



# It pays to have a business succession plan

Small business within the Australian economy is heading towards some major changes over the next 5 to 10 years.

Given that the definition of an Australian small business is one that employs less than 20 employees, there are many industries that will be significantly affected by these changes.

A study by RMIT University estimates that 97% of all businesses within Australia are small businesses and that the average age of the small business owner is 55 years. In the next 10 years 81% of these small business owners will be approaching retirement. Problem is 75% of these business owners do not have in place an exit strategy from their small business.

With only 10 years to go until retirement it is now time to commence implementing a succession plan for a planned and successful retirement.

## What is a succession plan?

Succession planning is a process undertaken by a business owner to ensure the continuity of the business into the future, regardless of the ownership or leadership.

Every business owner is going to exit his or her business at some stage of their business life. The challenge is to make sure that your exit is planned. By planning your exit you will be aiming to maximize the value of your business and accordingly unlock this value on retirement.

## Why is succession planning important?

Many small businesses are the small business owner's superannuation or retirement fund. You have invested not only your working life into this business but also your savings to fund the growth of this business.

If you do not plan your exit strategy correctly you may not have sufficient funds to achieve your personal goals in retirement.

Developing a succession plan with your accountant now and working on its implementation over the next 5 to 10 years will make it easier to achieve your personal, business and financial goals

## How do I go about the process?

The processes that might be involved in developing your plan may follow the following steps:

**Step 1.** You'll need to assess where you're at now - personal, financial and business wise.

**Step 2.** Set your personal, financial and business goals. By clearly defining your goals you can determine an appropriate plan to get there. A timetable for obtaining your goals is important. This ensures your goals are achievable in the timeframe.

**Step 3.** Plan your succession strategy by deciding whether to change leadership or exit from ownership.

Under the Changing Leadership strategy, you exit from the day to day running of your business without selling your business or your right to choose the strategic direction of the business. Key questions to consider with this strategy include: Who will be the new leader? Are there strong controls over systems and processes in place? Is the business structured appropriately?

If you choose to Exit from Ownership as your strategy, you not only exit from the day to day running of your business, but you also dispose of your ownership interests and the right to choose the strategic direction of the business. Key things to consider with this strategy include: Method of exit, for example employee ownership or merger; Method of business valuation; How to find an investor; Tax consequences of exiting.

When deciding on an exit strategy, there are circumstances and issues unique to the family farm business. Where there is someone in the family wanting to be the successor there may be an expectation gap between this person, or persons, and mum and dad. The gap will be the time frame on when to hand over the running of the farm, and on what terms this should take place. After all, mum and dad, and possibly past generations, have toiled on the land for the best part of their lives and are reluctant to release control.

Mum and dad might have serious reservations and fears about the potential successor. Do they have the experience to run the farm? Are they committed? Can they fund the purchase of land? Is the farm asset at risk in case of a relationship breakdown with their spouse?

There may be an additional complexity when not all siblings work on the farm. In that case how can the inheritance be made fair & equitable when the majority of the estate is the farm?

When mum & dad want to retire but the only asset is the farm how do they fund their retirement cash flow needs if a buyer can't be found or there is no successor?

**Step 4.** Consider the superannuation and retirement issues to ensure that your retirement is well planned for. Ask questions such as: What type of super fund best suits your needs? Are you making sufficient super contributions to achieve your goals? Have you sought tax advice on contributions and the consequences of your succession plan?

Once your succession plan is complete it should be continually updated and monitored to make sure you're on track to achieve your goals and that no risk has the capacity to cause your plan to fail.

Without planning your succession you are leaving it to chance that you will enjoy a financially comfortable retirement.

Article by Ruth Annett, Principal, WHK Western Victoria.



# STRAIGHT TALK

## Take a long term view

The past quarter has been a momentous, tumultuous and historic one when we witnessed panic on Wall Street, the collapse of Lehman Brothers, a mad scramble for capital from many Investment Banks and corporate consolidation. This led to mass withdrawals from US money market funds.

What started as a philosophical debate about the role of government in financial markets when the US Treasury 'rescued' Fannie Mae and Freddie Mac, became all too real by the end of the September – the US Congress voted against the A\$840 billion Targeted Asset Relief Plan (TARP) before it finally voted through the Rescue package 'take-two' in early October.

Here in Australia, the Rudd government announced its \$10.4 billion stimulus package in mid-October. The key points of the package are:

- \$4.8 billion for an immediate down payment on long-term pension reform;
- \$3.9 billion in support payments for low and middle-income families;
- \$1.5 billion investment to help first-home buyers buy a home;
- \$187 million to create 56,000 new training places in 2008-09;
- The implementation of the government's three nation building funds and bring forward the commencement of investment in nation building projects to 2009.

