

Are Canadian Entrepreneurs Ready For Retirement?

Canadians are aging, and Canadian entrepreneurs are aging even faster. The number of self-employed who are nearing retirement (ages 55 to 64) has been rising rapidly in recent years, growing by a whopping 7.5 percent annually since the beginning of the decade. This is double the growth rate seen in the 1990s. One-fifth of small business owners (or more than 500,000) are planning to retire within the next five years, and another 30 percent will retire by 2020. That is, within the coming 15 years, more than half of the country's current small business owners are expected to retire.¹

Chart 1
Retirement Fast-Approaching for Entrepreneurs

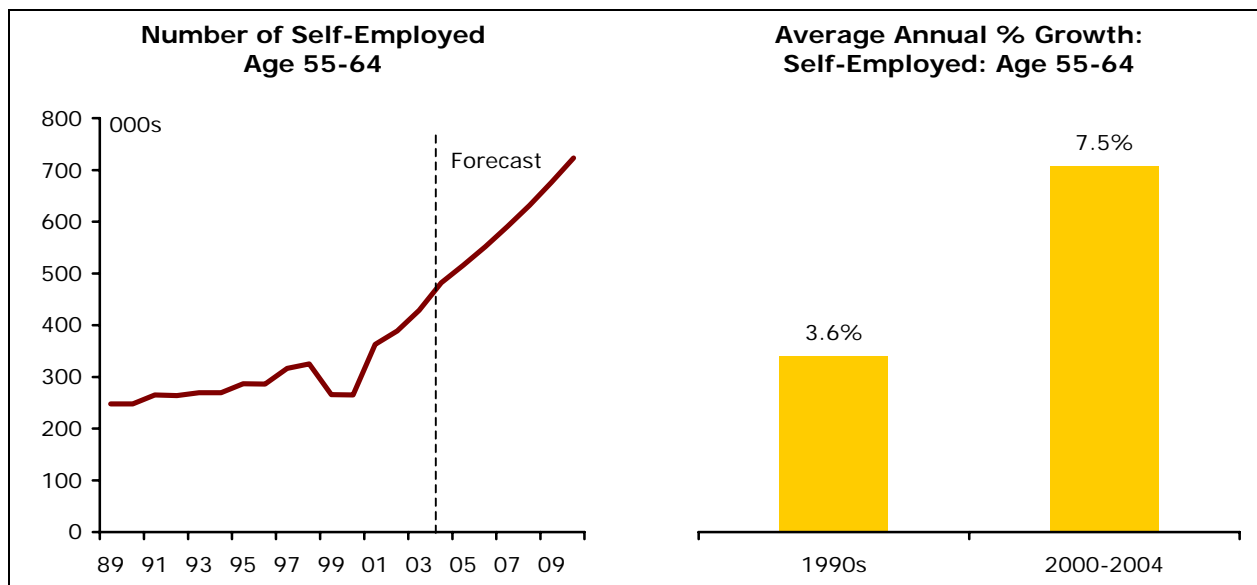
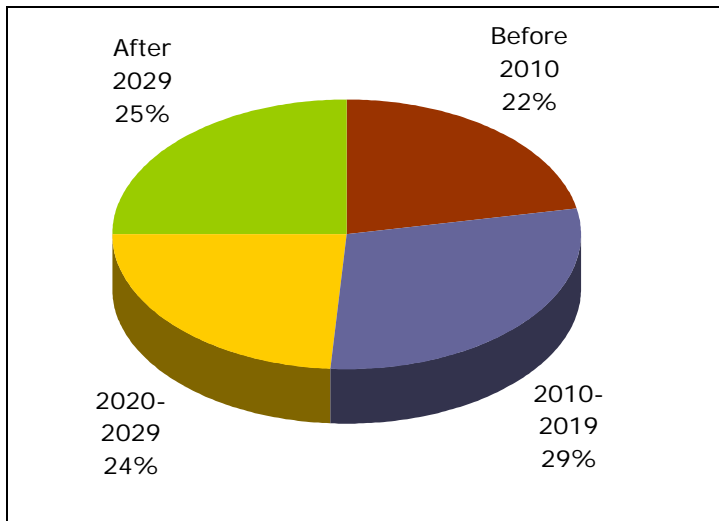


