THE ENTREPRENEURS' WEALTH MANAGEMENT EDGE

ONLY 2 PERCENT OF AMERICA'S ENTREPRENEURS WILL SUCCEED, EXECUTE THEIR 5 SUCCESS STRATEGIES & JOIN THE 2 PERCENT.

Thomas M. Griffiths

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It was the year 2000; I was 35 years old and was sitting in my doctor's office. He came walking in, sat down and said, "Tom, you know those chest X-rays we took, well they show spots on your lungs. We are going to have to send you to a specialist to get this looked into further." It turns out I had a lung disease; I worked with a specialist for five years to stop the progression and cure that disease. During that time, I had a chance to think about some very important questions:

What would happen to my business if I died?

How much money was my business worth?

How would my wife get paid its value?

Would it be enough for her to raise our two small children?

I was the owner of a very successful CPA firm; but like many CPAs that work with small business, I really didn't know much about business valuation, succession or estate planning. So I called my financial advisor and he told me, "Tom, I manage your investments, but I don't know anything about those sorts of business owner financial challenges." That's when I decided that I was going to become the best advisor for small business owners—the go-to expert at helping entrepreneurs overcome these sorts of financial challenges. One of the first things I discovered was that a shocking 98 percent of small business owners were failing to overcome these challenges. Only 2 percent were achieving everything they dreamed of when they opened their business! I call this rare, but highly successful, group the 2% Club. I studied this group of successful entrepreneurs for several years and identified five common strategies that they all use in achieving their success.

Interestingly, I discovered that while there were many solutions available for these challenges for large businesses, only a handful were practical to implement for main street business owners (those with less than $10 million of annual sales). Having at one time or another been sold a high cost, low value, impractical solution designed for a larger business, many main street business owners were rightfully untrusting of advisors when it came to helping them solve these challenges. Solutions which are practical for main street are different than those for larger businesses. My professional career is now dedicated to helping main street business owners identify and execute practical solutions for each of the five strategies for success employed by the 2% Club.

I am convinced that any main street business owner who is able to execute these five strategies can join the highly successful 2% Club. My personal mission is to share what I have learned from the 2% Club with as many business owners, and their advisors, as possible. That's why I have put together this whitepaper, to give you the insights and information that you may need to create a plan for executing the five strategies and joining the two percent.

Best of Success,

Tom Griffiths

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The Five Success Strategies

UNDERSTAND BUSINESS VALUATION

Strategy #1

The purpose of understanding business valuation is to understand how to create value, to create wealth. Many of the reasons owners get a business valuation have to do with the 98 percent of business failures. These reasons include death, disability, distress, divorce, shareholder disputes and goodwill impairment. Members of the 2% Club get a business valuation for five financial success-oriented reasons.

- To understand how to enhance the value of the business
- To provide information needed for tax strategies that build their wealth
- To track their net worth and select the proper asset allocation for investments
- To assist them in succession planning and business sale
- To properly protect their wealth and their family's interests

Each of these valuation purposes relates to one of the five success strategies. Business valuation is the foundation of all five strategies. Without an understanding of business valuation, owners lack the ability to make informed financial decisions and frequently make business expenditures with the mistaken idea that the expenditure will increase the value of their business. In effect, they are wasting their wealth.

Members of the 2% Club don't understand business valuation in the same sense that a professional business valuation analyst does. Rather, they understand business value more intuitively and probably could not verbally explain it to you. What they intuitively understand is that value is all about cash flow. It is really very simple—the value of a business is calculated based on the cash flow it produces. The higher the cash flow, the higher the value. This is called the income approach to valuation.

The value of all of the equipment and other assets in a business is only worth the value of the cash flow it produces. If the value of that cash flow is less than the liquidated fair market value of the equipment and other assets, then you stand to get more cash flow by closing the doors. This is called the asset approach to valuation.

Owners sometimes hear that businesses similar to theirs sell for some percentage of sales. This is called the market approach to valuation. Unfortunately it is fairly meaningless information for small business owners because regardless of what other businesses are selling for, your business value will be limited by the value of the cash flow it produces. Blue sky is the value of the business' cash flow minus the liquidation value of all its assets. To create blue sky, which is the same as creating value or creating equity, a business owner needs to increase the value of the cash flow beyond the liquidation value of the equipment and other assets. Essentially, to create equity you must increase cash flow. Business owners in the 2% Club understand that creating equity value is all about increasing cash flow.

