

Boomer retirement will not put small business out of business

Executive summary

During the next decade, half of Canadian small business owners over age 45, with a maximum of 10 employees, are planning to retire.¹ Since this sector plays a significant role in driving the Canadian economy, it has been widely suggested that these retirements will have serious negative repercussions. However, the BMO Retirement Institute believes the impact could be reduced because of the following four factors:

1. increased incidence of succession planning by small businesses could minimize the number of business closures upon retirement;
2. recession economics are prompting boomer small business owners to delay their exit;
3. retiring boomers will swell the ranks of the self-employed; and
4. the overwhelmingly positive experience of entrepreneurs will influence others to start their own businesses.

For these reasons, the Institute postulates that the predicted retirement of significant numbers of small business owners will not have a devastating impact on the Canadian economy.

The BMO Retirement Institute was established in 2008 to provide thought-provoking insight and financial strategies for those individuals planning for, or currently in, their retirement years.

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Four in ten said they plan to close down their business when they fully retire.

Retirement looms for business owners

The Canadian small and medium business sector (SME)² drives Canadian economic growth, employment and innovation. Small businesses employ approximately five million people in Canada and those with fewer than 50 employees contributed 26 per cent of Canada's GDP.³ The impact this sector has on the Canadian economy is quite significant considering seventy-five per cent of small Canadian businesses have fewer than 10 employees.⁴ Of concern is that most small business owners are between the ages of 45 and 70.⁵ A recent BMO Retirement Institute (the Institute) survey took a closer look at these businesses and found that during the next decade, half of Canadian small business owners over age 45, with a maximum of 10 employees, are planning to retire.

It is widely believed that their mass departure could represent a significant threat to the economy, the survival of their businesses, and the livelihood of the people they employ.

However, the BMO Retirement Institute believes the retirement of significant numbers of small business owners will not occur to the extent that it will have a devastating impact on the Canadian economy and postulates that the effects could be reduced based on four mitigating factors: increased incidence of small businesses engaging in succession planning; boomer business owners delaying their exit given economic conditions; retiring boomers turning to self-employment, and the positive experience of entrepreneurs influencing the future generation of small business owners.

Retirement does not have to mean shutting down

Business owners devote a significant amount of time, energy and money to develop their business, but it appears that owners regard their business as a finite entity that will not exist once they depart. So when owners contemplate retirement, they simply see it as a cessation of their business, with no one else qualified or wanting to take over the reins. In fact, the Institute found that many small business owners will simply walk away from their businesses. Most business owners fail to recognize the importance of creating a succession plan both from a personal and business perspective. Based on this viewpoint and lack of planning, they tend not to explore potential viable courses of action such as selling the business to someone else, including employees, apprentices or competitors or transferring the business to family members when exiting the business.

53 per cent have never given thought to succession planning.

Small business owners are not adequately prepared for succession and almost one in five said they do not know what will happen to their businesses when they retire. In addition, the Institute also revealed that only nine per cent of those surveyed said they have a formal⁶ succession plan in place and 21 per cent indicated their plan was informal⁷. Not having a formal succession plan is common regardless of the size of the business or the age of the business owner. In 2005, the Canadian Federation of Independent Business (CFIB) found the majority of SME owners⁸ are also not adequately prepared for succession: only seven per cent had a formal written plan. Sixty-five per cent had no succession plan at all.⁹ The incidence of succession planning has increased slightly since then. In 2006, the CFIB reported a three per cent¹⁰ increase in the number of SMEs having a formal succession plan in place.

The process of succession planning should begin well in advance of the target retirement date as it often takes years to develop a comprehensive plan. A smooth business transition requires a formal succession plan that outlines a retirement timetable and the estimated value of the business, as well as potential successors or purchasers. If the general intention is to pass the business on to children or family members, they may or may not have the drive, expertise and desire to carry on. And if they do want to take over the business, their views of what the business should look like can vary considerably from those of the founder. This partially explains why family businesses rarely succeed¹¹ beyond the first generation.¹²

Succession planning benefits both business owners and successors. With a formal succession plan, options and strategies that may be available to the business owner would be identified. The CFIB reported the majority of SME owners whom had a succession plan agreed to the benefits of planning in advance. Moreover, the majority of successors surveyed agreed that succession planning prepared them for the future as business owners and that succession planning on the part of previous owners provided financial stability to the business.¹³

Retiring from business ownership is not a step to be taken lightly given the complexity of the process and the personal financial impact on the business owner. Lack of planning has an impact not only on the business owner but also on the Canadian economy. The BMO Retirement Institute believes that having a proper succession plan or exit strategy in place could lower the risk of small businesses closing down or failing once the owners retire.

