Investing business profits

Your business has moved out of the startup phase, it's no longer as highly leveraged, and the challenges of tight cash flows and limited working capital are behind you. Now that you're generating profits, you need to decide how to use them.

"Even if you're young and just starting your career, you should be actively planning for and investing in your retirement," advises Chartered Accountant Stephen Shaw, Senior Vice-President and Director of MNP Corporate Finance Inc. in Toronto. "Many business owners assume that the proceeds from the eventual sale of their businesses will be sufficient to meet their retirement needs. Often, however, it isn't enough."

Shaw offers these seven tips for longer-term investing.

1. **Figure out your retirement needs -** Many people underestimate their financial needs for retirement and don't put enough aside – or don't begin saving for retirement early enough – to provide for the kind of lifestyle they want in retirement. Shaw recommends having a financial needs analysis completed by a professional financial advisor to determine how much you'll need to support your desired retirement lifestyle.

2. **Put together an investment strategy -** Based on your financial needs analysis, you can formulate a strategy that outlines how you'll allocate your cash flows: how much is required for personal consumption, how much will be reinvested into the business, and how much will be available for investment and saving.

3. **Invest in your business -** Since their business is usually their primary – if not sole – source of income, it makes sense that owner-managers will invest in and build it. Business needs can be diverse, however, so it's important that investments are focused on activities which are aligned with the business's broad strategic objectives and are likely to create longer-term value. As many owners get closer to retiring, they often prefer to put their money into personal savings rather than continuing to invest in a business they soon plan to sell. "Failing to reinvest sufficiently in the business may cause it to quickly lose its competitive edge," Shaw cautions. "In the long run, that will hurt a retiring owner, since a stagnating

business is less attractive to buyers and will command a lower sale price than a growing enterprise."

4. **Invest in real estate -** Diversification is one of the first rules of investing and investing outside the business helps minimize the impact of business-specific downturns. For business owners, one of the best opportunities to diversify is usually close at hand – the building and other premises that house the business. Owning rather than renting the business's premises can help provide protection against unavoidable changes in the operating environment that may reduce the business's competitive ability. "Real estate values typically appreciate in the long-term," Shaw says, "to the point where some owner-managers find the real estate they own is worth as much or even more than the business itself."

5. **Diversify your investments -** Owner-managers can further diversify their investments by putting funds into investment vehicles available in the public and private markets. Since they are entrepreneurs, many owner-managers have the risk appetite for investing in other enterprises and ventures. Others who prefer more traditional investments may prefer to consult an investment advisor for assistance in building a balanced portfolio appropriate for them, their age, risk profile and family situation.

6. **Take advantage of tax saving opportunities*.*** Privately owned businesses that are Canadian-Controlled Private Corporations for tax purposes are taxed at a low rate on their first $500,000 of active business income. With the elimination of the Ontario corporate surtax and the recent reductions in both federal and Ontario corporate income tax, business owners should revisit their remuneration planning to maximize the tax deferral now available and minimize taxes on amounts withdrawn from the corporation.

7. **Consider setting up a holding company**. Many business owners set up a holding company, through which they own the active business. Properly constructed, this can allow dividends to flow tax-free from the active business to the holding company, where they may be accumulated and invested without incurring additional taxes until the funds are distributed to the owner personally. A holding company also helps in terms of asset protection. If a claim arises against the active business, funds accumulated in the holding company may be shielded. Note that if the owner has provided personal guarantees or pledged the holding company's assets in respect of a security required by the active business, then personal assets may be at risk.

8. **Manage your investments to suit your age.** Putting together a retirement and investment strategy is a critical first step to help a business owner get the maximum benefit from the funds that are invested. To keep

investments on track, however, it’s important to keep your retirement and investment strategy up to date. The “right” mix of investment choices made when starting out in business will not necessarily be the most appropriate ones as the owner’s business and personal circumstances change, and as the owner ages and gets closer to retirement.

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