

From Nest Egg to Seed Investment: Empirical Evidence from ROBS Plans

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Background

Demographics, Retirement Security and Entrepreneurship

How are retirement security and entrepreneurship related?

- Entrepreneurship is an important phenomenon among older workers
 - ▶ In 2014, around 25% of all businesses less than two years old were operated by individuals 55 or older (US Census ASE, 2014)
- Given the aging of the US population, this phenomenon is likely to grow in importance
- Most new businesses are started by people who already have jobs. This implicates retirement security in two ways:

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 - ▶ Entrepreneurship/self-employment as a remedy for under-saving
 - ▶ Retirement savings as a form of startup capital.

Background

Rollovers as Business Startups

Empirically challenging to get the full picture of the extent to which retirement savings are being used to start businesses. But one exception: ROBS

- A ROBS transaction allows entrepreneurs to take their 401(k) savings from their previous employer and make a tax-free rollover into a new business that they start.
- This practice raises a broad range of questions about the relationship between retirement security, entrepreneurship, and the future of work
 - ▶ Concentrating a once well-diversified retirement portfolio into a single business?
 - ▶ Allowing access to capital for certain types of individuals who might otherwise be unable to start a business?
 - ▶ Postponing retirement by enabling "lifestyle entrepreneurship"

This Project

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- Dept of Labor / IRS Form 5500 filings

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 - ▶ Detailed look at demographics, business characteristics, sources of capital
 - ▶ Limited to respondents who completed a survey
- Dept of Labor / IRS Form 5500 filings
 - ▶ Limited data on firm performance, financials, and motivations
 - ▶ Required of all firms who set up ROBS plans

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- Small Business Owner Survey Data
 - ▶ What does a person using a ROBS look like?
 - ▶ Why do people use them?
 - ▶ What do their businesses look like?

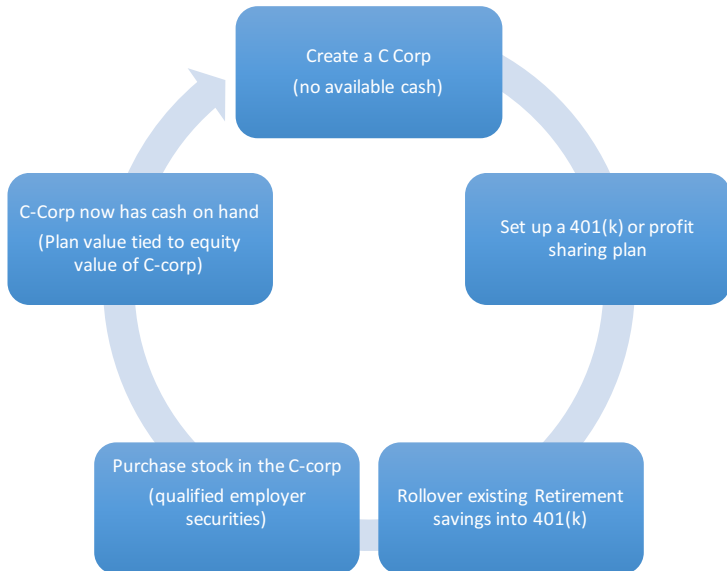
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- DoL/IRS Form 5500 Data
 - ▶ How Prevalent are ROBS plans?
 - ▶ Duration, Growth, Death of Businesses

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 - ▶ How Prevalent are ROBS plans?
 - ▶ Duration, Growth, Death of Businesses
- Conclusions and Next Steps

The Anatomy of a ROBS Transaction



Small Business Owner Survey Data

- Financial services firm that helps entrepreneurs secure financing
 - ▶ ROBS
 - ▶ SBA loans
 - ▶ other loans (unsecured, portfolio)
- Conduct an annual survey of current clients and potential clients
 - ▶ n=756
 - ▶ Invite about 6000 clients and potential clients to participate
 - ▶ Data from November 2018

Owner Demographics

Race	Non-ROBS	ROBS	p-val
Caucasian	0.35	0.76	0.00
Black	0.20	0.06	0.00
Hispanic	0.13	0.06	0.00
Asian	0.15	0.06	0.00
Native	0.03	0.01	0.27