Strategy #2

The purpose of using tax strateiges that build your wealth is to maximize your return on investment. To capitalize on tax strategies that build wealth, you must first be financially fit. Remarkably, only 1 in 10 business owners falls into this category.

In my experience, business owners who are financially fit will have well capitalized balance sheets which create opportunities to use tax strategies that build your wealth. Some business owners want this advice, don't get it from their CPA, but are otherwise satisfied with their advisor. So why aren't all CPAs giving wealth building tax advice? The simple answer is that most business owners can't benefit from it and therefore advisors don't give it. Let me explain: since 9 out of 10 main steet business owners are not not financially fit, they are, to some degree, financially stressed. They are the ones who seem to need solid financial advice the most, and are generally the ones who value it the least. For most CPAs, 9 of 10 business owner clients (90% of their practice) are in this group. Since 90% of the customers say they don't want the service, the CPA naturally concludes it is not important to provide it. In additiion, the 9 out of 10 business owners who are not financially fit consume a lot of CPA firm service and are therefore good CPA firm customers. This is becuase operating from a position of financial stress creates an increased demand for CPA compliance work, like the bank requiring regular CPA-prepared financial statements, or frequent debt refinancing and the related CPA involvement. Weaker balance sheets are more risky and increased CPA compliance work is a risk management measure by the bank. As a result, many main street CPAs are busy servicing the needs of the 90 percent of their best customers, the ones who are not financially fit and who do not value financial advice. They don't focus on the needs of the 10 percent of their customers who are financially fit and want the advice. This is why many main street CPAs don't see or tell you about tax strategies that build your wealth. It is simply not their focus.

A simple example is cash versus accrual basis of accounting for tax reporting. Cash basis tax reporting is available to most businesses with less than $10 million in annual sales. In the early stages of business ownership, most business owners are not financially fit and cannot benefit from the cash basis, so most elect the accrual basis of reporting. But as business owners become financially fit, they tend to capitalize their balance sheets and carry very little debt. At this point it is almost always advantageous to convert from the accrual basis of accounting to the cash basis of accounting. This simple tactic can have a substantial one-time tax benefit for the business owner; I have personally used this to create between $10,000 and $225,000 in tax savings for various clients. But 9 out of 10 business owners will never benefit from this tax strategy that builds your wealth because, in order to benefit, you must have a well-capitalized balance sheet, be financially fit and have a CPA who recognizes and suggests wealth building tax strategies. If you are a business owner who has done very well, pays down payables early, uses very little debt from the bank, and are not on cash basis, you may be missing out on significant savings from this, and other tax strategies that build your wealth.

Strategy #3

The purpose of investing outside your business is to establish financial security. Entrepreneurs are significant risk takers and routinely think of all their assets as available for risk-taking, but they almost always have a spouse who is the exact opposite and places a higher value on financial security.

This is a big part of the reason why the successful members of the 2% Club develop significant investments outside of their business, and do so in a fairly conservative fashion. They recognize that they have enough risk in their business. As they develop investments outside their business, they do so for the purpose of developing financial security. As a married couple develops assets, the entrepreneur thinks all the assets are for putting at risk in business ventures, but the spouse thinks the assets are for developing financial security. While this is never trouble in the early stages when there are no assets, in many marriages this develops into a battle the spouses don't quite understand and sometimes leads to divorce. Successful 2% Club members recognize that satisfying their spouse's need for financial security is important and they limit their significant risk-taking to their business venture. They develop investments outside their business in a conservative fashion to provide for financial security.

Most entrepreneurs will have 80 percent of their wealth outside their business before they begin to think about leaving it. This is a mark of business owners who will be successful in leaving their business because they have the financial wherewithal to control that decision. Business owners who fail to develop investments outside their business will not leave their business until they are forced to, because they are too dependent on it for their lifestyle. Entrepreneurs have a responsibility to their families, to their employees and to themselves to develop investments outside their business so they can one day successfully make the transition and move on to what is next in their lives.

Strategy #4

Among business owners who successfully exit their business, most say that money was not their number one consideration when deciding to whom to sell their business.

Most will say:

- Their legacy was more important;
- They wanted the business to continue successfully;
- They wanted a particular employee to have it; or
- They wanted to transition it to their children.

