



Shadforth Financial Group



Business Succession Planning

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Executive summary

Let's get down to business

Small businesses are a key part of Australia's continued economic growth.

The 1.2 million small businesses in Australia employ around 3.3 million people (47 per cent of the non-agricultural private sector workforce) and account for around 15% of annual GDP.

The Australian Bureau of Statistics defines small businesses as those employing fewer than 20 employees. A small businesses typically has the following characteristics:

- it is independently owned and operated;
- it is closely controlled by owners / managers who also contribute most, or all, of the operating capital; and
- the principal decision-making functions rest with the owners/managers.

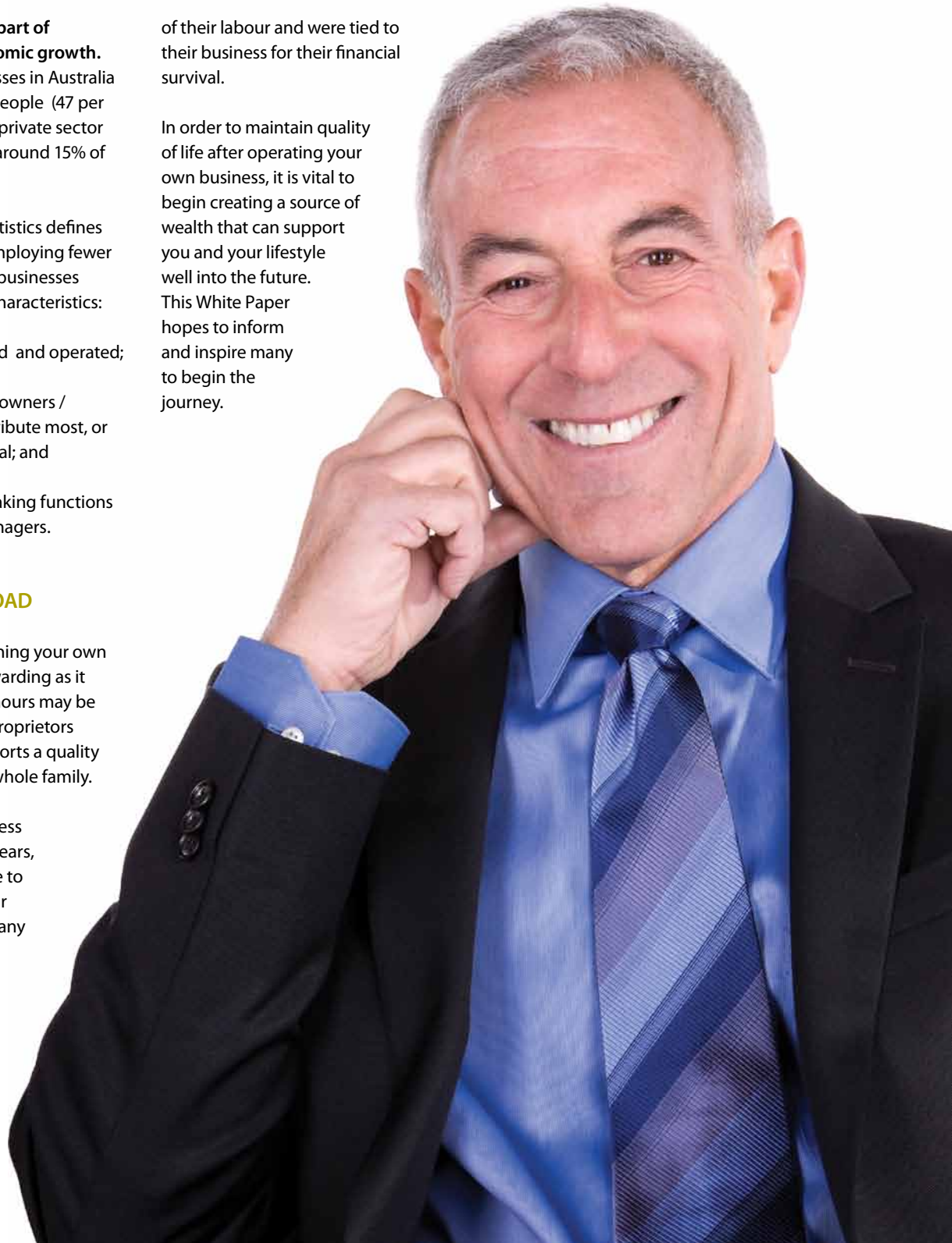
BUSINESS IS A HARD ROAD

There's no denying that running your own small business can be as rewarding as it is challenging. Though the hours may be long, many small business proprietors earn a good living that supports a quality lifestyle for them and their whole family.

