OLIN BROOKINGS COMMISSION PRESENTS

Main Street's Tidal Wave of Transition

BROOKINGS

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The Tidal Wave of Transitions on Main Street

Olin Brookings Commission[1], Fall 2024

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Executive Summary

Small and medium-sized businesses form the backbone of America's economy, employing over 61 million workers. In fact, 99% of the 33 million firms in the U.S. are small businesses. A quintessential part of the American dream is the ability to start a business, grow it, and eventually pass it on to the next generation—or, sell it to reap the rewards of your hard work.

However, this landscape is undergoing significant change. Many small businesses are owned by baby boomers—individuals born between 1946 and 1964. As these owners approach retirement, an estimated $100 trillion in small and medium-sized businesses will either be transferred to new owners, inherited, or sold. This wave of ownership transitions, often referred to as the "silver tsunami," is poised to have a profound effect on both the economy and local communities.

This impending shift, combined with the growing prominence of private capital investment in these markets, raises important questions: What types of ownership are these businesses

[1] This work was supported by a team far beyond the Commission itself. These contributions include but are not limited to report construction and writing by Amy Condra, empirical research and analysis by Dr. Daryl Van Tongeren (Hope College) and Dr. Jung Hyen Julie Lee (WashU, University of Iowa), and background research and analysis by Ben Wagoner (WashU / Ropes & Gray), Kate Kirchdorfer (WashU), Emma Peters, Swetbh (WashU), Aditi Vashist (WashU, University of Utah), Rohan Patel (WashU) and Jennifer Wintzer (WashU).

moving toward? How will these changes affect the broader economy and the communities in which these businesses operate?

In this study, we illuminate these issues by:

- Identifying strategies used by distinct groups when investing in lower middle market business market
- Codifying how owner's navigate trade-offs in transitions of business ownership
- Clarifying how different types of ownership structures affect workers in these firms
- Highlighting key policy implications based on these findings

Most specific to policy, our team focuses on a set of policy bundles that come out of this empirical work, including:

- **Policy Bundle 1**: Stemming the Tsunami by Increasing the Attractiveness of Owning a Small Company
- **Policy Bundle 2:** Increasing Options for Dual Purpose Ownership
- **Policy Bundle 3:** Expanding Options for Employee Ownership in Transition
- **Policy Bundle 4:** Incentives to Encourage Longer-Term Investor Behavior

This study was pursued with the generous support of the Bellwether Foundation and conducted as a robust partnership between Washington University's Olin School of Business and the Brookings Institution. Data collection was facilitated through collaborations with capital firms connected to the business owner community, including ENOVA International, Edward Jones, and U.S. Bank.

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Setting the Context for the Transition of Small and Medium Enterprises

Why does a wave of business ownership transitions matter, and what are the implications for owners, workers, and the communities where these businesses operate? The context below underscores the significance of this shift and its broader impact on the U.S. economy.

Contextual Insight 1: Small Businesses Are the Backbone of the U.S. Economy

- Small businesses employed an estimated 56.4 million workers in 2021 and generated over $16.2 trillion in revenue, according to data from the Census Bureau's Annual Business Survey (ABS).
- According to the Small Business Administration, businesses with fewer than 500 employees make up 99.9% of all U.S. firms.
- Of the 33 million registered businesses in the U.S., approximately six million have paid employees (Pew Research). Among those small businesses with employees, about three million (49%) have one to four workers, based on 2021 estimates from the Annual Business Survey. About a quarter (27%) have between five and 19 employees, 8% employ between 20 to 99 workers, and just 1% employ between 100 and 499 workers.
- Employees of small businesses represent nearly half (46%) of total private-sector employment. (Pew Research)

Contextual Insight 2: Demographic Headwinds Are Coming for Business Owners

- The future ownership of small and medium-sized businesses is likely to change significantly over the next decade. Nearly half of all private businesses are currently owned by individuals who are at or near retirement age. This amounts to approximately 2.9 million companies employing over 32 million workers. The impact of this shift will extend beyond business owners to employees and the communities that rely on these firms.
- Despite the inevitability of these transitions, many owners are unprepared. A recent study from the University of Minnesota Extension/Minnesota Center for Employee Ownership found that in Minnesota alone, more than 50,000 businesses have owners

aged 55 or older. Of these, over 85% lack a formal succession plan. For many owners looking to sell, finding a buyer can be challenging when the time comes to exit.

- These combined factors—large-scale ownership changes and inadequate preparation—will have significant repercussions. The transitions will affect not only the owners but also the employees, as firms either change hands or, in some cases, close their doors.

Contextual Insight 3: Small Businesses Enjoy a High Level of Public Trust, and Ownership Shifts Could Impact This Social Fabric

- A recent survey by the Pew Research Center found that 86% of U.S. adults believe small businesses have a positive effect on the country's direction.
- Small businesses currently enjoy higher levels of public trust than many other key institutions—such as large corporations, the military, public schools, banks, and churches. This reflects the societal value placed on these businesses.
- In an era of declining trust in institutions, it is essential to preserve the strong connection between America's small and medium-sized businesses and the communities they serve. Ownership transitions could disrupt this relationship, potentially weakening the social fabric that supports local economies.

Contextual Insight 4: While Small Businesses Provide Continuity Within Communities, the Opportunities They Generate for Their Employees Are More Mixed

- Recent policies that incentivize the generation of new businesses have appeared effective as seen by the increasing rate of new business incorporation. Proposed policies—such as the expansion of the Small Business Tax Credit—aim to sustain this growth.
- Contrary to the perception of high failure rates in small business ownership, many small to medium-sized enterprises (SMEs) have a long-standing presence. For example, as of 2021, the majority of these firms (59%) had been in business for at least six years, according to the Census Bureau's Business Dynamics Statistics. More than one in seven (15%) had been in business for over 25 years.
- However, the quality of jobs at small businesses varies. Research from Reimagine Main Street, supported by the Gates Foundation, suggests that employees at firms with fewer than 100 employees are less likely to be in "good jobs," as defined by the Department of Labor. While the Department focuses on factors such as wages, benefits, and

opportunities for advancement, an expansive view might also include the meaningfulness of the work itself.

- While studies by Nicholas Bloom, Raffaella Sadun, and John Van Reenen have shown that private investment can professionalize famly businesses, it remains unclear how this professionalism affects the experience of employees working in these firms.

Contextual Insight 5: Ownership Transitions Offer Opportunities to Diversify Business Ownership, Improve Employee Experiences, and Keep Wealth in Communities

- The current business ownership landscape lacks significant diversity. Where data on the race and ethnicity of majority owners are available, most small businesses (85%) were majority-White owned in 2021. Smaller shares were majority-owned by Asian Americans (11%), Hispanic individuals (7%), and Black or African American individuals (3%). Approximately 1% of small businesses were estimated to have American Indian, Alaska Native, Native Hawaiian or other Pacific Islander majority owners. (Pew Research/Annual Business Survey)
- Most small businesses are owned by men. According to the Annual Business Survey, in 2021, 61% of small businesses were majority-owned by men while 22% were majority-owned by women. Another 14% were owned equally by men and women.
- As ownership changes hands, there is an opportunity to promote greater inclusivity and diversity in business ownership. By fostering models such as employee ownership or supporting investor groups like Ownership Works, the potential exists to expand ownership opportunities for underrepresented groups, including women, people of color, and other marginalized communities. Such a shift could ensure that wealth and economic power are more widely distributed across all communities.

A Summation of the SME Transition Landscape

A wave of small business owners is set to retire in the coming years, leading to significant shifts in business ownership. If not managed properly, whether by leaders and owners within these firms or through the broader policy landscape, this transition could result in the shuttering of many businesses, a loss of trust in small businesses within communities, and negative impacts on both workers and the communities these businesses serve.

However, a well-executed transition offers opportunities for fresh energy and leadership, expanded access to capital, and potential innovation across the middle market.

To fully understand and identify areas for policy innovation, it is essential to consider the preferences of business owners, the effects on employees, and the broader policy implications.

Introducing Novel Data and Analysis on the Wave of Transitions

Comprehensive Study Design: Three Key Stakeholders

This report aims to shed light on the landscape of small and medium-sized (SME) business transitions by focusing on three key stakeholders.

- **Investors**: The first area of focus is identifying the behavior of various investor types in the SME space. While there is interesting research on the strategic actions of private equity (PE) investors, much of it centers on investors pursuing disproportionately large targets. This narrow scope overlooks the full range of investors who also play a crucial role in the SME market, such as employees, family offices, and competitors.
- **Owners**: The second area of focus examines the preferences of business owners during transitions. Understanding how owners navigate the trade-offs of potential sale options requires a novel methodology, one that is often absent from existing studies.
- **Employees**: The final group of stakeholders is the employees of these firms. From a labor perspective, it is critical to understand how these transitions impact the workforce—the largest group affected by ownership changes.

Throughout the analysis of all three stakeholder groups, we seek their interconnections, paying close attention to how the strategies pursued by investors influence the preferences of owners and the experiences of workers.

Study 1 - The Behavior of Investors in the Middle Market

A 2016 study by Paul Gompers, Steven N. Kaplan, and Vladimir Mukharlyamov provides a helpful lens for understanding how private equity firms behave as investors. .