Chart 2
Projected Retirement Date for Entrepreneurs

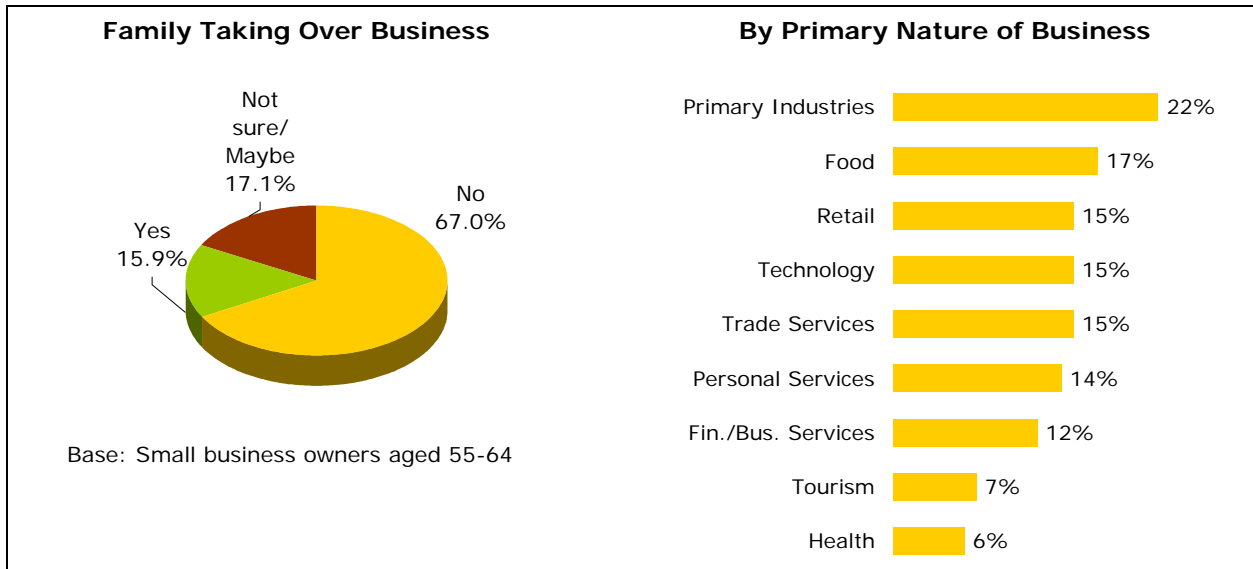


\$1.2 Trillion In Business Assets Poised To Change Hands By 2010 — Succession Planning Is Critical

The economic implications of the accelerated pace at which Canadian entrepreneurs are expected to retire should not be underestimated. The demographic realities of Canada in general, and the small business sector in particular, suggest that succession planning is increasingly becoming a critical issue. By the end of the decade, an estimated \$1.2 trillion in business assets are poised to change hands — the largest turnover of economic control in generations. Accordingly, faulty succession planning could have significant economic costs resulting from reduced productivity, job losses, premature sales and increased bankruptcy rates. Yet, only two in five small business owners have a clear plan for exiting their businesses. Moreover, at this stage of the game, a small business principle strength — the reliance on the human capital of the owner in almost every aspect of the business — is also becoming its primary weakness, since it means that adequate succession planning requires time that is often measured in years, not days or months. Still, 60 percent of entrepreneurs aged 55 to 64 have yet to start discussing their exit plans with their family or business partners.

