



## The Exit Strategies Newsletter

### *Some Exit Planning Statistics to Consider*

Business owners are well served in understanding the market forces that will likely impact their attempt to successfully exit their business. In 2009, Richard M. Trottier published a ground-breaking book titled *Middle Market Strategies*. The statistics that are provided in this newsletter are drawn from Richard's book and are presented here to paint a picture of how dramatically the small business marketplace has changed in the last twenty to thirty years and to help you draw some conclusions on how these changes may impact your plans for a successful exit.

#### **Transfer Trends**

Richard begins Chapter 10 of his book with the following quote:

"The number of middle market businesses will have doubled between 1980 and 2010. Transfers will have tripled . . . it is safe to say that the middle transfer market is become more mature . . . in the sense that it better addresses the needs of its participants, at least those participants who know how to use it to their best advantage." Trottier goes on to state that "the business transfer market now has more of everything: more deals, more buyers, more sellers, more transfer methods, more complexity, and more of each developing." It is clear that this is a fluid marketplace with many changes. Let's begin

by looking at some trends from the past 30 years.

#### **Key Trends That Could Impact Your Exit Plans**

One of the first concepts that an exiting owner needs to embrace for a successful exit is the shape of the market that surrounds them and by examining the trends in that market it helps to understand it better.

#### **Some Numbers Behind the Baby Boomer Trend**

The first [more obvious] trend that owners need to be aware of is the surge of retiring baby boomer owners. To put this trend in perspective, Trottier writes "the number of mid-market business transfers doubled in the 22 years between 1980 and 2002. It is likely to double again in the eight years through 2010. We estimate that there were a maximum of 10,000 mid-market business transfers of all kinds in 1980. In the year 2010 they may reach 38,000. The number of transfers is growing faster than the number of businesses."

To support these statements, Trottier offers a measurement of the middle marketplace as those businesses with \$5 million to \$500 million in revenue. He estimates that there are 300,000 of these businesses. He further states that "in 1980, the middle market had

an estimated \$635 billion in shareholder equity. It will reach \$1.5 trillion by 2010.”

Trottier also points out that an avalanche of capital has come into the U.S middle market to support this growth. He states that “total middle market capitalization will rise from an estimated \$1.8 trillion in 1980 to \$4.2 trillion by 2010.” These capital providers create more complexity as owners need to know these sources and understand which ones are most appropriate for their growth and transfer needs. This is no longer the province solely of the community banks.

#### Private Equity Groups (“PEGs”)

One of the leading sources of capital in the transfer markets is private equity. “In 1980 individual owners held about 91 percent of market equity; by 2010 they will hold only about 59 percent.”

He goes on to state that “we estimate that PEG investment in the mid-market in 1980 was \$57 billion – at most. By conservative estimates it will reach \$600 billion in 2010.” Another way to look at this change is to see that “PEGs controlled 10 percent of total private mid-market capitalization in 1980. They may control 48 percent by 2010.” In terms of numbers, Trottier estimates that “[PEGs] already own 30,000 to 35,000 of the 300,000 middle market companies, including many of the larger, top-performing firms.”

Underlying these new investors is another dynamic that is relatively new – an active and growing secondary market for the purchase of businesses bought by PEGs. You see, once a private equity group invests in a business, the mandate is [most often] to sell that business again in another 4 to 7 years at a higher price. Therefore, the PEG purchase today is going to lead to a cycle of

increased transfers in the future, creating more competitive pressure for your day-to-day business as well as a more competitive market for you to sell into when it is your time to exit.

Trottier concludes with a message to owners unaware of these changes . . . “Gone are the underfinanced, struggling family businesses of days gone by. They’ve been replaced by well-financed, professionally managed, very aggressive competitors who are out to redefine markets.”

Knowing about these changes to the market may help inform you as to how you might successfully transition your business. You may find that you need to get to know these groups better or you may choose otherwise.

#### What About Keeping the Business in the Family?

Many owners react to the news about the changing external transfer marketplace and think that they’ll avoid this by selling to their family members. Trottier writes: “conveying full business control within a family represented about 30 percent of all transfers in 1980. This type of transfer may be as low as 15 percent of all transfers in 2010, depending on market conditions.” Trottier concludes that “family transfers declined 50 percent in one generation”.

Owners who are thinking about an internal transfer need to also navigate the generational divide and the different work ethics that are instilled in the next generation. Simply put, it appears that junior simply does not want to waste his expensive education on distributing widgets for the rest of his life. Further, junior sees how hard Dad works and is not aligned with this ‘career path’ either. If you were / are thinking about a transfer to family members,

you may want to review these statistics and changes in attitudes to check the validity of many assumptions that you may be holding onto.

### **Concluding Thoughts**

As mentioned, you wear many hats in the day-to-day running of your business. The statistics presented in this newsletter represent an ever-changing marketplace for smaller businesses. There have certainly been many significant changes to the middle marketplace in the last 30 years, many of which will likely impact your business plans as well as your plans for a successful exit. We hope that these statistics provide a basis for further examination as to how you will achieve a successful exit in the future.

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