

Entrepreneurs

A challenging opportunity
for financial advisors in Canada



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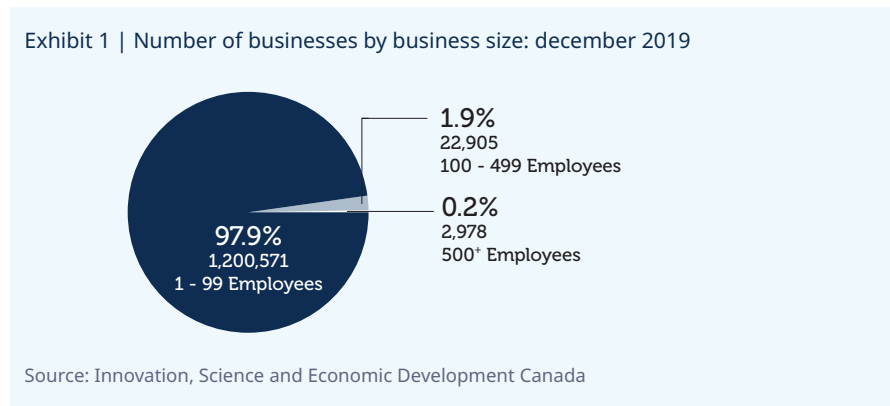
A challenging opportunity for financial advisors in Canada

Of the seven segments within Canada's High Net Worth (HNW) community, two stand out in terms of future growth and opportunity. The two segments – entrepreneurs and retirees – represent unique challenges for financial advisors given that the two groups tend to occupy the extremes of the risk appetite spectrum.

This brief paper will address the opportunity with entrepreneurs and highlight some of the major wealth management issues that set this segment apart. This paper is not a road map for success, nor is it a guide to products and services that might appeal to an entrepreneur; rather, the routes and solutions are as unique as the individuals themselves.

Some numbers

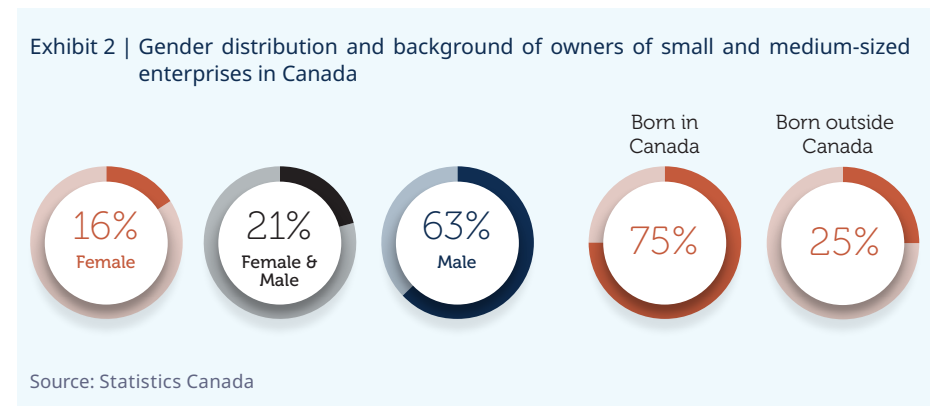
Before exploring the wealth management needs, expectations and attitudes of entrepreneurs, it is worth putting down some numbers to underline the breadth and diversity of the segment. At the end of 2019, small- and medium-sized enterprises (SMEs) in Canada, most of which are owner managed and have fewer than 500 employees, totalled 1,223,476¹ (Exhibit One). Removing the micro businesses (those with fewer than 10 employees) provides a better idea of the number of established entrepreneurs that may be seeking advice. That number is approximately 322,000, which is equivalent to 38% of the HNW segment.



Demographics

While good data is hard to come by, Government of Canada statistics offers some insight into the composition of the entrepreneur community. Knowing a bit more on a demographic level will help advisors develop sales and relationship programs that target this hard-to-penetrate segment that is in the sights of every private banker, financial advisor, full-service broker and investment counsellor across the country.

Additionally, 63% of SMEs are owned by men, with another 21% owned jointly by men and women (frequently related)². That leaves 16% owned by women, a share that is set to grow (Exhibit Two). A recent report in the United States indicated that 30% of new business startups had a woman at the helm and that the number of female business owners had increased by 114% in the two decades ended December 2020.³



Despite stories to the contrary, business ownership is not the playground of millennials but, rather, their parents, with almost two-thirds of SMEs managed by people over 50³. It is also not an occupation that attracts risk-takers without education, as 70% of entrepreneurs have a degree or diploma. Thus, Canada's entrepreneurs tend to be middle-aged and educated.