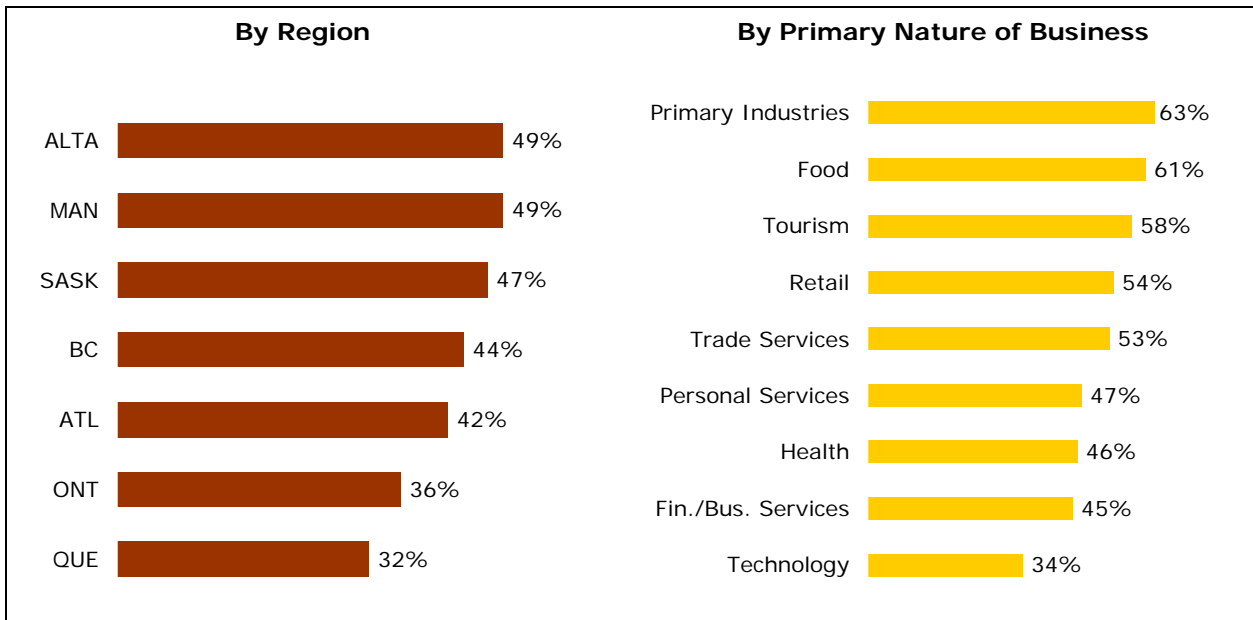
Note also that, among small business owners age 55 to 64, only about 15 percent have definite plans to transfer or sell the business to a family member (mostly to their children). Not surprisingly, business owners in the primary industries (such as agriculture, mining and forestry) show by far the highest propensity to transfer their businesses to a family member, followed by food and retail businesses.

Chart 3
The Next Generation of Family Businesses



Another 40 percent of small business owners plan to sell their businesses to outside interests², with entrepreneurs in Alberta and the Central Prairies showing the highest level of intention to sell, likely reflecting the high concentration of small firms in the primary industries sector in this part of the country. Self-employed in Ontario and Quebec are less likely to sell their business — not surprising, given the dominance of service-oriented businesses where the owner is, in fact, the business.