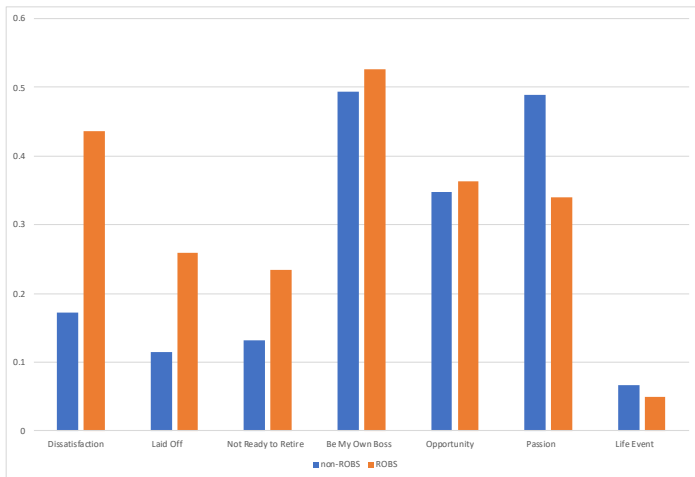
Education	Non-ROBS	ROBS	p-val
Associate's	0.15	0.12	0.16
Bachelor's	0.28	0.45	0.00
Master's	0.20	0.24	0.26
Doctorate	0.03	0.03	0.69
High School	0.33	0.16	0.00

Age	Non-ROBS	ROBS	p-val
18-29	0.07	0.00	0.00
30-39	0.18	0.03	0.00
40-49	0.26	0.21	0.10
50-59	0.31	0.51	0.00
60-69	0.14	0.22	0.00
70+	0.05	0.03	0.08

Sample Size	348	408	
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Reasons for Starting a Business

Which factors influenced your desire to go into business for yourself?



Pushed or Pulled into Entrepreneurship?

This table reports probit regressions in which the dependent variable is a dummy for whether the respondent in question launched their business by rolling over retirement assets. Push factors is the sum of "Dissatisfaction," "Laid off," and "Not ready to retire" from the previous table. Pull factors is the sum of "Be My Own Boss," "Opportunity," and "Passion" from the previous table. Point estimates are reported as marginal probabilities.

	(1)	(2)	(3)	(4)
Push factors	0.22*** (0.025)	0.20*** (0.027)	0.20*** (0.027)	0.18*** (0.028)
Pull factors	-0.05** (0.021)	-0.04* (0.023)	-0.04* (0.023)	-0.03 (0.024)
<u>Controls:</u>				
Race	No	Yes	Yes	Yes
Gender	No	No	Yes	Yes
Age	No	No	No	Yes
Observations	756	756	756	756

Standard errors in parentheses

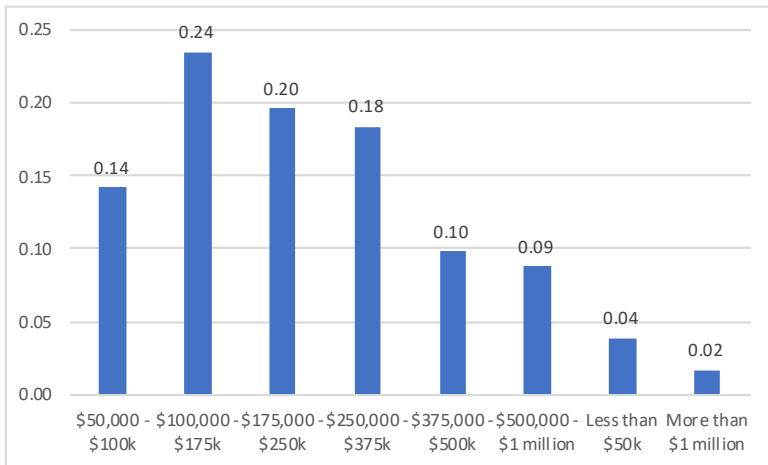
*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Employment

Employees	Non-ROBS	ROBS	Total
0-1	44	38	82
2-5	59	76	135
6-10	9	36	45
11-15	4	17	21
16-20	6	9	15
21-30	1	10	11
31-50	0	7	7
51+	1	7	8
Total	124	200	324

