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Money Matters

Avoid the trap of equating your business with yourself

by J. Laurent Thibault

Self employment is that fastest growing type of work in today's economy.

Recent statistics show that in 1995, for the first time in our history, self employed entrepreneurs (2,098,000 of them or 15.2% of those working) outnumber government workers.

Moreover, the growth in self-employment has accelerated in the 1990's so that by the end of the century, one of every five in the labour forces is likely to be their own boss.

The jury is out on whether this trend is a good thing, but it poses a difficult challenge for the hundreds of thousands who find themselves in a very unfamiliar situation and may not be planning their financial affairs smartly.

One of the biggest traps is the failure to distinguish between the individual and the business.

Entrepreneurs naturally want their business to succeed, and most of them proudly point out that they "plough everything back in the business". Many even forego the maximum annual RRSP contributions in order to invest in their business, even though RRSP's are the most powerful and tax-effective asset building mechanism.

In effect they are counting on the business assets to generate their retirement income, and this leaves them vulnerable.

Entrepreneurs are often themselves the company's biggest asset, but the first lesson of sound asset allocation theory is that putting all your assets in one category (particularly in a "soft" category such as your own talents or a personal business network) is a high risk strategy. You may get the big pay-off from your business in the end.

However, the rate of failure of small business is high, often because people burn out; or the management team is not diversified; or the family members who takes over the business cannot duplicate the original formula for success.

To be sure, maximum investment in the business may be unavoidable in the early years. But the smart

strategy for personal financial security is to build over time a portfolio of investment assets completely independent of the business, (with the maximum in a tax sheltered RRSP).

This approach also has added advantages. An entrepreneur who has ensured her or his financial independence outside the business can take a much more objective and critical view of key business decisions and can avoid questionable decisions that might flow from a desperate need for a business to succeed.

Another benefit is that the rate of return that a long term growth portfolio of mutual funds should be able to generate (in the 10% to 15% rate) provides a useful point of

comparison for the performance of the assets invested in the business.

The key point it is a mistake to equate the individual with "the business", which may be a lot more fragile than the owner is willing to admit.

The individual, however will keep on living longer than most people think ie: perhaps 25 years after retirement.

To generate an after-tax annual retirement income of \$50,000 (inflation adjusted for the 25 years) requires about \$1.4 million in investment assets.

Business owners owe it to themselves and their family to do some careful objective planning to achieve this goal.

Mr. Thibault is a Financial Advisor with The Equion Group.

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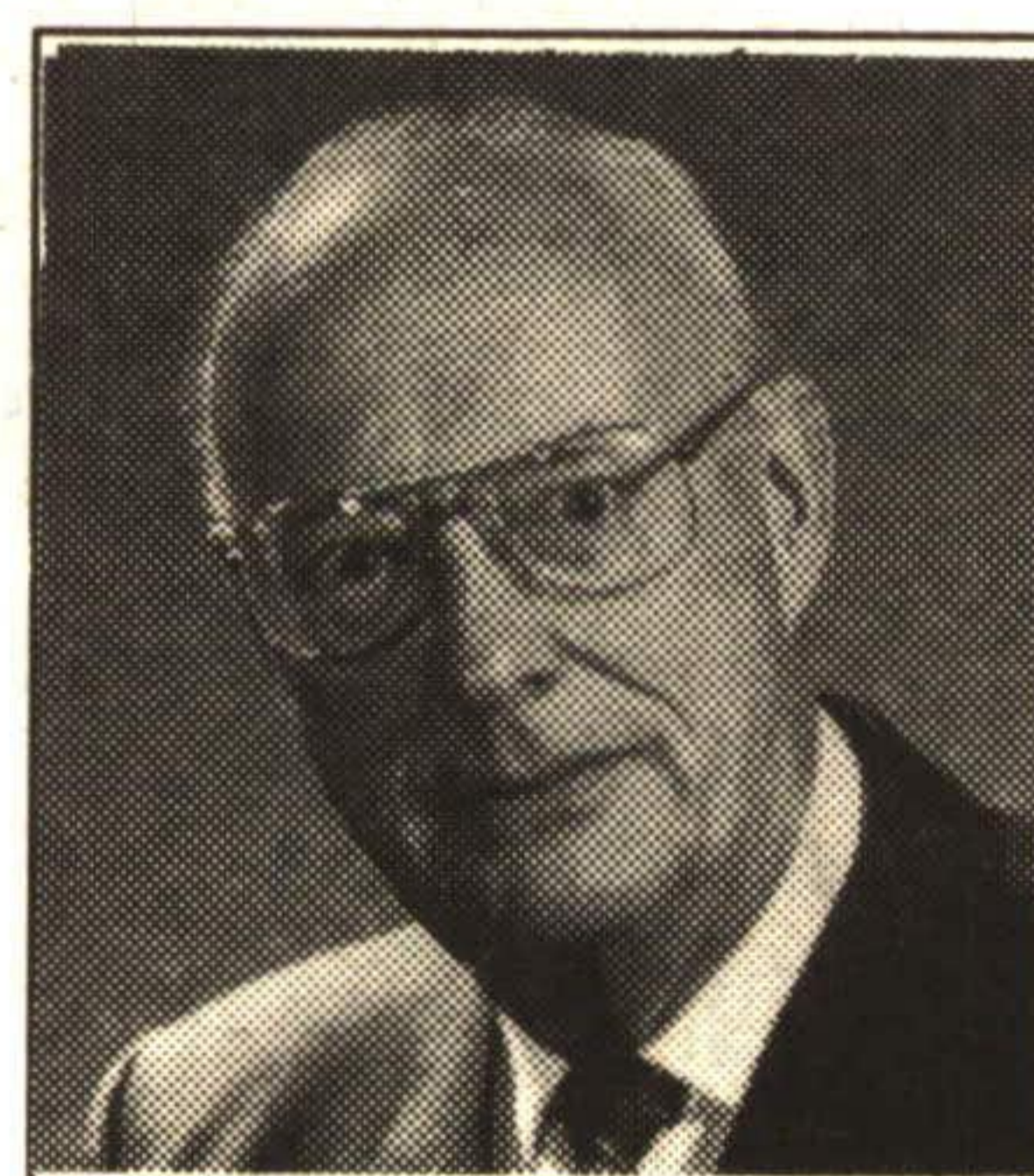
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