



FINANCIAL *Planning for Business*

A Tax, Financial, & Investment Report

WestPoint *Private client*
G R O U P



Scott Eckart Kevin Clasen

501 Congressional Blvd., Suite 200
Carmel, IN 46032

Tel: 317.805.2955

Fax: 317.805.2956

seckart@westpointfinancialgroup.com

kclasen@westpointfinancialgroup.com

www.wppcg.com

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Estate Planning and Your Family Business

Liquidating the family business in order to pay estate taxes is often an unpleasant reality for families of individuals who die without wills (*intestate*) or estate plans. If you own a family business, you should consider taking steps *now* to help assure one of your most valuable assets will still be around for your children, grandchildren, and beyond.

The Plain Facts

The terms "family business" or "small business" can be misleading, especially when you consider the impact these businesses have on the U.S. economy. Of all small companies in the U.S. employing fewer than 500 people, 88% are owned by families. According to an estimate by The Family Business Institute

(2005), 24.29 million family-owned U.S. businesses generate 64% of the gross national product (GNP) and employ approximately 82 million people (62% of the workforce).

It is natural to assume that many business owners would like to keep this kind of influence in the family. However, in reality, the situation is much different—only a fraction of business owners who want their family business to remain in the family take active steps to devise a *formal succession plan*, according to the Boston-based Family Firm Institute (1995).

Why is it that only a small number of business owners act on their intentions? **Business continuation** is often a

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Successfully Manage Your Cash Flow

Small business owners inevitably juggle many competitive priorities. While it can be challenging to keep everything running smoothly, "dropping the ball" on **cash flow** can be a costly oversight. Effectively managing the money flowing in and out of your company is key to staying in business. As you plan for success, three basic steps can help you successfully manage your cash flow: tracking, analysis, and budgeting.

Tracking Inflows vs. Outflows

For most businesses, cash flow is an ongoing process that tends to repeat over and over again as money cycles in from sales and out for expenses. **Inflow** refers to the money coming in to your business, for example, through the sale of goods and services or from the pro-

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difficult subject for family business owners to confront. In many cases, succession is often avoided, rather than planned. It is often a taboo topic.

Business owners may be reluctant to hand over a business they spent much of their lives building. They may be forced to confront and resolve sibling rivalry and other unpleasant family disagreements. Sometimes, an owner will have greater difficulty grooming a *family member* for succession because of the overlap of family and business boundaries. Additionally, if the owners plan to rely on the family business for retirement income, they may worry about the business's success under new owners.

Survival Planning for Your Company

However, the costs of *not* planning for the continuation of family businesses

may be enormous. Often, companies without formal succession plans are courting disaster. Statistics reported by The Family Business Institute show the following trends:

- Only 3 in 10 family businesses survive into the second generation.
- Only 1.2 in 10 survives into the third generation.

How can you make sure that *your* business avoids becoming one of these statistics? A sound solution is to establish an estate plan. Simply put, you need to do the following:

- Develop a formal management succession strategy that will help ensure your business stays in the family after your death.
- Equalize your estate so that if you have children, you can make alternative bequests to those who do not want to be involved with the family

business. At the same time, you can leave the business to the children who do wish to be active in the business.

- Guarantee that the business continues in an orderly manner after your death.
- Create a **buy-sell agreement** for family and non-family members who may own stock in your business.

As you can see, ensuring that your business lives on is a complicated issue that engenders many concerns. Care must be taken to ensure that *all* issues will receive open and honest discussion. With the right estate planning team and the right succession plan in place, you may be able to beat the odds to maintain your company's success and ensure your family's ownership for future generations. \$

Nonqualified Plans Can Boost Retirement Savings

Many of today's business owners may discover that qualified plan proceeds might fall short of meeting their retirement income needs. For this reason, finding alternative savings strategies has become a growing priority.

The use of **nonqualified plans** can play an important role in helping business owners fill their retirement savings shortfall. Since nonqualified plans are not subject to Employee Retirement Income Security Act of 1974 (ERISA) nondis-

crimination requirements, they can be used selectively.

Typically, the corporation funds the majority of the plan as a nondeductible business expense, with the owner/executive funding the remainder. Often, corporations provide owners/executives with a bonus to help cover this "personal" expense, along with income taxes incurred on the bonus.

Many nonqualified plans provide small business owners with additional tax-deferred savings opportunities (e.g., executive bonus plans and deferred

compensation). While there are several ways of funding such plans, **life insurance** has traditionally played a central role because of the potential for tax-deferred buildup of policy values.

Finding the most advantageous supplemental retirement funding mechanism can be important. A review with qualified insurance and tax professionals can play a key role in determining a course of action consistent with your personal goals and business objectives. \$

Successfully Manage Your Cash Flow

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ceeds from a bank loan. Your business expenses, such as buying inventory or paying off a loan, represent your **outflow**. One of the greatest challenges small business owners face is timing when money comes in and when it needs to go out. Even businesses with steady annual profits may face times of the year when money is tight—periods when there is a greater need for cash than there is cash on hand.



