GREATER SAN DIEGO

2017

Exit Planning Institute

A LOCAL MARKET STUDY:

The State of Owner Readiness

BENCHMARKING LOWER MIDDLE MARKET BUSINESSES AND EDUCATING OWNERS ON THE DIFFERENCES OF "ATTRACTIVENESS" VERSUS "READINESS"

IN PARTNERSHIP WITH

BNY MELLON
WEALTH MANAGEMENT

For business owners who have spent their lives building a business and watching it grow, preparing to sell can be a difficult and emotional process—but it doesn't have to be. Throughout my thirty-year career, I have seen how proper planning can ease such a transition. Without the right guidance, however, many business owners may experience gaps in their plans that can have long-term consequences for themselves, their families, their employees and even their communities. I've made it my mission to help business owners avoid those pitfalls, maximize the value of their business, and ensure they are personally and financially prepared for the next chapter of their life.

Since graduating from Northern Arizona University in 1981 I dreamed of returning to the west, where I was fortunate to travel extensively as a Lumberjack football player. In 2013, I finally made it back as one of the founding employees of BNY Mellon Wealth Management's San Diego region. Since then, I've gained a lot of experience and insight about our regional business community and its distinctive character. San Diego is a center of innovation with a culture of collaboration. Proudly, San Diego is the only city in North America recognized by National Geographic and the Brookings Institution as one of the "Global Smart Cities."[1] San Diego justifiably prides itself for being independent and unique.

It's fitting then that San Diego has the Advisor of the Year program. Held annually, the program recognizes experts in the range of M&A professions that make business sales successful, and provides a way for business owners to connect with the top advisors in San Diego. Such networking promotes further education and open discussion about running a business and the right way to go about transferring the ownership when the time is right. By sharing our insights, we hope to promote an exit planning ecosystem defined as:

"A system, or group of interconnected disciplines formed by interaction of a collaborative, like-minded community of professional advisors with a common goal to grow, preserve and transition wealth for business owners"

In the coming decade, we can expect business transitions to grow steadily; and demand for advisors who have expertise in working with business owners as well. Baby boomers reportedly own over 60% of closely held businesses today, per the Exit Planning Institute. Most of those business owners have a significant portion of their total net worth tied up in their business. So, it's important that the owners get the maximum return on the sale of their business to meet their future financial goals. That will require a team of knowledgeable advisors to ensure a successful transition.

[1] http://www.sandiegobusiness.org/wtcsd/national-geographic-channels-worlds-smart-cities-san-diego

Yet, the Exit Planning Institute conducted a study suggesting as high as 80% of these companies are not saleable with the team of advisors the owners have in place. Often, as the business owners' companies grow in size and complexity, their advisors' skills haven't kept up and they may not have the knowledge or experience to manage value enhancement, tax preparation, estate planning, cash flow analysis, exit/succession planning or wealth management.

In addition to assembling the right team of advisors long before it's time to sell, owners need to ensure they work together to avoid offering conflicting advice for the business owner. Naming one primary advisor or firm to take the lead and holding annual team meetings to discuss goals and planning opportunities can ensure they are working together.

It's clear that insufficient planning can have serious—if not disastrous—consequences. Yet a significant percentage of business owners have little to no exit planning in place, as you will see in this important study on the "State of Owner Readiness." We hope the findings in this report will prompt you start to identify ways you can prepare for the transition of your own business someday. The key takeaway here is that it's never too early to start planning.

David A. Noosinow, CEPA
Senior Wealth Director
BNY Mellon Wealth Management

The Exit Planning Institute State of Owner Readiness Survey

For San Diego middle-market businesses

Small businesses are the backbone of our economy. They provide jobs, as well as economic and social well-being for countless Americans.

The Exit Planning Institute surveyed more than 200 small business owners in the San Diego region and uncovered some glaring gaps in owners' awareness and preparation for an eventual sale or transfer of their business.

BY THE NUMBERS:

- **6 million** private companies in the U.S.[1]
- **63%** of these companies are owned by aging Baby Boomers[3]
- **4 million** baby boomer businesses expected transition over the next 20 years[4]
- **80% to 90%** of owners' assets are locked up in their businesses[5]

Unlocking those assets requires a sound exit plan. Otherwise an owner risks underpricing the business—perhaps by as much as hundreds of thousands of dollars—or not selling at all.

[1, 2, 4, 5] © Exit Planning Institute
[3] U.S. Census Data

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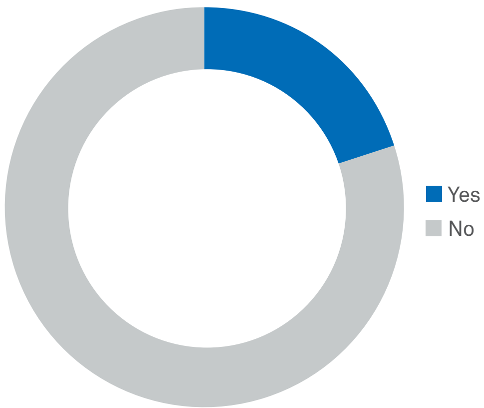
Key survey findings underscore the risks:

Figure 1:
Have you completed any formal education related to transitioning a business?

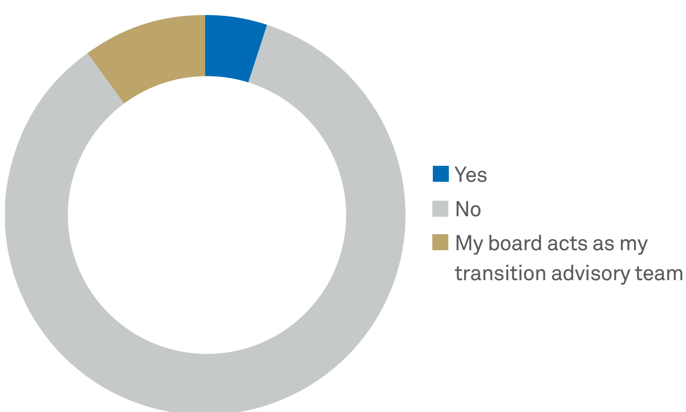


- 66% of owners have no formal transition plan; many see no urgency in developing one.
- 83% of owners say they have no formal education about exit planning.

Figure 2:
Do you have a contingency plan in place for the business that addresses the possibly of death, divorce, or disability.

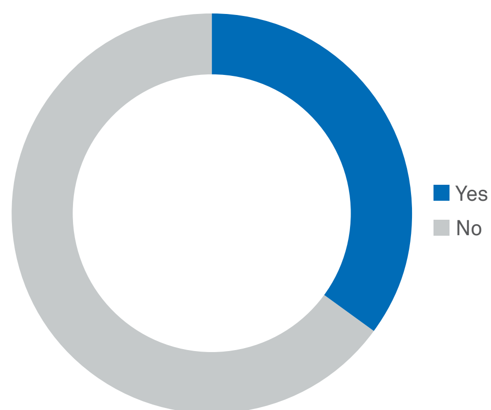
- 71% say they have no contingency plan for the business in case of death, divorce or disability.

Figure 3:
Have you established a formal transition advisory team?



- 88% of owners have NO formal transition advisory team to give them expert guidance on the tax, estate planning and legal complexities of a business sale.

Figure 4:
Does your estate plan provide for the sale of the business?

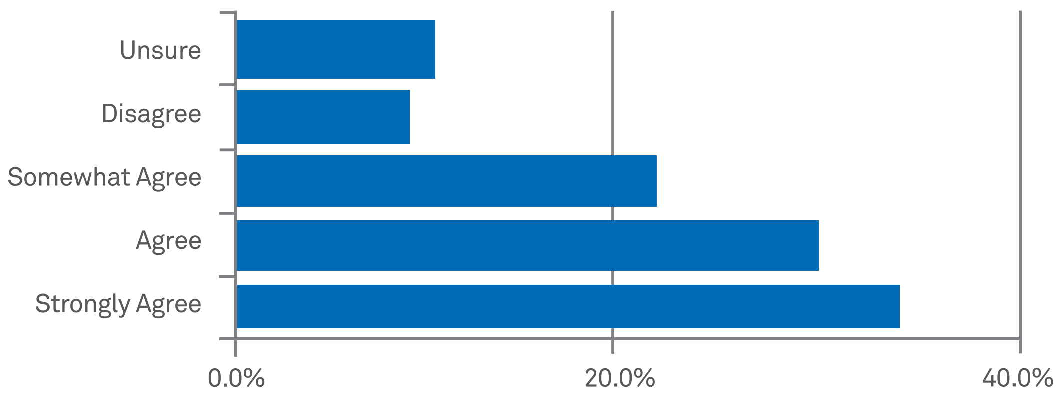


- 65% say their estate plan does not cover the sale of their businesses.

And yet:

83% of owners say they agree that having a transition strategy is important for their future as well as the future of the business.

Figure 5:
How much do you agree with the following statement? Having a transition strategy is important for my future as well as the future of the business.



Are you taking advantage of all the opportunities for your business and family?

Business owners who have a sound exit plan reduce risk for their companies as well as improve the financial well-being of their families, employees and communities.

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David Noosinow is a Senior Director at BNY Mellon Wealth Management. David, in conjunction with BNY Mellon's Portfolio Team and Wealth Strategists, works closely with successful entrepreneurs and wealthy families through the transfer of ownership of their privately held companies. With significant experience in transferring wealth, investment planning, mergers and acquisitions, and exit strategies, David's unique and valuable perspective helps owners navigate alternatives while avoiding potential landmines. This is accomplished by facilitating a team of advisors that specialize in maximizing enterprise value, personal and financial planning, tax mitigation to maximize net proceeds and making sure the owners and their families are prepared for the next chapter of their life.

Prior to joining the firm Mr. Noosinow was a Vice President at Bernstein Global Wealth Management, where he was able to establish himself as a trusted advisor in the previously untapped markets of Atlanta, Lexington and Louisville, KY. He was a frequent speaker at events sponsored by the Blue Grass Estate Planning Council, the Estate Planning Council of Louisville, and the Louisville Bar Probate and Estate Section.