## Will the latest package work?

The global economy needs to have the credit markets working again. We believe the rescue package will go some way in achieving this. The major issue is who can sell what and, most importantly, at what price? The US Government is in a position to hold assets for the long term.

In April's Financial Stability Report on the subject of problem loans, the Bank of England said that credit losses from the turmoil are unlikely to ever rise to levels implied by current market prices unless there is a significant deterioration in fundamentals, well beyond the slowdown anticipated. That is because prices are likely to reflect substantial discounts for illiquidity and uncertainty that have emerged as markets have adjusted but which should ease over time. This view neatly explains why the US Treasury and the Federal Reserve believe they can buy these loans, with the end result being taxpayers not greatly out of pocket or even in profit over the long term.

## What does history tell us?

A similar rescue package was put together in 1933. Known as the Home Owners Loan Corporation, it was a bid to refinance home loans, granting longer term loans to over one million people during the depression years. The Owners Loan Corporation stopped lending in 1935 and wound up in 1955, having made a small profit.

## What is the conclusion for investors?

It is clear that the world governments are doing everything in their power to prevent a more severe financial crisis. Share markets around the world have dropped substantially, effectively pricing in much of the future risk.

We believe that the key point for investors to keep in mind is to ensure their portfolios are well diversified and to make decisions on a rational basis.

In an article published by the Australian Financial Review in mid-October, Warren Buffett (regarded as the world's savviest investor with a net worth of \$62 billion) summarised why now is a good time to purchase equities. His words can give some comfort in that if we are buying good companies now and holding them over the long term, we are likely on the right track. It also describes moving to cash in this climate and how that can be dangerous for our portfolio's long term returns (this does not mean however that you should move all your investments from cash to stocks as we often need short term cash to meet expenses and to maintain appropriate liquidity).

## Below is an excerpt of his letter published in mid-October:

*"The financial world is a mess, both in the United States and abroad. Its problems, moreover, have been leaking into the general economy, and the leaks are now turning into a gusher. In the near term, unemployment will rise, business activity will falter and headlines will continue to be scary.*

*So ... I've been buying American stocks. This is my personal account I'm talking about, in which I previously owned nothing but United States government bonds. (This description leaves aside my Berkshire Hathaway holdings, which are all committed to philanthropy.) If prices keep looking attractive, my non-Berkshire net worth will soon be 100 percent in United States equities. Why?*

*A simple rule dictates my buying: Be fearful when others are greedy, and be greedy when others are fearful. And most certainly, fear is now widespread, gripping even seasoned investors. To be sure, investors are right to be wary of highly leveraged entities or businesses in weak competitive positions. But fears regarding the long-term prosperity of the nation's many sound companies make no sense. These businesses will indeed suffer earnings hiccups, as they always have. But most major companies will be setting new profit records 5, 10 and 20 years from now.*

*Let me be clear on one point: I can't predict the short-term movements of the stock market. I haven't the faintest idea as to whether stocks will be higher or lower a month - or a year - from now. What is likely, however, is that the market will*

*move higher, perhaps substantially so, well before either sentiment or the economy turns up. So if you wait for the robins, spring will be over.*

*A little history here: During the Depression, the Dow hit its low, 41, on July 8, 1932. Economic conditions, though, kept deteriorating until Franklin D. Roosevelt took office in March 1933. By that time, the market had already advanced 30 percent. Or think back to the early days of World War II, when things were going badly for the United States in Europe and the Pacific. The market hit bottom in April 1942, well before Allied fortunes turned. Again, in the early 1980s, the time to buy stocks was when inflation raged and the economy was in the tank. In short, bad news is an investor's best friend. It lets you buy a slice of America's future at a marked-down price.*

*Over the long term, the stock market news will be good. In the 20th century, the United States endured two world wars and other traumatic and expensive military conflicts; the Depression; a dozen or so recessions and financial panics; oil shocks; a flu epidemic; and the resignation of a disgraced president. Yet the Dow rose from 66 to 11,497.*

*You might think it would have been impossible for an investor to lose money during a century marked by such an extraordinary gain. But some investors did. The hapless ones bought stocks only when they felt comfort in doing so and then proceeded to sell when the headlines made them queasy.*