Not just business smart

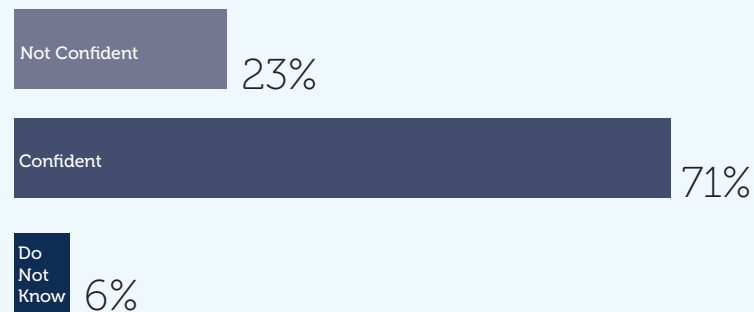
Knowing some of the demographic basics about entrepreneurs is only a start. Advisors seeking to attract and retain the personal wealth business of business owners need to understand much more.

At the beginning of any relationship, it is essential for an advisor to understand the level of financial knowledge of their client. Canadians, in general, tend to be humble and just 40% of those with portfolios in excess of \$500,000 indicate

that they possess an above-average knowledge about financial matters.⁴ Compare this to the 68% of entrepreneurs who rate themselves as either “Very Knowledgeable” or “Knowledgeable”⁴.

This high level of entrepreneurial confidence is underscored by the fact that 71% of entrepreneurs surveyed by BDC⁵ report that they know how much money they will need to fund their retirement (Exhibit Three) compared to 54% of Canadians overall.⁶

Exhibit 3 | Confidence by entrepreneurs in retirement preparation



Source: Business Development Bank Canada

The need for advice – and advisor challenges

Although they trust their own judgement, entrepreneurs appear to possess a lower level of confidence in the abilities of financial advisors than do most Canadians. In fact, two recent studies⁷ show overall levels of satisfaction, with advisors as ranging between 74% and 83%, with an even greater level of satisfaction being reported by investors claiming a high degree of financial literacy (87%) and those with portfolios over \$500,000 (85%). Compare this data with the 63% of entrepreneurs who trust their advisors⁷.

Notwithstanding this lower level of confidence in the financial advisor community, research suggests that entrepreneurs are, in fact, more likely to seek guidance from a wealth management professional than most affluent Canadians. The reasons for this are threefold: First, in the majority of cases, investing and financial planning are not the areas of expertise used by the entrepreneur to create sustainable wealth; second, generally entrepreneurs concentrate their efforts on creating wealth within their business, not outside their business. Finally, by default, the financial affairs of entrepreneurs are complex.

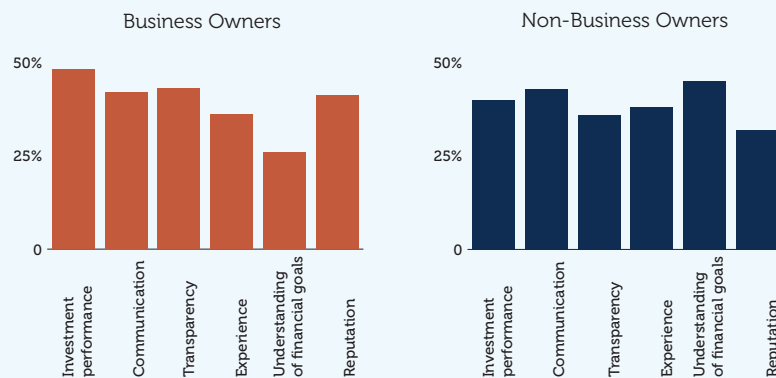
Finding the right advisor to work with can prove a challenge for the business owner. Successful financial advisors generally manage client wealth within a defined process and risk management framework which emphasizes diversification – an approach which is rarely consistent with the mindset of an entrepreneur who tends to focus on one or two areas of expertise and interest. The challenges associated with working with entrepreneurs are exacerbated by the fact that entrepreneurs are independent, not collaborative decision-makers and hold the view – supported by their commercial achievements – that their judgement is usually correct.

Choosing an advisor

A study undertaken in the United States highlights some differences between business owners and non-business owners in terms of issues of importance when selecting a wealth manager.⁸ At the top of the entrepreneur’s list is investment performance, an issue that barely makes third place on the list of priorities for non-business owners. That entrepreneurs are driven by achievements against targets, return on equity and growth, and the ranking of investment performance should come as no surprise.

Other issues that rank higher with entrepreneurs than with non-business owners include transparency around performance and fees and the reputation of the firm, the latter of which was rated as a desired quality by 41% of entrepreneurs compared to just 32% of non-business owners⁸. On the flip side, entrepreneurs are far less concerned than non-business owners about advisors developing a financial plan and understanding personal financial goals and are less focused on fees and commissions (Exhibit Four).