Education

Bachelor's Degree, Northern Arizona University

Affiliations

The Exit Planning Institute
ACG San Diego – Board Member
San Diego Venture Capital Group
The North County Estate Planning Council – San Diego

Charitable Organizations

Scripps Gift Planning Advisory Board

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Unless otherwise cited, data in this document has been sourced from the 2016 Greater Nashville "State of Owner Readiness" Survey conducted by the Exit Planning Institute (EPI) and Vanderbilt University in partnership with BNY Mellon Wealth Management. The survey data and report were managed, prepared and written by the Exit Planning Institute.

All commentary, recommendations, observations and conclusions in this presentation are generated from BNY Mellon Wealth Management based on the survey data and are proprietary to BNY Mellon Wealth Management.

The information provided is for illustrative/educational purposes only. All investment strategies referenced come with investment risks, including loss of value and/or loss of anticipated income. This material is not intended to constitute investment advice. Effort has been made to ensure that the material presented herein is accurate at the time of publication.However, this material is not intended to be a full and exhaustive explanation of investments options available. The information discussed herein may not be applicable to or appropriate for every investor and should be used only after consultation with professionals who have reviewed your specific situation.

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THE STATE OF OWNER READINESS
2017 GREATER SAN DIEGO REPORT

SURVEYED BY: California State University | San Marcos
SPONSORED BY: BNY Mellon Wealth Management
FOREWORD BY: David Noosinow, CEPA
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Survey Overview

In 2016, the Exit Planning Institute (EPI), in partnership with BNY Mellon and California State University, San Marcos, conducted a survey of business owners in the Greater San Diego region to determine their state of readiness to transition their businesses and unlock the wealth accumulated in the business. Additionally, we wanted to compare the Greater San Diego results to EPI's national survey. Last, we wanted to point out specific things that owners who are successful do versus those who are not and offer suggestions to business owners and business advisors regarding what they can do to improve the probability of a successful transition and unlock this vast wealth.

There are roughly six million operating privately held companies in the US. They represent approximately $30 trillion in sales. According to US census data, 63% of these are owned by Baby Boomers who now range in age from 53-71 years old with the average age being 62 years old. Although Baby Boomers are holding on to their businesses for a longer period of time, all Boomers will reach the age of 70 or older within 17 years. That represents nearly 4 million Baby Boomer businesses poised to transition. Assuming a business valuation of 50% of sales, reasonable by most standards, that further represents $10 trillion of wealth poised to transition.

Unlocking this wealth in the business is or should be of paramount importance to all business owners if for no other reason that **most owners have 80-90% of their financial assets located in the business itself**. Given the significance of this asset in the owner's wealth portfolio, the ability to monetize this wealth at some point will have a significant impact on the owner's financial security and lifestyle once they exit the business.

The significance of the business asset transition goes beyond the owner and owner's family. Failure to provide for the continuity of the business not only affects the owner's personal wealth for his or her family, but also affects all other stakeholders who depend on the successful transition of the business. "The business owner is the giver of life" wrote Leon Danco, a legendary expert on family businesses, in his book entitled Beyond Survival, a Guide for Business Owners and Their Families. With roughly 6 million operating privately held companies in the US representing around $30 trillion in sales and $15 trillion in wealth, the continuity of the owner's business matters not just to his or her family, but to the employees, vendors, customers, charities and the communities where the owner provides jobs and economic and social well-being for the business' local community.

What happens if the business does not successfully transition? The alternative is that the business shuts down. People lose their jobs. Families suffer. Communities suffer. And in many cases an owner's life's work is liquidated for pennies on the dollar.

Previous surveys conducted by the Exit Planning Institute (EPI), Price Waterhouse Coopers (PWC), the Alliance of Mergers and Acquisitions (AM&AA), Tom West, founder of Business Broker Press, and the Family Firm Institute (FFI), have determined that historical transition success rates are in the range of only 20-30% nationally.

It is the mission of the Exit Planning Institute and all Certified Exit Planning Advisors (CEPAs) worldwide to change this outcome. The beauty is that we have models (after all, 20-30% of businesses do successfully transition) which can be emulated by many business owners who decide that a successful business transition is in their future.

The significance of this is becoming more urgent as Baby Boomers, who own nearly two-thirds of all privately held businesses, face the inevitable condition of aging. Boomer owned businesses alone represent roughly $20 trillion in sales and $10 trillion of wealth in the US alone. Since Boomers are holding onto their business longer than previous generations, they must face the reality that preparing for their business transition is now an urgent imperative.

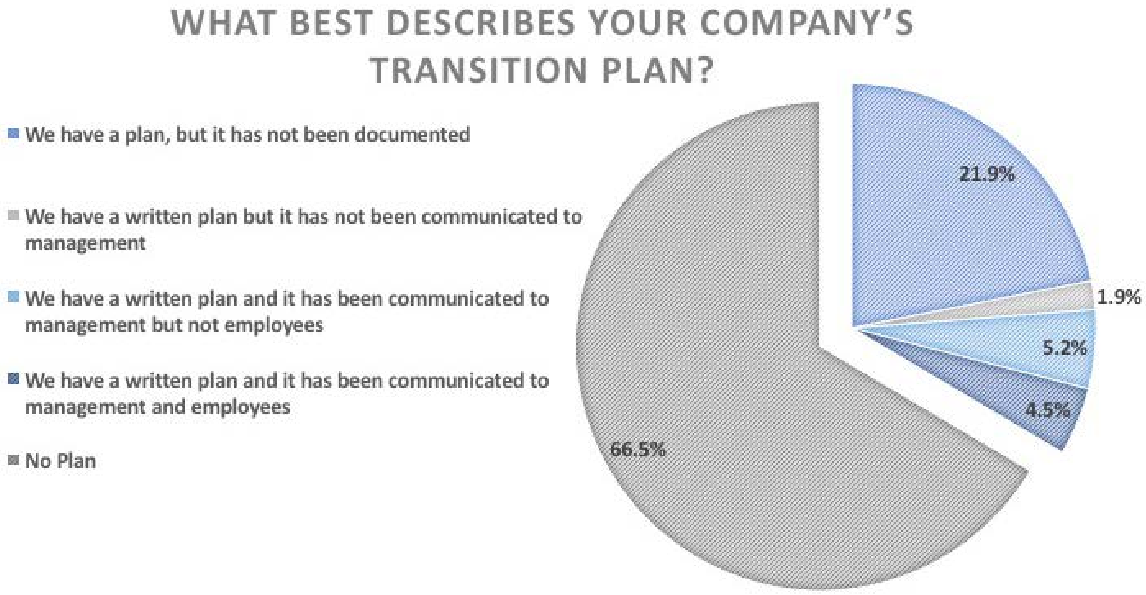
The community of owners must realize that transitioning a business is a high stakes, and for many, a once-in-a-lifetime endeavor that takes significant focus, action, and time to do it properly.

Doing it right has crucial benefits. For many owners, the business represents the vast majority of their wealth. For example, if the average middle market business, which we define as a business with sales between $5 and $100 million, holding a market value of $8.5 million, successfully transitions, the wealth at transition goes from $2.1 million in wealth to $10.6 million in pre-tax wealth. Even at an aggressive rate of return of 6% a year, the difference in pre-tax income is $510,000 ($637,000 vs $127,000) per year.

For the micro market, the consequences are even more compelling. In the micro market, which we define as those businesses that do less than $5 million in sales per year, the average business value is just over $300,000. Most of these businesses are owner operated, meaning the owner derives almost all income from the business. Roughly 5.7 million (94%) of the 6 million privately held businesses fall into this category. Assuming again that for many 80% of their wealth is locked in the business, successfully monetizing the business asset is the difference between having $400,000 at transition as opposed to $100,000.

To successfully transition three things must be addressed by the owner: 1) the owner must focus on maximizing transferrable business value for as long as they hold the business while positioning it to successfully transfer upon exit so they can harvest wealth locked in the business; 2) the owner must prepare financially for a lifestyle without the income from the business; and 3) the owner must plan personally for what they will do (their third act) after exiting the business.

To understand the present level of readiness to harvest this wealth, the current financial preparedness outside the business financially and understand how well owners have prepared personally, EPI has been conducting surveys of business owners with the help of its many strategic partners since 2013. National surveys were completed in 2013 and 2014. Two regional surveys were conducted in 2016 and several more regional surveys are planned in 2017.



Shown above: 66.5% of owners have NO transition plan AT ALL!

The survey results continue to demonstrate the lack of readiness to transition by many business owners which explains why most transitions fail. The report also demonstrates the need for massive education of business owners and business advisors with regard to how to successfully transition.

It is important for the reader to note that the survey answers reflect the owner's *perception*. Although the owner's answers may be factual, they are not based on proven fact. The only way this can be accomplished is through the completion of a thorough personal, financial, and business assessment conducted by an independent credentialed advisor, such as a CEPA.

Nevertheless, the data is useful to at least assess the *owner's state of mind* as it relates to being ready to transition from a business, personal and financial standpoint. Owner's would be wise to consider obtaining a personal, financial and business assessment to support their current perceptions and their business valuation. The owner will then avoid surprises when the time comes to actually transition the business. This is also necessary for proper estate and personal financial planning.

As stated earlier, we know from past studies that success rates in the US are in the range of 20-30% - far below what we need them to be from an economic and social standpoint. Some of the owner's responses in these studies reflect good reasons for why that is. Other answers may reflect an owner's misunderstanding or under estimation of what it takes to successfully transition. In other words, it may simply be that owners don't know what they don't know. Their lack of formal education certainly demonstrates that they have not accomplished enough education.

The intent for this data is that it be used as a business tool to discuss with the owner and to identify areas where education and services are needed. At minimum, the results should be reviewed with business owners to begin the process of validating their particular situation, educating them on critical success factors, and determining the probability of successful transition.

