2022 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 third largest economy in the world[1] in terms of GDP, accounted for 65% of all net new jobs created since 2000[2], and employs 61 million people in the U.S.[3]. In addition, for every dollar spent at a small business, 67 cents stays in the community it serves.[4]

The *2022 MassMutual® Business Owner Perspectives Study* takes the pulse of today’s business owners. Conducted by LRW 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 this study with key decision makers in your business — 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. We’ve seen recently what unexpected and unplanned for events can do to the small business community. The Federal Reserve estimated that an additional 200,000 businesses closed permanently due to the pandemic; that’s on top of the estimated 600,000 businesses that typically close in a given year.

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, 2020

[2] Bureau of Labor Statistics’ Business Employment Dynamics report, 2020

[3] Small Business Administration, Small Business Profile, 2021

[4] American Express Small Business Economic Impact Study, 2021

The personal side of business ownership

The decision to become a business owner is both a brave and noble one. When asked about the qualities a successful business owner needs to possess, words like drive, focus, confidence, and resilience all rise to the top. And, while business owners have undoubtedly spent a great deal of time building a successful business by leveraging these traits, there may be a lack of emphasis on some other just as important key words, such as lifestyle, value, exit, and legacy.

A majority of business owners say their business and personal financial wellbeing are interrelated. Yet, nearly the same percentage prefer to separate their business from their personal financial planning.

The research also shows there is a direct correlation between what motivated an individual to become a business owner and whether they prioritize their business or personal planning.

Those who are motivated internally by a passion for their trade (crafts people), a lifestyle of independence and being their own boss (freedom fighters), or cash and success (mountain climbers) prioritize planning for the business because their personal financial wellbeing is dependant on it.

Those who became entrepreneurs due to external factors, such as expectations from the family to take over the business (legacy protectors) or the owner died or left the business unexpectedly and someone had to take over (emergency entrepreneurs) prioritize their personal planning because the business is just a means to generate income.

As your read through the key findings from the research, think about how decisions you've made in the business could impact your current and future personal financial picture. After all, your business is your largest asset, the provider of income for you and your family, and the creator of intergenerational wealth. That's why it's vital to work with professionals who can help coordinate your business and personal planning.

83%

Say business and personal financial wellbeing is interrelated

YET

80%

Prefer to separate personal and business financial planning

AND STILL

52%

Say other than the income generated, I don't think how my business and personal financial wellbeing are related

How do business owners prefer to work with their advisors?

ONE-STOP SHOP

86%

Value a professional that can address both personal and business planning

QUARTERBACK

70%

Prefer to work with a single advisor on their planning issues

REFERRALS

58%

Find advisors via word-of-mouth recommendations

Business planning core pillars

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 business owners view each one.

The results show that business owners are not ready or too busy to address all of the core pillars. It also shows they are often conflicted or unsure on where to go for help. This emphasizes 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.

CORE PILLAR	% WHO THINK ITS IMPORTANT	TOP GO-TO RESOURCE
Keeping key employees loyal	69%	**Self/Business Partner**
Protecting the business from death of owner or key employee	62%	**Lawyer**
Knowing what the business is worth	61%	**Financial Professional**
Protecting the business from disability of owner or key employee	61%	**Lawyer**
Being fair and equitable to my heirs with the distribution of my estate	58%	**Lawyer**
Pulling out the wealth locked in my business when I exit	57%	**Financial Professional**
Transition ownership/finding a buyer at retirement	57%	**Lawyer**

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, with 69% of respondents saying it's on their minds. 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, only one in four offer any type of supplemental insurance benefits and even less offer supplemental retirement savings plans.

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 90% report taking steps to address the challenges of hiring and retaining key employees, with health insurance, increased wages and bonuses, and flexible work schedules 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 for information on the many types of benefits that may be of value to their key employees.

