IS THE CLOCK TICKING FOR BUSINESS SALES?

The potential impact of the retiring baby boomer generation on Mergers & Acquisitions activity

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INTRODUCTION

The oldest rule in business is that of supply and demand. But does that also apply to the sale of a business?

In today’s M&A market, dynamic, growing businesses are highly prized for a number of closely related reasons. In an era of lower interest rates, with record levels of cash on balance sheets, a specialist business may represent a sound investment for a range of organisations looking to grow. In turn, this has created a seller’s market, where a target business with the right profile can attract interest from multiple acquirers, and multiple acquirer types, from large trade organisations, to private investors and Private Equity.

Business is cyclical, of course, and many commentators estimate that a far greater number of businesses will come to market over the next decade. This white paper seeks to analyse this claim in the context of a number of key factors, including business owner demographics, international market trends and succession planning. We have included insight and analysis from business owners who have sold their businesses recently.

In short, we look to examine whether today’s seller’s market will soon be changing to a buyer’s market.

“In the US, 10,000 baby boomers reach retirement age every day”
UNDERSTANDING BABY BOOMERS

Much has been written about the baby boomer generation and the potential impact on society as the boomers, as a group, reach retirement. A lot of assumptions have been made, however the reality is less straightforward.

The post-war baby boom in the US between 1945 and 1965, resulted in a jump in the average number of births of between 20% and 30%. In the UK, the “boom” was less clearly defined but the average birth rate increased by up to 20% in 1946-47 and in 1960-65. Other countries in Europe experienced increases in birth rate similar to those in the UK.

The increased birth rates during this period led to a proportionate increase in the number of privately owned companies created by this group during the ‘70s, ‘80s and ‘90s. This increased level of commerce has contributed significantly to levels of employment and to national economies in the five decades since.

1. The United States Census Bureau
2. Economist Intelligence Unit
GLOBAL BUSINESS SALE INSIGHTS

As owners reach retirement age, it is reasonable to expect many of those companies to come up for sale. Business owners will seek to realise their investment and to pass on the responsibilities and commitment of running a company. An increase in supply usually leads to a reduction in price. Yet commentators around the world have not all seen the expected surge in businesses being offered for sale.

FOCUS ON THE USA

In the US this year, 10,000 baby boomers reach retirement age every day. Estimates of the number of companies owned by baby boomers and likely to come on to the market, ranged from 4.5 to 17 million businesses. However, listings of small businesses for sale are down in almost every state compared to five years ago.

Analysis of these companies shows that 95% have four employees or fewer. More than half post annual revenues below $500,000 and a quarter turn over $100,000. Many are asset-poor service companies with relatively low enterprise (sale) values. The sale of companies like these, after costs and commissions, leaves little for retirement. Further, succession planning at this end of the market is most likely to involve sale to a relative or employee.

A more representative figure is that 500,000 to 600,000 US SMEs, with annual revenues exceeding $4million, will require formal exit planning in the next 10 years.

1. Pew Research Centre 2015
INSIGHTS IN EUROPE AND AFRICA

In Switzerland, 70,000 small companies (around 12%) of all privately owned businesses are expected to change ownership in the next 10 years. The Swiss market has seen an early increase in businesses for sale, in line with expectations. However local M&A advisors report that business owners do not see the increase in numbers of companies for sale as a concern, because they are confident in the high quality of their products and the richness of the Swiss industrial infrastructure.

Their confidence also comes from the fact that Swiss SMEs derive an average of 30%-40% of their business from exports. In a country where only one in 300 companies has more than 200 employees, privately owned Swiss companies with a turnover greater than 10m CHF ($10m US) expect any likely acquirer to be international.

In South Africa, the driving forces are different. Major political and economic changes are having a significant impact on private business owners and their attitudes to selling their businesses.

Andre Bresler, Director, BCMS South Africa said: “[Statistical institute] Statistics South Africa estimates that 841,000 people left the country between 1995 and 2005. Many private company owners do not have family succession planning in place, they are also looking to emigrate to be with their children and grandchildren during their retirement years. This is likely to have a strong impact on the supply of companies for sale in the coming years.”

Evidence from countries around the world suggests that business owners are being influenced by a number of factors. Many recognise that to sell their companies for the best price, several years of documented growth are needed. Companies emerging from recessionary conditions or periods of restricted growth may have a less attractive financial history, and owners are waiting for business to improve before they sell.