Four in ten small business owners have revised their retirement date.

Delayed Retirement slows impact

Small business owners, over age 45, are working longer. This decision is partially influenced by boomers' unique attitude toward aging and work, as well as the impact of recent economic conditions. Boomers place a high priority on living a vigorous and robust life as they age, and express a strong desire to continue being actively involved and engaged in the world.¹⁴ This desire often translates into working past the usual retirement age. More recently, the economic turmoil has caused some business owners to consider working longer to secure a steady income stream and to rebuild retirement assets.

Small businesses are not immune to volatility in the economy. Overall, the Institute found that the recession has had a negative impact on the bottom line of 56 per cent of small businesses. From a personal perspective, four in ten small business owners over age 45 indicated the recession has caused them to revise their retirement date. If the attitude towards working longer lingers even as the recession eases, it will serve to reduce the number of small business owners who will retire within the next 10 years, thereby easing the expected impact on the economy.

While the idea that small business owners will be working longer is good news for the economy, it is still a concern that some owners do not seem to have a retirement plan. Almost one in five small business owners (16 per cent) feel they have to revise their retirement date but are unsure by how long. As noted earlier in this report, lack of planning could have a negative impact on both the business owner and the Canadian economy since owners who now plan to work longer will eventually retire one day. The Institute believes educating small business owners on the importance of having a succession plan is necessary to ensure the future well-being of the Canadian small business sector.

Positive Trend to Self-Employment

Self-employment among all age groups – not just boomers – has grown faster than total employment over the past three decades. For the most part, self-employment is not precipitated by job loss or an economic recession. The decision to become self-employed is a deliberate choice taken voluntarily.

Individuals may be drawn towards entrepreneurial activity for a number of reasons. The BMO Retirement Institute found that 52 per cent of those surveyed indicated the main reason for starting or

One in three small business owners running a business for less than 10 years started their business either when they were approaching retirement or during retirement.

One-third spoke to a professional or financial advisor before starting their businesses.

running their own business was the desire to work for themselves and only 11 per cent indicated they started their business following a job loss. Therefore, it comes as no surprise that between 1990 and 2008, growth in the number of self-employed individuals was seen mostly among those aged 55 years and more than doubling from 350,000 to 723,000.¹⁵

While the recession is affecting business as a whole, over the past 20 years the number of small businesses has been growing during economic downturns, as well as during periods of economic growth.¹⁶ Recent BMO Economics research¹⁷ confirmed this trend and indicated that self-employment does not spike during recessions, but tends to increase at a steady rate, no matter what is happening in the economy. If the positive trend to self-employment continues, it will lessen the impact of small business owner retirements to the Canadian economy. Moreover, with more boomers possibly engaging in self-employment post-retirement, the Institute speculates that Canada could well experience a boom in new businesses as the oldest members of the largest cohort in history are about to turn 64.

The anticipated growth in self-employment could help maintain the Canadian small business sector, but the decision to become self-employed requires prudent planning. While this may appear self-evident, just one-third of business owners spoke to a professional or financial advisor before starting their businesses.

For those who are approaching retirement, or who are already retired, starting a new business is not a step to be taken lightly. Many small business owners report that self-employment demands more hours of work, affords less sleep and entails more stress than working for someone else. With freedom comes the responsibility for the ultimate success or failure of the business and the well-being of those who are financially dependent on its profitability. Add to that the potential lack of expertise in running a business and the uncertainty of being able to earn income, and retirement may not be the optimal time to start a new business.

However, purchasing a well-established business from a retiring owner may be more appealing. Retiring owners who sell their businesses may have the opportunity to mentor their successors. This could prove financially and emotionally rewarding for both parties. The economy also benefits immeasurably from an untapped resource of experienced small business owners who are able to guide and advise the next wave of entrepreneurs, while at the

92 per cent
said they would
do it all over again.

same time reducing the number of business closures as current owners retire.