Figure 1. Gomers et. al (2016)
PE Investment Levers and Frequency Used

	Mean
Reduce costs in general	35.6
Improve IT / Information Systems	26.1
Introduce shared services	15.6
Increase revenue / improve demand factors	70.3
Redefine the current business model or strategy	33.8
Change CEO or CFO	30.6
Change senior management team other than CEO and CFO	33.4
Improve corporate governance	47.0
Improve incentives	61.1
Follow-on acquisitions	51.1
Strategic investor	15.6
Facilitate a high-value exit	50.0
Purchase at an attractive price (buy low)	44.3
Purchase at an attractive price relative to the industry	46.6
Other	9.8

Conducted as a survey of 79 investors, the study identified and then assessed the strategies used by private equity investors with their portfolio companies. Figure 1 outlines a set of "investing levers" and shows how frequently investors viewed these as significant value drivers in their deals.

The most commonly pursued strategies were:

- Increasing revenue/demand factors
- Improving incentives
- Engaging in follow-on acquisitions

Cost-cutting ranked lower on the list, although this strategy may be more attractive with a shorter investment horizon, or when there is a need to quickly sell the company to another buyer.

While this research provides valuable insights, it focuses on a different kind of investor than those typically buying small to mid-sized businesses. Specifically, only 11% of the surveyed investors (9 in total) focused on deals worth less than $25 million—and the mean assets under management for these firms was just under $10 billion.

The private investment landscape for small and medium-sized enterprises differs significantly, not only potentially in terms of the strategies used, but also in the wide set of transition types these companies pursue. For example, SMEs may sell to family members, convert to employee ownership (such as through an employee stock ownership plan, or ESOP), or sell to individual buyers or competitors. Each of these strategies is likely to engage different value-driving strategies.

To better understand this sector, we organized a meeting with 15 investors in New York City in May 2024. This informal discussion was followed by a survey of 28 investment professionals to explore how various types of investors—such as middle-market PE firms, family offices, strategic corporate buyers, and employee ownership transitions—behave in the lower middle market compared to the larger targets analyzed by Gompers and colleagues. The results below highlight some of the key differences likely to emerge when examining the investment landscape.

Figure 2. Investor Perception of Investor Behavior in the Lower Middle Market Transactions

			Olin Brookings Commission 2024 Follow-Up - Lower-Middle Market Investor			
TYPOLOGY OF STRATEGIC LEVERS	PE - Gompers et al (2016)	Ranking Most Common	Lower Middle Market PE (Today)	Family Office	Strategic / Corporate	Employee / ESOP
Reduce costs in general	35.6%	8	3.41	2.64	4.00	2.05
Improve IT / Information Systems	26.1%	12	4.04	2.91	3.78	2.63
Introduce Shared Back-Office Services (e.g., Accounting, IT, HR, etc.)	15.6%	13	3.33	2.73	4.22	2.11
Increase Revenue / improve demand factors	70.3%	1	4.07	3.05	3.74	2.79
Redefine the current business model or strategy	33.8%	9	3.37	2.64	3.61	2.21
Change CEO or CFO	30.6%	11	3.74	2.59	4.09	2.37
Change senior management team other than CEO and CFO	33.4%	10	3.56	2.41	3.74	2.26
Improve corporate governance	47.0%	5	3.59	3.09	3.78	2.68
Improve incentives	61.1%	2	3.89	3.45	2.83	3.37
Make follow-on acquisitions	51.1%	3	4.63	2.95	3.17	1.89
Bring on a strategic investor	15.6%	13	2.81	3.32	2.48	2.05
Facilitate a high-value exit	50.0%	4	4.59	3.18	2.35	1.95
Purchasing at an attractive price (buy low)	44.3%	7	3.44	3.50	2.65	2.53
Purchasing at an attractive price (relative to industry)	46.6%	6	3.52	3.38	3.09	2.37
			Color Interpretation Key			
				= More Frequent		= Less Frequent

Interpreting the Data: In the chart above, note that numbers of 3 of a 1-5 scale (colored in white) indicate that the survey respondents believe that a particular investor (e.g., family office) pursued a particular strategy (e.g., improving incentives) with the same frequency and what Gompers et al (2016) find in their study of private equity investors. If the numbers were higher than 3 (shown in green), they thought this investor used this strategy *more* frequently. If the numbers were less than 3 (shown in red) they thought this investor group utilized this strategy *less* frequently.

As an example, looking at the cost reduction average of 35.6%, this group of investment professionals saw lower middle market PE investors and strategic buyers using this strategy *more* frequently than the investors studied in the 2016 project (as shown by green) but thought family offices and ESOPs were in generally less likely to pursue this approach.

Study Results:

1. **Lower Middle Market PE**: For our study participations, their perception is that lower middle market PE firms were even more aggressive in using the outlined strategies as their larger PE counterparts. The primary exception is their lower likelihood of bringing in a strategic investor, likely due to the smaller deal sizes. Most distinct from the original study, these firms are the most likely to be focused on driving a high-value exit from the transaction.
2. **Family Office**: Family offices are perceived to operate with a different strategic model. They were perceived by this group to be less focused on cost reduction, and more likely

to drive value through buying at a lower price (perhaps, for example, by making a case for value alignment with the buyer), improving incentives, and bringing in a strategic investor. They are also less likely than PE firms to change leadership, both at the CEO level and among senior executives.

3. **Strategic/Corporate Buyers:** Strategic or corporate buyers display an approach that contrasts with family offices. Their strategy is oriented around cost reduction, leadership changes, system development, and governance improvements. They are less likely to focus on exit strategies, initial purchase price, or finding another strategic partner.

4. **Employee Ownership (e.g. ESOP)**: The employee ownership model tends to be less aggressive across most strategic levers, except in its focus on improving incentives. This likely reflects the deign to link more employees into ownership packages. There is a lower likelihood of follow-on acquisitions due to the cost and potential debt structures, and less emphasis on securing a high-value exit.

Study 2 - The Preferences of Owners in Transition

Figure 3. Example Conjoint Question

Imagine that you and your partners are planning to sell your business. Would you choose Buyer 1 or Buyer 2?

(1 of 10)

	Buyer 1	Buyer 2
Buyer's time horizon	Medium-term (6-10 years)	Short-term (0-5 years)
Buyer's strategy for your company	Growth through market expansion, product development, and acquisitions.	Improving operational efficiency (e.g. optimizing supply chains, and implementing best practices).
Buyer's anticipated change to your company's culture	Maintain the same culture	Significant cultural shifts
Nature of the buyer	Your employee or employees	Member(s) of your family
Buyer's financial offer	7.5% above existing company valuation	Equal to existing company valuation
	Select	Select

The second key stakeholder group worth understanding in these transitions is the business owners themselves. Given how difficult it is to accurately assess owner preferences using simple ratings in isolation from their trade-offs, we applied a conjoint analysis approach to gain deeper insights.

As shown in Figure 3, each survey asked a business owner to identify their preference between two hypothetical investors in their current business, each offering a different “package” of attributes. This exercise was repeated 10 times for each respondent, allowing us to aggregate responses and identify the “utility” driven by different buyer dimensions.

In our conjoint study, we varied the buyer and their offer across five attributes:

1. **Time horizon:** (0-5 years, 6-10 years, or 10+ years)
2. **Company strategy:** (growth, operational efficiency, debt financing)—reflecting investor strategies from the Gompers et al. study
3. **Anticipated changes to company culture:** (none, few, many)
4. **Nature of Buyer:** (family members, employees, private equity, competitors, private individuals)
5. **Financial offer:** (0, +-7%, +-15% over current market value)

This study was conducted in partnership with three capital partners—U.S. Bank, ENOVA, and Edward Jones—who facilitated access to business owners for survey distribution. The initial results reflect results from ENOVA and Edward Jones, with U.S. Bank currently in collection.

Study Results

We have obtained 187 responses to to our survey thus far. These owners had the following characteristics:

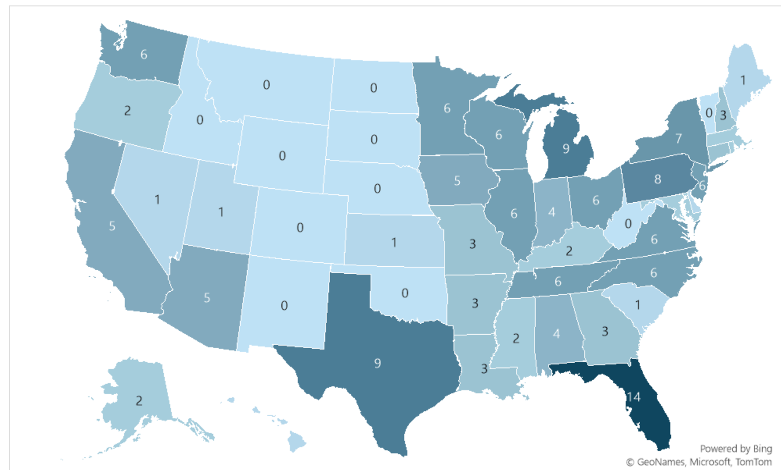
Owner characteristics:

Female	27%
White	73%
Black	8%
Age 40 or under	17%
Age 40-60	50%
Age 60+	33%
Bachelor's degree	51%
Years owning business	14

Business characteristics:

1-10 Employees	72%
10+ Employees	25%
$500k or less in sales	47%
$500k-$5M in sales	39%
$5M+ in sales	9%

Business Locations:



Owner's Preferences

Conjoint analysis allows us to measure owner's preferences when evaluating purchase offers, both at a high level (e.g., is owner type more important than the attractiveness of the financial offer) and within a given category (e.g., is there preference for employee over a family buyer?).

