Taking Care of Your Business

By David Choo

Starting your own business is like falling in love for the first time. You can feel the passion and energy surging through you, but as you start to dream it's often left to family and friends to spot potential obstacles and worry about the downside. Here are some questions that every business owner needs to ask.

My experience with business owners is that their work and business is more than just their passion, it's their life – not just financially but emotionally, psychologically and socially. As we toast the successful entrepreneurs who make it we often forget the sacrifices and struggles they went through, not to mention the many others who bit the dust.

But as a financial planner and adviser, I am concerned about three major aspects of my clients' business. Has the company been structured in a suitable way, has sufficient attention been paid to taking care of risk exposure, and will the business be able to continue in the event that its owner cannot? These are fundamental questions, and ignoring them could spell disaster.

WHAT'S THE BEST WAY TO STRUCTURE MY BUSINESS?

Let's begin by looking at the way a business is set up. A business, whether it be a proprietorship (one owner) or a partnership (two partners or more) is not a legal entity separate from its owners, which means that those owners have unlimited and, in the case of partners, joint liability for all the debts and liabilities incurred by their firms and by their business partners.

A company, on the other hand, is a separate legal entity from its shareholders, so a company shareholder's personal liability is limited to the capital he has put into the company and is separate from the liability of the company as a whole and from other shareholders' liabilities.

It is therefore normally safer to be a shareholder than a proprietor or partner, whose assets can be recovered by creditors and banks to settle business debts. Shareholders who stand as personal guarantors for their company's borrowing also risk losing their personal assets, but this is their decision to take.

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It is mainly because of the undue personal financial risks partners face that the Ministry of Finance is keen to introduce limited partnerships (LPs) and limited liability partnerships (LLPs), both of which are currently under consideration. The LLP is a business structure that offers all its members limited liability while allowing them to retain the flexibility of operating the LLP as a traditional partnership.

Unlike a general partnership or a limited partnership, the LLP is a separate legal entity from its members, which means that property can be owned in its name and survive changes of partners. The LLP is suitable for professional firms, start-ups and family-owned businesses, and an LLP partner does not assume personal liability for the debts or obligations incurred by the partnership or other partners. His liability is capped to the amount he has agreed to contribute to the LLP, though a partner will assume unlimited liability when he knowingly causes the LLP to commit a tortious (wrongful) act.

WHO TAKES THE DECISIONS AROUND HERE?

No prizes for guessing which form of business has the simplest decision-making process – the sole proprietor. He doesn't need to call a meeting and he doesn't need to convince anyone that he's right. A partner's action in business is generally binding on the other partners and so it behoves them to agree on a course of action first. Similarly, shareholders and directors will often meet to ensure that there are no surprises. Delegation is necessary but the ultimate responsibility and financial risks fall on shareholders.

HOW WILL I BE TAXED?

Proprietors and partners are taxed on their income derived from the business according to a personal, graduated rate. Companies, on the other hand, being separate tax entities, are subject to flat corporate tax, while the shareholders and directors are subject to a personal, graduated tax rate for their remuneration.

Companies that do well are therefore likely to pay more taxes, so closely held companies (where the shareholders themselves are the key managers and directors) will likely remunerate the directors or shareholders well to reduce on flat corporate tax. A tax consultant will be able to recommend whether or not incorporating a business or partnership is a good idea, but many companies have found it advantageous from a tax point of view.

HOW WILL I RAISE CAPITAL?

Generally the ability to raise capital for a business depends on one's asset and credit standing. The more owners there are, the higher the capacity to raise capital. Bank loans may depend on the creditworthiness of the key people and availability of collateral. The form of business that can raise the most capital is the public limited firm but it can be at the expense of control.

HOW DO I MANAGE MY RISK EXPOSURE?

All business owners should do a thorough risk-management exercise to identify and manage risk exposures. This includes strategies of risk prevention, reduction, transfer and retention. Most firms have appointed insurance agents or brokers to take care of insurance risks, but only a few have done a thorough risk audit. Potential catastrophic losses that are not identified and insured can destroy a business. An excessive concentration of physical assets is a good example, but exposures like public liability, product liability, professional indemnity, and directors and offices liability must also be addressed.

WILL MY BUSINESS BE ABLE TO CONTINUE WITHOUT ME?

Of the three main concerns I mentioned earlier, business continuity is the most neglected but the most likely to be encountered. Busily tending to present business concerns, most owners forget that long-range planning is important. We're not talking here about dealing with future decisions, we are talking about dealing with the future of present decisions.

Will your business survive without you? Will you pass your business interest on to your other shareholders or your family, and are your children likely to fight over it? Will you retain the services of your key people?

If a business owner has not thought about these things it's not because they are deemed unimportant, it's because they have not sat down to consider their consequences fully. Proprietorships and general partnerships are the most prone to succession failures, but company shareholders also have to sort these issues out.

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The death or disability of a key person can upset the apple cart, and just as writing a personal will is important, writing a "business will" can prevent many problems of succession. Many a good business, built painstakingly over decades, has been destroyed over a few weeks because no continuity plans were in place.

The last resort is, of course, liquidation, but from a financial perspective it is the least attractive option. It can be avoided by strategies like appointing and empowering a successor and through buy-and-sell agreements, whether funded by life insurance or other means.

But few businesses, including those that are in the know (accountants, lawyers and financial advisers), have taken action to ensure their business continuity, which brings us back to where we started. Setting up a business may indeed be like falling in love for the first time, but another saying tells us that 'love is blind, and marriage is an eye-opener'. Business owners must keep their eyes open at all times because an unplanned end to a business, whether due to liability losses or business continuation problems, is financially worse than a divorce – you lose custody of the business you love. **si**

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