“Entrepreneurs are choosing to work longer if they don’t believe the economic climate is right to sell”

Derk Kropholler, BCMS Benelux
SNAPSHOT: THE CLASS OF 2016

The following table anonymously profiles 10 UK business owners who sold this year through BCMS, alongside their stated reasons for selling. Interestingly, the majority are entrepreneurs who personally established the businesses they have now sold, and the average length of time served with their business was over 15 years.

<table>
<thead>
<tr>
<th>SECTOR</th>
<th>MAJOR SHAREHOLDER AGE</th>
<th>STARTED BUSINESS?</th>
<th>YEARS WORKING IN COMPANY</th>
<th>REASON FOR SALE?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail</td>
<td>49</td>
<td>Yes</td>
<td>15+</td>
<td>To allow business to grow faster</td>
</tr>
<tr>
<td>Food</td>
<td>59</td>
<td>No</td>
<td>20+</td>
<td>Timing – other deals in the sector</td>
</tr>
<tr>
<td>Design / manufacture</td>
<td>47</td>
<td>No</td>
<td>15+</td>
<td>Business requires backing of larger organisation</td>
</tr>
<tr>
<td>Construction</td>
<td>60</td>
<td>Yes</td>
<td>25+</td>
<td>Chosen retirement age</td>
</tr>
<tr>
<td>Engineering / design</td>
<td>54</td>
<td>Yes</td>
<td>25+</td>
<td>Lost appetite to run business</td>
</tr>
<tr>
<td>Commercial manufacturing</td>
<td>68</td>
<td>Yes</td>
<td>15+</td>
<td>Chosen retirement age</td>
</tr>
<tr>
<td>Engineering</td>
<td>52</td>
<td>Yes</td>
<td>20+</td>
<td>Retirement – other directors wishing to stay</td>
</tr>
<tr>
<td>Business services</td>
<td>53</td>
<td>Yes</td>
<td>10+</td>
<td>Planned exit strategy – started business to sell</td>
</tr>
<tr>
<td>Retail</td>
<td>46</td>
<td>Yes</td>
<td>5+</td>
<td>Planned exit strategy – started to sell</td>
</tr>
<tr>
<td>Machining</td>
<td>62</td>
<td>No</td>
<td>40+</td>
<td>Retirement – lack of succession</td>
</tr>
</tbody>
</table>
IS THE NEXT GENERATION READY?

Many of the potential buyers of private companies are members of Generation X, those born between 1965 and 1985. Now between 30 and 50 years old, they are the natural successors to take on the leadership of companies created by the previous generation. However there are concerns that they may be unprepared, or unable financially to raise the funds necessary to take on established companies.

A number of factors have changed the landscape for this next generation of potential business owners.

The structure of education during the ’70s, ’80s and ’90s changed, and the percentage of the population attending university in many developed countries rose. The result is that many people started paid employment later. In some countries, loans and charges for higher education, introduced in the ’80s and ’90s, have left graduates from Generation X with increased levels of debt. This has been compounded by the rising cost of housing and more restrictive lending conditions.

Additionally, the levels of unemployment among the under 25s in many countries between 2008 and 2015 were unusually high, meaning that many graduates have had fewer earning years in which to build up financial resources.

The combined result is that a smaller proportion of Generation X has the equity and financial resources necessary to secure commercial loans.

“The next generation may be unprepared or unable financially to raise the funds to take on established companies.”

UNDERSTANDING THE GENERATIONS

<table>
<thead>
<tr>
<th>THE SILENT GENERATION</th>
<th>BABY BOOMERS</th>
<th>GENERATION X</th>
<th>MILLENNIALS/GENERATION Y</th>
<th>GENERATION Z</th>
</tr>
</thead>
</table>
KEY CHALLENGES FOR BUSINESS OWNERS

This chart, generated from a 2016 BCMS survey of UK business owners, offers clear insight into the issues that impact on business owners on a day-to-day basis. Finding and keeping staff and the demands of bureaucracy/regulations make up two of the three responses – factors typically beyond a business owner’s direct strategic control, and key reasons cited for seeking a sale.