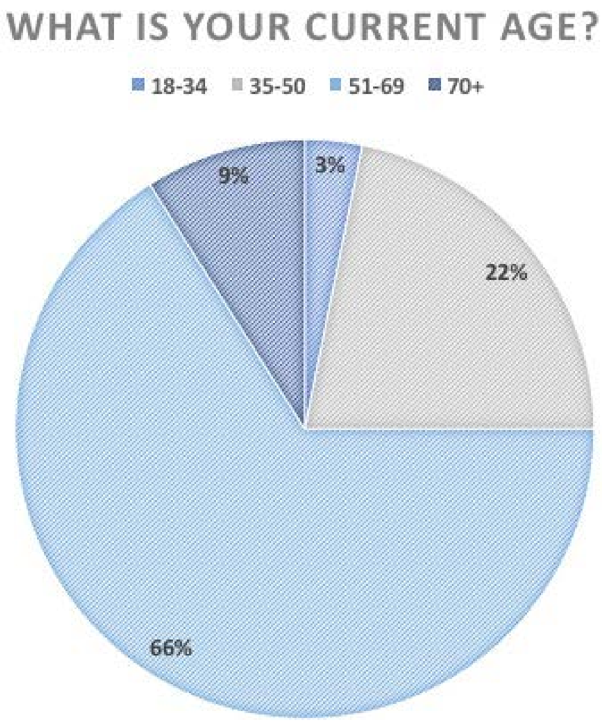
This report is divided in to three sections. In Section 1, we make general observations about the data collected from the Greater San Diego survey and compare it to the national surveys conducted by EPI in 2013 and 2014. In Section 2, we provide analysis of the data and make observations as to what it means to the business owner. In Section 3, we recommend actions business owners and business advisors should take to improve the probability of a successful transition and capture this hard-earned wealth.

4,000 surveys were distributed with 203 responses (5.08%). The survey included 50 questions organized as follows:

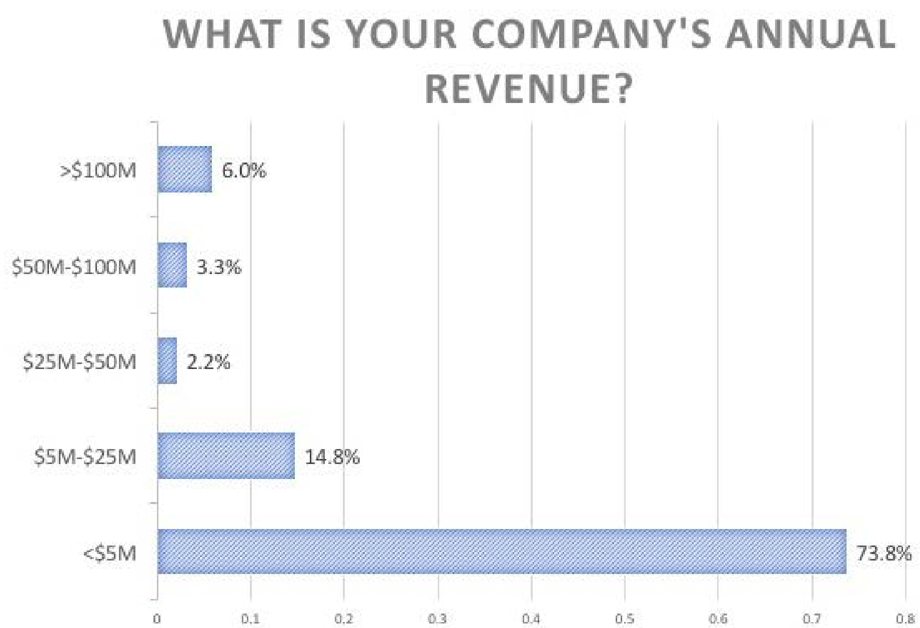
- demographic information (age, gender, annual revenue, legal structure, industry, most trusted advisor, etc.);
- current transition plans and thoughts; and
- owner, shareholder and family readiness to transition, and company readiness to transition.

Section One: Demographic Data

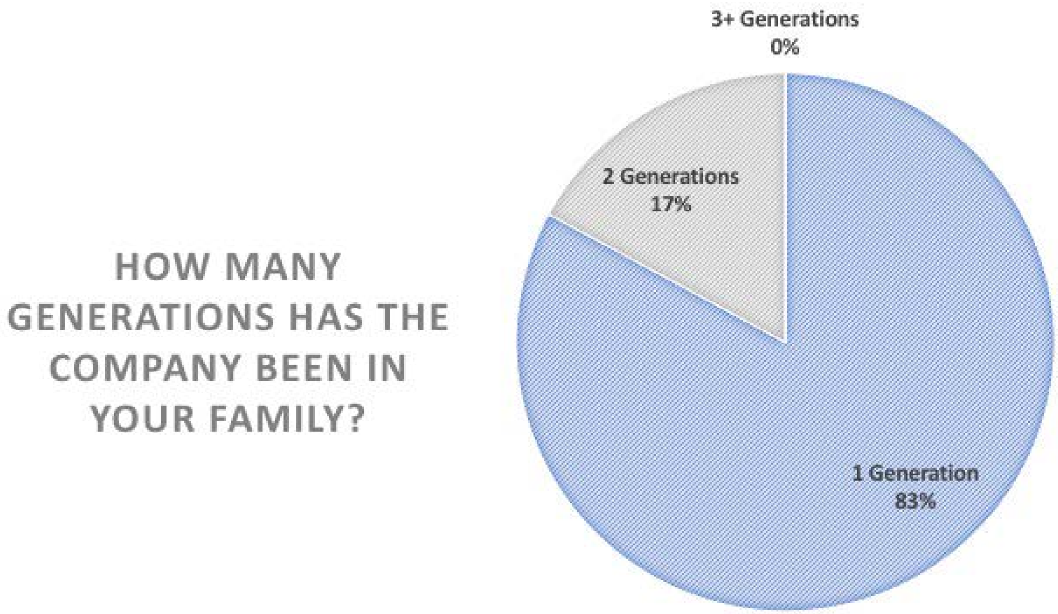
What Our Owners Look Like



- Owners Ages: 66% of the respondents were Baby Boomers. This aligns with the US Census data which stated that 63% of privately held businesses are owned by Baby Boomers. 75% of the San Diego sample were 51 years of age or older. The importance of transition significantly rises as the owner ages meaning that it is highly likely that a successful transition of the owners most valuable asset, the business, should be a high priority for 152 of the 203 owners surveyed.



- Business Size: 74% had business sales of less than $5 million, 20% had sales in the range of $5-100 million, and 6% had sales of $100 million or more. The Greater San Diego data leans more heavily towards businesses over $5 million in sales versus the national US Census data which states that of the six million privately held operating companies, 94% do $5 million in sales or less, 5.8% between $5 million to $100 million, and only .2% do over $100 million in sales.



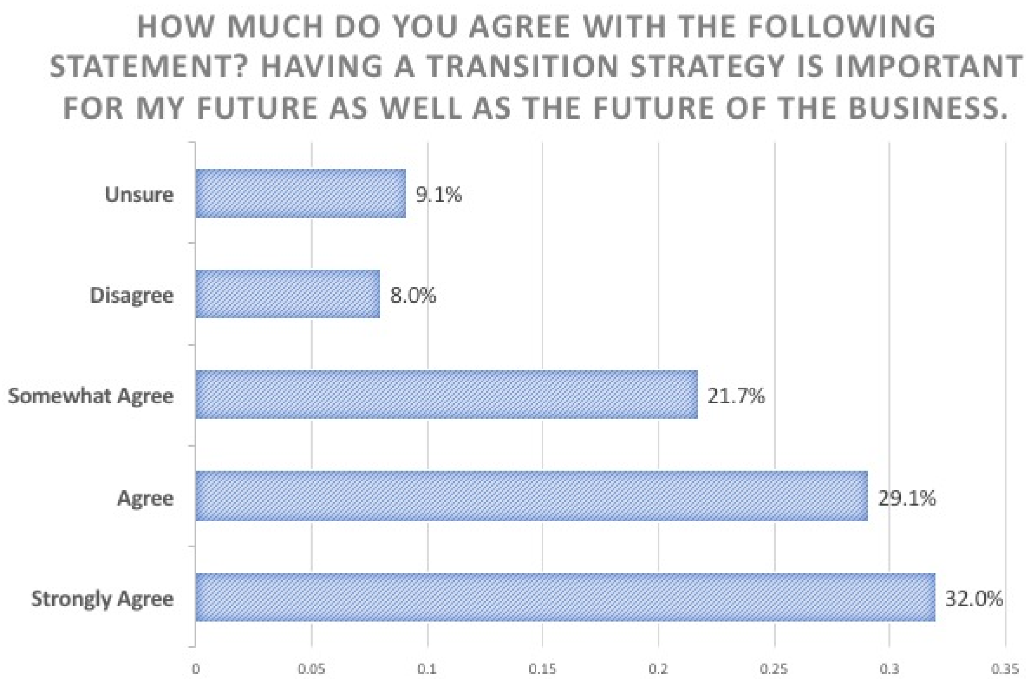
- Family Ownership: 65% were family owned businesses with 83% of the businesses being first generation businesses started by the owner. This data aligns on two fronts. First, in a previous survey conducted by Tom West of Business Broker Press. Mr. West's study indicated that only 20% of businesses that go to market actually sell. Additionally, a Family Firm Institute study indicated that only 30% of business that transition from generation 1 to generation 2 are successful, and it gets progressively worse from there.

Section Two: Analysis and Relevant Observations

What Does It All Mean?

Given the general lack of family and business transition readiness as evidenced from the survey results, it is not surprising that 70-80% of transitions fail to be successful.