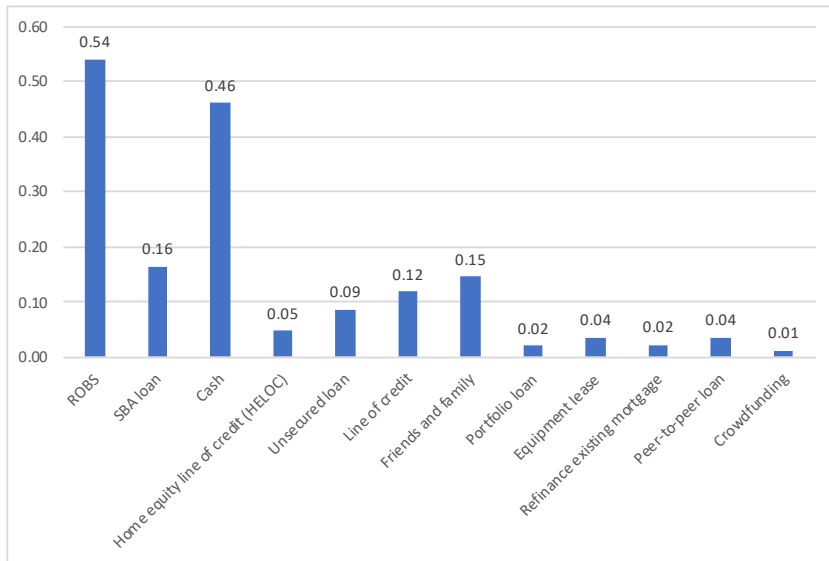
Distribution of ROBS balances

How much capital did you invest in your business using 401(k) business financing (ROBS)?



Sources of Financing

Which forms of financing did you use to start your business? (Please check all that apply)(n=756)

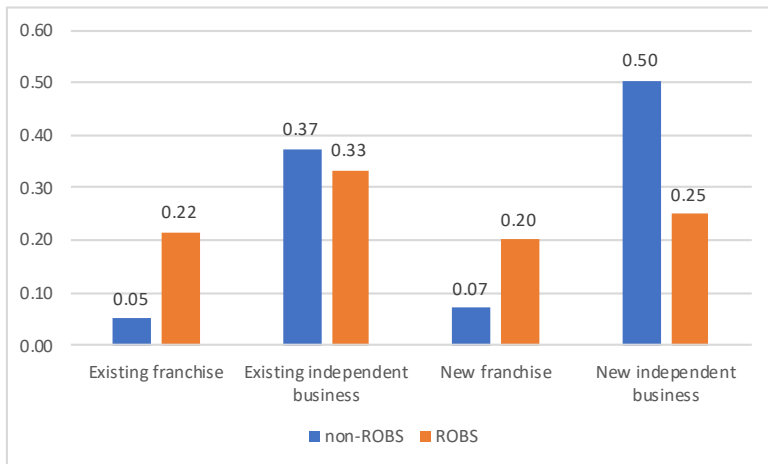


Complementary Sources of Financing

Financing Type	Non-ROBS	ROBS	p-value(diff.)
SBA Loan	0.109	0.210	0.0002
Cash	0.664	0.287	0.0000
HELOC	0.043	0.053	0.493
Unsecured Loan	0.115	0.064	0.0129
Line of Credit	0.152	0.091	0.0091
Friends & Family	0.221	0.083	0.0000
Port. Loan	0.289	0.0145	0.1821
Equip. Lease	0.037	0.034	0.8225

Types of Businesses Purchased

What type of business do you own?



In Sum

What the Small Business Owner Survey Tells Us

The proto-typical entrepreneur behind a ROBS transaction is a

- a well educated mid- to late-50s white male or white couple,
- who typically puts in excess of \$250,000 of retirement income,
- and not infrequently adds leverage from SBA loans,
- because they were laid off, dissatisfied with their current work, or not ready to retire,
- to buy a new or existing franchise.

Form 5500 Data

Data Overview

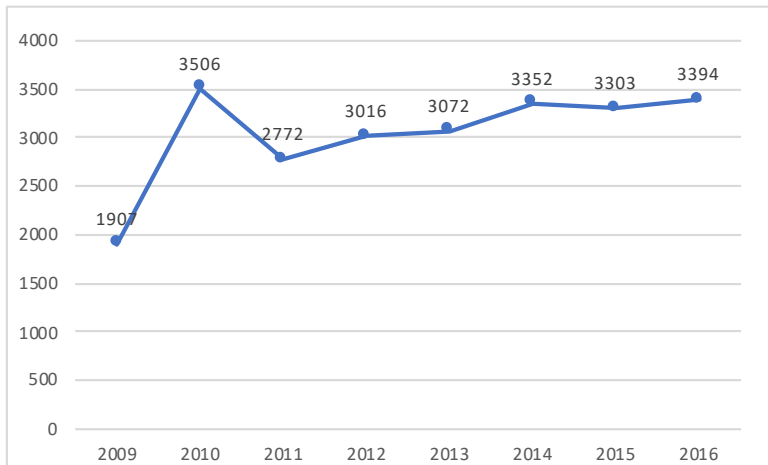
The IRS, DoL, and PBGC jointly developed the Form 5500-series so that employee benefit plans can satisfy annual reporting requirements.