Figure 4.

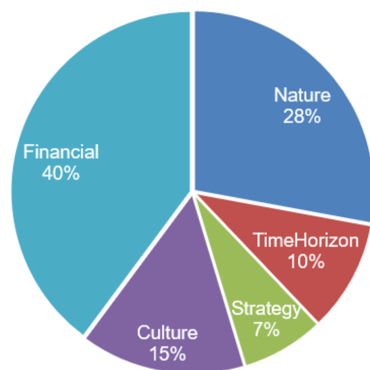
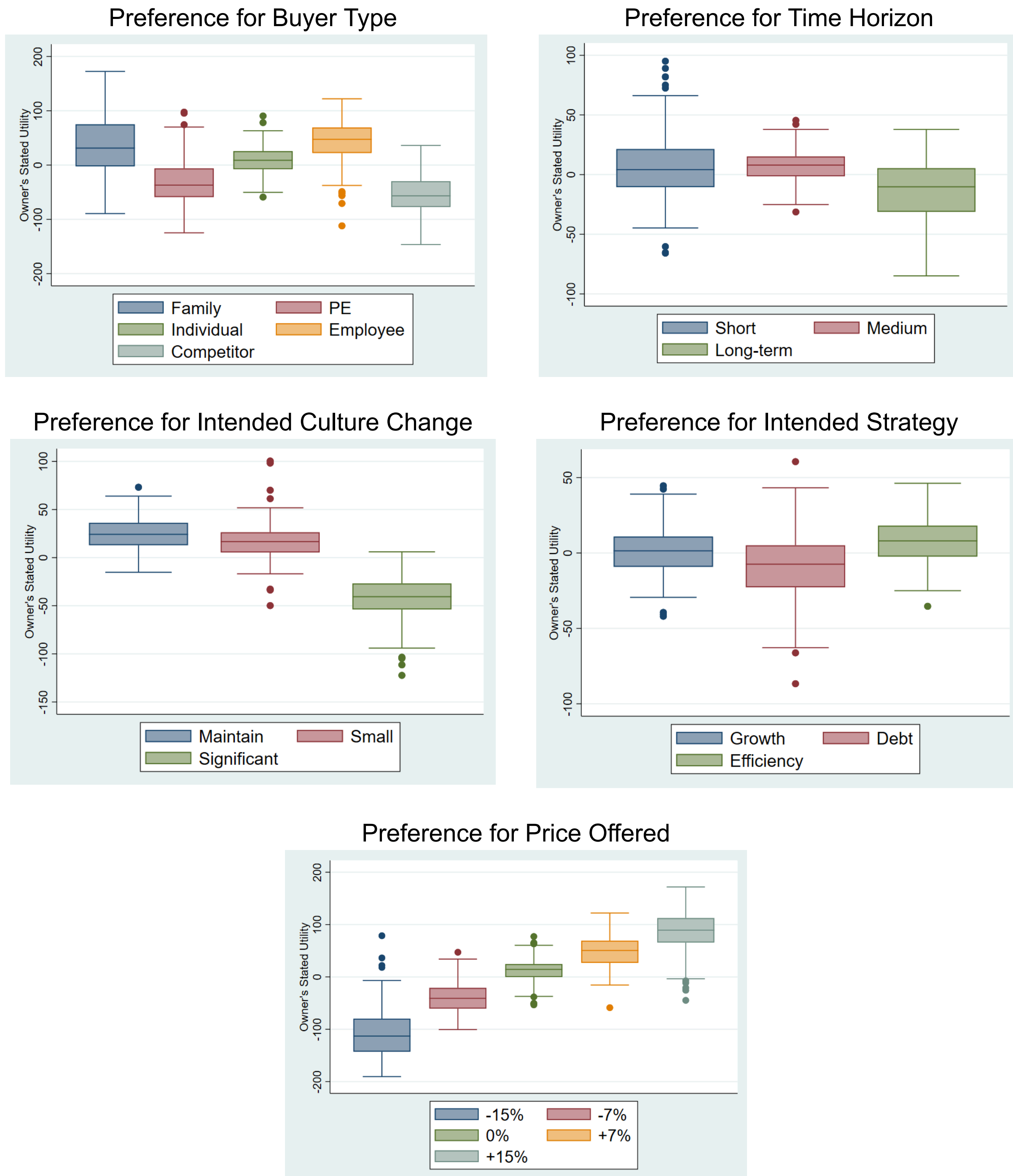


Figure 4 shows the importance that our owners placed on different dimensions of a purchase offer. Not surprisingly, we see that our owners placed the most emphasis on the financial value of the deal. Interestingly, among the remaining categories, the owners cared most about the nature of the buyer (e.g., PE, family, employee, strategic). Concerns about changes to the company culture ranked next, followed by the buyer's time horizon and then changes to the company strategy.

Next, we show the relative preference that our owners had for different choices *within* each one of these five categories.

Figure 5. Owner's Detailed Preferences Within Buyer Dimensions



Note: Shaded boxes = 25-75th percentiles. Whiskers = 5th and 95th percentiles. Dots = outliers Utilities calculated from hierarchical Bayes estimator with 5000 repetitions.

As we look across Figure 5, several details stand out. First, we see that our owners would most prefer to sell to a family member or employee, and they would least like to sell to a competitor or a private equity investor. Second, we see that our owners have a strong preference against the buyer making significant changes to the company culture, a preference that is notably much larger than, say, using a strategy that adds more debt to the company after the sale. Finally, we see a predictable preference among our owners for a better financial offer, which gives us extra confidence that the owners were taking the survey seriously and paying attention.

We probed the data further and noticed the following patterns, which we do not tabulate here in the interest of space:

- Female owners placed more importance on culture change and less importance on the financial terms of the deal, relative to male owners.
- Owners' preferences did not seem to vary with owner age, race, education, or with company size, measured by employee count or sales.

Summary and take-aways from our analysis of owners' preferences

- The financial terms of the offer are the most important, even in this setting where we might expect respondents to downplay financial value for social desirability reasons.
- Despite the fact that financial value is most important to the buyer (and the highest value is the preferred outcome), the relative utility of price is overcome by a combination of other factors. As such, owners might be willing to take lower price offers when there is alignment on some of the four remaining factors: owner type (ideal- family or employee), time horizon (ideal - long-term), strategy (ideal - operational efficiency), and culture (ideal - some changes but not overly robust).
- The sellers are especially concerned about selling to buyers who a) are competitors, or b) plan to institute large changes in the company culture.
- From an ownership preference, both family and employee ownership were attractive to this group, also likely because of their willingness to generate cultural continuity between where the firm is now, and where they anticipate it would be under new ownership.

Study 3 - The Outcomes of Workers in Ownership Transitions

The final study looked at employee outcomes following ownership transitions. Using the platform Prolific, we surveyed employees who self-identified as having experienced some form of ownership change in their place of employment. We then captured their experiences across various outcomes, tracked over time. Specifically, we measured individual aspects of job quality, sense of job as a calling, work as meaning, career commitment, and job satisfaction. These elements were analyzed both individually and as part of a simplified composite measure. The full set of items is included in the appendix.

Because we developed a unique measure of job quality based on the Department of Labor's construct, it is worth highlighting the three items below. Whereas some are tied to pay and benefits, others assess opportunities for advancement and broader aspects of firm culture:

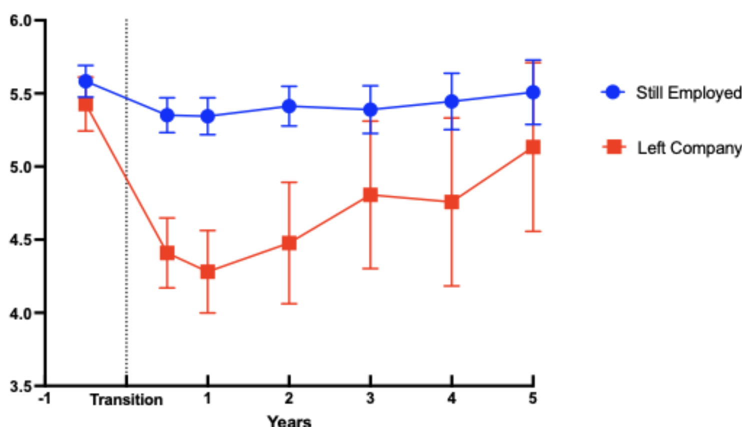
- *"I had a competitive wage and benefits"*
- *"All workers were valued and respected by leadership"*
- *"There were transparent promotion/advancement opportunities"*

All items assessed were rated on a 1-7 scale, ranging from "strongly disagree" to "strongly agree." In the results presented below, unless otherwise specified, the measures represent an aggregate of all assessed items.

Study Results

Key Finding 1: Ownership Transition is Difficult for Employees, Especially Those Who Leave the Firm – Voluntarily or Not.