*Today people who hold cash equivalents feel comfortable. They shouldn't. They have opted for a terrible long-term asset, one that pays virtually nothing and is certain to depreciate in value. Indeed, the policies that government will follow in its efforts to alleviate the current crisis will probably prove inflationary and therefore accelerate declines in the real value of cash accounts.*

*Equities will almost certainly outperform cash over the next decade, probably by a substantial degree. Those investors who cling now to cash are betting they can efficiently time their move away from it later. In waiting for the comfort of good news, they are ignoring Wayne Gretzky's advice: "I skate to where the puck is going to be, not to where it has been."*

*I don't like to opine on the stock market, and again I emphasize that I have no idea what the market will do in the short term. Nevertheless, I'll follow the lead of a restaurant that opened in an empty bank building and then advertised: "Put your mouth where your money was." Today my money and my mouth both say equities.*

*Warren E. Buffett is the chief executive of Berkshire Hathaway, a diversified holding company.*

Should you wish to discuss further, please speak with your WHK adviser.

# Time to get focused...

Sometimes there seems to be so much to do... where do you start? This is the time to prioritise – what are the most important things for your success?

Start with identifying the key performance indicators (KPI) for your business – those things that are critical for your success. There are three different kinds of KPIs to be aware of.

## 1. Generic KPIs

You can identify these by asking yourself three simple questions:

- How do we get business?
- How many inquiries do we convert into sales? and
- What is the average value of a sale?

For example, let's assume you are a radiologist who gets sales from doctors' referrals. Therefore, an important success factor might be to develop effective relationships with doctors. To successfully measure this, you then establish the number of referrals you get from doctors as a KPI.

Other KPIs tied to this particular critical success factor may then be the average transaction value, number of transactions per doctor, and so on.

## 2. Industry-specific KPIs

The second kind of KPIs are those that are specific to your industry. So using our earlier example, you would need to identify all of the critical success factors for your radiology practice. For this example, let's say the success of the business depends on:

1. getting the X-rays done quickly (you can gain a competitive advantage doing more in a day);
2. reputation for safety; and
3. client care.

Those success factors would then need metrics—or KPIs—against which to monitor progress. So as a radiologist, you may want to

measure the number of x-rays performed in a day for the first one, the number of incidents for the second, then the level of client satisfaction by issuing feedback forms for the third.

Where possible ensure the KPI is set against industry benchmarks so you can be sure you are achieving best practice.

## 3. Initiative-specific KPIs

The third kind of KPIs are those that measure progress against specific initiatives. For example, if you have a particular issue with staff turnover, then you may consider implementing a specific training/retention program to address this. Setting metrics around this initiative will help it stay on track.

## Conclusion

Don't forget the principle "What you can measure, you can manage". Essentially, by establishing KPIs, you will be in a better position to control the results you want to achieve from your business.

If you would like assistance in identifying appropriate KPIs for your business and industry benchmarks, please speak with your adviser at WHK.

*Article adapted from Alliance news Principa by Dominic Ruso, Brampton Ontario, Canada*



# Responsible and Sustainable Investment.

Much has been written about the Government's proposed Carbon Pollution Reduction Scheme (Green Paper) and how this may impact on our economy and the future success and viability of individual companies.

Already a whole new dictionary of terminology and acronyms has been developed and expectations have built up around the value that could be extracted from the proposed Carbon Pollution Reduction Scheme.

But who knows what the real cost or benefit may be?

The answer is no-one really knows. But what we do know is that the combination of a growing global population and its associated energy demands, an increasing scarcity of water, food sources and oil and the ever present impact of climate change will have an economic impact.

This presents risks to companies at many levels and while some companies are taking these issues seriously there are many companies who still seem to believe that it is someone else's problem to solve.

The development of Responsible or Sustainable investment principles has taken place over the last few years, developing from ethical investment concerns which were driven more by personal feelings, into a broader interest in how companies are dealing with the issues of sustainability and their future success.

Corporate Social Responsibility (CSR) is a common term used to define the broader issues which can be split into 3 main areas:

- Environmental concerns; and how companies deal with the inevitable impact their products and processes have on the environment, use of energy etc;
- Social issues; such as how the company deals with its employees, outsourced workers overseas, the local community etc;
- Governance; the Board and management structure, legal compliance and trade practices etc.

Companies are now rated on the basis of these issues. And as you might expect companies which rate well across these areas generally perform better than others. A global study of over 4,000 companies showed that over 5 years, companies which rated in the top 10% on governance issues, generated on average almost 4% pa extra return for investors. Put simply, companies which are proactive, perform better.

