusion of fresh ideas and leadership. It also implies that the current owners are financially tied to the business until they die. Often in this scenario there is no one left around to take over leadership of the business when it is forced to change hands.

"I don't want to retire. I always want to have a hand in it because I love it. I really enjoy what I do. I just want to take more time and travel and do what I like to do."

– MALE, CONSTRUCTION

Your business is your livelihood and your legacy

A successful business begins with building a solid financial foundation and then planning for all outcomes. Business planning is not something that's done overnight. Our hope is that this research will provide you with the steps you can begin to take today to set your business on the path to a more financially secure future for you, your family and your employees.

At MassMutual, we recognize the challenges you face and are equipped to help you prepare for the future with more confidence. Our goal is to help you stay focused on the task at hand — running your business — while working in concert with your trusted advisors to help you create a financial blueprint for the long-term success of your business. In fact, we have financial professionals who are trained and certified to work specifically with business owners like you.

Put our qualities of strength, experience and stability to work for your business. To learn more about how MassMutual can help you protect what you've worked so hard to build, visit massmutual.com to find a MassMutual financial professional in your community.

Methodology

The research was conducted by HawkPartners for Massachusetts Mutual Life Insurance Company (MassMutual) via a 20-minute online survey of 914 general population business owners from December 17, 2017 – January 4, 2018. HawkPartners selected U.S. business owners with the following screening criteria:

- Business owner/partner, excluding sole proprietorships where owner is sole employee
- Fewer than 500 employees
- 1+ years in business with no more than 25% in business from 1 – 3 years
- 2016 sales revenue of $250K+

The sampling margin of error for this study is +/– 2.7% percentage points when looking at the results for the total small business population, based on a U.S. Small Business Employer population of 5.8 million. These are at the 90% confidence level.

The information provided is not written or intended as specific tax or legal advice. MassMutual, its employees and representatives are not authorized to give tax or legal advice. Individuals are encouraged to seek advice from their own tax or legal counsel. Individuals involved in the estate planning process should work with an estate planning team, including their own personal legal or tax counsel.

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