



Financial Planning and Your Small Business

FPA
THE FINANCIAL PLANNING ASSOCIATION

The Financial Planning Association® (FPA®) is the membership organization for the financial planning community. Its members are dedicated to

supporting the financial planning process in order to help people achieve their goals and dreams. FPA believes that everyone needs objective advice to make smart financial decisions and that

when seeking the advice of a financial planner, the planner should be a CERTIFIED FINANCIAL PLANNER™ professional.

To locate a CFP® professional in your area, visit www.fpanet.org/public or call 800.647.6340.



It's Your Business— and Your Life

If you're like most small business owners, your personal life and business life are practically inseparable. That's why it's important for your personal financial planning to take into account the unique considerations—and opportunities—of owning and operating a small business.

A 'Big Picture' Process

Financial planning is the process of wisely managing both your personal and business finances so that you can achieve your goals and dreams. You can do financial planning on your own or with the assistance of a financial planner, such as a CERTIFIED FINANCIAL PLANNER™ professional.

FINANCIAL PLANNING TAKES A "BIG PICTURE" APPROACH

Examine all areas of your finances—investments, tax planning, insurance, retirement planning and estate planning—in the context of your business to make sure they work together to achieve your goals.

Either way, it makes sense to follow a financial planning process that includes:

- Setting realistic financial and personal goals
- Evaluating where you are now financially
- Developing a plan to reach your goals
- Putting your plan into action
- Monitoring your plan to stay on track with changing goals and circumstances

This brochure can help you get started. It draws on the expertise of thousands of members of the Financial Planning Association.

A Different Kind of Investment Plan

Small business owners frequently focus all of their investment money, including for their retirement, on their own business. After all, it's the business they know best.

The problem with investing solely in your own business is one of risk, because for every immensely successful business, dozens more either fail or return only modestly. That's why financial planners typically counsel business owners to diversify at least some of their investment money. The following are a few suggestions:

- **Start with a written investment plan** that takes into account your business and will keep your finances steady through rough times.

- **Build a cash cushion** for your family and your business. Set aside at least three to six months of cash flow (some planners recommend a year or more) in a liquid account, such as a money market fund.
- **Resist the temptation to invest only in companies in your industry**, or those with whom you do business. If your industry experiences a downturn, both your business and the stocks you've invested in could slump at the same time. Similarly, avoid investing only in the stock of small companies or only in local real estate.
- **To better diversify**, planners commonly recommend balancing off your business investment with large company, non-regional, domestic stocks, as well as international securities and perhaps real estate investment trusts that invest in other regions and industries. Bonds are another important component of a diversified investment portfolio.
- **Use your diversified portfolio** as a receptacle account for harvesting cash flows from your business when they exceed your current lifestyle needs.
- **The exact mix of cash**, bonds and stock depends on your particular circumstances, age and tolerance for risk. The key is to remain diversified. Your business may ultimately provide all the money you need, but the other investments are there in case that doesn't happen.

Taking on Debt

The flip side of investing money is borrowing. Here are a few considerations to keep in mind when your business has financing needs.

- **Determine how much you'll need.** This entails developing a good business plan (see sidebar). Include in the plan a break-even analysis, which estimates the amount of revenue the business must generate to cover expenses before even a dime of profit is made. The analysis can help you determine the funding you need to survive until you reach—and exceed—the break-even point.
- **Don't be too conservative** when estimating your financing requirements. Some experts recommend adding 10 percent to your estimate to cover unexpected needs.
- **Weigh all your financing alternatives.** Personal savings, loans from family or friends, credit cards, commercial bank loans, personal bank loans, federally backed loans or private investors. Each choice has pros and cons; think them through carefully.
- **Arrange for credit sources in advance.** Don't wait until the last minute.