- Competitive marketplace: 47%
- Finding and keeping good staff: 41%
- Red tape / bureaucracy: 39%
- Finding new customers: 37%
- Dealing with client expectations: 22%
- Maintaining quality and efficiency: 20%
- Lack of budget: 15%
- Technological changes: 14%
- Other: 8%

Source: BCMS Survey of business owners, May 2016. Respondents were allowed to choose multiple categories.
The global recession of 2008 – 2010 and the subsequent banking crisis resulted in a tightening of credit available to small & medium sized businesses. Banks dealing with increased bad debt, more stringent regulation and higher capital demands have become more risk-averse and this has impacted the funds available to small and medium enterprises (SMEs).

For many small business owners, access to capital funding when buying an existing business is essential, as it is for investing in, growing and expanding a business through its different stages. For a capital-light generation, the opportunity for business ownership in the current financial climate may depend more on personal private financial resources than on entrepreneurial ability.

The tightening of credit is demonstrated by statistics from the British Bankers Association that show bank lending to small UK businesses fell from £49.8bn ($71.6bn), in April 2011 to £37.4bn ($53.8bn), in Q4 2015. This was despite government efforts to support small businesses through targeted lending. One example is the Funding for Lending scheme by the Bank of England that has made additional funds available with which the banks can support the SME sector. As a result net lending to SMEs in the UK rose slightly in 2015.

Where balance sheets justify it, private equity funding has also remained generally available. In the UK, Steve Anstey, Director at BCMS commented: “Private Equity is still active, using more equity than was the case pre-credit-crunch, but still has access to debt fairly readily.”

Elsewhere in Europe, commercial credit has become less easily available. Lenders are requiring more detailed business plans and performing more stringent due diligence checks. Less flexibility of terms is also evident, with some lenders being unwilling to amend business plans and loan agreements within a year of the original approval.

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1. Bank support for SMEs. British Bankers Association www.bba.org.uk
In South Africa, the availability of commercial credit has tightened in line with other regions. However government support exists for some commercial loans under the Black Economic Empowerment (BEE) legislation that enables BEE acquirers to access much higher levels of debt with less stringent security arrangements.

Across markets in general, where the availability of credit has reduced the number of outright buyers, succession strategies that reflect these conditions have grown in popularity. Partial sales have allowed business owners to mitigate risk while retaining a stake in the business. Owners can realise some of the value from the business while the new shareholder brings fresh ideas, skills, funding and energy. Management buy-outs (MBOs), buy-ins (MBIs) and combined arrangements (BIMBOs) have all become more frequent.

“Commercial credit has become less easily available. Lenders are requiring more detailed business plans and performing more stringent due diligence checks”

**WHO IS BUYING BUSINESSES?**

The chart below shows the breakdown, by general acquirer type, of BCMS clients between January and May 2016. Traditionally, privately owned business sales have been fuelled by larger trading organisations acquiring strategic targets. That is why it is particularly interesting to note the substantial proportion of financial buyers of SME businesses. M&A is also an international industry: around 30% of BCMS UK clients sell to an acquirer based or headquartered overseas.

*Financial buyer category includes sales to Private Equity, private investors and MBO/MBI deals

Source: BCMS analysis – global deals, Jan-May 2016

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CAN YOUR TEAM TAKE OVER?

In the UK, 63% of small business owners are over 50. Of those over 60, little more than a third (36%) agree that they have a clear succession plan – this means they have identified an individual, management team or other organisation who will ultimately take over the business. The remaining two thirds (64%) have no clear plan and most (60%) do not expect to resolve the issue in the next five years.¹

Steve Anstey of BCMS UK comments: “Those motivated by retirement are probably less concerned about the right market conditions to sell and more about exiting at a time that suits their lifestyle planning. A related factor is whether their business is worth whatever is needed to afford the desired post-sale lifestyle.”

Many SMEs recognise that their lack of preparedness for business transfer is a challenge. In the UK, over half (56%) of respondents to an Economist Intelligence Unit survey agree that SME owners wait too long before thinking about succession planning. The impact of procrastination is even more apparent to those currently dealing with the retirement of the business owner or who expect to do so in the next five years – almost two thirds (64%) believe that SME owners wait too long to figure out succession.

Derk Kropholler of BCMS Benelux sees evidence of the same trends in the Low Countries. “It seems that entrepreneurs are choosing to work a bit longer if they don’t believe the economic climate is right. With interest rates being so low, they question whether taking their funds out of a business makes sense.”