Figure 6. Employee Outcomes - Stay vs. Go



Our initial analysis focused on an aggregate measure of job quality, followed by a comparison of employees who stayed with a firm post-transition and those who left, whether voluntarily or not..

Across all employees, there is a significant dip in self-rated job quality, which remains notable through year 4. By year 5, job quality levels for both groups generally return to baseline.

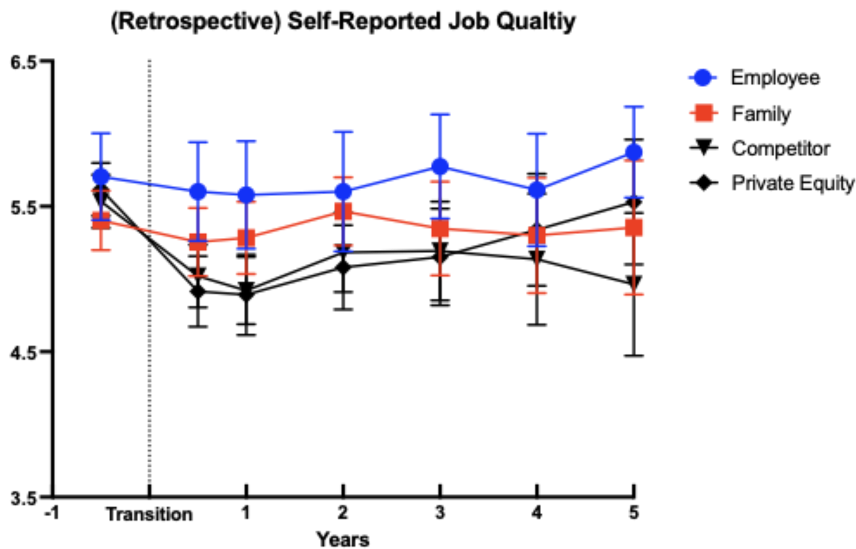
When comparing those who stayed with the firm to those who left, much of the decline in job quality can be attributed to the employees who left, either because the job felt lower quality or

because they were let go in the transition. However, there is still a noticeable decline for those who remained. Overall, ownership transitions present challenges for employees as they adjust to changes in leadership or governance.

Key Finding 2: Some Transitions Are More Employee-Friendly Than Others

In our second analysis, we examined the dip in employee outcomes across different types of ownership transitions. As illustrated in Figure 7, the effects of ownership transitions vary widely depending on the buyer. We outline some of those differences below.

Figure 7. Employee Outcomes by Ownership Change

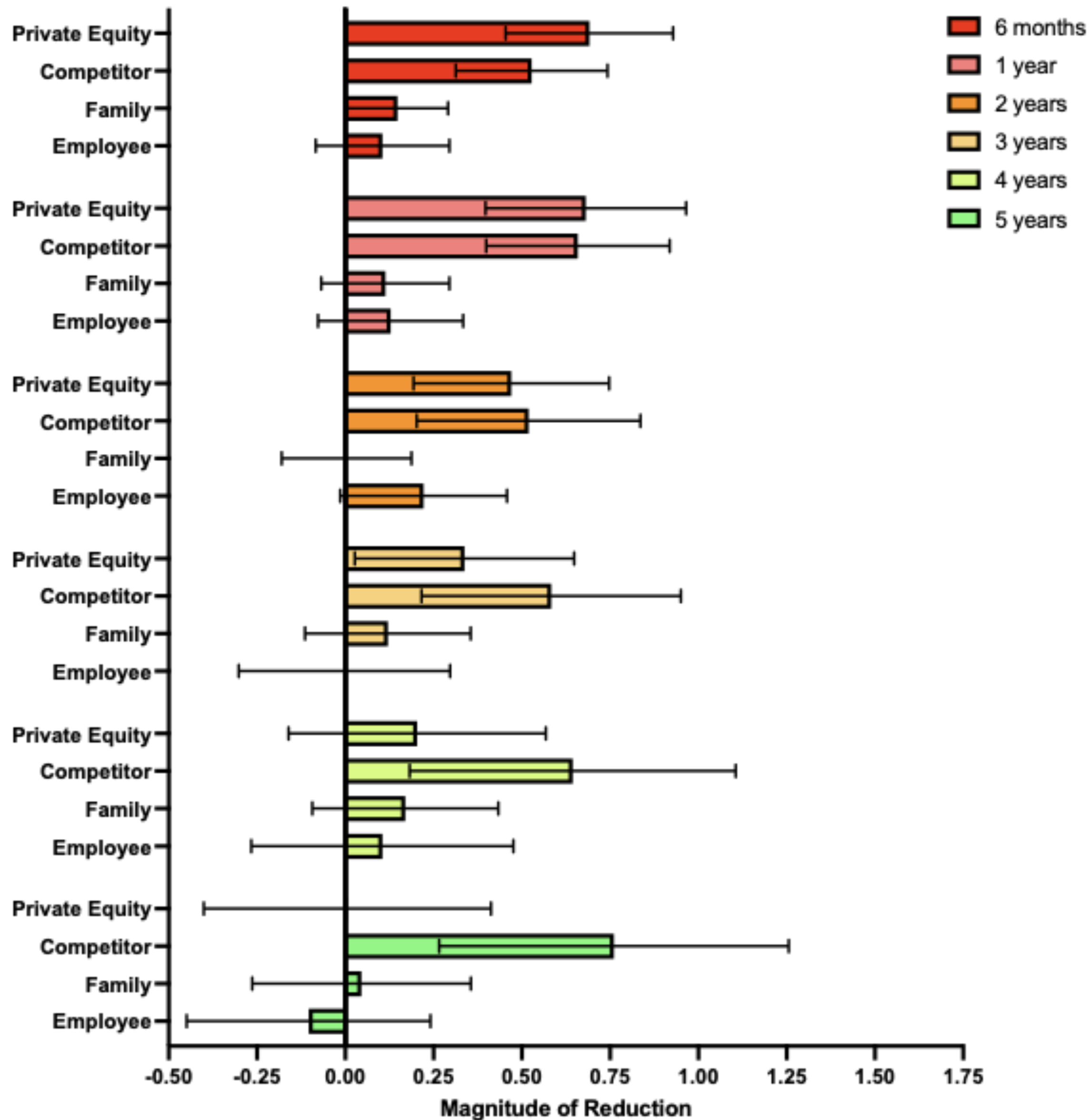


- **Employee ownership:** When employees purchase shares, the composite measure of employee outcomes remains relatively stable, with a slight increase by the end of the observation period.
- **Private equity purchase:** When a private equity investor purchases shares, employee outcomes decline until year 4, after which they stabilize.

- **Family Transitions:** In cases where family members buy shares or there is a transition across generations, there is a similarly small dip as we see in employee ownership. That said, there is also less eventual upside when compared to family or investor investment.
- **Competitor purchase:** When a competitor acquires the firm, employee outcomes experience a decline, with no recovery by year 5.

A more detailed breakdown of these changes is provided in Figure 8.

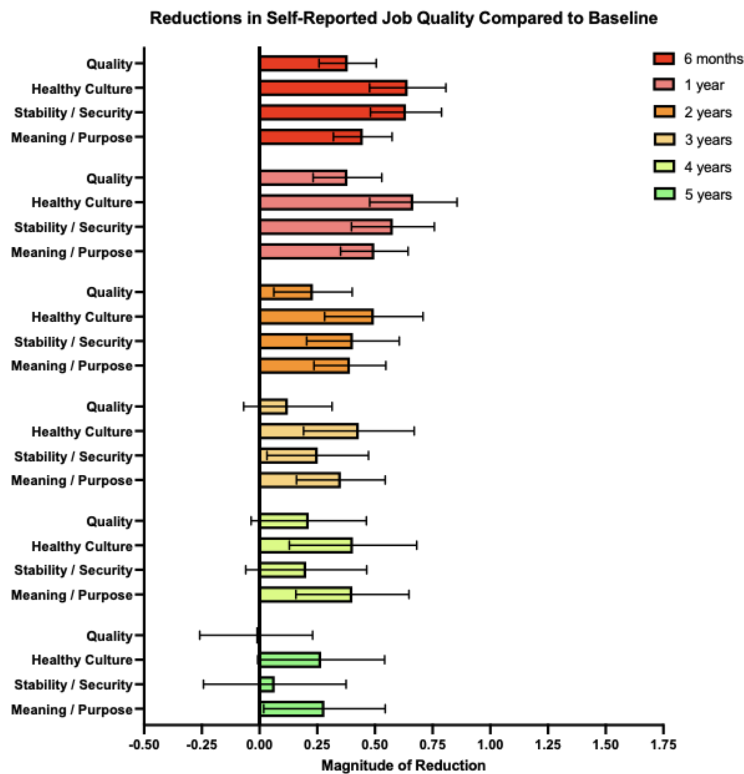
Figure 8. Employee Outcomes by Distinct Ownership Types



Key Finding 3: Post-Transition Job Improvements are Delayed, and Work Meaning and Culture are even Slower to Recover

Whereas much of our analysis focused on composite measures of job quality, we also broke down the overarching measure into distinct factors, including job quality, healthy culture, work stability, and job meaning and purpose. Each factor was assessed with individual items, with the results shown in Figure 9.

