



## **White Paper**

### **The Fabled Wealth Transfer: Urban Legend or Reality?®**

By Steve McNaughton and Dennis Roberts

While economists fret over quantifying and apportioning the fabled \$10 to \$136 trillion baby boomer's wealth transfer wave, M&A practitioners, business valuers and other M&A support professionals, as well as small business brokers, need to plan for this: over the next 18 months in excess of 1,000,000 privately held businesses will change hands and many of them will require the assistance of one or more of these professionals.

And, that's just the first set of breakers to hit the beach. A tidal wave of businesses being sold will follow.

According to the Federal Reserve Survey of Consumer Finances, 50,000 businesses changed hands in 2001, which was about average. By 2004, the Federal Reserve Survey reported the number of companies sold increased to 350,000, and it goes on to project that by 2009, 750,000 will be sold. This can admittedly be a little misleading: while there are 23,343,000 businesses in the United States, only 5,697,759 actually have employees, obviously leaving a lot of very small and home-based businesses (a total of 17,646,000 of them in fact). Nevertheless, these too will usually require some sort of support services in transferring the business to a third party.

But to put the real middle market baby boomer business transfer opportunity into perspective, consider this. The US Census Bureau in 2002 estimated there are at total of 5,697,759 businesses in the United States with one or more employees (usually many, many more) with sales totaling in excess of \$22 trillion. Assuming a conservative 50% value to revenue ratio, that equates to a market value of \$11 trillion. While Census data indicates that many of even these totals are small mom-and-pop businesses (79% of them in fact with under \$1 million in sales), almost 21%, or 1.2 million, are middle market firms with sales of \$1 million to \$1 billion annually. Collectively these 1.2 million firms had sales totaling \$9.8 trillion and carry a conservative market value of \$4.93 trillion. Most of these, based on population data, will be sold or otherwise disposed of (left to family members, for example) by the baby boomers who own

### **What to Do: How Financial Pros and Owners Can Benefit**

Given that the largest transfer of wealth in history is beginning to unfold, what should a financial professional do to be sure he or she is well positioned for business? What should a business owner be thinking about?

The answer, in both cases, is an early focus on exit planning and eventual exit (sale) execution.

Let's start with the financial professional. The business valuator, M&A firm, and CPA need to get up to speed on how a business can build value through tax planning, strategic growth planning, and tight management. Then they need to get out in front of the business owners who will need their help with a compelling message about why these owners urgently need to begin thinking about exit planning now.

Once you've effectively driven the critical nature of exit planning to the top of business owners' minds, you'll still need to convince those owners why they ought to consider your firm's services in particular.

These are two separate problems, and we'll begin with the first.

### **Becoming an Expert in Exit Planning and or Exit (Sale) Execution**

The first step is to learn what exit planning is all about. Although many middle market M&A firms have established practices in exit planning, a number of CPAs are so absorbed in day-to-day activities and annual projects, they've spent little time focusing on exit planning. This is a tremendous opportunity they are missing. CPAs are, in fact, the most trusted financial advisors most private business owners have, and if they're smart, they can leverage this into very significant practice revenues.

All businesses have accountants, many employ valuers, and for many mid-sized businesses, that accountant or valuator is paid

about 67% of those middle market businesses. In fact, based on the assumption that most of these will be disposed of by their owners at around age 65, there will be over 800,000 middle market businesses with an estimated total value of \$3.3 trillion disposed of between 2011 and 2029. On average, about 43,000 a year from 2011 until 2029, and that is just the baby boomers and . . . just the middle market.

Just how soon the nearly 1.2 million US middle market businesses might be disposed of, at least to the extent they are owned by boomers, can be approximated by using the Federal Reserve Survey of Consumer Finance estimate that 9% (or 7,020,000) of the nearly 76,000,000 baby boomers own a business. Applying the earlier-mentioned Census Bureau business ratios to the Federal Reserve's estimate of about 7,000,000 baby boomers businesses provides one way to quantify the dollar value of this rapidly approaching M&A wave. Using simple math, if the baby boomers own 67% of the aggregate (a not unreasonable assumption based on the estimate that the age of most middle market business owners is between 40 and 65), they own 67% of the middle market split and, therefore, 67% of the segmented \$4.93 trillion market value. This thought process pegs the value of baby boomer businesses at \$3.30 trillion based on the 2002 Census statistics.