> "In 2020 I had almost nobody after my employees left. I'm just now getting people back so I'm finally rebuilding, but I can't keep employees more than a year or two. There's constant turnover."
>
> — FEMALE, TELECOM

Knowing what the business is worth

Knowing what the business is worth is very much top of mind with 61% of business owners saying that knowing their valuation is important and half saying they've had a valuation done in the last three years.

Measuring business health is the main reason to obtain a valuation

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 26% of respondents considered a valuation to know if the business will be a sufficient component of their **retirement** income plans.
- Only 21% considered a valuation for the purposes of creating an equitable distribution of the owner's assets as part of an **estate plan**.
- And, only 20% considered a valuation for the purposes of establishing a **buy-sell agreement** between partners.

Future value is just as important as current value

In addition, the study indicates that even though over three-quarters of business owners received a valuation that met or exceeded their expectations, nearly half are interested in knowing their future value to assess their business's growth potential.

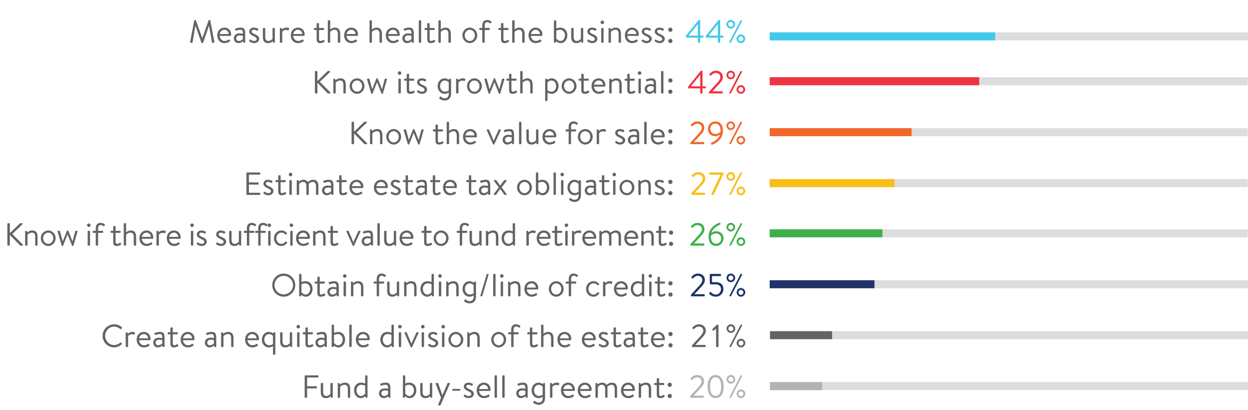
To accomplish this business owners should understand their "enterprise value," which is based on combining three distinct measures: business operations, financial results, and market data (or how similar businesses have sold in the marketplace).

With enterprise value, business owners can identify strengths and spot operational weaknesses in the business by looking at specific "value drivers." Think of these as the different levers you can pull to enhance the operations, and thus the value, of the business. Some of the drivers are in the direct control of the owner, such as their senior management, sales and marketing, and HR. While others are market driven, such as barriers to entry, market size, and competition. The resulting figure is a measurement of the business's ability to generate future revenue and profit.

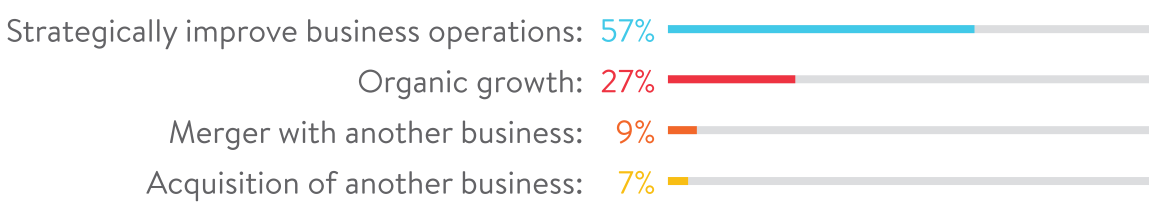
Nearly half of the survey respondents believe their business values will grow in the future and site strategically improving the operations in the business as their number one growth strategy.