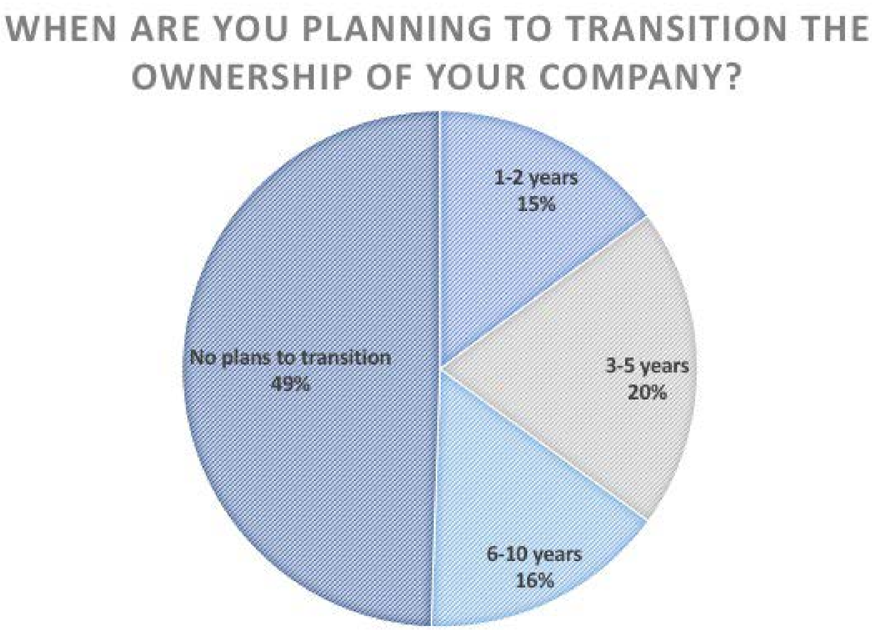
As you read through the rest of this report, the reader should bear in mind the following:



83% of the business owners indicated they agreed with this statement: "Having a transition strategy is important for my future as well as the future of the business."

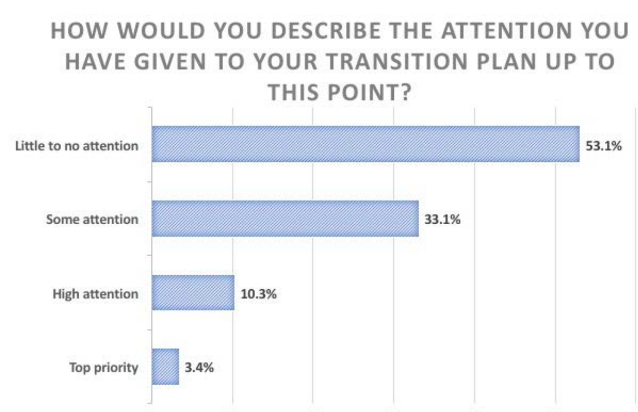
Despite this, The State of Owner Readiness Survey of San Diego indicates owners are woefully unprepared for this milestone emotional and financial event.

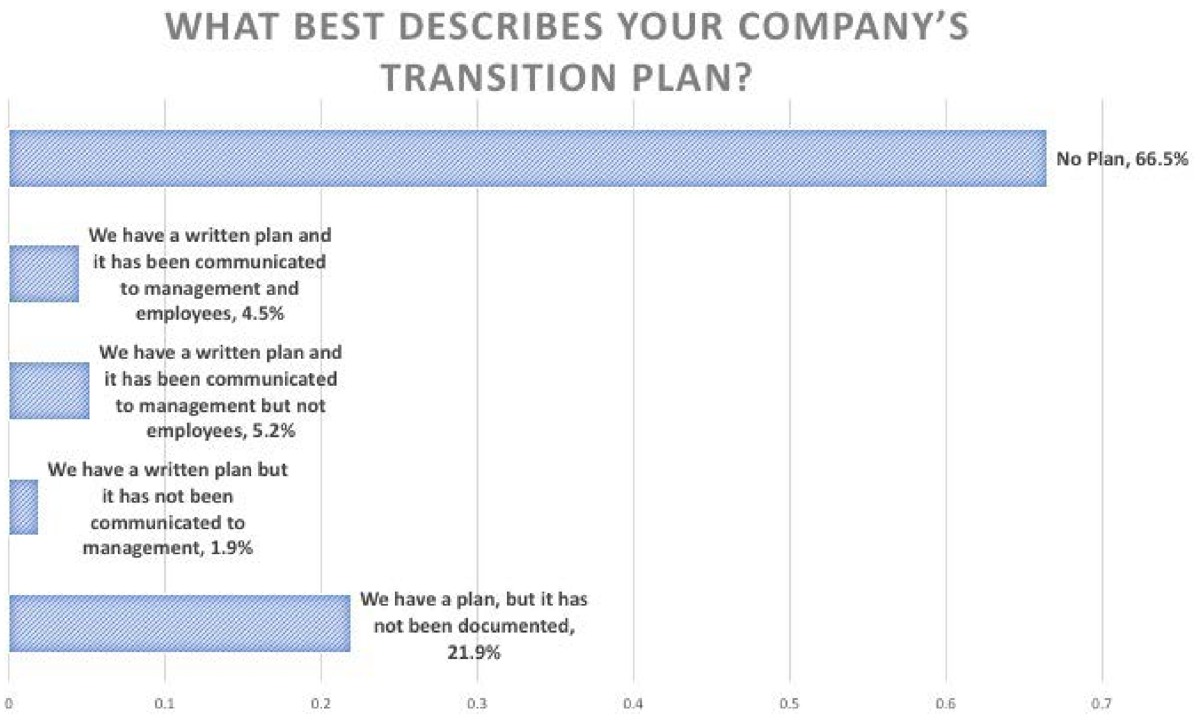
State of Transition Planning is Very Weak



Even though 75% of the respondents were age 51 or older, almost half (49%) of the owners indicated they had "no plans" to transition their business. 35% indicated they were planning to transition within 5 years and 51% within 10 years.

- **53% indicated they had given little to no attention to their transition at this point.** Only 14% indicated they had given it high to top priority





- 88% had no *written* transition plan. 66% said they had no plan at all (vs 49% in national survey). 22% said they had a plan but it was not written or communicated. Only 5% stated they had a formal written plan that had been communicated to both management and employees.

- Only 25% of the business owners said they were comfortable their managerial team would be successful if they were not involved with the business post transition. One-third indicated they had not even thought about management succession.

WHAT DO YOU WANT TO ACCOMPLISH AS PART OF THE TRANSFER OF YOUR BUSINESS?

(MOST IMPORTANT TO LEAST IMPORTANT)

1	GET FULL VALUE FOR MY BUSINESS
2	MAINTAIN THE LONG-TERM VIABILITY OF THE BUSINESS
3	MINIMIZE OR ELIMINATE CAPITAL GAINS TAX
4	PROVIDE BENEFIT TO MY MANAGER AND EMPLOYEES
5	TRANSFER WEALTH TO MY CHILDREN OR GRANDCHILDREN

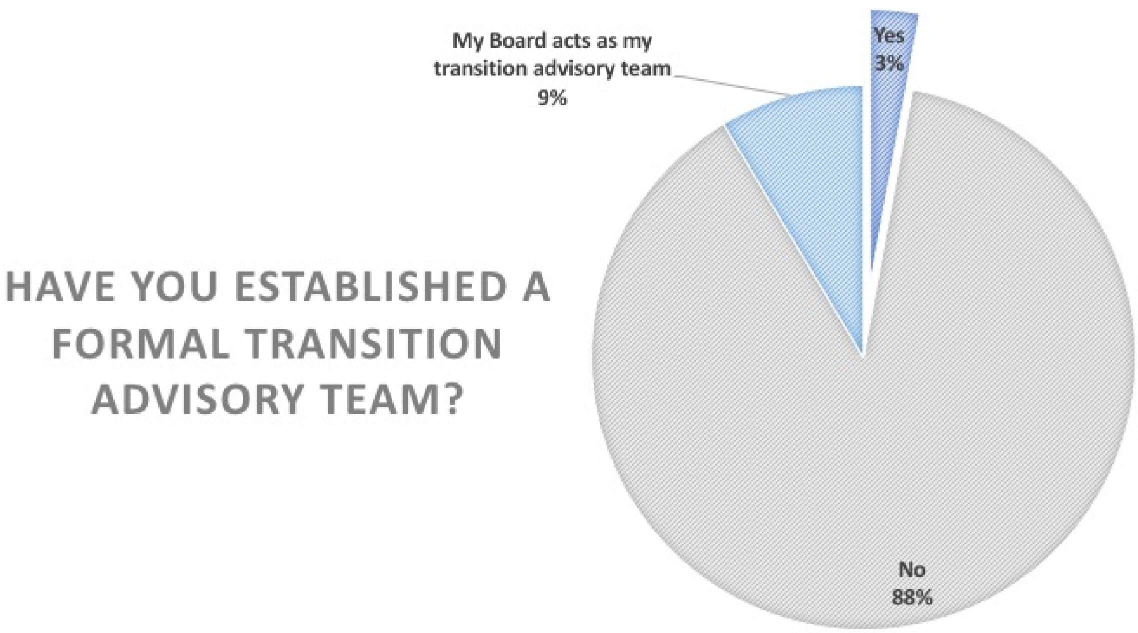
66% of the owners indicated that "Getting full value for my business to fund my retirement or other business interests" was their number 1 goal in the transition of the business. Yet,

- only 19% of those that had a plan said their plan included value enhancement virtually taking maximizing the value of their business off the table.
- only 20% had a formal valuation of the business done in the last year and less than 40% have had a formal valuation in the last three years.
- 65% have never had their financial statements audited.