Figure 9. Outcomes by Different Job Dimensions



Following ownership transitions, most measures experienced a decline, particularly in work culture and job security. Over time, the following trends emerged:

- **Job quality:** Recovered by year 3, with employees reporting on items such as "my job is high quality."
- **Job security and stability:** Declined through year 3 but recovered to baseline levels by years 4 and 5.
- **Work meaning and purpose:** Declined significantly and did not recover over the 5-year period.
- **Work culture:** Remained less healthy until Year 5, with only marginal improvement by that time.

In summary, whereas job quality and security seem to improve over time (by years 3 or 4), work culture and employees' sense of meaning and purpose in their jobs do not recover as quickly or easily and were not back to baseline levels by year 5.

Key Finding 4 - Investors Pursue Different Strategies, but Those Strategies Matter Regardless of Investor Type

The final analysis links employee outcomes to the initial study of investor behaviors. We were particularly interested in whether employees' experiences with new owners or investors aligned with the strategies reported by investors (as Gompers and colleagues highlighted) and the perceptions of other investment professionals (as shown in Study 1). Figure 10 illustrates employee perceptions of strategies pursued by different types of investors.

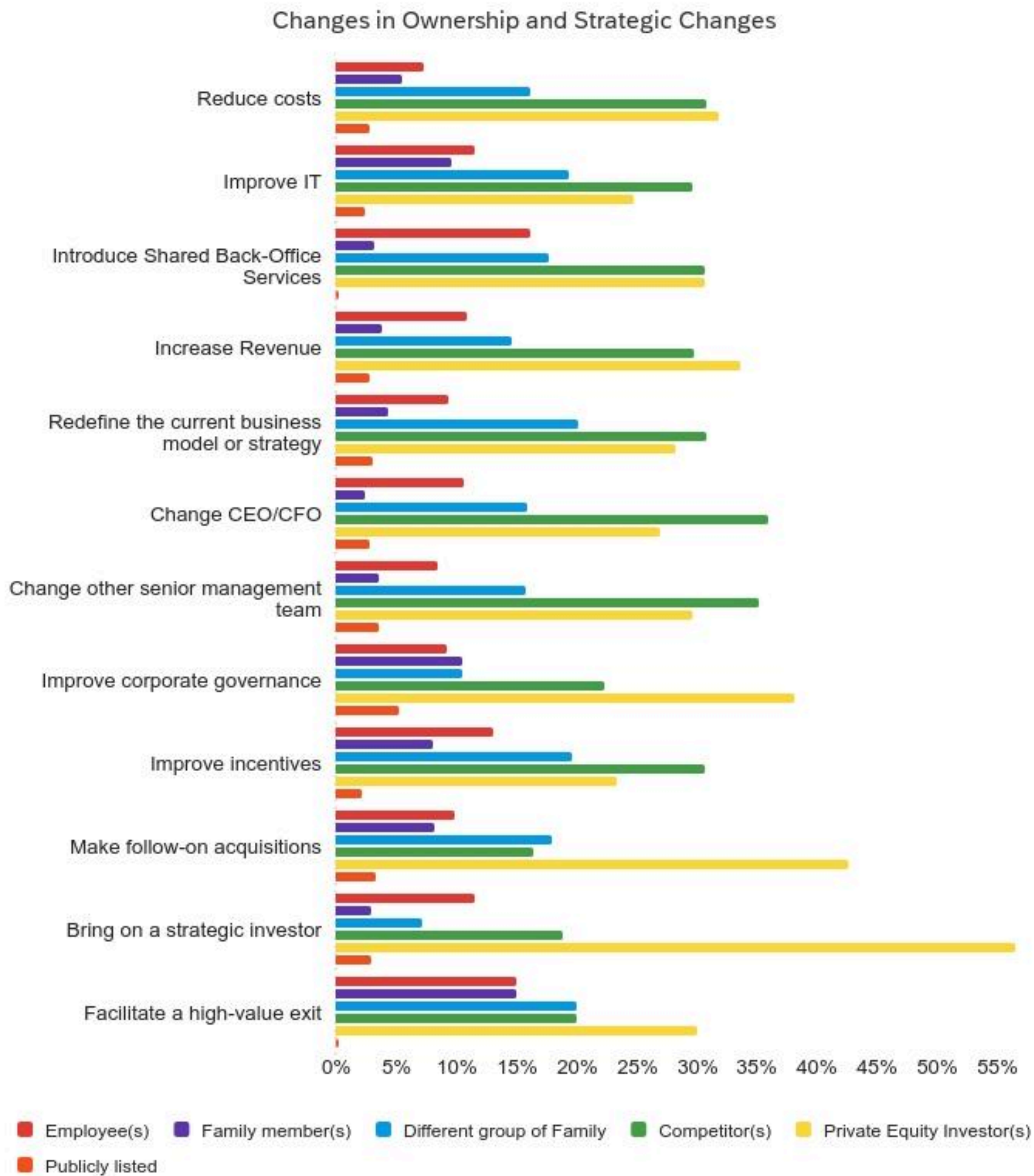


Figure 10. Employee Perception of Strategies Pursued by Different Investors

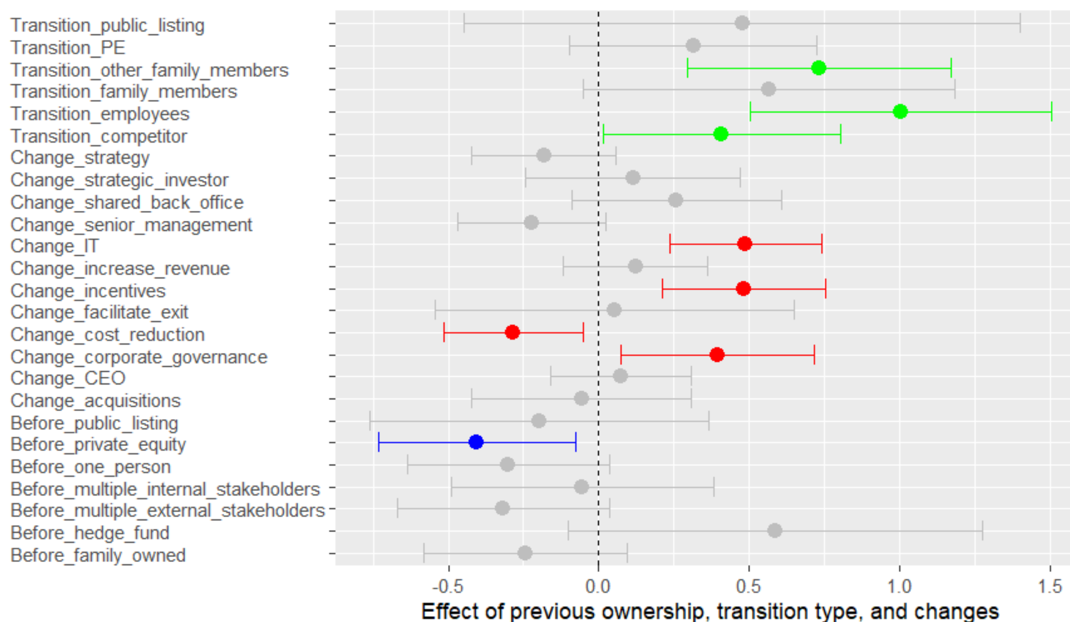
Taken together, employees in these studies observed differences in the strategies pursued by the new owner, and a similar kind of expanded frequency for both strategic buyers and private equity investors. These variations are notable, as high-level discussions about certain investor types being inherently good or bad are less informative than focusing on the strategies pursued and the reasoning behind them.

Figure 11 - Percentage of respondents that still work at company they are evaluating	
Employee Ownership	81.8%
Family Transition	70.3%
Competitor Purchase	61.2%
Investor / PE Purchase	65.9%

Outside of self-reported strategy, we also looked at whether the employee responding to the survey still worked at the company they were evaluating. On this measure, we find a higher percentage of respondents who were still at firms who transitioned to employee ownership (significant difference), with lower levels in the other three. While this measure does not capture the reason they left, it does suggest some differences for employee retention.

In our final analysis, we run a regression of individual investor strategies against the aggregate measure of employee outcomes, controlling for the previous owner and new owner type. This approach allowed us to address a key question: Independent of who the new owner is, which investor strategies had a positive or negative impact on employee outcomes? The full results of that regression are available in the appendix, but a visualization of the significant findings is shown below. Any dot or lines with color (blue = ownership before, green = ownership after, red = strategy pursued) are significant effects on a dependent variable of composite employee job quality.

Figure 12. The Impact of Investor Strategy on Aggregate Employee Outcomes[2]



[2] **Note**: Before AA or Transition_AA means ownership before or after the shift to the AA; e.g., Transition to other family members (e.g., intergenerational transition), Transition to employee-ownership, Transition to competitor is found to be positively related to the employee job quality. Change__AA indicates change made after the ownership transition, for example Change_IT means changes made in IT service. Participants were asked to respond multiple times to all that apply. Note that in this regression we maintain a split between family transitions and a family member buying significant shares versus a folding it together in other models.