Improving health in later age is an influence on business owner behaviour, evident in the US where the traditional retirement period is being pushed out as people live longer. The prospect of retirement is less and less attractive to many owners who are still capable of running their companies.²

There is some evidence that some business owners put off making succession plans because they wish to involve family members but are unable to achieve the necessary commitment.

¹. Economist Intelligence Unit
Jonathan Dunn, Head of Major Transactions Group at BCMS commented: “There seems to be a theme that family succession plans are getting more difficult to establish. Younger generations are more focused on the wider opportunities rather than being seemingly locked in to the family business.”

It is clear that the factors influencing succession planning within privately held businesses vary widely, by country and by sector. Expert advice specific to individual circumstance is essential for those planning to exit in the medium term.

“Don’t wait until you get too old, when you have to sell. If you do, the buyer will sniff that and you are automatically on the back foot.”

Andrew Sesemann, former owner of Cox Agri
ARE BUSINESS OWNERS PLANNING AHEAD?

BCMS asked its new clients for 2016 one key question: “Do you have a clear management succession plan in place?” Interestingly, only one in five respondents have actively developed a second tier of management to control day-to-day operations of the business. A further 20% had identified key individuals, who could, with time and training, take over operations.

Typically, acquiring organisations are risk averse and will not want to see over-reliance on shareholding directors in their target businesses. A business that is well prepared for sale in terms of financial planning, administration and future strategy is likely to be more attractive to an acquirer, and a strong management team can often be a positive selling point.

“We grew the business, but we knew we would give it 5 to 8 years, then look to exit”

Deborah Richards, former owner of Travel Point Trading, who sold her business to Amey plc after 10 years’ trading.

Source: BCMS Research 2016
The analysis provided here can only give a snapshot in time, of companies in different markets dealing with a unique set of commercial and demographic conditions.

There is a widely held belief that the baby boomer generation has benefitted from a fortuitous combination of economic growth, political stability and technological advance. However for those who have spent a lifetime building a business, the best way to capitalise on that investment will vary depending upon individual circumstance.

Below are some of the key questions that will assist you in the decision-making process.

• What is really important to you as an individual?

• What is happening in your sector? Check your specialist trade media – is there increased deal activity? Could this be the best time to sell in your market?

• If you stay with the business, will you have greater potential for a higher sale price in future?

• Do you have a good management team who will enable you to stay involved, if you reduce your role?

• If you are happy to continue as an owner, is there scope for further growth beyond the next two years?
If other business owners are holding back, is it better to sell now before a large number of companies are offered for sale?

Have you considered a partial sale to realise some investment now and to mitigate risk?

How can you as a business owner assess your readiness for sale?

Should you begin to prepare your company for sale and then hit the market?

Are you willing to work through a transition period? If so, for how long?

If the questions above have provided food for thought and you would like to discuss the options and tactics best suited to your particular circumstances, you can always discuss your specific situation with a BCMS business strategy advisor.

“Put your house in order. You will get more for your business, the cleaner your business is.”

Robert Spenceley, former owner, South Lincs Food Services
EXECUTIVE SUMMARY

• Ongoing strong demand for growing, specialist business from multiple acquirer types
• Clear evidence many older business owners are postponing seeking a sale
• Relatively few SME business owners have a clear ‘exit strategy’ in place
• The next generation of business owners may not have adequate access to funding
• Expected global increase in the number of businesses offered for sale in coming years
• Effective preparation gives business owners a clear advantage when seeking sale
ABOUT BCMS

BCMS is a specialist lead advisor to shareholders of private companies. The company is a market leader in its chosen area of expertise, having completed over 500 deals in the last decade alone. BCMS is the world’s leading advisor to privately owned companies by deal volume, according to data disclosed to Bureau van Dijk’s Zephyr database.*

A family business, professionally run, BCMS has grown substantially since it was first established in 1989. Much of its international expansion has taken place in the last five years: BCMS has established offices across five continents and the company now employs 260+ staff.

* Source: BvD/Zephyr. BCMS tops the ranking search that includes completed deals in all value ranges by volume in the period 1 January to 31 December 2015, and specifies completed acquisitions, Management Buy-Outs (MBOs), and Management Buy Ins (MBIs) for private (non-publicly listed) companies. Search date: Jan 7 2016.

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