And a broader study looked at 30 separate pieces of research into the quantitative relationship between CSR issues and investment

performance, and found that only 3 studies showed a negative correlation. In other words, investing "ethically" does not mean you have to forego some of your return.

In 2006 the United Nations developed their Principles for Responsible Investment. These have already been adopted by over 200 investment managers globally, including 40 managers in Australia who control over \$360 Billion of funds under management – over 27% of all managed assets in Australia.

So, whenever (if ever) the Carbon Pollution Reduction Scheme is established in Australia, the issues and how they will impact companies now and in the future are already being considered around Board tables, the investment managers' committees and the public pension funds – at least by those of them who wish to continue to survive and prosper.

*Mark Mackintosh, Adviser and Representative, Prescott Securities Adelaide.*

*Mark is a member of the Responsible Investment Association of Australasia.*

# Testamentary Trusts

One way of creating an effective and flexible estate plan is to include the option for a Testamentary Trust in your will.

A testamentary trust (TT) is a trust created from a will. Instead of all of the assets of a deceased estate being distributed to the beneficiaries, some or all are retained in a trust for the benefit of beneficiaries. It provides the option of either a discretionary or fixed trust with each providing different benefits.

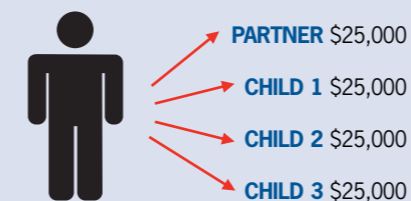
The persons nominated as trustees of a TT have the ability to determine which beneficiaries receive distributions and the timing and amount of distributions. Alternatively, the Trust may provide for fixed entitlements for beneficiaries, although flexibility is recommended to retain the advantage of any tax planning opportunities. It is important to consider carefully who are to be the trustees of the TT. They should be persons who you know have some financial management skills and can be trusted to act in the best interests of the beneficiaries.

## Tax minimisation

A TT allows for tax effective income distribution. Through flexibility of distribution of income the TT effectively lowers the rate of tax paid on Estate income. The diagrams below illustrate the potential tax benefits of using a TT.

### With a Testamentary Trust

Assume \$100,000 in taxable income and beneficiaries have no other income



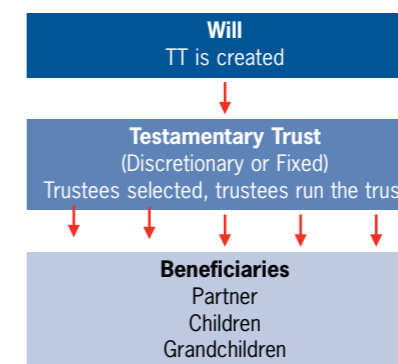
Total tax payable for partner and 3 children will be \$12,900 or effective tax rate of 12.9%

### With No Testamentary Trust

Assume \$100,000 in taxable income and beneficiaries have no other income



Total tax payable for partner (no tax payable by children as \$2,667 is the current tax free threshold applying from 1 July 2008 for minors after allowing for the low income rebate) will be \$24,179 or an effective tax rate of 24.17%



However, you must be careful as any income not distributed to beneficiaries each year is taxed at 46.5% in the hands of the trustee.

## Asset protection

A well drafted TT may also assist to protect the assets of beneficiaries of the estate. As the TT is not owned directly by the beneficiaries it can offer a level of protection from creditors. It can also provide protection of your estate for subsequent generations as the assets will never be directly available in property settlement disputes, be available for spendthrift children, or in the event of matrimonial breakdown. The family court may however have some regard to assets in a TT and could adjust the assets outside of a TT in determining the asset split between a husband and wife.

If a beneficiary is not capable of handling their own financial affairs or have special needs, you could leave part of your estate for that person's benefit by naming them as the primary beneficiary (but not a trustee) of a TT. It prevents abuse of the trust assets by unscrupulous people or irresponsible individuals.

A TT within a will allows beneficiaries the flexibility and choice that a normal or standard will simply cannot match and is not just for the wealthy. A well-planned TT can last for up to 80 years after the death of the will maker, and can provide ongoing asset protection with significant tax savings for partner, children, grandchildren and great-grandchildren.

You should consult your accountant, solicitor and financial adviser, to ensure that you are aware of all the advantages, disadvantages, costs and responsibilities before you make the decision to include this in your will.

The above comments provide only a general overview of the concept of a TT. Specific advice should be sought in relation to your personal estate planning needs.

*Peter Hickey, Adviser & Representative, Prescott Securities, Robina Qld.*

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