Focus on Tax Planning

Taxes are a fact of life for everyone, but for small business owners, the maze of tax regulations can be especially daunting. A solution, say CFP professionals, is to think in terms of tax planning. Business ownership, in particular,

BUSINESS PLANS AND BUSINESS PLANNING

Business plans are a topic unto themselves and beyond the scope of this brochure, but keep in mind that there are two basic types of business plans, which are distinguishable from each other by their respective purposes.

- *"Money-raising" plans are designed expressly to assist in obtaining debt or equity financing, for start-up or expansion, by favorably impressing commercial or investment bankers.*
- *"Operating" plans are more practical in nature and have little or nothing to do with raising money; they are essentially a roadmap for owners to create and reference in pursuing business objectives.*

Before creating a business plan, be clear about its purpose—that will guide both the plan's content and its format.

In addition, if you decide to work with a financial planner to develop your business plan or your personal financial plan, look for a planner who understands both business planning and personal financial planning. Ideally, you want someone in your corner who can advise you about the financial aspects of running a business as well as guide your personal financial planning decisions.

provides a fertile ground for tax planning. Tax planning is a year-round approach that is done in the context of your overall financial picture. The goal is to make sure that a given tax saving strategy won't undermine your other important financial goals.

Take the decision of choosing a business structure, for example. Sole proprietorships, partnerships, S or C Corporations, and LLCs or LLPs have different income tax requirements and tax calculations. New laws might prompt you to consider changing from one business structure to another to reduce your tax bite. While this could be a wise move, be sure to consider nontax issues as well, such as how a new business structure will affect your ability to shield your personal assets from business creditors, take deductions for fringe benefits, and pass the business to your heirs.

In other words, don't let the "tax tail wag the business dog." Here are a few other tips from financial planners:

- **Keep up on the basics of new tax laws—** newspapers, magazines and online sources provide a wealth of information.
- **Expect your financial planner and/or accountant to alert you to tax planning opportunities** presented by changing laws and regulations.
- **Utilize a professional tax preparer.**
- **Look for areas in your business that present tax savings opportunities,** such as saving in your company retirement account, timing income and expenses, and

using charitable gifting strategies.

- **Be cautious** about basing tax planning too heavily on what you think future tax laws might be. The laws may never materialize.

Ultimately, tax planning is less a goal in itself than a means to help achieve your other business and personal goals. Saving taxes should complement, not dominate, your financial life.

Insurance to Protect What You Value

Another critical aspect of financial planning and your small business is insurance—what kind, how much and at what cost. The following are a few considerations to keep in mind:

- **Liability insurance.** The type of liability insurance you need depends on the industry you're in, and liability laws are constantly changing. Consult an insurance professional for your specific needs.
- **Property insurance.** Review your coverage to make sure it reflects recent building improvements or additional property. Determine if the coverage will rebuild or repair according to current building codes, and if it will cover replacement costs at current prices, or only at a set limit or depreciated value. Also learn what kind of disasters your insurance will—and will not—cover. Consider whether inventory coverage is appropriate for your situation.
- **Business interruption insurance.** This

insurance covers lost income and overhead expenses when a business must temporarily close its doors due to a covered disaster.

- **Life and disability insurance.** Businesses frequently provide this coverage to employees as a fringe benefit. Small business owners also may need life and disability insurance for business purposes, such as collateral for a loan, to fund a business succession plan or to mitigate the loss of a key person.
- **Workers' compensation insurance.** If a business employs three or more people, workers' compensation insurance must be provided.
- **Health insurance.** Health insurance premiums have become a major expense for business owners, but there are ways to keep costs under control and still offer this important benefit to your employees (and yourself). One example: Establish a less expensive, high-deductible health plan and supplement the plan with a tax-advantaged health savings account (HSA). An employee's contributions to an HSA are tax deductible, and tax-free distributions can be used to pay for current medical expenses or save for future health insurance premiums.

Remember Your Retirement

"Too complicated and too expensive." That's the response planners often hear from small business owners on the subject of company retirement plans.