Another important consideration is how the business will be funded. Since the most commonly cited source for funding a new business is a withdrawal from personal savings (42 per cent) or taking out a loan (21 per cent), seeking professional financial advice is a wise course of action. The withdrawal of funds from retirement savings plans, such as RRSPs or RRIFs, can have a lasting effect on an individual's retirement lifestyle. Depending on the size and timing of the withdrawals, these retirement plans may be depleted much sooner than anticipated, resulting in less money to fund a desired retirement lifestyle. Finally, the possibility that the business venture simply may not succeed underlines the importance of seeking professional advice – especially when personal savings are the primary source of funding.

The Enduring Appeal of Business Ownership

Enthusiastic entrepreneurs are exerting a persuasive influence on those who are considering starting their own business. Satisfied business owners convey the message that opportunities await those who are willing to take a risk by becoming a business owner. As they look back on their own experience, most business owners reported that they would happily do it all over again while others indicate they will never retire or that retiring from their existing businesses means they will be able to mull over another new business venture. Employees who are on the cusp of retirement from traditional jobs, on the other hand, may also be receptive to this message and represent a mother lode of potential business owners. This is especially true of baby boomers who do not view retirement as retreating to a rocking chair on the back porch.¹⁸ They intend to chase their dreams, which may very well include starting or running their own businesses.

This is good for the Canadian economy because it shifts the pressure of job creation away from large enterprises and promotes innovation from a diverse pool of talent. In fact, the Institute believes boomer small business owners will pass the baton to their cohorts who are retiring from the traditional work force.

Conclusion

The retirement of Canadian business owners over the next 10 years will shape the future of small business in Canada. Despite widespread concern that these retirements will create serious

repercussions to the Canadian economy, four factors have the potential to slow or lessen its impact.

In examining the current behavior of small business owners over age 45, with a maximum of 10 employees, it is clear that they are not strategizing their exits. Creating a comprehensive succession plan can greatly increase the odds of success and maximize the personal, professional and financial benefits for both the business owner and the successor. The Institute believes having a formal plan in place could educate owners to recognize that business closure at retirement is not the only option for them.

Secondly, the fact that the recession has caused many business owners to consider working longer than they had planned means the owners will not retire all at the same time, thus creating a lesser impact to the economy. In addition, the BMO Retirement Institute believes the economy will benefit from lifelong boomer employees turning to some form of self-employment which will further ease the pressure of small business owner retirements. Finally, there is no reason to believe that the Canadian entrepreneurial spirit would come to an end with boomer business owner retirements. Satisfied business owners are exerting a persuasive influence on those who are considering starting their own business. This will help refresh the small business ranks with a diverse pool of young people, immigrants, women and retiring boomers who are eager to start their own business. Advisors such as accountants, lawyers and bankers have a role to play in encouraging and guiding individuals to consider options available when entering or exiting business ownership.

- (1) BMO Retirement Institute Small Business Survey, Harris/Decima, August 2009. Unless indicated otherwise, all survey results are the BMO Retirement Institute Small Business Survey conducted by Harris/Decima in August 2009. This survey was based on Canadian small business owners (sole-proprietors or co-owners) who are at least 45 years of age and run a business with a maximum of 10 employees.
- (2) The small and medium sector includes small business with less than 100 employees and medium size businesses with 100-499 employees. "Self-employment" refers to a business owner with no employee payroll.
- (3) Key Small Business Statistics, Industry Canada, July 2009
- (4) Key Small Business Statistics, Industry Canada, January 2009
- (5) Small Business Quarterly, Volume 10, No. 4, February 2009
- (6) "Formal succession plan" means that you have consulted with a professional such as a lawyer, or accountant and you have documented your succession plan
- (7) "Informal succession plan" means that you have not consulted with a professional and you have not documented your succession plan; however, have considered/discussed your general plans with friends, colleagues, or family members
- (8) SME businesses with fewer than 500 employees.
- (9) Succession Can Breed Success, CFIB Research, June 2005
- (10) CDN: SME Succession: Update, CFIB Research, October 2006
- (11) One-third survived to the second generation and only 15 per cent into the third.
- (12) Business Transition, CIBF, May 2004
- (13) Succession Can Breed Success, CFIB Research, June 2005
- (14) State of the Baby Boomers Report, conducted by The Strategic Counsel for the BMO Financial group, June 2006.
- (15) Small Business Quarterly, Volume.10, No. 4, February 2009
- (16) Industry Canada August 2009 Volume 11, No. 2
- (17) Economic Research: Self-Employed ≠ Unemployed, BMO Capital Markets, May 2009
- (18) State of the Baby Boomers Report, conducted by The Strategic Counsel for the BMO Financial group, June 2006

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