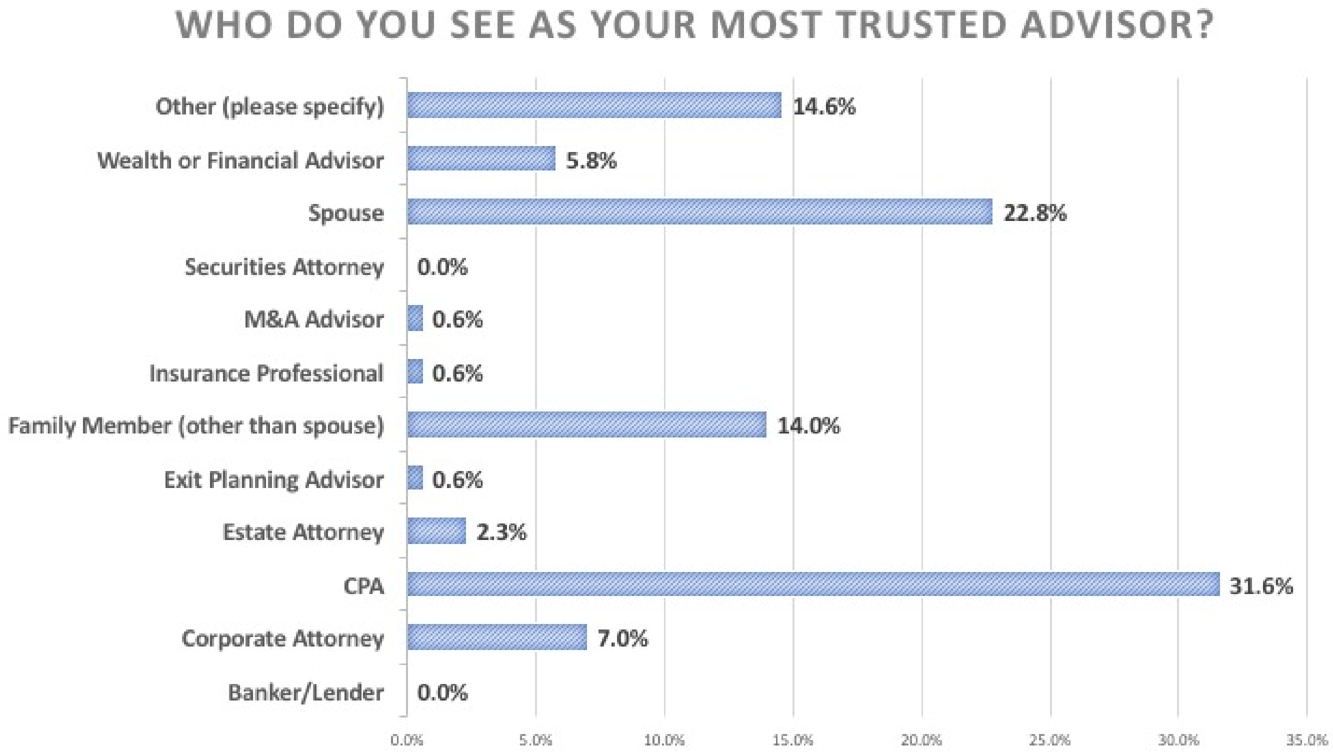
Not Enough Use of Outside Resources

Many owners are going it alone or do not see the value of using outside resources to get educated and to help with the transition.

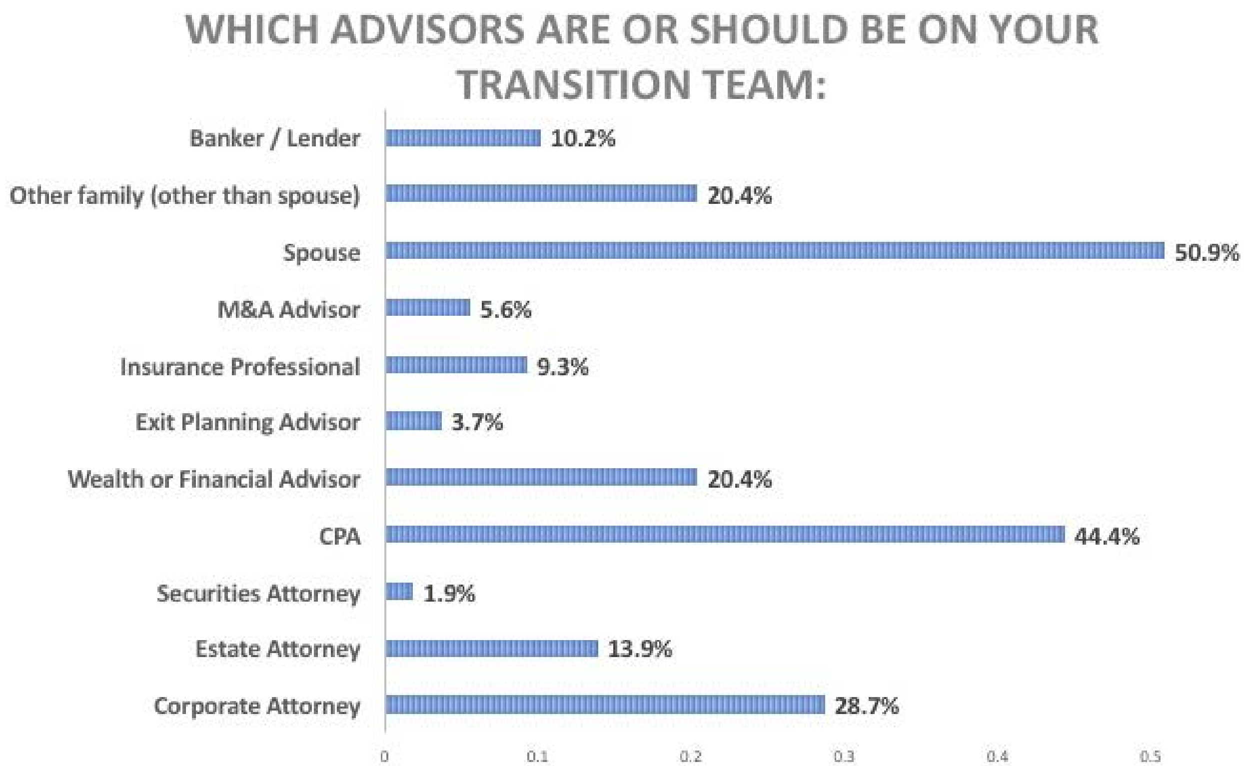
- Only 20% have sought outside advice. The number 1 reason was that owners were not ready to retire, highlighting this common misunderstanding: that exit strategy is nothing more than good business strategy. Exit planning is not something you do down the road. Exit planning is now. The everyday actions that owners choose to take or not take affect the owner's ability to exit successfully.



- Only 3% have set up a formal transition team. 9% indicated they use their board of advisors as their transition team. This is a mistake usually. Most advisors and many owners should realize that the skillsets needed to transition a business can be much different than those skillsets of the members who sit on the owner's advisory board.
- Only 20% of the respondents have an outside board of advisors. For those that did, only 9% had non-family members on the board of advisors.



- The most trusted advisor status went to the CPA, similar to the national surveys. 32% of the owners indicated their CPA was their most trusted advisor followed by spouse (23%), other family member (14%) and other (which included peer groups, board advisors and business coaches).

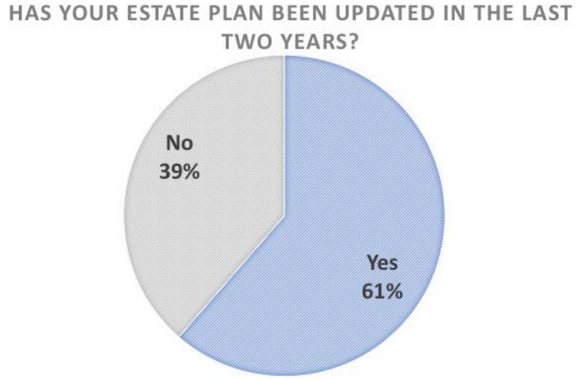


- Surprisingly, although 29% of the owners indicated their corporate attorney should be or is on their transition team, only 7% voted the corporate attorney was the "most trusted advisor."

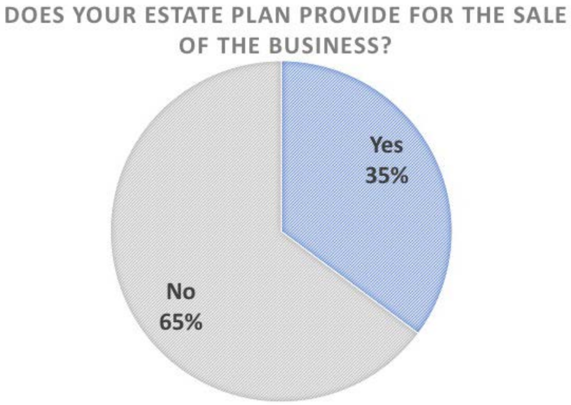
- Similarly, 20% of the owners stated the wealth manager/financial planner should be or is on the transition team. Yet only 6% considered the wealth manager/financial planner the most trusted.
    - *This is surprising and I believe is a huge opportunity for the financial planning industry. It is clearly a best practice to have a wealth manager or financial planner involved in the transition process as early as possible. I don't even know how it's possible to design a transition strategy without the involvement of the financial planner. The role of the financial planner is critical in determining the owner's financial needs before, during and after the exit. Their role in evaluating options to optimize the owner's post business lifestyle is critical and often dictates the available exit options, the structure of the exit transaction and internal or external options. The financial planning industry and owners themselves would benefit tremendously if the financial planning industry did a better job of educating owners on the role of the financial planner and wealth manager in the transition process.*

Are Estate and Personal Financial Plans Accurate?

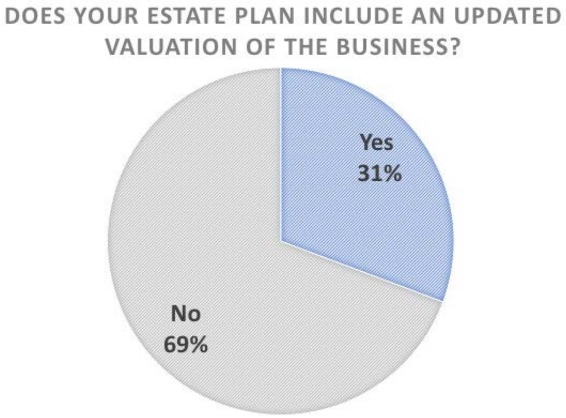
There appears to be confusion over whether or not estate and financial planning is needed. It should not be a question of whether or not to have one – most owners should. The question really pertains to the comprehensiveness of the plan given the size of the owner's portfolio. 42% of the respondents said they did not have an estate plan; 58% did. However...