Figure 13. The impact of investor strategy on composite employee outcomes

Employee Perception of Strategy Pursued Post Ownership Transition	Relationship to Composite Employee Outcome
Reduce costs in general	Significantly Negative
Improve IT / Information Systems	Significantly Positive
Change senior management team other than CEO and CFO	Significantly Negative
Improve corporate governance	Significantly Positive
Improve incentives	Significantly Positive

The negative impact of cost reduction on employee outcomes is not surprising, but the fact that it holds true regardless of the type of investor is noteworthy. This reinforces the idea that focusing on broad investor categories (e.g., "family ownership is good," "private equity is bad") is less useful than examining the specific strategies employed by these new owners. Even though different investor types may have varying incentives, it is the strategies they implement that ultimately drive employee outcomes. Strategy matters.

It is also worth noting that, within this population, changes in the CEO did not have a significant impact on employee outcomes; however, changes in other senior leaders did. This may reflect the fact that many employees are more directly affected by functional leaders in their day-to-day roles than by the company's top executive.

Interestingly, the strategies that lead to the most negative outcomes—such as cost reduction—are often associated with short-term actions. While not a focus of this study, you might anticipate that value creation linked to financial engineering might be similarly short-term in focus. In contrast, strategies like improving research and development (R&D), corporate governance, and incentives require longer-term implementation to yield positive results. This suggests that finding ways to incentivize longer-hold strategies could lead to better outcomes for employees and perhapas the businesses more broadly.

Study Implications

Logic for Identifying Relevant Legislation

Legislative changes are necessary when existing laws conflict with new policy goals or do not provide sufficient authority for implementation. For example, if tax policies incentivize certain financial decisions—such as promoting debt financing over equity due to the tax deductibility of interest on debt, and such investment behavior are counter-productive to the society we want to create —then tax laws need to be adjusted accordingly. A robust set of policies impacting business transitions, including both incentives and constraints, can be found in Appendix 1.

That said, pursuing legislative or administration policy change is inherently difficult. Legislation requires agreement from both chambers of Congress, and Congressional deadlock has become more common in recent years. The 118th Congress has been one of the most unproductive in recent memory, and five of the six least productive years being since 2011.

Despite these challenges, there are reasons to be optimistic about legislative changes related to small business transitions. First, small businesses are among the most politically popular entities, receiving bipartisan support. A 2024 study by PEW Research found that 88% of Democrats and 87% of Republicans hold favorable views of small businesses.

Second, both the Senate and House have committees dedicated specifically to small business issues, allowing them to focus on advancing legislation within their jurisdictions. Even for issues that fall outside these committees, such as tax and antitrust matters, the political popularity and influence of small businesses often extend across Congressional jurisdiction. Finally, the upcoming 2025 tax bill expirations present opportunities to rethink various factors impacting small businesses, as identified in this study.

If legislative action is blocked, administrative action remains a possibility, especially under a sympathetic administration. Recent examples within the small business space include executive action around new green lenders. We hope that the data presented in this study will provide empirical rigor and precision for policy discussions, even if bipartisan disagreements slow legislative progress.

In the section below, we outline a set of policy bundles designed to support a more robust and functional small business landscape during periods of transition. Rather than proposing entirely new legislation, we have identified existing bills that align with the core findings of this study. Recognizing that legislative expertise often resides with policymakers, our hope is to offer a rigorous empirical understanding of the key stakeholders involved in these transitions.

Opportunities for Policy Innovation

Policy Bundle 1 - Stemming the Tsunami by Increasing the Attraction of Small Business Ownership

A transition of business ownership can occur naturally due to demographic shifts, such as the retirement decision of existing owners. However, transitions can be more exogenous when the policy conditions impacting the relative ease of business ownership impact individuals in those roles – making them pursue this path before they might otherwise want. In discussions with current business owners, many outlined some of those pain points when discussing challenges such as the rising costs of goods, a shortage of high-quality labor, and an increasing difficulty in competing with larger firms.

While not dealing directly with the point of transition, therefore, the first bundle of policies focus on levers that make small business ownership more attractive as a whole. This can be seen as a set of policies that stem the tide of transition or make the decision to purchase a small business more attractive, and thus increasing willingness to pay on the part of the new owners. Examples of these policies include but are not limited to:

- **H.R. 7024 - Tax Relief for American Family and Workers Act (2024) - Introduced by Representative Jason Smith (R-MO):** This bill extends three critical business tax incentives: (1) the deduction for domestic R&D expenses; (2) the EBITDA standard for determining the limitation on business interest; and (3) 100% bonus depreciation. Small businesses have been most acutely impacted by the lapse of these key policies, and the idea is that such changes would increase domestic small business investment by reducing the associated tax costs while increasing tax certainty and simplicity

- **S. 4764 – Coordinated Support for Rural Small Businesses Act - Introduced by Senators Jeanne Shaheen (D-NH) and John Kennedy (R-LA):** This bill focuses on rural businesses, providing targeted resources and support to help them thrive in areas where larger companies have less presence. By addressing key challenges such as limited access to capital, skilled labor, and infrastructure, this legislation helps level the playing field for rural small businesses.

- **Extensions to the State Trade Expansion Program (STEP) and improved access to federal contracting opportunities for small businesses.** This includes:
    - **S. 4414 - The STEP Modernization Act of 2024** to streamline the application, reporting and compliance requirements,
    - **S. 3772 - The Subcontracting Simplification Act** to require the Small Business Act to require prime contractors to communicate subcontract opportunities to small businesses in a clear, concise and accessible manner,
    - **S. 3971 - The Small Business Contracting Transparency Act** amends the Small Business Act to require SBA to provide an annual report to the Senate and House Small Business Committees on certification activities and contract awards within the Women-Owned Small Business (WOSB), Historically Underutilized

    Business Zone (HUBZone) and Service-Disabled Veteran-Owned Small Business (SDVOSB) programs.
  - **H.R. 7987 - The Plain Language in Contracting Act** which makes federal contracting opportunities more accessible to small businesses by requiring notices to be written in clear and accessible language."

- **S. 5063 – Helping Small Businesses THRIVE Act (Introduced by Senators Bill Cassidy (R-LA) and Jeanne Shaheen (D-NH)** - The bill aims to help small businesses manage costs by allowing them to hedge against price volatility in essential commodities like gasoline, diesel, and electricity. The legislation directs the Small Business Administration (SBA) to establish a program to assist small businesses in locking in prices for critical inputs, offering them protection from unpredictable price spikes.

Many of these bills reflect bipartisan sponsorship. All focus on helping small businesses compete with larger corporations. Describing the core underlying logic, Senator Shaheen adds this when discussing the THRIVE proposed legislation in particular: "Small businesses are the backbone of our economy and deserve a level playing field. By empowering them to lock in prices for key commodities, we can help small businesses compete with larger businesses, create good-paying jobs and expand their business."

The final factor linked to conditions of ownership is the upcoming tax reforms. particular, we focus on potential of the lifetime gifting exclusion to be halved in January 2026, from approximately $14 million to $7 million per individual, barring Congressional intervention. As one investor noted in our discussion, this will likely trigger an accelerated sale of private companies and the gifting of stocks before the new policy takes hold.

To the extent that legislators think maintaining small private and family ownership is an important part of the US economy, avoiding an accelerated wave of transitions could entail either extending this exception or considering models where certain types of business (smaller family-owned entities, for example) might have a business exemption to this change.

In writing in the UC Irvine Law Review, for example, Professor Ben Means makes a case for a state based family corporate status, or F-Corp, (similar to B Corp available in 38 states and Washington, D.C.) that could provide clarity on who receives such exceptions. To the extent that this is seen as a path toward protecting generational wealth, we would anticipate understandable pushback. But if these businesses provide a bedrock to local communities, then reason for support might be more clear.

Policy Bundle 2 - Increasing Options for Dual Purpose Ownership

Our second bundle of policy relates to extending or generating opportunities for the continuation of the ownership models that seek to balance profit and other social purposes. Indeed, we would argue that in an owner's care for things like long-term investors and cultural continuity, there is a desire for an owner to steward things which might be lost in particular kinds of transition.

In some ways, this is a case for control by owners embedded within communities or with particular purposes that extend beyond maximization of returns alone. Here again is Professor Ben Means with a piece on the value of insider control based around its broader stewardship purposes. He writes:

> *Controlled companies can soften the harder edges of capitalism by bringing the values of controlling owners into the marketplace. Unlike the managers of public corporations with widely dispersed shareholders, controlling owners have a personal stake that gives them reason to identify with their business and to care about its long-term success. A stewardship model signals commitment to other investors while also potentially benefiting employees, customers, and communities* (Means 2018: 935)

The two sections below outline policies centered around two forms of ownership that might be more naturally oriented around this dual mission. The first is about making it easier to transition from family to family (versus family to investor or competitor), and the second is about allowing for expanded ownership by charitable foundation as seen by models pursued by Hershey, historically, and Patagonia, more recently.

F. Corp and Transition Incentives

As mentioned earlier, Professor Ben Means makes a theoretical case in the UC Irvine Law Review for the potential benefits of a state designed family corporate status, or F-Corp, similar to the existing B Corp status. In this piece, he outlined the particular tax challenges for family businesses that might need to be addresses, and could be a part of a 2025 reform. He write:

> *Family businesses often lack the accumulated assets necessary to buy out incumbent owners who are ready to retire, and banks may be reluctant to provide credit to younger, unproven managers. To reduce the financial burden, thereby incentivizing lifetime transfers of ownership and control, lawmakers could offer low-cost loans, tax subsidies, bidding preferences for government contract work, and free counseling.* (Means 2022 1277-78).