Almost 3.3 trillion of anything is a staggering quantity to grasp. For instance, 3.3 trillion hours ago was 150 million years before the first dinosaur existed. A 3.3 trillion-gallon wave would form a puddle eight inches deep the size of Lake Michigan. How about 3.3 trillion equals the number of miles America drives each year (200 billion gallons of gas @ 17 mpg), the total barrels of extractable oil shale reserves, and the number of miles to the farthest star (Andromeda Galaxy) that can be seen by the naked eye?

And keep in mind that these are more or less present day dollars. When a 3% growth rate is incorporated, these numbers become much larger. For example, at 3% inflation for the next 18 years, the value of middle market business transfers from baby boomers alone could well exceed \$6 trillion.

Will all the companies be sold? Probably not. Historically, one third will be passed on within the family and about two thirds will be sold. Price Waterhouse published in a Trendsetter Barometer Survey that 51% of business owners surveyed planned to sell their business to a corporate acquirer, 18% planned to pass it on to family members, 14% anticipated a management buyout, and the remaining 17% (although the article did not specify) must plan to take it with them or not pass it on at all. Can you really take it with you? We will leave that one for theologians.

\$10,000-\$40,000 for a typical business valuation engagement. An investment banker who puts together an exit deal can typically get paid as much as \$500,000 to \$1,000,000. There's little doubt most CPAs and valuers can begin to put in a bit of time on exit planning whether; they do it as an investment banker executing the transaction (and many are starting to do just that) or as an M&A support professional who includes providing exit planning services on an hourly rate basis.

If you're a CPA, spend some time learning how businesses can build sales value that goes far beyond the obvious factor of profitability, far beyond it. One of the best sources of education in the field is the partner alliance of the National Association of Certified Valuation Analysts (NACVA), the Consultants' Training Institute (CTI), and the Middle Market Investment Banking Association (MMIBA). Combining resources and extensive experience, they offer an array of benchmark training, from the introductory level, to an M&A certification program, to exit planning, and a turnkey investment banking program. Training is available not only in live seminars held in major U.S. cities, but through convenient webinars. Moreover, NACVA is supported by hundreds of association members willing to mentor others, and the organization offers reference material, software, and customized databases for additional support.