Chart 4
Planning to Sell the Business

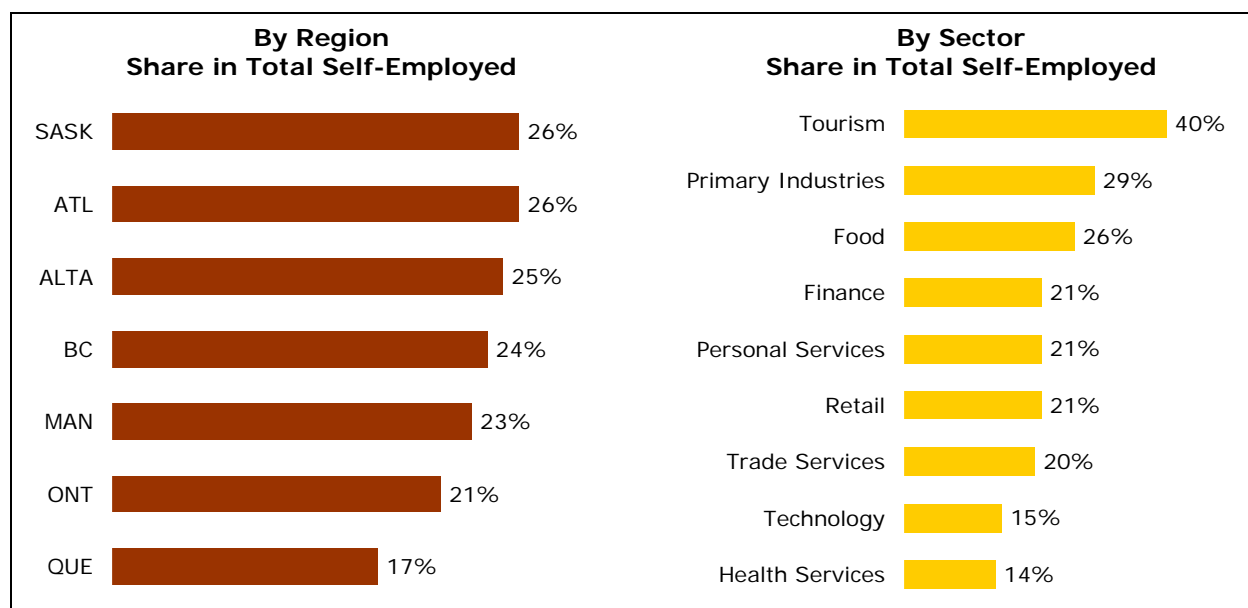


Entrepreneurs Closest To Retirement

Considering the entrepreneurs who plan to retire by the end of the decade, there seems to be a very slim margin separating the regions other than Quebec. Small business owners in Saskatchewan, Atlantic Canada and Alberta are most eager to retire, with around one quarter of them planning to exit the labour market within the next five years. Only two provinces, Ontario and Quebec, fall below the 22 percent national average of small business owners planning to retire by 2010. The heavier concentration of entrepreneurs in service and technology-oriented businesses in these provinces, which are less physically demanding, may account for these small business owners not being in a rush to retire.

Looking at the entrepreneurs who plan to retire by the end of the decade by sector, those in tourism have the highest rate of self-employed approaching retirement, followed by those in primary industries and food. By contrast, only one in six self-employed in the technology sector plan to retire by the end of the decade. This reflects not only the relatively young age of those who operate in this field, but also the fact that the vast majority of these businesses are SOHOs (Small Office/Home Office).

Chart 5
Entrepreneurs Planning to Retire By the End of the Decade



How Prepared Are Canadian Entrepreneurs For Retirement?

Beyond the macroeconomic implications of small business succession, another important concern is the microeconomic ramifications for the small business owners themselves. More specifically, to what extent are entrepreneurs financially ready for retirement? To be sure, optimism is a key ingredient for a successful entrepreneurial career. And indeed, in survey after survey, small business owners reveal this inherent optimism. But how realistic are their retirement plans?

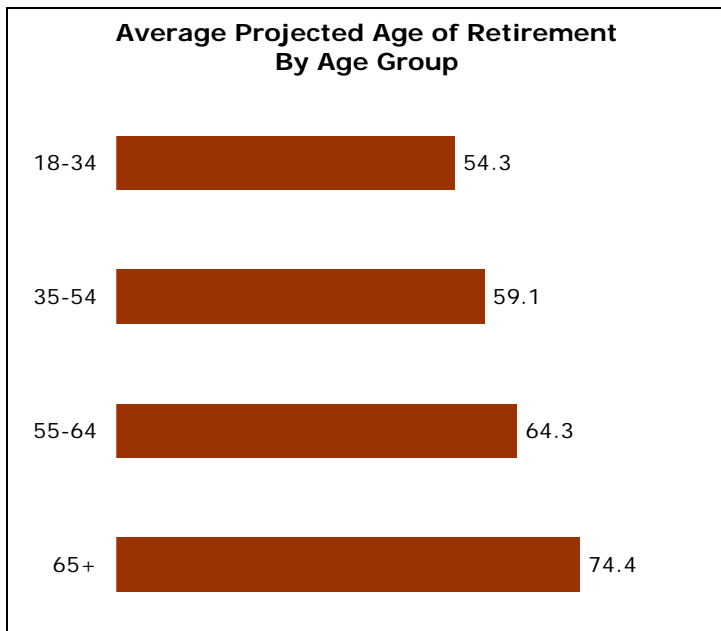
It turns out that, at times, there is a gap between plans and reality. As highlighted in our recent study — *Canadian Small Business: Back in High Gear* — the number of post-retirement age self-employed who are still working is on the rise.