> "We did use a third party for our valuation and deal structure. He suggested a model and all of the specifics about how it works"
>
> – CO-OWNERS, WHOLESALE DISTRIBUTION

REASONS FOR HAVING THE BUSINESS VALUED:



HOW DO YOU PLAN TO GROW THE VALUE OF YOUR BUSINESS?



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

These two concerns are on par with each other in terms of their importance, with over 60% saying each is top of mind. The issue lies in the actual planning that's been done, or lack thereof. Only 32% of respondents have a buy-sell agreement in place. Fortunately, 80% of business owners say they have established an emergency fund to weather future challenges with 65% of them saying it would last between 4 and 12 months.

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.

only **32%**
of business owners have a buy-sell agreement in place

A buy-sell agreement should be drafted to protect the business from the six D's — death, disability, divorce, departure, default, 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.

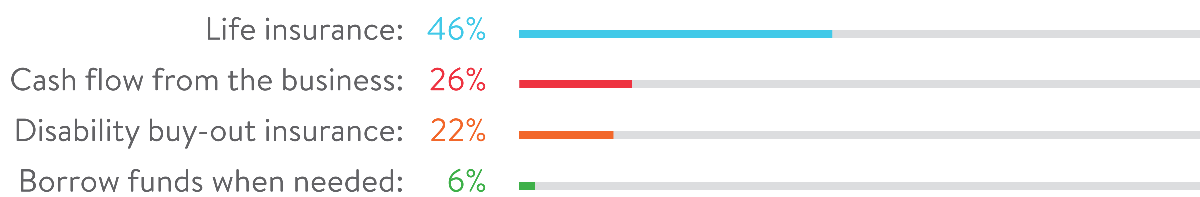
A buy-sell agreement must also be properly funded in accordance with the current value of the business. Funding buy-sell agreements with insurance products, specifically life insurance and disability buy-out insurance, is often the most effective method. Otherwise, remaining owners may be forced to liquidate business 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 46% say its funded with life insurance, and only 22% say its funded with disability buy-out insurance. The rest are funded with cash flow from the business or by owners borrowing the funds when they are needed.

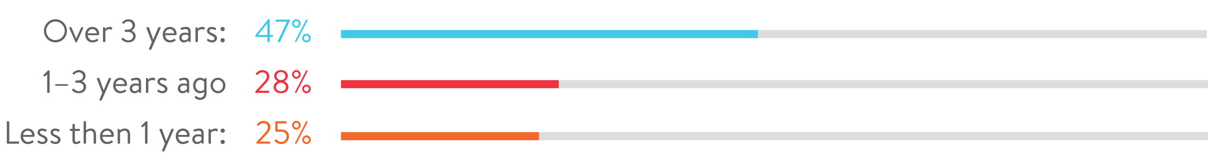
It is also recommended that a buy-sell agreement be reviewed at least every three years to reflect any changes, such as business value, family relationships, and ownership interest. The study shows that nearly half of all buy-sell agreements may be stale.

> "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?



Pulling out the wealth that's locked in the business upon exiting

The primary goal for our survey respondents when they exit their businesses is to maintain their current lifestyle in retirement. This is further evidenced by the fact that nearly two-thirds said they will only exit when either: a) the right buyer comes along, or b) their future financial security is assured.

The business is my "baby" versus my "lifestyle"

When asked why they never plan to leave the business, owners often have two sides to their reasoning. The first is the idea that the business is their "baby." This implies that the reason they don't leave is because they'll miss running the business and/or don't believe anyone else can run it like they do. In fact, 62% and 52%, respectively, shared this reasoning.

