

CLIENT INC.

Entrepreneurs are often so consumed by running their businesses they leave little time to focus on their personal financial planning. As **Alison McAlpine** reports, this is where advisors can provide some much-needed advice as neglecting one's own finances can have unintended consequences for the business

About 18 months ago, Steven Williams, financial consultant and tax consultant with The Small Business Advisors in Calgary, advised a small business owner to protect himself with disability insurance. The client hesitated. He was busy. He postponed the decision. Six months later, he fell off a roof and broke both his arms. Out of commission for eight months, he admitted he should have listened to Williams.

This may be a dramatic example, but the roots of the problem are all too common in Williams's experience. "A lot of small business owners are so busy focusing on what they do they don't [spend sufficient] time dealing with what they should be dealing with in terms of planning for themselves," he says.

Samir Stasi, CFP, an advisor with Queensbury Strategies in Toronto, agrees. "They are doing everything to grow the business, and they have this hope that should the business be successful they're good for life. They focus on the opportunity they see at hand and forget good old financial planning."

Optimism is generally a good thing — and entrepreneurs tend to have it in spades. But the costs are high if it leads them to neglect personal financial planning.

"The biggest consequence is a higher exposure to risk," says Denise Gallant, CFP, an advisor with Applied Wealth Strategies in Sydney, N.S. "The risk is that their health will fail and then

their business will fail ... and many small business owners run a true family business. Their spouse is engaged in the business. Their spouse's income is coming from the business. Some of their children's income may be coming from the business. So the whole lifestyle is tied to the health of that business."

Then there are the opportunity costs. "They're missing out on a lot of potential ways to optimize their financial situation, including things such as tax planning and maximizing the wealth they can not only build within the corporation but also extract and pass on to future generations," says Jeff Swanson, CFP, wealth advisor with Swanson Financial Footprint Inc. in Vancouver.

Furthermore, as Scott Plaskett, CFP, senior financial planner and CEO at IRONSHIELD Financial Planning in Toronto, observes, "The longer they go with the neglected financial planning, the more challenging it is to get them on track. If you can set things up initially and set it up right, then you don't have to unravel all those mistakes later on."

So, where should an advisor start when working with small business clients? Keep in mind that a business owner's priorities change through the life cycle of a company. Startups often need access to credit above all else. Mature businesses need an exit strategy that maximizes the company's value. Either way, Stasi believes it's very important to build a "firewall" between business and personal affairs.

That said, a small business owner's personal financial plan-



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ning needs often run parallel to the needs of any other client — with some critical additions. Swanson, like many advisors, begins with the basics: retirement planning, investment planning, insurance planning, tax planning and estate planning.

RETIRE? ME? NEVER!

Many business owners can't imagine themselves retiring, but they need to recognize and plan for the fact that at some point they may want to slow down or stop going to work altogether. And, according to Plaskett, they all need to answer the question of how much liquidity they would need to live the retirement lifestyle they want.

That's because business owners may have an impressive net worth but very little liquidity. In addition, suggests Plaskett, knowing the minimum a client needs to retire in comfort is valuable in negotiations when the time comes to sell a business and retire on the proceeds.

If a client's retirement plan includes the sale of the business, Swanson says it's critical to set things up well in advance to maximize the lifetime capital gains exemption (now \$750,000 and proposed to increase to \$800,000 in 2014) that may be available to the business owner, his wife and even his adult children. "I find a lot of business owners aren't structured properly for that; and if they're not structured properly when the time comes to sell the business, it'll be too late [to fix it]," he points out.

"Business owners need to think about having an individual pension plan if they are successful and if the business can fund a retirement plan," adds Stasi.

ASSET DIVERSIFICATION

"Many business owners don't diversify much in their investments. Basically, most of the investment is in the business. They've taken everything and put it into the business because they feel, 'Hey, I can make a 30, 40 or 50 per cent return on my investment in my business. Can you offer me something close to this?'" says Stasi. "But they don't realize that putting all their eggs in one basket — in the business — is a dangerous strategy."

He offers a case in point. One of his clients owned a successful chain of dollar stores. Stasi recommended that he take some profit out to build a diversified investment portfolio, including retirement savings and education savings for his three children. As part of his argument in favour of this approach, he pressed his client to think about the impact if a big dollar store opened nearby.

"Four years ago," Stasi says, "Dollarama showed up, and we all know the rest of the story. He had to get out of the business at the very last minute, and [he ended up having to accept] half of what he was offered before."

Even so, the client counted himself lucky. One year after he sold, all four of the stores he had created were out of business. "His net worth dropped dramatically and he had to start a fast food business. He took all the money that he took out of that [dollar store] business, put it into the fast food business, and now he's working 80 hours a week again," says Stasi.

Plaskett's take is that although investments outside a small business often can't match returns from a small business, advisors have

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an important role to play in helping businesses preserve their wealth — as Stasi tried to do.

There's another angle where advisors can add value by promoting asset diversification, adds Swanson. "A lot of incorporated business owners with holding companies just have the cash sitting there for two reasons: they don't want it to fluctuate [and] they're so busy in their business that they don't really attend to it. So I put together a lot of recommendations and strategies to not only grow that money, but to also do it tax-efficiently because that's so vital in holding companies with high tax rates."

PROTECTING BUSINESS AND FAMILY

Clients who don't run businesses often need a mix of life, disability and critical illness insurance — but small business owners need to protect their business as well as their family.