Chart 6
The Number of Self-Employed Over Age 65 is Rising Fast



Furthermore, it appears that younger entrepreneurs are much more optimistic about their projected retirement age, with self-employed under the age of 35 expecting, on average, to retire at the age of 54. At the same time, those self-employed between the ages of 35 and 54 believe that they will retire at the age of 59, which is much closer to the actual average retirement age of 62 for entrepreneurs. This, combined with the finding that almost one in three small business owners does not have a good sense of his/her planned retirement age, and there is a real reason to believe that for many Canadian entrepreneurs a worry-free retirement is not exactly a certainty.

Chart 7
Retirement Age – A Moving Target for Canadian Entrepreneurs



Financing Retirement

Reliance on the Sale of the Business Decreases With Age

In order to better assess the level of retirement readiness among Canadian entrepreneurs, we need to take a more detailed look at how small business owners plan to finance their retirement.

Here again we see a clear distinction between younger and older entrepreneurs. Young small business owners plan to rely much more heavily on the sale of their business to finance their retirement needs, and less on government or corporate pensions. As entrepreneurs get older, they scale down their projected revenues from the sale of the business and upgrade their expected income from pensions. While this observation might reflect some cynicism among young Canadians regarding the sustainability of the Canadian and Quebec pension plans, it probably also reflects unrealistic expectations about the projected value of their businesses. On average, selling the business is expected to generate roughly 30 percent of self-employed retirement income, while pension income accounts for 16 percent.

Table 1
Planned Sources of Retirement Income for Entrepreneurs³

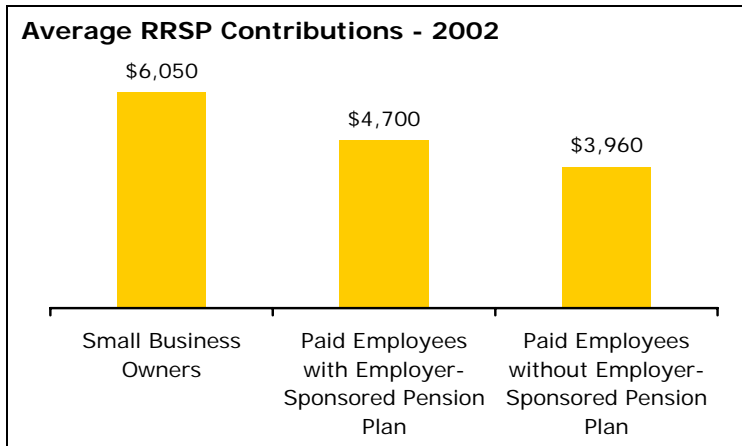
	Average	18-34	35-54	55-64	65+	Male	Female
	%	%	%	%	%	%	%
Sell Business	31.0	35.7	33.2	26.3	13.8	29.9	33.7
RRSP	28.1	29.3	28.0	28.2	27.1	28.4	27.5
Other Investments/Income	24.5	25.9	23.9	25.2	23.2	26.1	20.8
Pensions	16.3	9.1	14.9	20.3	35.9	15.6	18.1
	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Entrepreneurs' RRSP Contributions

Regardless of how one interprets the numbers, the most obvious observation is that RRSPs and other investments play a significant role in the retirement plans of Canadian entrepreneurs. Those two vehicles account for more than half of their projected retirement income, with little variation across age and income groups. This is a tall order, one that requires discipline and a certain degree of investment savvy.