However, there's often another rationale for not leaving the business that is more based on the financial preparedness of the owner. Specifically, fearing they will have to make adjustments financially when they exit, and feeling they are ready to exit emotionally but not financially. Almost the same percentages as above, 60% and 48%, respectively, shared this concern.

There are two types of business owners: lifestyle owners and value creators. A lifestyle owner is comfortable with the state of the business as long as it supports their current lifestyle and meets their income needs today.

In contrast, the value creator prioritizes growing enterprise value over income, realizing that when business value grows the income will be there for today and tomorrow.

In an effort to extract the wealth that's locked inside the business, they know how much it can realistically contribute to their future income, choose an exit strategy that is in alignment with their personal financial goals, and take the necessary steps to build an asset that is transferable.

The process has begun for some but few have seen it through

This is a process that begins and ends with sound exit planning. Unfortunately, only 35% of business owners have started this process, and of those who've started, only 8% have completed it.

Exit planning is a verb — an action. It's an ongoing, comprehensive strategy that allows business owners to leave their businesses when they want, for the money they need, and to whomever they choose. The process of exit planning should address the following:

Your goals: Identify what you want to get out of the business when you retire. Only half of business owners have identified their future income needs.

Your successor(s): Choose who will be taking over for you and outline a plan to ensure they are properly selected and prepared. Only one in three have identified their successors.

Management: Define steps needed to keep vital, non-owner management in place so they stay onboard through the transition and beyond. Only one in three have built a strong management team.

Transfer: Determine when and how the transition will take place and what needs to happen leading up to that time. Only 17% have set a time line for exit.

Finances: Identify where the funds will come from to buy you out and whether it will be a lump sum, installment sale, etc. Only one in five have identified potential buyers.

And finally, everything must be documented and communicated to all parties who may be impacted by your plan (family members, key employees, trusted advisors, etc.). Less than half have discussed their exit plan with family members and internal stakeholders.

WHAT ARE YOUR ATTITUDES TOWARDS LEAVING THE BUSINESS?

I'm concerned about missing my role as a business owner:	62%
I will exit when the right buyer comes along:	62%
I would exit sooner if my financial security were assured:	60%
I believe I will have to adjust my lifestyle financially when I exit:	60%
I can't exit because no one can run it like I do:	52%
I am emotionally ready to exit, but not financially:	48%

EXIT PLANNING STEPS COMPLETED

I've identified my future income needs:	50%
I've discussed my plan with family members:	42%
I've discussed my plan with internal stakeholders:	41%
I've built a strong management team:	34%
I've identified successors:	33%
I've identified potential buyers:	20%
I've set a time line for my exit:	17%
I've completed the plan:	8%

Being fair and equitable regarding distribution of 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, nearly 60% of business owners believe its a concern, yet less than 30% have what's called an "estate equalization" strategy.

When it comes to dividing up ownership in the family business, fair does not always mean equal. Over half of business owners say they either plan to divide the ownership in the business equally among all children regardless of their involvement or will let the children figure it out themselves. 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 may be off doing something else. Not to mention the potential animosity this could create in the family. Alarmingly, only one in four business owners say maintaining family harmony and avoiding familial conflict is a goal when exiting the business.

Estate equalization is a strategy to help resolve this issue. It involves equalizing your estate so those working in the business get the business and those not working in the business get 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 may have to wait until your death to receive theirs?

Finally, paying estate taxes and fees is still an issue that may need to be addressed. Only 36% 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.

only **51%**
of business owners
have an estate plan

> "I'm embarrassed to say we don't have a will or life insurance in place. We're really way behind...I really need to make that a priority. We forget about it and then there's so many other things to deal with more immediately. That's really the only reason we haven't done it."
>
> – CO-OWNERS, WHOLESALE DISTRIBUTION

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

Equally among children, regardless of business involvement:	40%
Children working in the business get the business, others get other assets:	30%
Children working in the business get a larger ownership percentage:	17%
Children will divide among themselves:	10%
I don't care:	3%

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

I have life insurance:	36%
I have sufficient cash in the business:	22%
Business assets would be liquidated:	17%
Heirs would have to borrow funds:	13%
Personal assets would be liquidated:	12%

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 either plan to work in their businesses beyond 10 years from now or have no idea when they plan to retire.