In discussions with his clients, Stasi raises the topics of key person insurance for the business owner and others, as well as business loan protection and buy-sell funding. He also stresses creditor protection because small business owners may be personally vulnerable to liability if, for example, they secured business loans with personal property (as with a home equity line of credit). Segregated funds, holding companies structured to separate lines of business, and liability insurance may all be useful tools to mitigate risk.

Living benefits insurance in particular can be a hard sell to business owners [Read "Sudden Impact" on page 16], many of whom have a good story to share about working through illness (e.g., Gallant's "I had my gallbladder out two years ago and I was back to work in 10 days.") Once again, small business owner optimism can preclude comprehensive planning. And even when clients are interested in managing risk with insurance, adds Gallant, "it's difficult to keep them engaged in the needs identification through any underwriting that needs to be done."

Whenever insurance is used for a small business owner, Swanson emphasizes that advisors need to make sure it's paid for and distributed to beneficiaries in the most tax-efficient way.

SAVING TAXES

Income deferral. Income splitting. Income sheltering. Small business owners have many opportunities to reduce their tax bill. One of the most popular strategies for incorporated business owners is to pay themselves dividends instead of a salary. By going this route, they receive tax-favoured income and don't have to pay into

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the Canada Pension Plan. The downside, however, is that they miss out on accumulating registered retirement savings plan (RRSP) contribution room and may not be able to take advantage of a host of personal income tax deductions.

Williams encourages clients who take dividends to set aside the maximum employee plus employer CPP contribution (\$4,712.40 in 2013) in a Tax-Free Savings Account (TFSA) or open an account as part of their plan to self-finance their retirement. But that doesn't address what Gallant worries is an often overlooked issue. "With the Canada Pension Plan, you also have access to a pretty robust disability benefit to age 65," she says. "Sometimes business owners are not recognizing that they're not only giving up their retirement benefit, but they're also giving up the disability benefit."

Another way business owners may be able to save taxes is with a health spending account. "If you're pulling \$80,000 a year out of your business and you have medical expenses, you should have a health spending account," Williams says. "If you're spending \$1,000 a year — which is pretty easy to do — then you should have it written off in the business, as opposed to having it on your personal tax return, which would give you next to no benefit at all."

LEAVING A LEGACY

The biggest challenge many small business owners face when contemplating their legacy is identifying a successor in the business, says Gallant. "If you have a business with value and you want to

Being a team player

By the time a small business owner engages a financial advisor, he or she often has an accountant and lawyer in place. And, because planning for small business owners can become complex, the financial advisor may end up working closely with these other professionals.

"I think [small business owners] go from practice professional to practice professional on an as-needed basis ... but they don't really have a quarterback, and this is where the real opportunities for advisors come forward — when they can be that trusted steward," says Evan Thompson, president, Evan Thompson and Associates, in Toronto.

"I think the small business owner appreciates that their experts can work with each other and come up with an integrated solution that's been vetted by all," observes Denise Gallant, CFP, an advisor with Applied Wealth Strategies in Sydney, N.S. "I don't necessarily see myself as a quarterback, but I do see myself in the same league as the other experts. We bring something else to the table."

"You need to earn the trust [of the client's other advisors,] and you need to show them that you can add value; and then they will welcome you," adds Samir Stasi, CFP, an advisor with Queensbury Strategies in Toronto. And it can be challenging, he adds. "You need to know what you are doing, how to approach the situation, and you need to be careful you don't step on anyone's toes."

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Do you have what it takes?

Here are some of the qualities advisors who work with small business owners say are essential to bring to this market:

- Listening skills
- Organizational skills
- Problem-solving skills
- Flexibility
- Persistence to follow up
- Well-rounded knowledge
- Big-picture thinking
- Ability to identify with a business owner's challenges

"An entrepreneur is a certain type of person. They can be quite feisty, they can be quite controlling, and they don't like to feel that they've been told what to do. They like to feel that it's a collaborative decision that they're reaching with their advisor," emphasizes Evan Thompson, president, Evan Thompson and Associates, in Toronto.

transition that to somebody else, you have to have somebody whom you want to give it to and who wants the business," she explains. An added complexity if an adult child is interested in the business and able to take it over is equalizing bequests to other children, she points out.

Of course, there's no escape from death and taxes. Plaskett has been working with one client who has a business worth \$10 million — and a potential tax bill, should he and his wife die, worth more than all his personal liquid assets combined. "In


essence, by dying, he bankrupts his family," says Plaskett.

Possible solutions in cases like this could include life insurance, if the business owner qualifies, an estate freeze and a family trust. "In financial planning, it's all about liquidity," Plaskett emphasizes. "You can have all the wealth in the world, but if you can't pay for dinner because you don't have any liquid investments or liquid cash, then you're not wealthy."

YOUR BEST ADVOCATES

Win over small business owners and you can earn a steady stream of referrals from them and from the other professionals they work with, says Swanson.

"This is a group of people that knows the value of good service. They'll be your strongest advocates if you do right by them," agrees Gallant. But to do right by them, she adds, "You absolutely have to have a strong administrative team and you have to follow up on every piece of the process. It is your [job] to finish things because the business owner is not going to — not without a nudge."

Adds Plaskett, "It's a market worth pursuing for me because I really get a lot of pleasure from working with business owners. I like the challenges. I like the level of complexity. It keeps me sharp. And every case is different, which means I can become more creative in my solutions." 

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