While working in your business may support you for many years, what is left when you decide to close up shop and retire? Our research showed that too many Australian small business operators had neglected to build an income stream independent

of their labour and were tied to their business for their financial survival.

In order to maintain quality of life after operating your own business, it is vital to begin creating a source of wealth that can support you and your lifestyle well into the future. This White Paper hopes to inform and inspire many to begin the journey.



The 'small business' experience

Australians love working for themselves.

In fact, there are over 25,000* new business start-ups in Australia every year. People go into business for all sorts of reasons.

"I want to be my own boss."

"I want to do something I enjoy."

"I want financial independence."

Statistics show, however, that less than 25% of those businesses will still be around in five years time, and 80% of those will close up shop within the next five years. Many small businesses fail in the first year due to the proprietor's lack of management or financial experience.

Let's face it, running a small business is hard work. And if you're still running a successful business after five, or even 10 years, you're doing very well indeed.

BUILDING A BUSINESS

With hard work and long hours, many small business proprietors find they can earn a good living and enjoy a rewarding lifestyle. They have a comfortable home, can afford the odd holiday and even put their kids through private schools.

But as they approach retirement, they soon discover they are unable to stop work and enjoy the fruits of their labour because they are financially dependent on the income that the business produces. They're forced to stay in the business because they are the business!

INDEPENDENT WEALTH

The key factor for almost every small business owner is building wealth and security independent of their business. Investing in an income stream that is not reliant on their own physical labour.

Financial independence, however, is not just about income – it's about planning. Which is how so many small business owners, earning even a moderate income, are able to accumulate significant sums to ensure an alternate income stream.

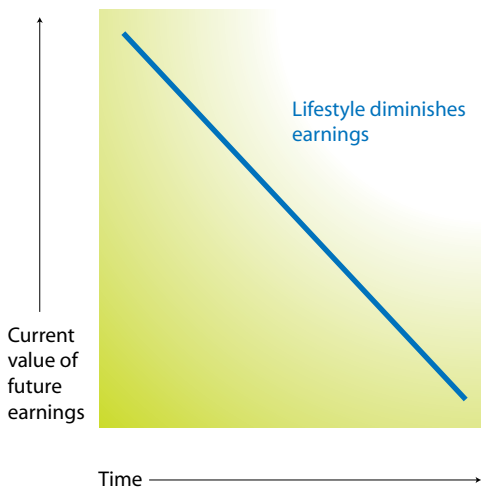
They're forced to stay in the business because they are the business!



*ABS 2006 Census Data

The value of future earnings

Current Value of Future Earnings over time

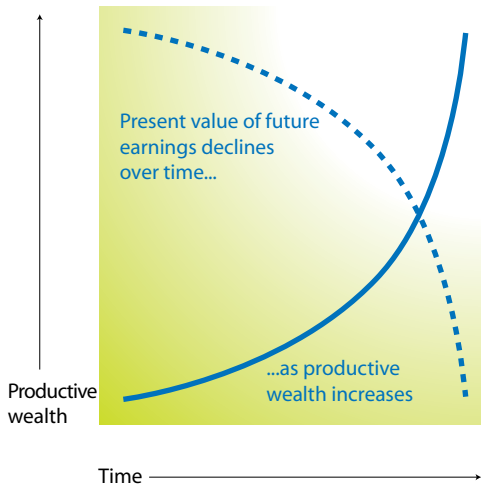


In a thriving small business, your future earning potential seems limitless. With the enormous financial and lifestyle sacrifices that are often required to build and maintain a business, many proprietors feel the urge to “make up for lost time” by overspending. That’s where a positive cash flow can lead to a lifestyle that is unsustainable over time.

The ‘present value of future earnings’ is often a business proprietor’s biggest asset. If future earnings are simply used to meet family expenditure, however, the real value of future earnings declines significantly.