The good news is that you have better options today than you may realize. And the reality is, most business owners cannot afford *not* to establish a retirement plan. Even if you assume that you'll easily sell your business when you retire and live on the proceeds, it's risky to assume that it will work out that way.

The plan you choose depends on many factors, including the number of employees you have and whether you want to help them with retirement; how long you have before your own retirement; your tax situation; what you currently have saved for retirement; and how much money you'll need for the retirement you envision.

A wide array of plans are available to small business owners: traditional defined benefit pension plans, 401(k) plans, profit-sharing, Simplified Employee Pension Plans (SEP) and Savings Incentive Match Plan for Employees (SIMPLE) are among them. Your financial plan-

A RETIREMENT PLAN CAN ACCOMPLISH SEVERAL OBJECTIVES

It can enable you to:

- *Put away money for retirement*
- *Save on taxes*
- *Provide a benefit to employees*

ner can help you analyze the options to determine which plan is best for your situation.

For example, a 401(k) plan may cost more to administer than a SEP or SIMPLE, but it also provides more liability protection for the owner's assets. A SEP is easy and inexpensive to establish and maintain, but owners must fund contributions for eligible employees at the same rate they fund their own accounts. In contrast, employees are responsible for funding their SIMPLE accounts, but the owner must match employee contributions up to 3 percent of the employee's pay.

No matter which plan you and your financial planner choose, start your retirement plan as soon as possible. In the early years of your business, cash flow may not be on your side, but time is. Take advantage of it.

Business Succession Planning

Estate planning—and more specifically, business succession planning—is essential for anyone who owns a small business because typically the business is the largest asset in the owner's estate. This is not just a tax issue. Without business succession planning, it's unlikely that your business will survive to the next generation or sell for its true value. (This assumes, of course, that succession or sale is a goal.)

Here are 6 business succession planning mistakes to avoid.


- **Waiting too long to plan.** An ideal succession plan requires laying the groundwork over many years—some experts recommend planning your exit strategy from the day you start the business. How you want to exit the business tomorrow strongly influences how you structure and operate the business today.
- **Assuming the children will take over the business.** Talk to your children to determine what they really want. Learn their desires as soon as possible in order to pursue other avenues if necessary, such as selling to an employee or partner or finding an outside buyer.
- **Dividing the business equally among heirs.** Equitable doesn't have to mean equal, and in the case of a business, establishing an equal partnership among heirs can be a recipe for disaster. As an alternative, determine which child has the talent and genuine desire to run your business, and plan a way to leave your other children non-business assets, such as life insurance.
- **Overlooking the possibility of a disability.** Most business succession plans address the owner's retirement or premature death, but may overlook the possibility that the business owner could become disabled and no longer able to run the business. A good succession plan addresses this possibility.
- **Failing to fund the succession plan.** If your plan is to sell your business to a family member, partner, employee or outside buyer at your death, disability or retirement, how will they come up with the funds to purchase

the business? Loans and cash are two options, but also analyze the pros and cons of using life and disability buyout insurance to fund a succession plan.

- **Planning alone.** Business succession planning is complicated. The tax issues alone should send you to an expert for advice. In addition, consider working with an outside expert who can lead family meetings and ease family conflicts by providing a knowledgeable, objective perspective.

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CHECKLIST

- ☐ Conduct personal and business financial planning in tandem
- ☐ Set realistic personal and business goals
- ☐ Analyze current financial situation
- ☐ Develop a plan to reach goals
- ☐ Set objectives to support goals
- ☐ Put plan into action
- ☐ Monitor plan for changes
- ☐ Diversify investments
- ☐ Build a cash cushion
- ☐ Estimate realistic financing needs and plan for them in advance
- ☐ Weigh the pros and cons of all financing alternatives
- ☐ Do tax planning in the context of overall financial goals
- ☐ Determine risk management and insurance needs
- ☐ Consider establishing a retirement plan
- ☐ Make business succession planning a key component of estate planning if succession is a goal



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