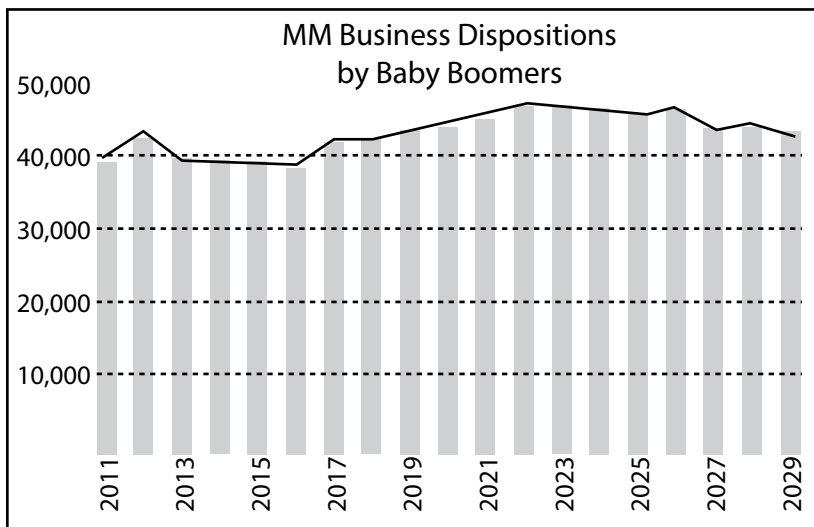
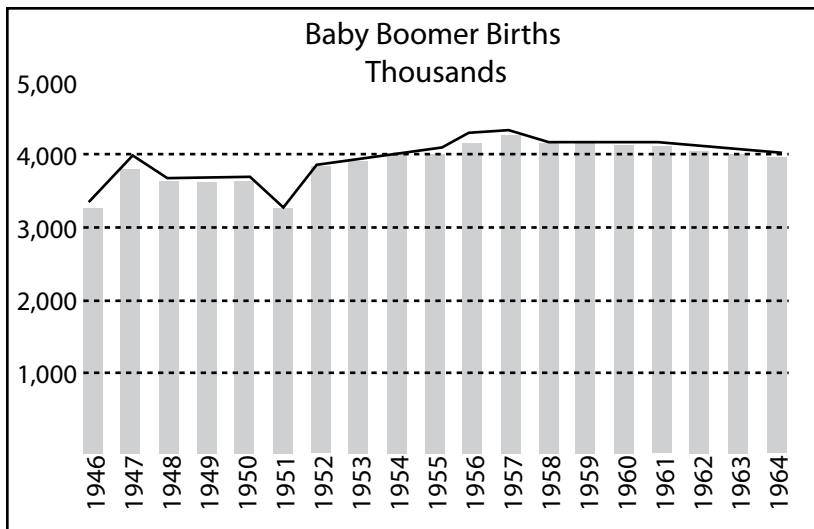
Begin to explore how businesses go about actually building value well in advance of their sale, ideally about three years. Think about important considerations such as a target departure date, succession planning, how to measure the value of your current business and what the value drivers are, both negative and positive. With this knowledge, the owners of most businesses can improve the value dramatically over a three-year period.

### **Building, Branding, and Self Identification**

Once you've developed your exit planning or investment banking expertise, figure out how to announce it to the world! The three main styles most firms take are a generalist approach (open to doing any M&A transaction, but not aggressively going after it), the more aggressive geographical approach (specialize in a specific region or area of the country), or a specialist approach (make an effort to be known as the very best in putting

Clearly, the degree to which the “Me Generation” boomers voluntarily (or not) turn over their wealth to “Generation X,” remains to be seen. But based on the Price Waterhouse study, 65% of them will be sold and those will have an estimated value of almost \$2.2 trillion dollars. The degree to which boomers, the “Me Generation,” turn over their retirement security to irresponsible “Generation X” rather than sell to a third party, remains to be seen. The study suggests 65% of those businesses—with an estimated value of almost \$2.2 trillion—will be sold, the remaining, one must assume, split between their heirs and the grave.

Just looking at the baby boomer population bell curve leaves a fair approximation of the coming prospect flood. When the tidal wave of baby boomer wealth arrives, obviously, has as much to do with the economy and interest rates as purely age, but judging from the Federal Reserve Survey mentioned earlier and the chart below, the selling wave has already begun. It should steadily rise over the next 10–12 years, peak during the 2020s, and then slowly taper off the next 10–12 years.



together deals of a certain vertical type).

Many CPAs and valuers are reluctant to identify themselves as investment bankers. Many are not even sure what the term means. If you are assisting clients in the sale or purchase or financing of businesses and you are paid a success fee, you are doing M&A investment banking, and you might as well identify yourself that way and reap the big fees. You will need the appropriate licenses which are not all that hard to get. Of course you can also provide exit planning and other M&A support services on an hourly rate basis as a CPA or valuator.