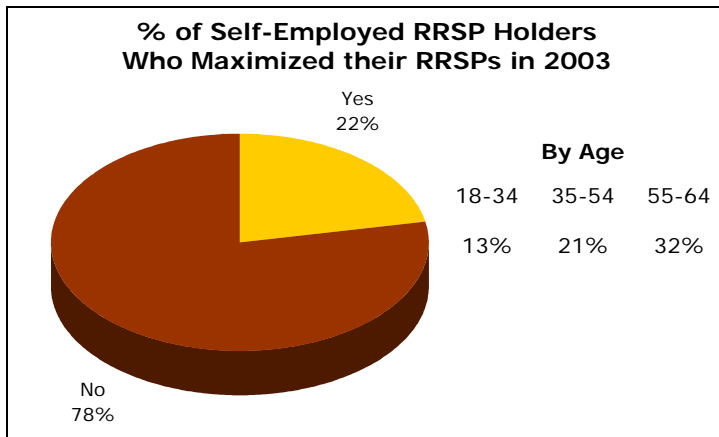
Are Canadian entrepreneurs contributing enough to their RRSPs? A quick look at the numbers suggests that self-employed indeed rely on RRSPs more than regular employees. In fact, almost 70 percent of small business owners own RRSPs, compared to 55 percent of paid employees. Self-employed are also contributing more to their RRSPs, with the average annual contribution of just over \$6,000. These contributions are 25 percent higher than those made by regular employees who belong to employer-sponsored pension plans, and more than 50 percent higher than regular employees with no corporate pension. When we consider that the average self-employed person earns 10 to 15 percent less than people who work for someone else, these contributions are even more significant.

**Chart 8
Small Business Owners Contribute More**



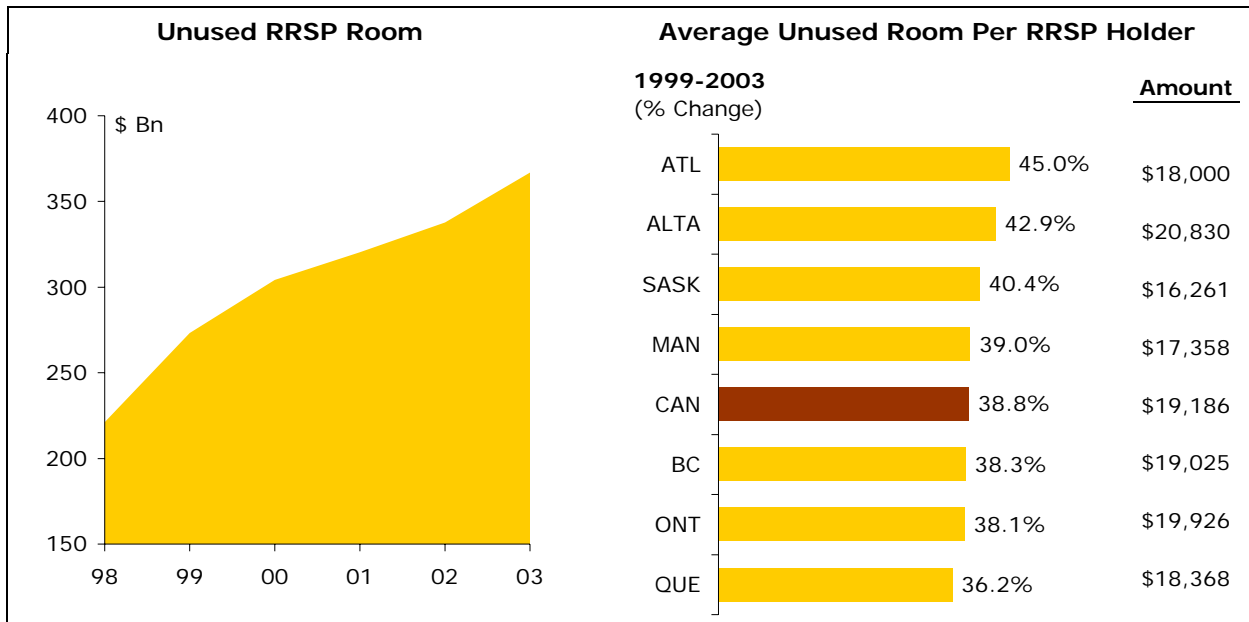
But that’s where the good news ends. A closer examination reveals a dark cloud on the retirement horizon for Canadian entrepreneurs. Only 35 percent of self-employed contributed to their RRSP in 2003, and only one in five maximized his/her contribution. The median RRSP contribution constitutes roughly 10 percent of median income — well below the 18 percent allowed. Not surprisingly, the share of those who maximize their RRSPs rises with age, but even in the age group of 55 to 64, only one-third of small business owners maximized their RRSP contributions in 2003.