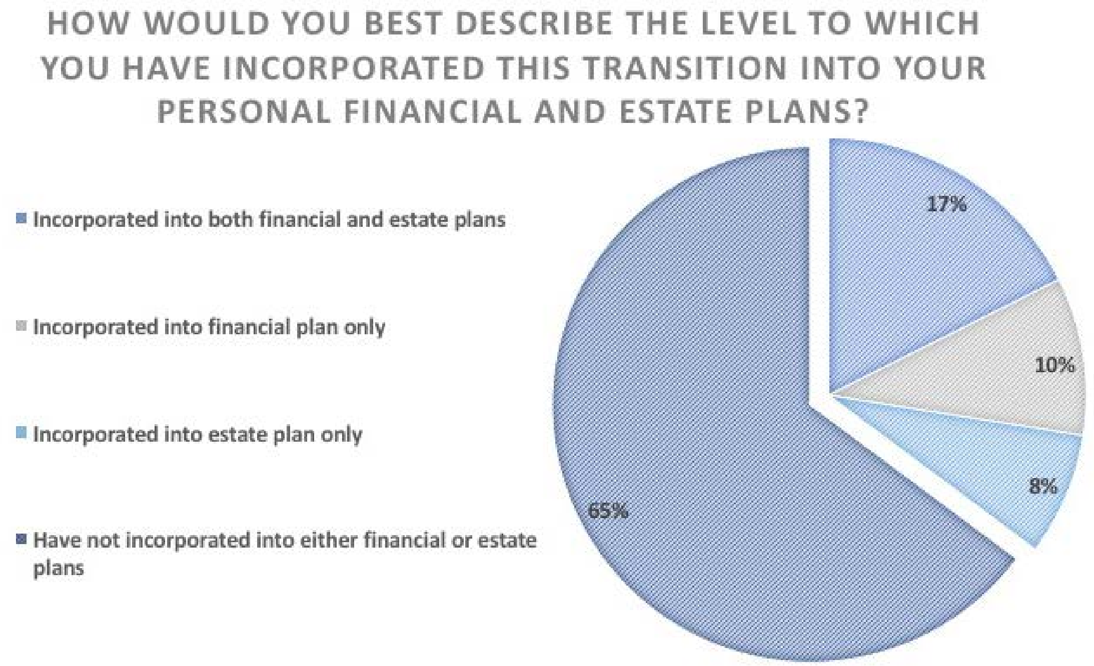
Only 61% said their estate plan had been updated in the last two years.



65% said their estate plan does NOT provide for the sale of their business.



69% indicated it did NOT include an updated business valuation.



- 65% indicated their transition plan had NOT been incorporated into either their financial or estate plan.
- 70% said they did not know how much they NEEDED (vs wanted) to net from the sale of the business.
- 0nly 17% have a tax minimization plan; of those that did only 37% said it was updated.

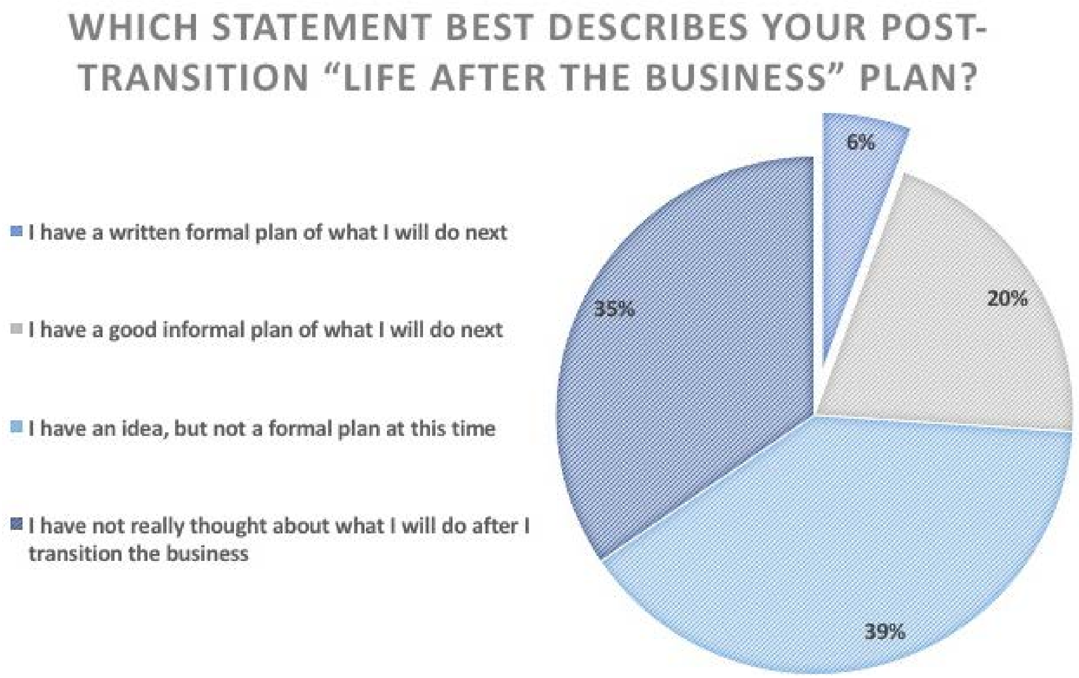
What is very worrisome is that the business transition and updated business valuation were not incorporated into the estate plans of a majority of those that actually said they had an estate plan. If the business typically accounts for 80-90% of the owner's net worth, how can estate planning be effective when 65% or more of business owners who have an estate plan have not incorporated the business transition into their plan, and there is limited tax and needs analysis completed?

That being said, 66% answered that getting full value for their business to fund their retirement or other business interests was their number 1 goal in the transition of the business. More than half indicated they planned to transition the business in 10 years or less and a third said they were planning to transition the business in 5 years or less.

This appears to be another big opportunity for both owners and those that provide financial planning and estate planning services.

What's Next? The Third Act

Owners continue to demonstrate that they do not understand the importance of personal planning in a successful transition.



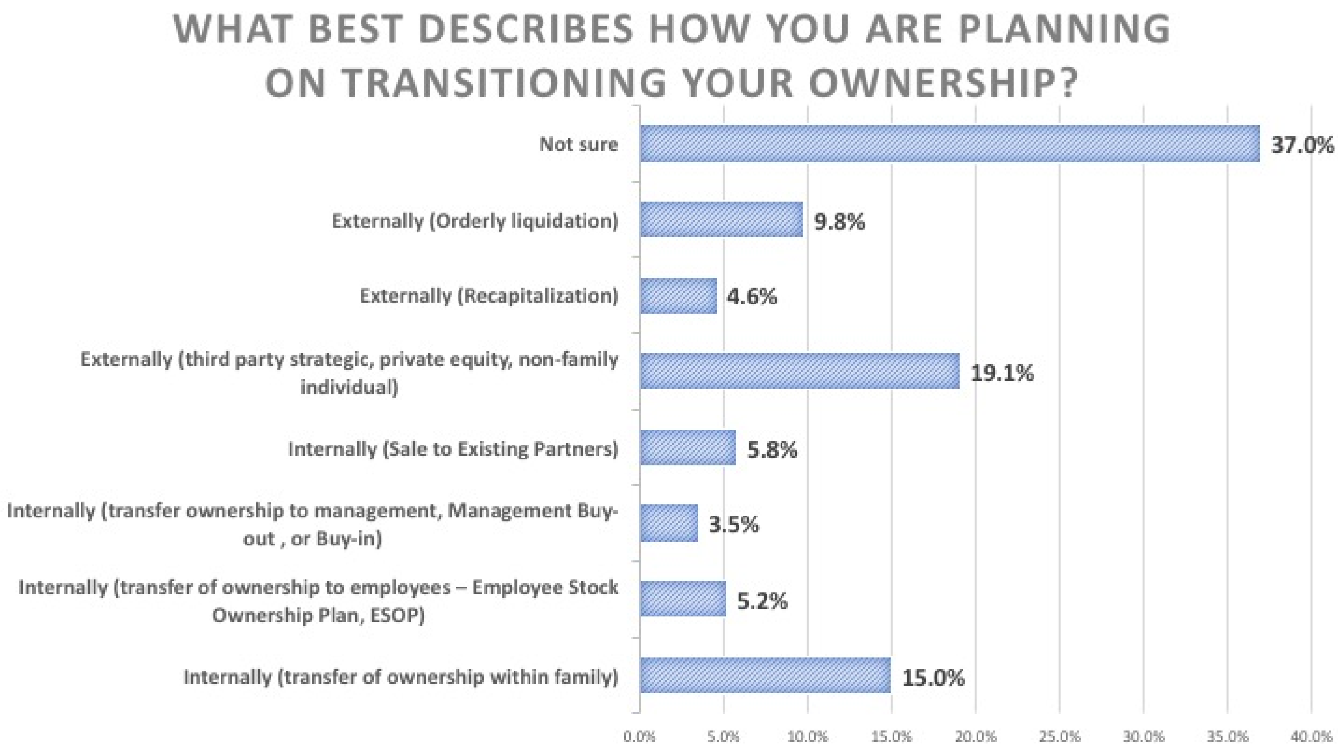
The fact that only 6% of the owners indicated they had a written post transition personal plan reflects an overly optimistic view of their future. When asked about the state of their post transition personal plan:

- More than one-third indicated they had not even thought about it.
- "I have an idea" was the most popular answer

This is consistent with a Price Waterhouse Coopers study that found that 75% of business owners surveyed within one year of exit profoundly regretted the decision. This was mainly for personal, not financial reasons. An owner's identity is closely tied to his or her business. Losing that is the emotional equivalent of losing a loved one. Owners spend untold hours working in and on their business. The owner's personal needs often take a back seat on the priority list. However, personal planning by the owner on "what's next" it vital to a successful third and best act.

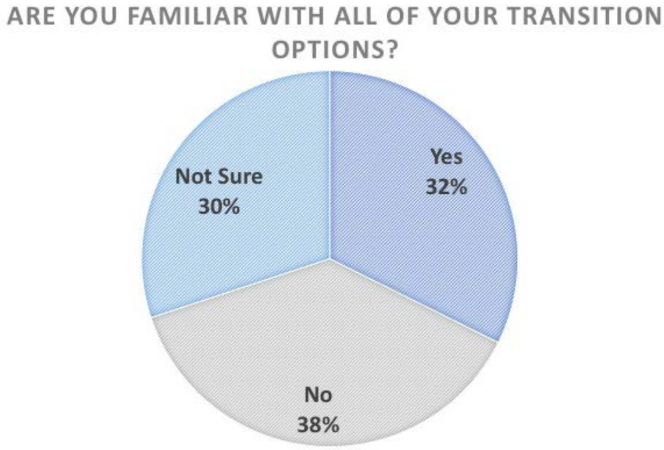
When asked about post transition lifestyle, many owners plan to remain active. The most popular activities were consulting (31%), philanthropy (23%) and investing and sitting on a board (16%). 15% may like to teach. 53% indicated their plan was to retire and 18% indicated they had no plans.