The generally positive outcomes for employees in firms going through generational transition lend credence to this model. Support here can also be found in the general interest of family firms in socio-emotinoal wealth versus financial wealth alone, and the cascading impact on communities in particular. Further work is needed to verify these claims, but if these findings hold, finding ways to bolster family transition through clarity on who fits this mold (F-Corp) and tax subsidies might make these positive employee outcomes more likely.

Expansion of Dual-Purpose Models

Over the last few years, interest has grown in dual-purpose tools for ownership such as the Purpose Trust, employed most publicly by Yvon Chouinard in his 501(c)(4). As outlined in his letter announcing the transition:

> 100% of the company's voting stock transfers to the Patagonia Purpose Trust, created to protect the company's values; and 100% of the nonvoting stock had been given to the Holdfast Collective, a nonprofit dedicated to fighting the environmental crisis and defending nature. The funding will come from Patagonia: Each year, the money we make after reinvesting in the business will be distributed as a dividend to help fight the crisis.

Other models of foundation ownership in the US include the ownership of publicly traded Hershey by the Hershey Trust Company, through approximately 30% of Hershey's stock and 80% of the voting shares.

Such models of foundation ownership are less common in the U.S. due to the Tax Reform Act of 1969. In this model, private foundations are subject to the Excess Business Holdings Rule, which limits the amount of ownership they can hold in a for-profit business, typically to 20%.

In other countries, Germany most notably, such models of significant Foundation financial ownership and majority voting control, what they call "Stiftung," are more common. These ownership models can be found in German companies as diverse as Bosch, Bertelsmann, and Zeiss. The intent in these models is to ensure the long-term stability of the business while also leveraging some of the financial benefits for a particular charitable purpose.

Exploring a re-opening of these kinds of models is not without support from this report. Such evidence includes a growing interest in creative models of dual purpose ownership (e.g., Patagonia), the interest on the part of ownership to pursue social ends as seen in our work, and some evidence that high performance is possible here as seen by examples such as Hershey. An expansion of these kinds of ownership models would allow small business owners greater optionality and methods of extending their legacy by supporting the communities in which these companies were founded.

Policy Bundle 3 - Expanded Options for Employee Ownership in Transition

The third policy bucket deals with employee ownership more directly. The data from business owners in this study suggests relatively high preference for employee ownership in transition. The employee data is also suggestive of the potential positive outcomes for the employees within this kind of transition. Taken together, facilitating a greater amount of employee ownership during these transitions, and perhaps novel models for doing so, is a worthy policy objective.

Recent bipartisan initiatives, such as the [Employee Equity Investment Act](), support this by providing expanded loan guarantees to investor groups focused on expanding employee ownership. Below are several pathways to facilitate transitioning to employee ownership in existing small to mid-sized businesses.

- **S. 2515 - Employee Ownership Expansion Act- Sponsored by Senator Ben Cardin (D-MD) and Senator Steve Daines (R-MT) -** The bill aims to incentivize business owners to sell their shares to ESOPs, allowing employees to become part-owners of their companies. The legislation includes provisions for tax deferrals and technical assistance to companies forming ESOPs.

It is important to recognize that employee ownership can take many forms beyond traditional employee stock ownership plans (ESOPs), and not all transitions are suitable for an ESOP structure. As one business owner noted "for a decently valued family company of a smaller size, the amount of debt required to move toward a full ESOP would put a lot of pressure on our people-first, paced-growth model." As such, continued work to expand the models for employee ownership is needed.

A second policy lever involves encouraging investors to incorporate employee ownership into private investment deals—whether through private equity funds, family offices, or similar arrangements. This model has recently gained recent traction, with Kohlberg Kravis Roberts's Pete Stavros advocating for it through his non-profit, Ownership Works.

However, this approach is not suitable for all firms. As one investor commented:

> *"The best candidates for this kind of transition are businesses with lower-paid hourly FTEs. In contrast, in our estimate, the model does not work with all businesses. Given the economic impact to an individual can get really diluted the more employees you have, often the company simply can't give away enough for the math to be meaningful. As a result, it becomes more about the feeling of ownership, less the economic impact."*

While encouraging more ESOPs in private equity is a worthy endeavor, our question, what could encourage a broader range of employee ownership in investor behavior? One investor argued that one path is the offering of a tax credit against a long-term capital gain for equity given to employees. Such models would encourage models beyond ESOP alone to drive more equity into the hands of employees, even the majority owner sits outside of the region.

Another family office investor we spoke to outlined how policy adjustments around the treatment of phantom equity might yield similar benefits. As an investor, their strategy is to reserve a portion of common stock for managers to purchase at the initial buy-in price, either immediately or after the point of transition. These shares track the company's value over time and, if held for more than a year, are taxed at the capital gains rate. However, once these shares run out, the investor often must create additional units of phantom equity, which track the firm's value but are taxed as ordinary income. Thus, while employees may feel like owners, the taxation of phantom

equity as ordinary income reduces the financial benefits, which could discourage investors from pursuing such structures. Adjusting tax policy to treat long-held phantom equity as capital gains could incentivize more investors in the lower middle market to pursue this approach.

In either case, whether through mainstreaming existing models of providing employee ownership through ESOPs (e.g., Pete Stavros and Ownership Works), encouraging investor behavior through tax credits, or changing the taxation of phantom equity, encouraging greater employee ownership through the investor class is a fruitful opportunity for innovation forward.

Policy Bundle 4 - Incentives to Encourage Longer-Term Investor Behavior

The final, and perhaps most challenging, hurdle is promoting long-term behavior on the part of investors. This is particularly difficult because it often falls outside the direct jurisdiction of the Small Business and Entrepreneurship Committee and may require broader changes to the tax code.

That said, unlike some broad-scale advocates or critics of specific ownership types (e.g., those arguing for or against family ownership, or private equity as an asset class), our study shows that, even when controlling for who the owner is, before *and* after a transitions, it is the investor *strategy* that matters the most for employee outcomes. In our assessment, the liklihood of pulling many of these strategic levers that matter most to the long-term vibrancy of the business and the employees within is directly linked to the investment time horizon. Put simply, strategies aimed at creating sellable value will differ significantly for those operating with a three- to five-year investment horizon compared to those planning for 10 years or more.

The policies identified below aim to spur greater long-term investment behavior amongst investors, whether they are employees, private equity funds, individuals, or families.

4A - Capital Gain Extensions at 10+ Year Holds

The distinction between short-term and long-term capital gains was first introduced in the Revenue Act of 1921 to encourage individuals to hold assets for longer periods, and thus promote greater economic stability. Originally, holding assets for two years qualified them for long-term capital gains treatment. Today, assets held for less than a year are taxed as short-term capital gains, while those held for more than a year are taxed at the long-term capital gains rate.

That said, in private investment, the distinction between holding assets for less than or more than one year is relatively arbitrary in terms of the time horizon required to create value in private company investment. For example, both six-month and two-year buy-and-hold periods would be considered quick flips, even though the latter would benefit from lower tax rates.

One recommendation then is to offer incentives for holding assets over longer periods—such as 10 years or more. While a model like this might introduce some complexity to the current tax

code, it is still simpler than a true gradation system that varies based on year-to-year differences in the exact length held.

Further research is needed to determine how this change could influence investor behavior and whether the optimal holding period should vary by industry. In either case, we suggest that encouraging more investors – of a variety of different forms – to adopt longer time horizons would likely yield net benefits for companies, employees, and the communities in which they operate.

4B - Modifications to the Qualified Small Business Stock (QSBS) Exemption

Another policy that could be adjusted to increase the time horizon of the investor is the Qualified Small Business Stock (QSBS) Exemption. Under current U.S. law, QSBS allows investors in qualifying small businesses to exclude up to 100% of capital gains from federal taxes, provided the stock is held for at least five years. The exemption applies to investments in C corporations with gross assets of $50 million or less at the time of issuance, which must also operate in active business sectors excluding certain industries like professional services and finance.

As one investor noted, however, they would trade a longer time horizon of investment in exchange for increasing the enterprise valuation limit. While beyond the scope of this study, considering different combinations of assets and time (e.g., $60M and 7 years, $70M and 10 years) and their impact on investor time horizon warrants further exploration.

Looking Beyond Policy Alone - The Role of Educational Institutions

Because of the role of many on the Commission within American business schools, one final opportunity for expanding the vibrancy of the small business landscape outside of policy alone is worth noting – education. While some of the challenges of small to medium-sized enterprises can be addressed through policy, still others will require innovation by investors, business owners, and yes, educational institutions. Specific to the latter group, by providing small business owners with the skills and knowledge needed to improve their operations, these institutions can help support thriving businesses—ultimately benefiting local communities and the broader economic ecosystem.