As can be seen in the top diagram, the current value of your future earnings reduces as income is spent over time. For this reason, spending must be controlled and a reasonable portion of any free cash flow directed to accumulating wealth in order to build wealth independent of the business.

Wealth Accumulation over time



WEALTH ACCUMULATION

Wealth accumulation can take the form of investment or debt repayment. It is only when financial assets outside the business build up that business proprietors are truly liberated from the heavy reliance on business income alone.

From this point, it becomes simpler for individuals to marry lifestyle and income needs without conflict, as seen in the bottom diagram.

To sell or not to sell

People are always looking to buy a successful small business. And why not – somebody else has done all the hard work. But when you are so close to the day to day operations of your business it can be difficult to assess its true market value.

Unless you already have your retirement plans in place, any number of uncertainties will cloud your judgment:

- What is our business really worth?
- How much tax would we have to pay?
- What about our staff?
- When do we want to retire?
- What would we do if we weren't ready to retire?
- How much income do we need to be comfortable?
- How much do we need to have saved to sustain our income needs?

SOBERING STORIES

We've all heard horror stories of people selling too early and for the wrong price and ultimately having to start a new business or find employment to maintain their income. Even worse, the story of the same business resold in the short to medium term for a vastly superior price with little improvement.

Equally sobering are the stories of those owners who keep working well past the point that is needed in accumulating wealth and make unnecessary lifestyle sacrifices.

These varying experiences can cloud the issue of a sale. Without a sounding board for advice, and time to commit to making the decision, you will be unable to even begin seriously thinking about selling your business.

In addition to the financial considerations associated with 'retirement', you need to ask yourself if you are ready for such a substantial lifestyle change. Whilst the idea of selling the business and winding down may sound very attractive, it may not always be as fulfilling as anticipated.

My business is my superannuation

Selling up at the end of your business career is not always a reliable method of wealth accumulation. For many, beyond plant and stock, there is little else to sell. Your greatest hope is that your business's reputation and level of 'good will' increase the sale price.

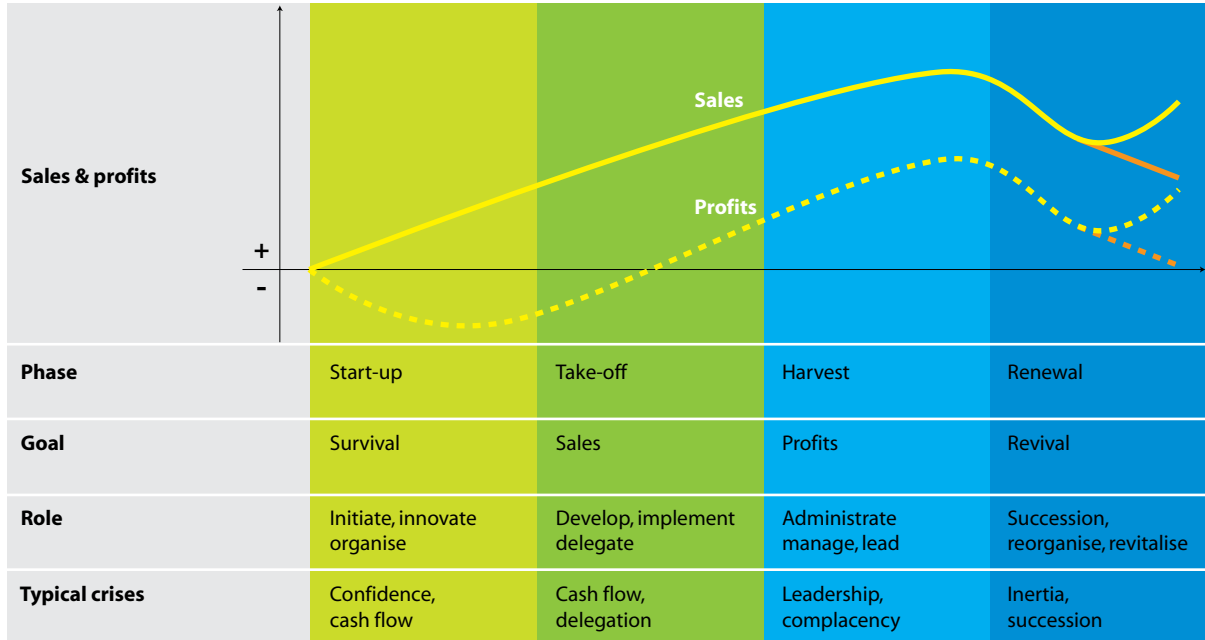
Making the most of weekly and monthly proceeds is extremely important to any small business operator. Unfortunately, superannuation is generally not a priority owing to ongoing working capital requirements, cash flow demands and lifestyle spending that prevent the building of significant wealth outside the business.