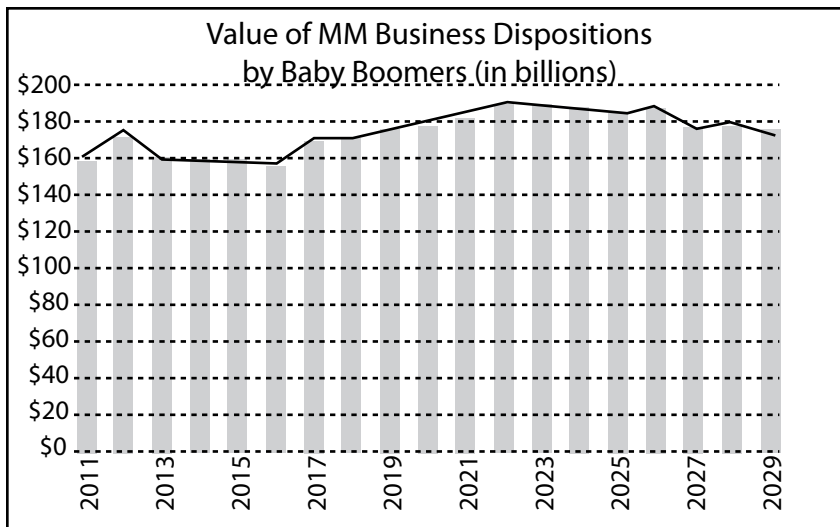
The good news about being a specialist is that by focusing, publishing papers, and using a limited marketing budget, you can become fairly well known within just a few years. The cautionary news about being a specialist is that you're putting all your eggs in one basket . . . and might be vulnerable to any serious downturns in your specialty industry.

For that reason, many experts think the best approach is to build a firm with a generalist approach and then choose one or two areas to build specialty subsidiary practices. Once you've gained your exit planning expertise and/or M&A expertise, go all out and make a sustained effort to become known to current business owners—and future business sellers—through a two-pronged effort: Branding and self-identification.

Branding means getting in front of the business owners today. You can do this through ads, through direct mail campaigns, through public relations efforts, by sponsoring seminars, and many other approaches. You can also do this by being active in Chambers of Commerce, business associations, and even non-profit organizations where you'll find a remarkably high number of business owners.

The key thing to know about most business owners is this: They usually make their decision to sell their business based on lifestyle issues (they're tired, stressed, have health issues, or simply want to enjoy life) or because they see their business unexpectedly in a wave of high value (a bubble) and want to take advantage of it; but once they make a decision to sell, the deal is, in the vast majority of instances, finished in 12 months! What a shame!

Most business owners haven't thought



To say the baby boomers dramatically impacted every market they touched is a gross understatement. For the past 60 years, the boomers have been the market. Now, how boomers dispose of their pool of wealth creates waves. This legendary wealth transfer, the “holy grail” of the financial planning industry, of course goes beyond just business transfers and sales and touches everything from insurance, savings, stocks, bonds, and mutual funds to annuities. These financial products, however, represent only half of the projected wealth transfer. The boomers’ equity in residences, land, farms, personal property, and privately held businesses doubles any number. Even the IRS is salivating over the prospect of the projected \$16 trillion tax bill the federal government will take off the top.

Estimating the size and allocating the disposition of this fabled wealth has preoccupied planners and economists for years and confused M&A practitioners as well. It is not uncommon for casual observers to attribute the “\$10 trillion opportunity” to sales of businesses. But that is wrong. What we have done here is segmented that part of the wealth transfer in an attempt to clear up at least that aspect of the urban legend.

As to the urban legend itself, it began simply enough in 1990 when Robert Avery and Michael Rendell, both Cornell University economics professors, projected the WW II generation would pass on \$10 trillion to the baby boomers. Over time, like all legends it seemed to self-embellish. In 1999, John Havens and Paul Schervish of Boston College, two economists wearing bull-market spectacles, built a simulation model based upon combining what baby boomers inherited and what they earned. Havens and Schervish’s wealth transfer number soared to \$40.6 trillion when projected over 55 years.

about exit planning because their business is their life; once they begin to think about it, 12 months isn’t enough time to get the businesses in the fittest shape to maximize sale value.

It’s best to establish relationships with these owners, get them thinking about exit planning, and build a commitment over three years to get the company into shape for possible sale. But since advisors often don’t have this opportunity, you need to structure your organization to be able to move quickly to make a deal happen once the owner has decided to sell.

Self-identification is another important part of an advisor’s marketing strategy, and that means simply touting that your business does, in fact, have a specialty practice in exit planning and or M&A work. If you look in the phone book or common web directories, you’ll be surprised at how few CPAs identify themselves as resources to potential clients in these very lucrative fields.