**Chart 9
Maximizing RRSP Contributions**



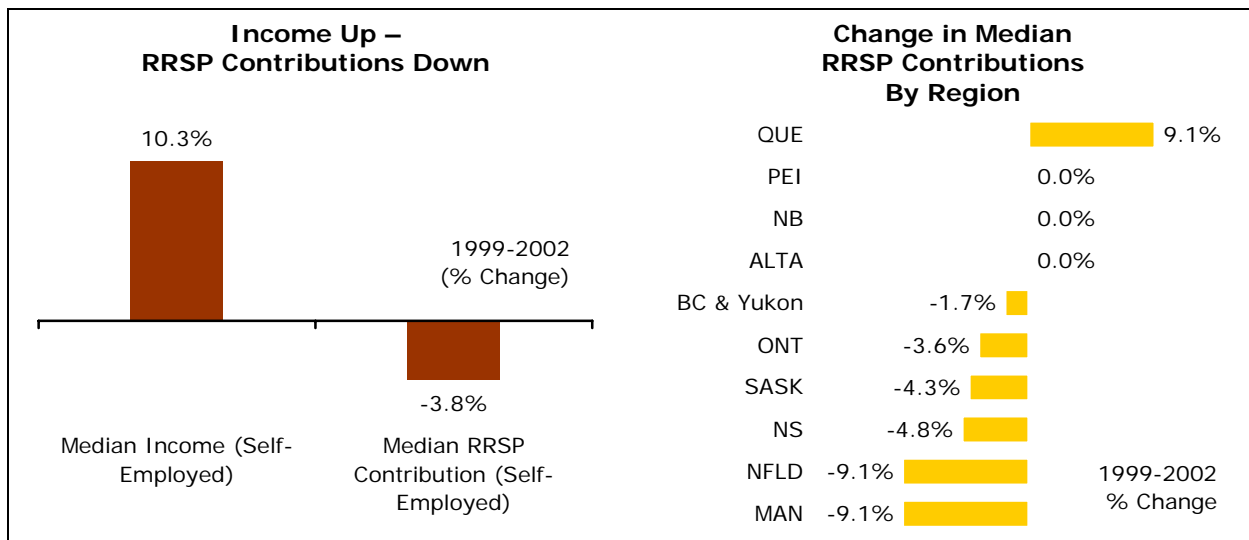
What’s more, despite the alarming demographic picture described earlier, the pace at which small business contribute to their RRSPs is, in fact, declining. While the median income of small business owners increased by 10 percent between 1999 and 2002, the median RRSP contribution made by self-employed during the same period fell by 3.8 percent. Consequently, the cumulative unused RRSP room for self-employed has been rising rapidly over the past few years. At the end of 2003, it stood at an astounding \$370 billion, or close to \$20,000 per small business owner with an RRSP.

Chart 10
Maximizing RRSP Contributions



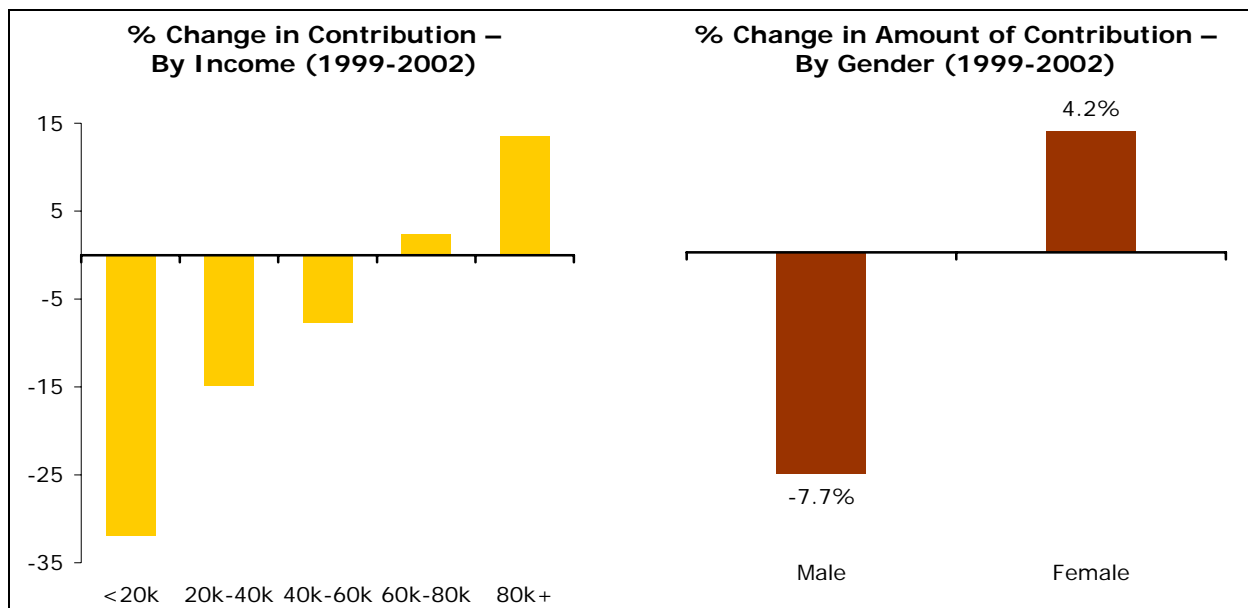
The slowing pace of RRSP contributions by self-employed is not uniform. It masks a clear divergence among regions and demographic groups. The fastest deterioration was in Atlantic Canada where average unused contribution room rose by close to 45 percent since 1999 — clearly reflecting the slow income growth in the region for the past few years. Only small business owners in Quebec increased their RRSP contributions between 1999 and 2002.