- Employer or Plan Administrator of a Pension or Welfare benefit plan covered by ERISA must file
- For retirement plans, employers report details on the retirement plan, including number of participants, and whether the plan offers employer securities.
- Plans with one or two (in the case of married couples) participants can file the EZ or short form.
- However, ROBS plans cannot opt into the EZ or short form because they offer employer securities.
- Thus, they can be identified by their size, whether they offer employer securities, and their plan name. (Not an ESOP, fewer than 3 participants.)

We build a conservative estimate of the number of ROBS plans over time by flagging all 5500 filings with qualified employer securities, which are not ESOPs, which have fewer than three participants in their initial filing year.

Form 5500 Data

New ROBS businesses



Form 5500 Data

Startup Year	Qualified Employer Security Values				
	P25	P50	Mean	P75	P95
2009	61,005	117,898	154,894	200,000	418,157
2010	49,649	101,002	149,686	194,990	430,337
2011	60,000	119,000	164,533	207,449	461,096
2012	63,233	120,082	163,416	216,924	430,167
2013	67,075	131,666	176,851	234,816	485,000
2014	70,000	133,659	188,794	240,000	524,501
2015	72,089	140,000	194,960	250,000	540,000
2016	77,437	140,121	200,704	249,970	535,810

Form 5500 Data

Startup Year	Total Retirement Plan Asset Values				
	P25	P50	Mean	P75	P95
2009	65,507	123,574	164,143	209,281	442,619
2010	53,375	109,080	158,237	204,133	453,543
2011	68,330	127,710	177,124	222,172	498,009
2012	70,526	133,374	180,451	233,406	483,569
2013	74,975	145,225	194,426	254,633	510,519
2014	76,772	147,415	207,491	262,278	562,158
2015	79,745	150,661	210,172	269,614	581,153
2016	83,984	154,341	222,503	274,046	599,970

QES Values Over Time

Year	N	p25	Median	p75	p95	p99
Initial	24,322	65,000	125,000	225,000	490,000	887,542
$t + 1$	18,375	41,289	106,192	219,655	528,023	1,066,363
$t + 2$	13,455	38,571	111,492	234,300	599,222	1,284,767
$t + 3$	9,466	38,906	119,568	258,589	664,969	1,431,722
$t + 4$	6,421	40,033	125,919	275,273	762,800	1,664,655
$t + 5$	4,053	38,695	133,560	288,255	867,100	2,100,000

The Evolution of Firm Values over Time

2,742 in top three; 2,496 in bottom

Year	Group	Failed	Bottom 3	Middle 4	Top 3
2010	Top 3	4.2%	11.1%	19.3%	69.6%
2010	Bottom 3	8.1%	57.9%	35.8%	6.3%
2011	Top 3	5.8%	10.0%	26.7%	63.3%
2011	Bottom 3	15.2%	50.2%	39.7%	10.1%
2012	Top 3	9.8%	13.6%	24.8%	61.5%
2012	Bottom 3	21.7%	43.4%	43.0%	13.6%
2013	Top 3	13.8%	14.6%	27.8%	57.6%
2013	Bottom 3	29.0%	38.6%	47.1%	14.3%
2014	Top 3	18.4%	15.2%	30.7%	54.1%
2014	Bottom 3	35.0%	42.7%	42.2%	15.1%

Firm Survival

Year	Percent Surviving:		
	At Least 2 Yrs.	At Least 3 Yrs.	Alive in 2016
2009	0.78	0.679	0.393
2010	0.746	0.643	0.426
2011	0.779	0.677	0.509
2012	0.805	0.701	0.595
2013	0.789	0.666	0.666
2014	0.776	0	0.776
2015	0	0	0.874
2016	0	0	1

In Sum

What the Form 5500 Tells Us

- Number of firms started with ROBS is growing over time.
- Amount of capital used to start a ROBS firm is increasing over time
- But there is wide variance in amount of capital used to start a ROBS firm
- The variance grows over firm lifespan
- About 30 percent of firms fail within 3 years

Conclusions

Our goal is to shed first light on an understudied source of financial capital for entrepreneurs and understand its broader implications for retirement security.

- Some ROBS filers are probably better off than if they had remained in traditional employment
 - ▶ They delay retirement while working a job they are passionate about
 - ▶ Their wealth accumulates over time
- But some are undoubtedly worse off
 - ▶ Failure rates are similar to other types of startup activity
 - ▶ Considerable retirement savings could be lost
- Next steps:
 - ▶ Conduct surveys of ROBS filers to measure their financial literacy and sophistication
 - ▶ Use our summary statistics to calibrate a retirement savings model to understand who is helped, who is harmed
 - ▶ Combine with IRS data to get a better sense of how businesses fare