Diversifying Your Personal Wealth

Commercial Real Estate

One of the first outside investments the 2% Club typically make is the purchase of the commercial real estate that their business will operate from. Owner-occupied commercial real estate is one of the best outside investments the business owner can make. Owner-occupied real estate makes available significant tax deductions, and it represents an investment that generally increases in value. Real estate tends to be a very stable, appreciating asset and, in the end, its value is mostly relative to the cash flow it creates - much like business value. The stable appreciating nature of this investment makes it ideal for the financial security-seeking 2% Club members. They often keep the real estate as an investment after selling the business that occupies it.

Marketable Securities

Marketable securities are typically the last outside investment entrepreneurs will develop. They will normally establish a successful business, characterized as one that generates excess cash flow which can be invested elsewhere. Then they will use some of that excess cash flow to purchase real estate for their business to operate from. Last, when there's really nothing else to do with the excess cash flow, they will begin to invest in marketable securities. The asset allocation in their marketable securities is frequently over 50 percent in bonds. Outside investments are typically very conservative for successful entrepreneurs.

These business owners have generally accumulated 80 percent of their wealth outside their business. With their business wealth only representing 20 percent of their total wealth, they are free to make the choice to whom they sell or transfer their buisness to, because money is not their number one motivation. There are many other surprises in store for business owners when it comes to exit and succession planning.

Many business owners are surprised to find out that their business is only worth three to five years' worth of profit. Sales to third parties will typically generate the value on the low-end ratio of three times profit, whereas sales to an insider will typically generate a value on the high-end of about five times profit. The biggest reason for the difference is negotiating leverage. With a third-party sale, a seller has little leverage and will normally pay more taxes. With an inside sale, the seller has significant leverage and will generally pay less in taxes, thus providing a higher net for the owner.

You may be surprised to learn that it often takes two or more years to successfully plan a sale. And once the sale is finalized, it may then take several more years before you ultimately get paid for the sale. That's why it's so important to stay informed about exit and succession planning — many of the decisions that you make well in advance of the sale pave the path for your success. A simple example is checking the credit of your intended buyer. Many inside sales have failed when the business owner finds out that even though the inside buyer was willing to purchase, the inside buyer has poor credit and cannot get the financing.

Since exit planning is essentially business valuation taken in a planning context, your exit planning will benefit from your understanding of business valuation, which is the first strategy of the 2% Club.

Strategy #5

The purpose of protecting your wealth is to protect the lifestyle you worked so hard to create for yourself and your family. Money can't buy you happiness, but a lack of money can certainly make you miserable. Business owners in the 2% Club don't take unnecessary risks with their wealth because they don't want to jeopardize their lifestyle, their happiness, and their sense of well-being. The successful 2% Club have four central wealth protection concerns:

- Understanding your entrepreneurial appetite for risk
- Taking steps to realize the value from your business
- Protecting yourself against theft from people in positions of trust
- Creating an estate plan that accomplishes the three P's

Understanding your entrepreneurial appetite for risk

When it comes to financial security, the rule for entrepreneurs is "don't mess it up." The risk-taking nature of entrepreneurs often makes them their own worst enemy when it comes to their financial assets. Entrepreneurs have no trouble at all putting all their assets at risk. Successful members of the 2% Club set aside enough financial assets to maintain financial security and use other designated assets for risk-taking. This keeps them from losing financial security once established. Your spouse will love you for taking this step, especially if your spouse values financial security more than you do.

Taking steps to realize the value from your business

What will happen to your business if you die or are unable to work? Business contingency planning can be as simple as a one-page contingency plan stating your wishes. A buy/sell agreement is an important document, especially if you have co-owners. More importantly, the buy/sell agreement should be funded and based on a frequently updated valuation or valuation formula, because small business values vary more than the stock market.

Protecting yourself against theft from people in positions of trust

Each year, a significant number of business owners suffer significant wealth loss, through no fault of their own, when a trusted employee takes advantage of them. There are simple steps you can take to help prevent problems such as inventory theft, embezzlement, business conversion, forgery, and other employee and non-employee means of unjustly taking your business assets. Your CPA can help you put safeguards in place for your business and spot common warning signs of potential problems.

Creating an estate plan that accomplishes the three P's

For most people, estate planning is not about minimizing estate taxes, because most people will not have enough wealth to be subject to the federal estate tax. As a result, estate planning is typically about three things:

- What Property do you have?
- What People do you want to give it to?
- What Process do we use to make that happen?