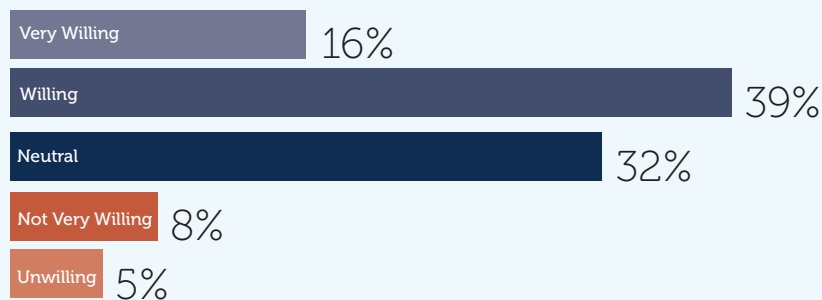
Exhibit 4 | Desired qualities of a financial partner/advisor (percentage identifying)



Source: Boston Private

Entrepreneurs are also attracted to wealth management firms that offer a lot more than plain vanilla investment solutions. Ownership of tangible assets or funds that invest in tangible assets, such as investment real estate and timberland, are popular with entrepreneurs, with over 50% of surveyed business owners reporting ownership and another 34% indicating an interest.⁹ While the attraction is primarily portfolio diversification and yield enhancement, it also poses an opportunity to assume risk, an essential characteristic of successful entrepreneurs (Exhibit Five).

Exhibit 5 | Willingness of business owners to take personal investment risk



Source: Business Development Bank Canada

For the sake of comparison with the average investor, 55% of Canadian entrepreneurs are willing to assume a level of risk in their personal investments compared to 42% of investors in general. The difference becomes even more stark when the willingness to assume significant risk is concerned with the percentages being 16% and 5% respectively⁹.

Thinking about the future

The need for sophisticated financial advice becomes much clearer to entrepreneurs when they begin to consider retirement, legacy planning and business succession – the latter being an issue unique to all entrepreneurs. Some observers have even suggested that employees of a family-owned business may enjoy a more comfortable retirement than their bosses as a result of almost mandatory participation in a variety of retirement and pension plans.

Throughout the life of a business, the owner(s) are faced with a variety of decisions that could impact both the financial strength of the enterprise and the creation of personal wealth for the owner and his or her family. Among these issues are the ownership structure of the business, including the use of trusts; income splitting through the payment of a salary to family members and/or paying dividends to family members; the use of insurance including disability and critical illness associated with the business owner(s); and the use of Individual Pension Plans and supplemental executive retirement plans. The list goes on, and advisors dealing with entrepreneurs are expected to be aware of the unique wealth management opportunities and challenges faced by business owners, whatever the lifecycle stage of the business.

One other issue linked to legacy planning that should not be overlooked by advisors is the growing evidence that entrepreneurs of both sexes place considerably more importance on contributing as both donors and volunteers to charitable and community organizations than non-business owners (Exhibit Six). Advisors need to be aware of the use of private foundations, donor-advised funds and insurance to meet the philanthropic goals of their clients.

Exhibit 6 | Drivers of change in financial priorities (multiple answers permitted)

	Business owner	Non business owner
Family	70%	73%
Personal fulfillment	51%	45%
Philanthropic activities	39%	25%
Social and civic commitment	26%	16%
Material possessions	21%	11%
Religious communities	18%	27%

Source: Boston Private

Other things to consider

Giving wealth advice to entrepreneurs also places additional demands on advisors, as they are forced to develop and maintain an understanding of the operating business that is creating wealth for the individual and his or her family; the structures, such as holding companies, trusts and foundations, that have been used to hold assets outside the operating company; and the dynamics and expectations of the family whose members may not always agree with the founder of the business.

Perhaps more than other types of clients, entrepreneurs possess a desire to see the wealth they have created – both within and outside their business – passed on to successive generations. However, despite it being a priority, research by Deloitte indicates that just 30% of wealthy families see their wealth survive beyond the second generation, while a mere 10% of families preserve their wealth beyond the third generation.¹⁰ Advisors are often called upon to mediate between family members who wish to preserve and grow wealth and those who are more interested in spending it.

Another complicating factor is that entrepreneurs tend to use multiple advisors, some of whom are focused on the financial aspects of the enterprise, while others deal with wealth and liabilities of the business owner and his or her immediate family outside the business. As a result, advisors who work with entrepreneurial families need to be both objective and diplomatic, not to mention financially alert and able to navigate a maze of competing opinions and priorities. Certainly, that is not a task for the faint of heart, although it is one that represents an opportunity for financial advisors to build their own business alongside those of their entrepreneurial clients.

Notes

- ¹ Key Small Business Statistics 2020. Innovation, Science and Economic Development Canada. 2020.
- ² Statistics Canada 2019.
- ³ <https://www.fundera.com/resources/women-owned-business-statistics>
- ⁴ Investor Experience Research Study. Ontario Securities Commission. August 2020.
- ⁵ Financial literacy among Canadian entrepreneurs and business owners. BDC Research and the Telfer School of Business at the University of Ottawa. December 2017.
- ⁶ BMO RRSP Survey conducted by Pollara Strategic Insights. November 2020.
- ⁷ Innovative Research Group. 2019.
- ⁸ The Why of Wealth Survey. Boston Private. 2018.
- ⁹ U.S Trust Insights on Wealth and Worth. 2017.
- ¹⁰ Private company issues and opportunities 2020. Deloitte. 2020.



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