As noted earlier, while small businesses hold bipartisan support and relatively high trust from society, they are not always the most professional entities and the jobs are too often of lower quality when compared to those at larger firms. Leveraging the World Management Survey (WMS) tool, research by Nicholas Bloom and colleagues has shown the distinct challenge of professionalism by both family and founded-owned firms (see Figure 12). And yet, this research shows that this gap can be bridged both by who is managing these firms (see the positive impact of a non-family CEO) and by education of those in ownership and management.

Figure 14 - Professionalism of Different Groups by Ownership Structure.

Specific to education, within medicine, Bloom and colleagues find that access to executive education programs significantly increases the professionalism of hospital administrators and the systems in which they manage. By extension, engaging existing business owners in short-term executive education or degree-based programs focused on what it means to be a competent strategic owner could yield substantial benefits—whether by helping them build sustainable, long-term businesses or preparing them to create value that can be captured at the point of sale.

This same emphasis also applies to education of private company investors. The way future private investors are taught at business schools nationally and globally should reflect some of the potential tensions between short-term time horizon and true long-term valuation creation. Encouraging creativity in the deployment of patient capital is a significant opportunity for innovation for leading business educational institutions.

Conclusion

In this paper we have outlined both the challenges and opportunities facing small and medium-sized enterprises (SMEs) in the upcoming wave of ownership transitions.

As current owners retire, we will see unprecedented shifts in ownership, impacting millions of businesses across the U.S. economy. This transition provides significant opportunities for reimagining ownership structures, including increasing employee ownership, promoting long-term investor behavior, and fostering greater inclusivity in business leadership.

However, without thoughtful policy interventions, many businesses may struggle to survive—jeopardizing jobs, community cohesion, and local economies.

To inform this work, our team looked at three key stakeholders in the transition – the investor, the owner, and the employee, believing that win wins across these groups provide opportunities to generate a more robust small to medium sized business landscape for years to come.

From this work, we identify a set of robust opportunities::

1. **Stemming the Tsunami**: Increase the attractiveness of small business ownership through targeted support and tax incentives, particularly for rural and minority-owned businesses.

2. **Promoting Dual-Purpose Ownership**: Expand options for dual-purpose ownership models that emphasize both profit and social purpose, allowing businesses to maintain community and employee-centric values.

3. **Encouraging Expansive Forms of Employee Ownership**: Expand pathways to employee ownership through legislative initiatives like the Employee Ownership Expansion Act, ensuring that transitions benefit both investors and workers.

4. **Incentivizing Long-Term Investor Behavior**: Introduce tax incentives to encourage long-term investment strategies, reducing the risks associated with short-term ownership transitions that can destabilize firms and negatively impact employee outcomes.

These policy bundles, if implemented, could help ease the impact of ownership transitions by protecting workers, sustaining communities, and fostering a more inclusive and resilient economy.

Finally, educational institutions and business schools have a unique role to play in supporting SME transitions. By offering owners and managers the skills needed to navigate complex transitions, we can ensure that more businesses thrive in this new landscape. Through these combined efforts, the upcoming wave of transitions can reinvigorate the vital role that small businesses play in the American economy.

Appendix

Table 1 - Specific Measures of Employee Outcomes in Transition

I. **Job quality** - based on an overarching Department of Labor Construct
   A. I had a competitive wage and benefits
   B. All workers were valued and respected by leadership
   C. There were transparent promotion/advancement opportunities
II. **Job as a calling** [1 = strongly disagree to 7 = strongly agree]
   A. I worked in a job that closely aligns with my calling.
   B. I worked in a job to which I feel called.
III. **Work as Meaning Inventory** [1 = strongly disagree to 7 = strongly agree]
   A. I had found a meaningful career.
   B. I viewed my work as contributing to my personal growth.
   C. The work I did served a greater purpose.
IV. **Career commitment** [1 = strongly disagree to 7 = strongly agree]
   A. I liked my job too well to give it up.
   B. My job was an ideal line of work.
V. **Job satisfaction**
   A. I felt fairly well satisfied with that job.
   B. Each day of work seemed like it would never end (reverse scored).

Table 2 - Investor Strategy and Employee Outcomes Regression

Full Regression Results

	Estimate	Std. Error	t value	Pr(>|t|)	
(Intercept)	4.52541	0.25525	17.729	< 2e-16	***
BUSINESS OWNERSHIP BEFOREHAND ("Which of the following describes the business before the ownership transition? Check all that apply")					
One person	-0.27097	0.17982	-1.507	0.132568	
A family	-0.21764	0.17989	-1.210	0.227019	
Multiple external people	-0.29006	0.18608	-1.559	0.119777	
Multiple internal people (e.g. ESOP)	-0.03595	0.22506	-0.160	0.873145	
Private equity	-0.39329	0.16768	-2.346	0.019453	*
Hedge fund	0.56178	0.35434	1.585	0.113606	
Public listing	-0.18267	0.28820	-0.634	0.526525	
Do not know	0.21868	0.41465	0.527	0.598197	
TRANSITION TYPE PURSUED					
Employee(s)	1.02670	0.25877	3.968	8.5e-05	***
Family members(s)	0.58595	0.31677	1.850	0.065037	.
Other family	0.75594	0.22705	3.329	0.000945	***
Competitor(s)	0.43102	0.20491	2.103	0.036004	*
Private equity	0.34160	0.21569	1.584	0.113977	
Public lsting	0.51062	0.47483	1.075	0.282802	
INVESTOR STRATEGY PURSUED					
Cost reduction	-0.27779	0.11833	-2.348	0.019345	*
Improve IT	0.49232	0.12829	3.838	0.000143	***
Introduce shared back-office	0.26040	0.17654	1.475	0.140951	
Increase revenue	0.12326	0.12206	1.010	0.313155	
Redefine strategy	-0.18204	0.12206	-1.491	0.136568	
Change CEO/CFO	0.07483	0.11964	0.625	0.531988	
Change senior management team	-0.22933	0.12560	-1.826	0.068556	.
Improve corporate governance	0.39446	0.16392	2.406	0.016528	*
Improve incentives	0.48536	0.13870	3.499	0.000515	***
Make acquisitions	-0.05734	0.18550	-0.309	0.757372	
Bring strategic investor	0.10685	0.18225	0.586	0.557997	
Facilitate exit	0.06022	0.30447	0.198	0.843315	

Signif. codes: 0 '***' 0.001 '**' 0.01 '*' 0.05 '.' 0.1 ' ' 1
Residual standard error: 1.202 on 431 degrees of freedom
(15 observations deleted due to missingness)
Multiple R-squared: 0.2157, Adjusted R-squared: 0.1683
F-statistic: 4.558 on 26 and 431 DF, p-value: 6.947e-12

Table 3 - Relevant Policies to Ownership Transitions

Policies constraining transition options:

Policy Lever	**Example**
Federal Antitrust Enforcement	Antitrust law prohibits a business combination when its effect may be substantially to lessen competition or to create a monopoly. Markets in which anticompetitive effects are assessed may be regional or even local. Both federal regulators and private parties possess prosecution authority.
Federal Restrictions on Ownership in Sensitive Industries	The President possesses the authority to suspend or prohibit transactions resulting in foreign ownership of domestic businesses when such ownership threatens to impair national security.
Federal Industry- and Contract-Specific Restrictions	FCC rules limit the number of radio or television stations a single owner may be licensed to operate.
State Restrictions on Ownership	Most states prohibit nonlawyer ownership of law firms.
State Corporate Law Fiduciary Duties and Shareholder Rights	Delaware grants appraisal rights to shareholders who dissent from a merger, preventing a majority shareholder from effecting a transition transaction which would squeeze them out at less than the fair market value of their shares.

Policies incentivizing certain transition decisions:

Policy Lever	**Example**
Estate, Gift, and Inheritance Taxes and Exemptions	The $13.61 million federal estate and gift tax exemption allows the transfer of private company stock without imposing tax at the point of transfer. Recipients are granted a step-up in basis.
Tax Forgiveness of Gain On Sale	50% of any gain resulting from the sale of qualified small business stock receives federal tax forgiveness.
Capital Gain Recognition Deferral for Sellers	A seller of private C-corp. stock to an ESOP who

	held such stock for three years prior to sale and reinvests the sale proceeds in domestic stock or corporate bonds may defer recognition of federal capital gains resulting from the sale.
Privileged Acquisition Financing	The SBA supports the lending of acquisition financing to individuals, ESOPs, and qualifying small strategic acquirers through its 7(a) loan program, which may reduce the cost of acquisition financing available to those buyer types. In calculating federal taxable income, businesses acquired by ESOPs may deduct subsequent contributions made to the ESOP that the ESOP then uses to repay its acquisition loan's principal and interest.
Favorable Tax Treatment of Debt Capital	Interest payments on debt are deductible from federal taxable income, while dividend payments are not, thereby reducing debt's cost of capital relative to equity.
Dividends Deductibility	Dividends *are* deductible from federal taxable income when they are paid in cash with respect to shares owned by an ESOP.
Holding Period Requirements for Preferential Tax Treatment	Long-term capital gains treatment at the federal level, typically available for gain resulting from the sale of stock held for at least one year, is available to private equity fund sponsors receiving such gain through a carried interest mechanism only if the stock is held for at least three years.
Availability of Government Funding	The Small Business Innovation Research program requires every federal agency with an extramural research and development budget exceeding $100 million to set aside 3.2% of that funding for small businesses.