One important tool that can help you track your inflow and outflow is the **cash flow statement**. This basic document records the date and nature of all cash inflows, as well as the date and nature of all outflows—tracking the movement of funds, typically on a monthly basis over the course of a year. Your **profit and loss statements** and your **balance sheets** will be great resources for this information. With a detailed cash flow statement, you're ready to analyze your situation and make projections.

Cash Flow Analysis

Understanding your cash inflow and outflow patterns

will help you make the wisest money management decisions. As you analyze your inflow resources, study the ways in which **accounts receivable** and **credit** may affect your cash flow. Accounts receivable are sales that represent a *promise to pay*, rather than immediate cash. When you extend credit, you are essentially making a loan. It is important to understand your financial capacity to provide credit, as well as to establish policies that help you collect what is owed on time. Mismanaging either one of these inflows could lead to negative cash flow.

As for your predictable outflows, you may find that by staggering some payments you can free up cash for others. For example, seasonal businesses may find that rescheduling payments can help ease cash flow during slower months. Other businesses may find that carrying less inventory helps cash flow.

There are several warning signs that may hint at cash flow problems. Consider the following five indicators:

1. Difficulty meeting payments
2. Excessive or obsolete inventory
3. Inability to make economical purchases due to lack of cash
4. Outstanding receivables
5. Excessive short-term debt

Planning ahead may help you maintain positive cash flow and avoid problematic shortfalls.

Preparing a Budget

In addition to helping you with your day-to-day money management decisions, a **cash flow budget** can help you plan for future growth and expansion. Your budget can be as detailed, or as basic, as you need it to be, providing monthly breakdowns of cash inflow and outflow, or weekly or daily projections. Based on your analysis of your past cash flow, consider making a plan for the next year.

In order to estimate your future inflow, you'll need to forecast next year's sales. Using last year's figures will help you. Remember to factor in any relevant variables, such as economic trends or developments in competition.

As you predict your outflow, be sure to account for your operating expenses, accounts payable, and loans. The more accurate you can be, the easier it will be to predict shortfalls and find solutions. Keeping good records and thoroughly evaluating your financial history will make it much easier for you to project your needs.

In addition to providing you with the information you need to make sound business decisions today, a detailed cash flow analysis and budget can help you plan for tomorrow. Successful money management lays a strong foundation for profitability and growth. All in all, smooth cash flow is good for business. 💰

Protect Your Business with Disability Income Insurance

Many business owners who understand the need for life insurance coverage often tend to overlook the potentially greater risk from a serious *disability*. According to the Insurance Information Institute (III, 2005), an individual age 40 has a greater chance of missing *at least* three months of work due to an accident or illness than of suffering an untimely death.

How long would *you* be able to cover your personal and business overhead expenses if your income and revenues were to stop today? As a business owner, you could find yourself in a dire situation.

Consider the following hypothetical example. At age 48, Richard Barker was the president and co-founder of a small, but growing, machine tool company. He thought he was in excellent health. However, one day without warning, he suffered a minor cardiac incident. Although it left no lasting damage, the follow-up surgery resulted in complications that sidelined Rick for the next two years. By the time he was finally able to return to work, he had narrowly missed declaring personal bankruptcy and losing his business. Unfortunately, his retirement savings had been depleted in the process.

According to the National Center for Chronic Disease Prevention and Health Promotion (CDC,

2005), chronic conditions, such as heart disease, diabetes, and cancer, are leading causes of disability and affect the quality of life of 90 million Americans. What can *you* do if such a situation prevents you from fully performing the duties of your job? There are two important types of insurance protection that can help safeguard a portion of both your income *and* your business.



First, **disability income insurance** helps replace a portion of your lost income while you are totally disabled. Most employer-sponsored plans replace salary for only a minimum period of time, typically 26 weeks or less. However, you can extend coverage either by purchasing an *individual* disability income insurance policy or by participating in a *group* plan through a business or professional association. When purchasing a policy, carefully examine the definition of disability. Some policies protect against loss if you are unable to work in your *own* occupation, while others

cover you only if you are unable to engage in *any* work at all.

Second, a **business overhead expense policy** helps pay for a variety of overhead expenses once you become totally disabled under the terms of the policy. Thus, if you are temporarily unable to generate revenue, you can rest assured the bills will continue to be paid without interruption.

If your disability becomes permanent, there still is one glaring issue that will need to be addressed—what will happen to your company? Will you be forced to sell it below fair market value (FMV)? If you have co-owners, they may agree to continue your salary on a *temporary* basis, but they may be unwilling or unable to do so indefinitely. With a **disability buy-out agreement**, your salary would continue for a specified period of time. If it appears that you are *permanently* unable to return to work, your co-owners could use the proceeds from a disability buy-out policy to purchase your share of the business.

Don't let a disability derail your business. Disability income insurance, a business overhead expense policy, and a disability buy-out agreement are tools that can help keep your future—and that of your business—on track. \$

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