However, more important than **when** business owners will retire is **how** business owners will fund that retirement when the time comes. Less than half (46%) believe they are on track with where they want to be with their retirement savings and say it will be an almost even split between funding retirement with both the business and assets outside the business.

WHERE WILL YOUR RETIREMENT INCOME COME FROM?

52% Assets outside the business (qualified plans, investments, etc.)

48% Income from the business/proceeds from the sale of the business

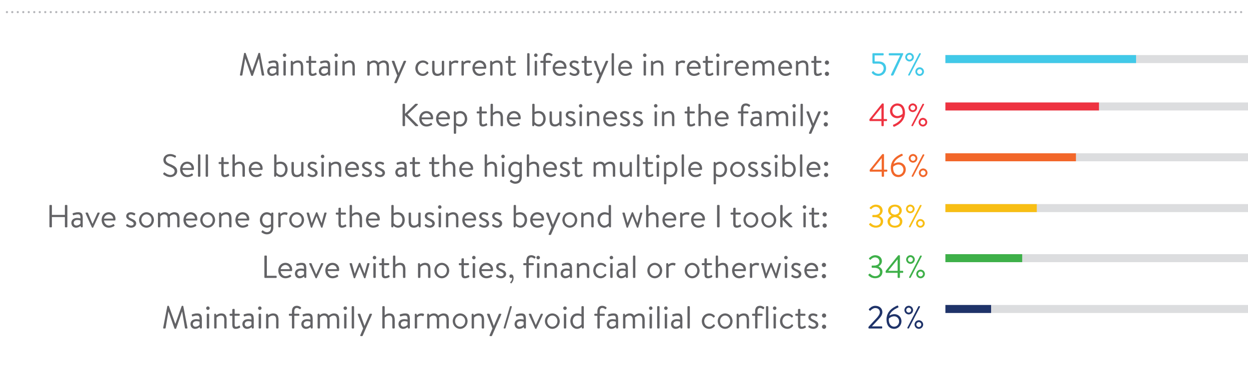
But here's the reality: 65% of business owners have less than $500,000 saved for retirement. That means business owners are underestimating their financial reliance on the business post-retirement. When this is coupled with the fact that only half of our respondents have obtained a business valuation, identified their future income needs, and chosen an exit strategy that will maximize their future income, you can see how retirement planning is a potential blind spot for today's business owners.

Owners who say "the business is my retirement" need to be certain of a few things. First, if the plan is to sell the business to a third-party, be sure you've built a transferable business that can be sold to a ready, willing and able buyer.

Second, if the plan is to transfer the business to the next generation, be certain that the children are willing and able to buy you out or keep you on the payroll even when your contributions to the business diminish. And third, if the business is sold to someone who can't pay the full value up-front, like a family member or key employee, be sure those individuals are equipped to run the business successfully so the terms of the installment sale are satisfied and the acquisition is completed.

If the business is the owner's retirement, there will be negative consequences if one of these three outcomes fail to happen. It could mean retiring later than expected (or not at all), being forced to reenter the business after retirement, perhaps in an effort to rescue the business, or accepting a lower standard of living.

BUSINESS OWNER'S GOALS UPON EXIT



> "I am probably not well suited to complete retirement. I would probably drive everyone around me crazy because I am a restless soul."
>
> – MALE, PROFESSIONAL SERVICE

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 LRW for Massachusetts Mutual Life Insurance Company (MassMutual) via a 20-minute online survey of 800 U.S. business owners in December of 2021. LRW 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 with no more than 20% over 100 employees
- 1+ years in business with no more than 10% in business from 1 – 3 years
- 2020 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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