

## WHY ARE YOU IN BUSINESS?

This is not a silly question. So often, business proprietors don't know why they are in business. Are they in business just to earn a salary? Are they in business to make a decent profit (return on investment)? Are they in business to pass the business on with a good capital growth?

My view is that if you are not in business to make a decent profit (return on investment) over and above a decent annual income for the proprietor and you haven't made a decent capital growth on the value of the business over time then you shouldn't be in business.

Making a decent return on your investment (profit) is only part of the story. This is only equivalent to otherwise investing the money that you invested in the business into other investment vehicles such as managed funds (which not only pay you a dividend but grow in value). Otherwise you are going backwards financially.

So let's look at achieving capital growth on the value of your business. The overall goal for anyone in business should be that you either sell all or part of your business after a given time that you have set yourself to build your business. What you don't want to do is walk away from your business after working in your business for many years. And the solution can be quite simple, albeit, implementing a business model that takes time, money and effort.

So what are we talking about here?

Option 1 – You can work in your business to just earn an average annual income and run the business in an add hock manner (maybe taking cashies which is illegal – you are attempting to minimise profit so you don't pay too much tax). It is not an attractive proposition to an intending purchaser so you have to dump or attempt to sell the assets at written down value. You receive virtually no capital gain when you want to exit and have a high chance you will need to depend on a pension at retirement.

Option 2 - You work in your business to earn a better annual income, run the business so you make as much profit as possible (no cashies, minimise tax by employing pro-active tax strategies) and you systemize the business. This becomes more attractive to a prospective buyer and you may receive a sale price. Might not be as good as you could get, but at least it is something. If you are lucky and part of your tax minimisation strategy was to fully contribute to super, then you may not need to entirely rely on the pension at retirement.

Option 3 – You work on your business to not only earn a better annual income, but you build your business to achieve a good return on investment (profit) and you become innovative with your business and more particularly, your product offering, your marketing strategy and your market positioning. Your business becomes unique and when the time comes to sell, you can command a good resale price (make excellent capital gain on your investment).

I will illustrate the difference with the following table. In the case of Option 1, the value at sale is calculated at 1 times the annual profit (barely the value of the written down value of the plant and equipment). In the case of Option 2, we have given the business a sale value of 3 times the annual profit. The reason is that the prospective buyer sees value in having systems in place so the business is easier to step into. In the case of Option 3, we have given the business a sale value of 4 times annual profit. The reason being is that the prospective buyer sees greater value in purchasing a business that has a unique market position which is more likely to give a higher return on investment for the purchaser. I hope you can see the rationale behind the times factors.

Results of the Strategies after Being in business for 5 years	Option 1	Option 2	Option 3
Annual Profit	\$25,000	\$66,000	\$132,000
Five Years of Annual Profits	\$125,000	\$330,000	\$660,000
Less 30% Company Tax	(\$37,500)	(\$99,000)	(\$198,000)
Profit after Tax	\$87,500	\$231,000	\$462,000
Add value of business (@ times factor)	\$25,000	\$198,000	\$528,000
Exit gain after 5 years	<b>\$125,000</b>	<b>\$429,000</b>	<b>\$990,000</b>
Less start up investment (say)	(\$100,000)	(\$150,000)	(\$200,000)
Capital Gain to Wealth	<b>\$25,000</b>	<b>\$279,000</b>	<b>\$790,000</b>

So I ask again, why are you in business? If you are an option 1 business, then you have to question why you are in business.

Remember, the end goal is to exit the business with a capital gain that becomes your passive income (that is, you invest the capital gain in managed funds, say, and earning 8% per annum). If you only have \$25,000 to invest, you will not earn much annually in retirement.

If your goal is option 3, then you need to take action to position your business so that it becomes unique. We can assist you with your business so that you achieve capital growth. However, it will take effort, commitment and investment to turn your business into a valuable asset when you want to exit your business.

I would like to recognise Noel Spann, CEO of ECROtrain Pty Ltd and Group25 Local Business Achievers Clubs for his articulation of this concept and the table of figures.

**Derek Miles**  
**MNIA, MFAA, B.Bus.Acc, Reg Tax Agent**