### **For the Business Owner**

If you’re a business owner, the best favor you can do yourself is to begin to think about exit planning now, even if you have no intention of selling your company. The second imperative is to get professional help from a financial professional trained in this field.

Once you sell a business, you’ll only know how much you got for it. There’s no way of knowing how much you could have gotten if you had professional advice. But the difference is almost always substantial. “When business owners get professional help, they can occasionally get two or three times as much as when they sell it themselves,” says Dennis Roberts, CEO of the McLean Group. “And without a doubt, the owner will almost always be able to get at least 20 percent more than he or she otherwise might have; so the fees are worth it.” Roberts notes that his figures are based on extensive review on large numbers of reported transactions and business comparables.

If there’s a dark side for the business owner in all of this, it’s this: All these sales will be happening in a relatively short amount of time. The tidal wave is business owners hitting age 65 in the next 20 years, and there are a lot of them. At some point, there will

Other economists, perhaps fueled by the prospects of federal grants, criticized Havens and Schervish's estimate as being too conservative because it lacked both middle and upper-range growth scenarios. A 2% secular growth rate only equates to \$41 trillion. A 3% growth rate scenario would equate to \$73 trillion, and a 4% secular growth scenario projects to \$136 trillion. To finally cap the legend, staff economists at the Council of Economic Advisors adopted the \$41 trillion figure as the "official projection" by 2052, and most accepted a more conservative discounted present value estimate of \$33 trillion.

Now that you have the facts, feel free to distort them at your pleasure.

begin to be a glut and a need for buyers, which could conceivably drive prices down. The best way to avoid getting caught in that is to get ready now.

### ***Steven McNaughton***

*Steven McNaughton is a senior managing director of McLean, Markowitz & McNaughton, the market intelligence and competitive analysis division of The McLean Group. Mr. McNaughton brings more than three decades of acquisition search and business analysis experience. In 1982 Mr. McNaughton and his partner founded Markowitz & McNaughton, Inc., a specialty acquisition support and competitive analysis firm servicing the needs of Fortune 1000 corporate acquisition and planning executives. Within 18 years, the business expanded to 90 professionals, servicing such firms as General Electric, 3M, Phillip Morris, AT&T, Cincinnati Bell, MasterCard, Grumman, Bombardier, Honeywell, Thiokol, and numerous others. During that period, he pioneered unique business analysis frameworks, ran the firm's acquisition search programs that resulted in several hundred acquisitions, and performed competition due diligence on thousands of other acquisition targets. Ultimately Markowitz & McNaughton, Inc. was acquired by the world's fourth-largest public relations firm, and Mr. McNaughton completed his employment contract in June 2004. He has served as a board member on several corporations and nonprofit organizations and holds a BA in Journalism and Public Relations from Ohio University.*

### ***Dennis Roberts***

*Dennis Roberts is chairman of The McLean Group, LLC, a national, middle market investment bank providing mergers and acquisitions (M&A), capital formation, market intelligence, business valuation, litigation support, and exit planning services to businesses generating up to \$500 million in annual revenues. He has more than 35 years of accounting and investment banking experience involving a multitude of transactions across a wide variety of industries and markets. Mr. Roberts was the founder, chairman, and CEO of a publicly held national bank from 1984 to 1992. Prior to that, he was founder and senior partner of a large Washington, DC area accounting firm that he sold to his partners in 1987. While a practicing Certified Public Accountant (CPA), Mr. Roberts focused on mergers and acquisitions, commercial finance, and similar transactions. A graduate of Benjamin Franklin University (which subsequently merged with George Washington University), he holds the Certified Valuation Analyst (CVA) designation from the National Association of Certified Valuation Analysts (NACVA). Mr. Roberts is also Accredited in Business Valuation (ABV) by The American Institute of Certified Public Accountants and is an enrolled Federal Tax Accountant. He teaches, lectures, and writes on M&A, business valuation, and corporate finance to national audiences. Mr. Roberts is a Financial Industry Regulatory Authority (FINRA) registered representative and firm principal (Series 7, 24, 28, 63).*