KNOWING WHEN TO GET OUT

Timing the sale of your business is vital to achieving the optimal result, as illustrated in the chart below. Unfortunately, many proprietors are too close to their business to know when to call it quits.

Many feel they don't have the supports to keep the business running smoothly at a time that coincides with their planned exit.

Small business life cycle



In business, timing is everything

Like any organic entity, a business has a natural life cycle through which it must move in order to continue growing. As outlined above, the phase of the business life cycle can determine not only the level of profitability, or the market value of your business, but also when it is optimal to get out.

The **Harvest phase** can often lead to complacency, with an underutilized balance sheet and a lower sales price.

The **Renewal phase** can be an extremely rewarding phase where a business can push to new highs. It does require, however, a serious commitment in time and energy to re-invigorate the entire business and prepare again for take-off.

It should not be assumed that the ideal time for retirement and the ideal time for a sale will necessarily coincide. Much planning is required.

USE YOUR CASH FLOW TO BUILD A WEALTH STREAM

As discussed earlier, the importance of using your business cash flow to build income producing assets outside of the business should not be overlooked.

Operating a small business is an all or nothing equation – there's not a lot of time or energy for anything else.

The day to day operations of your business can be the biggest barriers to accumulating wealth through your career. One of the biggest issues facing any business proprietor is time, or the absolute lack of it.

For many, operating a small business is an all or nothing equation. They open long hours, six days a week, then do the paperwork on the seventh. Frankly, there's not a lot of time or energy for anything else.

Become independent of your business

Many small business owners are so immersed in their business they can't see where their business is going, particularly when it comes to using the assets built into the business to become independent of it.

With a lack of time to learn about investment options, hasty decisions are often made that do not fit with a long term wealth accumulation plan. Effective

investment management is a time consuming proposition, in which shortcuts can often lead to difficulties.

The barriers to building wealth independent of your business may be considerable, but the consequences of failing to do so are even greater: *staying in business for the sole purpose of earning enough income to support your lifestyle.*

So how do you organize your finances so you can enjoy the important things in life, like time with your family and having a life outside of your business? The solution lies in a customized Wealth Management Program.

The Wealth Management Solution

The Wealth Management Solution does not simply mean conventional investment management.

Rather it is a marriage of portfolio management and a highly detailed strategic plan dedicated to achieving total certainty in financial outcomes.

Your desired financial outcomes may include short, medium and long-term goals varying in degrees of importance and orientation.

The key to the process is the in-depth understanding of what is really important about the accumulation of wealth.

WHY IS MONEY SO IMPORTANT?

Understanding this concept will result in decisions being made that contribute to the grand plan, rather than detracting from it. All investment decisions blend with an overarching strategy that is determined by your position in life and your ultimate lifestyle objectives.