As a starting point, it's a good idea for everyone to have a will, as well as the standard healthcare directives and powers of attorney that accompany it.

If you're an entrepreneur who is financially fit, it can also be a good idea to consider a living trust as part of your overall estate plan. A living trust helps your estate avoid probate which, in many cases, can take about three years and cost significant legal fees. So even though federal estate taxes are not an issue, avoiding probate of your estate through a living trust can be highly beneficial to your family members who survive you.

A living trust is completely revocable, and therefore changes nothing when it comes to your taxes. However, any assets that are placed in the trust are not subject to probate. The trustee of the living trust can simply go about his or her business, without judges or attorneys being involved, and wrap up the affairs of the estate according to your wishes. A key with living trusts is designating a trustee whom you feel confident will distribute the assets according to your wishes. There are other probate-avoiding mechanisms such as pay on death accounts for your bank accounts, transfer on death accounts for marketable securities, transfer on death car registrations, transfer on death deeds for real estate, and deferred tax retirement accounts.

In many cases a standard will that creates a testamentary trust and has the accompanying healthcare directives and powers of attorney is sufficient to meet your estate planning needs. Your CPA's annual review of your estate planning can help you avoid the common pitfalls that happen due to changing circumstances and assure that your estate planning meets your people, property and process wishes.

Putting It All Together

A CPA who specializes in working with Main Street business owners may be able to help you execute each of the five success strategies employed by the 2% Club. Ideally, your CPA should be able to provide you with advice and guidance on all five strategies. If not, perhaps your CPA has assembled a team of professionals with the right focus and good coordination. Going it alone can be a difficult task; after all: it appears that only 2% of business owners are successful in figuring it out. In the absence of an advisor who can give you the advice, planning and feedback that you need, you are responsible to figure it out yourself.

Not all of the five strategies will seem equally important at any one point in time. However, as your business grows and your needs change, each of these strategies has an important role to play in your success. Advisors that were great when you started out may no longer be able to meet your changing needs. That's why it's important to reassess your advisor team and assure that you are working with people who are meeting your current needs, are helping you measure your progress toward your goals and keeping you on the right track.

Keep in mind that many CPA firms may not offer support for all five success strategies, so you may need to interview more than one CPA to find one who best meets your needs. The right CPA will recognize the importance of these strategies to Main Street business owners. Having access to expert guidance and advice helps you build your wealth and achieve your most important personal goals, so hiring the right CPA firm is a good value and offers a good return on your investment.

I am not saying that joining the 2% Club will be easy. If it were, everyone would do it. But I do believe that joining the 2% Club can be significantly easier when you are getting coordinated advice on all five success strategies. If you're financially fit or well on your way to achieving financial independence, it's a good idea to look for an advisor with the right focus who can help you coordinate all five of the strategies we discussed here. You don't want to miss out on wealth-building opportunities due to lack of focus and coordination. You owe it to your employees, to your family, and most of all to yourself, to see that your wealth management is done correctly. You'll be happy you did.

Best of Success,

Tom Griffiths

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Wealth-Building Strategy	Role of Your CPA
#1 Understand the Value of Your Business	▪ Conducts regular valuations of your business ▪ Helps you understand the consequences of decisions on business value ▪ Suggests ways to improve visibility of cash flows to increase value of business over time
#2 Use Tax Strategies that Build Your Wealth	▪ Integrates business and personal tax planning ▪ Employs tax-loss harvesting when appropriate ▪ Identifies tax-reduction strategies you may not yet be using
#3 Develop Investments Outside Your Business	▪ Helps you create equity in your business ▪ Assists with liquidation of that equity when the time comes ▪ Offers tax-advantaged investment strategies that build your wealth ▪ Manages the marketable securities asset allocation with careful consideration of your business interests, real estate and other investments in the design ▪ Prevents you from taking excessive risk
#4 Stay Informed About Exit and Succession Planning	▪ Offers advice for buying and selling businesses ▪ Has extensive knowledge about how to plan for the best outcome from the exit or succession of your business ▪ Knows how to create and harvest business equity
#5 Protect Your Wealth	▪ Helps you protect the value of your business against theft from people in positions of trust ▪ Offers tips on increasing the value of your business through a sound exit plan ▪ Reviews your estate planning to assure that it will meet your objectives and that the designed process will transfer your property to the people you wish ▪ Assists you in protecting the lifestyle and financial security that you have worked so hard to establish

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