Chart 11
Falling RRSP Contributions Among Entrepreneurs



By income, small business owners with relatively low income were responsible for the entire decline in RRSP contributions between 1999 and 2002. At the same time, the average contribution made by those self-employed who earn more than \$80K a year rose by no less than 13 percent. Furthermore, virtually all the decline in total RRSP contributions was concentrated among men, with the number of women contributing, and their actual dollar contribution, rising by 2.3 percent and 4.2 percent respectively between 1999 and 2002.

Chart 12
Higher Income and Female Entrepreneurs Contribute More to their RRSPs



While financing retirement is a priority for many people, this is especially true for those who are self-employed. Canadian entrepreneurs are not as ready for retirement as they can and should be — and time may be working against them, given the growing number of “seniorpreneurs” (small business owners over the age of 55). Beyond individual retirement planning, with \$1.2 trillion in business assets poised to change hands by the end of the decade, succession planning must be a key focus for entrepreneurs to avoid creating a negative ripple effect throughout the Canadian economy. Professional advice and diversifying sources of income can help ensure a worry-free transition to retirement for Canadian entrepreneurs.

Notes:

1. Note that a 1999 Deloitte & Touche study suggested that 75 percent of family business will retire within 15 years. The results of the 2004 CIBC Small Business Outlook Poll are somewhat different, likely due to the time difference between the two surveys and the fact that the Deloitte & Touche survey focused exclusively on family businesses.
2. “Don’t know/not stated” responses were included in this percentage and in Chart 4.
3. Percentages may not sum to one hundred due to rounding or the acceptance of multiple mentions.

Sources:

This report was written by CIBC World Markets.

Unless indicated otherwise, the data sources used in this study are the 2004 CIBC Small Business Outlook Poll, Statistics Canada and CIBC World Markets. As well, unless indicated otherwise, small businesses in this study are defined as firms having between one and fifteen employees including the owner and having revenues under \$5 million for the year 2003.

The 2004 CIBC Small Business Outlook Poll was conducted by Decima Research between July 13th and August 6th, 2004 and was based on a randomly selected sample of 1,829 Canadian small business owners (defined as those businesses having between one and fifteen employees including the owner and having revenues under \$5 million for the year 2003). With a sample of this size, the results are considered accurate within ± 2.3 percentage points, 19 times out of 20, to what they would have been had the entire Canadian population of businesses with one to fifteen employees and revenues under \$5 million been polled. The margin of error will be larger within regions and for other sub-groupings of the survey population. The sample of respondents is representative of the region, Census Metropolitan Areas and employee size of Canada's small businesses according to the June 2002 Business Register data produced by Statistics Canada.

** For sample sizes less than 20, the base is too small to report and results are shown as N/A. Percentages of all grouped response categories are rounded based on the final sum of the components. Unless indicated otherwise, "don't know/not stated" responses were excluded from these percentages.*

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