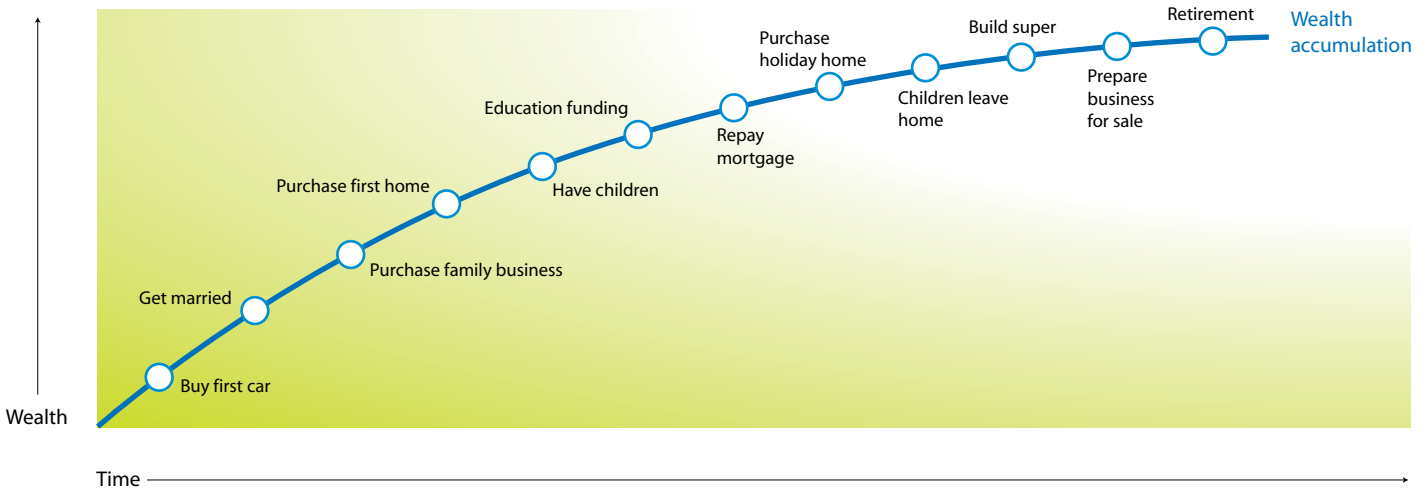
The diagram below represents a typical time line for many business proprietors and milestones that may occur along the way.

Just like running a successful business, a Wealth Management program takes a great deal of time, planning and expertise. The diagram depicts the typical set of common but complex issues faced by business proprietors.

It would be unusual for individuals committed full time to the running of their business to be responsible also for their own wealth management process.

The pressure on small to medium business in Australia is such that, statistically, more than 75% of all businesses fail within the first five years.

More than half of these failures occur due to either financial mismanagement or management inexperience.



Delegate to ensure growth

The Wealth Management Process relies on delegation. Quite simply, one of the best ways to ensure that your financial objectives are plotted and outcomes are achieved is to entrust the task to someone else.

It is not possible for just one professional to be expert in every aspect of the entire wealth management process. Rather, a comprehensive wealth management program draws on the expertise of several professionals coordinated by one individual who essentially acts as your Chief Financial Officer or 'CFO'. The role of the CFO is to clarify your needs, devise strategies to achieve them and to call in expert help to execute those strategies.

Using this approach, taxation and business structure issues can be managed by an accountant, estate planning issues by solicitors and business management issues by expert consultants and business coaches. It is your CFO who sets the overall strategy, chooses the appropriate investments and coordinates a range of experts in the pursuit of your long term financial goals.



Reap the rewards of a Wealth Management Process

A CFO Wealth Management Process will see each aspect addressed and coordinated under a priority ranking from 'critical' to those of lesser immediate importance and revised when required.

Your proximity to retirement will of course impact on the range, and importance of certain issues and a customised approach needs to be set out and managed according to your particular circumstances and needs.

As all financial, business and lifestyle decisions are fully integrated you can expect the following positive outcomes:

- **More Time** – You are free to spend time on those things really important to you.
- **Financial Certainty** – With short, medium and long term objectives plotted, strategies will be maintained to ensure that you are kept on track. The most important things to you will be central to the whole program.

■ **Peace of Mind** – With an established network of professionals available and coordinated by your CFO, you can rest assured knowing that everything is in good hands.

■ **Synergies** – An integrated approach may reduce costs and complexities and typically will achieve far greater results sooner!

About Shadforth Financial Group

HELPING SUCCESSFUL PEOPLE MAKE SMART DECISIONS ABOUT MONEY

The Shadforth Financial Group Limited (SFG) is one of Australia's leading privately-owned financial advisory firms.

Our aim is to help clients generate and maintain wealth over time. We have many clients from all walks of life who are supported by 300 employees in 14 Practices across Australia.

We are united in our commitment to act with the highest standards of ethics and integrity for the benefit of our clients, providing quality financial advice and best of breed solutions and services. This includes low cost and highly diversified core investment options.

Being privately-owned, we are free of ownership or control by the large banks and insurance companies that dominate Australian wealth management. We provide transparent, fee-based advice.

Today, our experienced, highly qualified and dedicated Private Client Advisers offer clients uniquely personalised financial advice, and develop financial solutions and services that are tailored to each client's unique set of circumstances and objectives.

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A copy of this document will be provided without charge upon request.