Exit Options: San Diego Owners Not Analyzing Their Exit Options



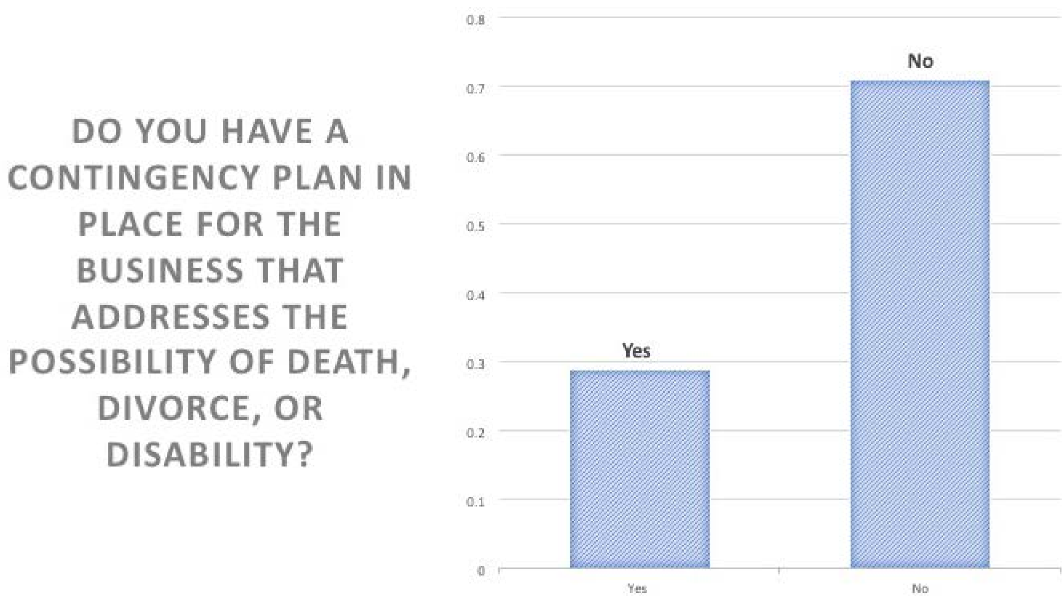
When asked, "What best describes how you are planning on transitioning your ownership?" 37% indicated they were "not sure", 30% indicated some form of inside option and 33% indicated some form of outside option.

- The most popular inside option was to transition the business to a family member (15%) followed by partner (6%), employees (5%) and management (3.5%). Despite family being the number two overall most popular option, 42% have never had a family meeting about the business.
- The most popular outside option was sell to a third party including a strategic, private equity or non-family member (19%), followed by orderly liquidation (10%) and recap (4.6%)
- These data points are consistent with previous surveys. Family and third party sale were the most popular options.



When asked if they were familiar with their exit options, 68% of owners said "no" or "not sure" (which means "no"). Not being aware of all their exit options means owners risk leaving money on the table when they exit. This has been a consistent statistic in all previous surveys.

Business Risk Not Appropriately Addressed

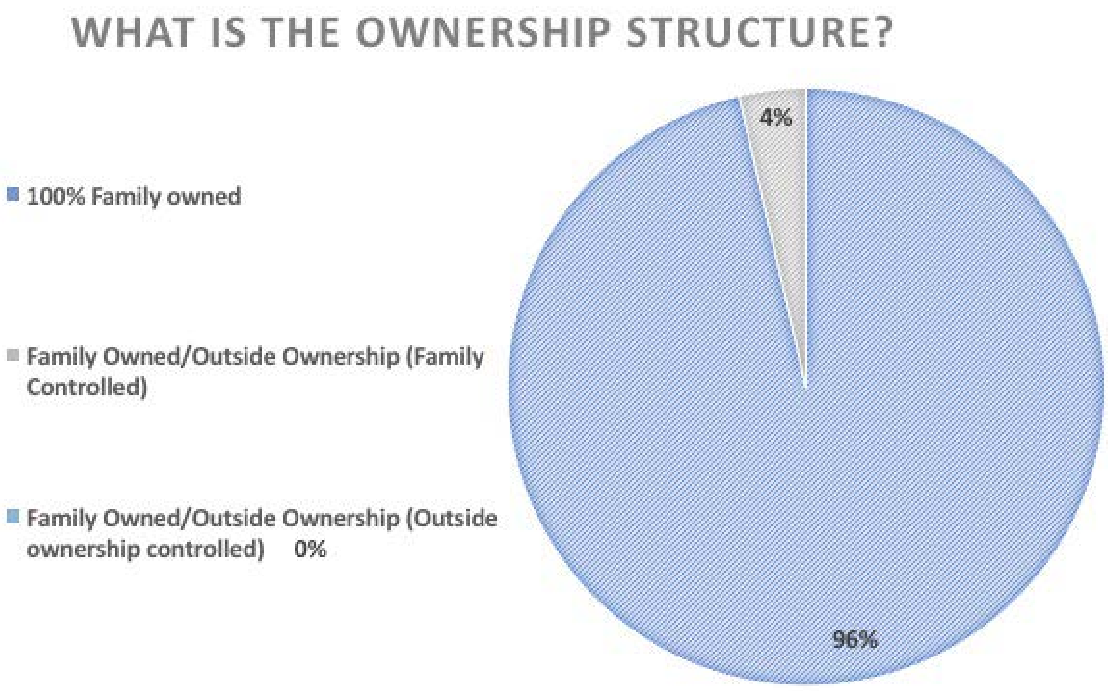


71% of the owners indicated they have no contingency plan should they be forced into an exit. Of those that did say they have a contingency plan, but only 56% have it documented.

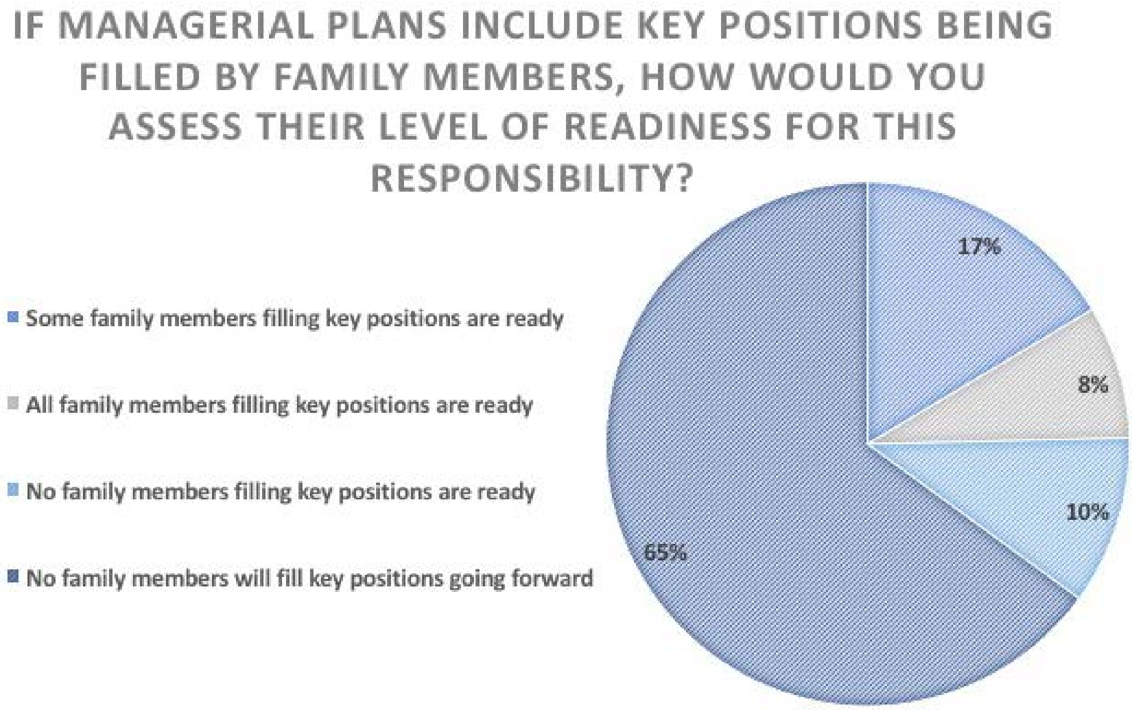
Buy-Sell Agreements: Not Present or Not Up-to-Date

Of those businesses that have multiple partners, less than half (48%) have a buy-sell agreement. Only about half (53%) of those that have a buy-sell agreement have had it reviewed and updated within the last three years. 63% do not have it funded by life insurance.

Family Is Important, But Are They Ready For Transition?



96% of the sample included businesses that were 100% family owned. The owner's answers reflect the importance of family as the spouse ranked #2 as the most trusted advisor (23%) and other family members ranked #3 (14%).



However, when asked to rank family readiness for the business to transition, 55% of the owners ranked the level family readiness incorporated into the transition plan below average. And 42% said they had never had a formal family meeting about the business.

- This may be because 65% said family members would NOT be filling key positions and only 15% had decided on a family transition as their preferred option.
- If family members were filling key positions going forward, 72% said these family members were at least somewhat ready.
- For those that had incorporated family readiness into their transition plan, 55% indicated family members were aware of both managerial and ownership transition plans. Only 21% said they were not aware of either.

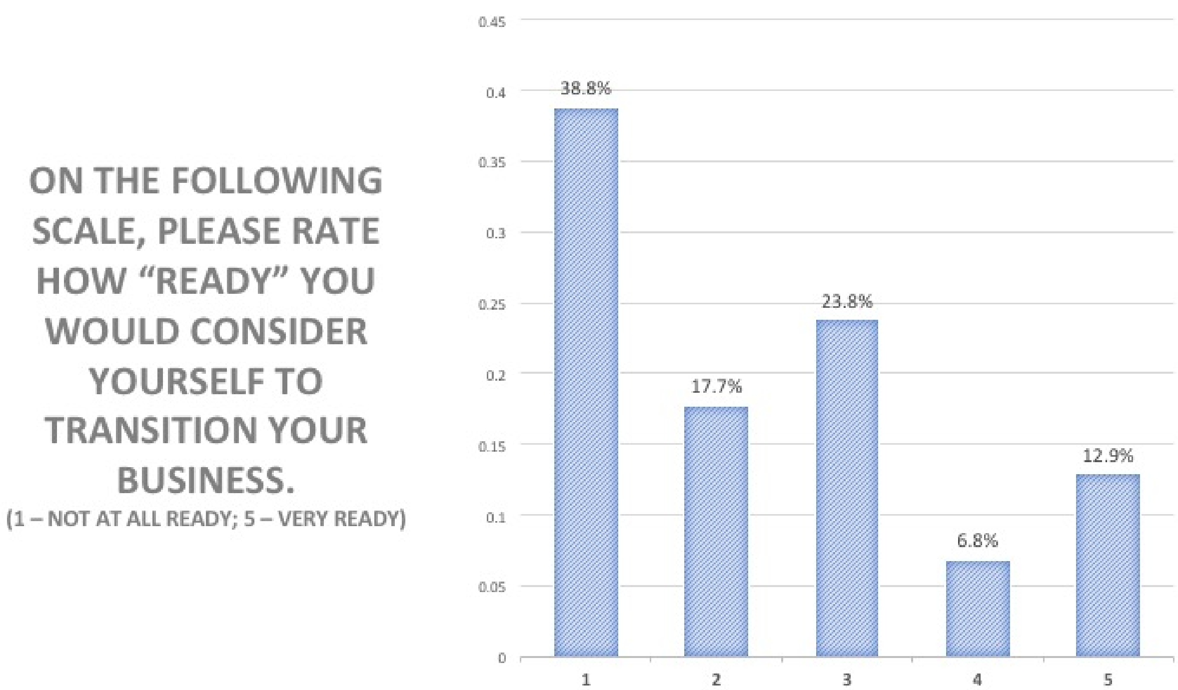
The danger here is that there is a tendency for business owners to do less transition planning when a decision has been made to transfer it to family. The family should approach the transition with the same vigor as if they were planning to sell it to a third party, even if the family has decided on an inter-generational transfer. What makes a business valuable to a third party are the same characteristics that make it valuable to the next generation. One major reason we don't see success rates much higher for family transitions versus third party sales is because some owners do not approach the family transition in the same way they would approach a third party sale and they end up transitioning a business to a less experienced family member (child) who is undercapitalized and has not mitigated risk appropriately.

Section Three: Recommended Actions

Advice to Business Owners

Business owners of all sized businesses must become much more proactive if they are to improve successful transition rates and harvest their most significant financial asset. Success rates are not likely to improve as long as exit planning is viewed as "something I can do down the road" instead of being an imperative integrated into the way the business is operated today. With $10 trillion of wealth at stake from an aging generation of business owners (remember 75% of our survey respondents were 51 or older) a greater sense of urgency is required.

So, What Should You Do?



When asked how ready the owners felt in regards to the business being ready to transition, 57% of the them answered below average. 35% of the owners surveyed indicated they had not prepared a transition plan because they were "not ready to consider." Additionally, 19% said they were "using the business to save for retirement." Other reasons included "too busy", "building value first", and "passing to family."

Owners need to realize that they need to redefine their present paradigm of what exit planning is. Until they do, progress will be limited. The need to realize that exit planning is nothing more than good business strategy. Their best practice is to integrate the actions of a successful transition into the way they run their businesses every day. Owners accomplish this by following the principles of the 5 Stages of Value Maturity: (1) identifying what they have now; (2) taking risk mitigating actions to protect their wealth; (3) building value consistently over time; (4) positioning the business to have multiple exit options and perhaps multiple exit events; and (5) actively managing their wealth (including the business wealth) before, during and after the exit event.

"Exit planning is nothing more than good business strategy."

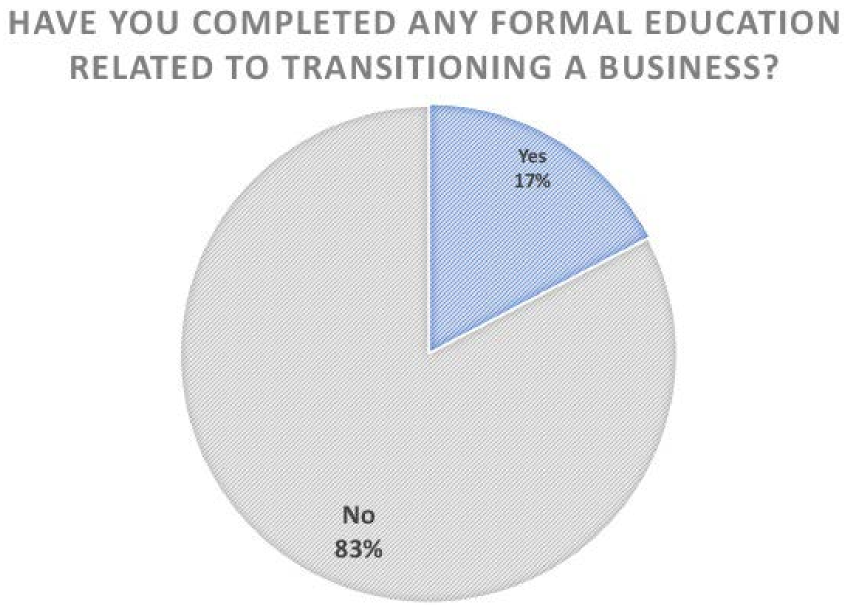
Clearly, this is not being accomplished today. Although it may be understandable that only 42% of the owners have estate plans, 80-90% of the owner's net worth is likely to be in the business and 70-80% of that business wealth is tied to intangible assets. To check this, owners need only look at their present income statements and balance sheets. Does the income produced on the income statement (for tax purposes) really reflect the true cash flow benefit assumed by the owner or future owner? The answer is often no when the owner considers normalized income and expenses, discretionary expenses charged to the business and one-time non-recurring charges. Does the owner's present balance sheet reflect the true "market value" of the business? Again, not often. The balance sheet (again for tax purposes) reflects the book value of the owner's written down business assets; not the true market value which would include the value of the business' intangible assets.

"Does the owner's present balance sheet reflect the true "market value" of the business? Again, not often."

Management systems must be adapted to provide the owner strategy and feedback on the value of intangible assets, or "The 4 Cs" (Human, Customer, Structural, and Social) on a regular basis. Most accounting and management systems today do not provide feedback on the value of the business. Focusing on value first drives all other positive outcomes including increases in sales and profit. Integrating personal and financial goals and plans with business planning assures the business owner is prepared for all possible events from a personal, financial and business standpoint (a concept called The Three Legs or Master Planning). Owners must realize that 50% of all exits are not voluntary – not on the owner's terms or timeline – due to at least one of "The 5 Ds": Death, Disability, Divorce, Distress, and/or Disagreement.

"Most accounting and management systems today do not provide feedback on the <u>value</u> of the business."

By focusing on regular and relentless execution of actions to protect, build and harvest business value (which is likely 80-90% of the owner's net worth), owners position themselves to be able to harvest that wealth in good times or bad.



Despite 83% of the respondents stating that a transition strategy was important for their future and the future of their business, the survey results clearly show that their business owners still require vast education. **83% of the survey respondents indicated they had accomplished "no education" on the subject of exit planning**. Owners can start by educating themselves. Today, there are a vast number of resources available within their peer groups, their advisors, universities and economic development organizations, and there is literature on the subject. A good place to start would be to read *Walking to Destiny* by Christopher Snider, the president and CEO of the Exit Planning Institute (for a full list of reading references visit www.snidervalueindex.com).

Advice to Advisors

The "most trusted advisor" status continues to go to the CPA (32% of owners indicated that their CPA was their most trusted advisor). Of all the possible advisors to the owner, the CPAs most likely have the best insight of all outside advisors into the financials and operations of the business. Going beyond self-imposed boundaries and becoming more consultative with the owner as it relates to managing the value of the business and exit options is an opportunity that would benefit them as well as the business owner.

Surprisingly, only 6% of the owners said their wealth advisor was their most trusted advisor. This is unexpected given that the wealth manager is the one advisor (perhaps also the business attorney) that is with the owner through the entire process, not only leading up to the transition event, but thereafter charged with managing the owner's windfall after the exit event. They are also vital in helping the owner select and structure the appropriate exit option. This is another indication of the owner's misunderstanding of the value provided by the wealth advisor before, during and after the exit event and their lack of education related to all their exit options.

Thank you to our contributors.

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And thank you to the respondents in the San Diego County market for their contribution by participating in this study, created to educate and empower middle market owners nationwide.

About the Exit Planning Institute

The Exit Planning Institute (EPI) delivers innovative learning experiences, performance-enhancing resources and strategic tools designed to enhance the exit planning profession. Formed in 2005 to serve the needs of CPAs, financial planners and wealth managers, attorneys, commercial bankers, management consultants, M&A advisors, ESOP and family business advisors, the Exit Planning Institute is considered the standard trendsetter in the field of exit planning across the globe. It is the only organization that offers the Certified Exit Planning Advisor (CEPA) Program and qualifies for continuing educational credits with eleven major professional associations, making it the most widely accepted and endorsed professional exit planning program in the world. For more information, please visit www.exit-planning-instutute.org.

About the Certified Exit Planning Advisor (CEPA) Program

The CEPA Program created in 2007, is the only program of its kind. Developed by nationally recognized experts in the field of exit planning, this 5-day executive MBA style program includes 22 modules taught by a faculty of 13 nationally recognized instructors. The CEPA Program offers professionals an innovative learning experience, performance-enhancing resources, and the strategic tools to help them advance their exit planning practices. The program is held five times a year at state-of-the-art executive education centers including the University of Chicago's Booth School of Business and the University of San Francisco's Graduate School of Management downtown campus.

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