



Becoming a boss to pay for retirement

As financial security becomes more fleeting, hard cash from a small business grows more attractive

There was a time when the three legs of the retirement stool — Social Security, pensions and personal savings — were solid. Since those legs are more than a bit wobbly these days, I advocate an improved three-legged stool for retirement financial security: paper assets, income-producing real estate and ownership in an operating business.

The first two are asset classes all advisers understand, but what about ownership in an operating business? When included as part of a properly allocated investment strategy, ownership in an operating business can provide a reliable source of steady income and a potential for high returns on the back end.

When talking about ownership in an operating business, I am referring to ownership in a privately held company. Private ownership is important because it means the company isn't subject to the vagaries of shareholders or the volatility of the stock market.

Such companies represent a wide variety of business sectors, industries and organizational models. Some, such as candy maker Mars Inc., are quite large. Others, such as your local service station or coin laundry, can be quite small. But size doesn't matter; success does.

Another key aspect to private ownership in an operating business is to find one in which the boss, while having some management responsibilities, doesn't necessarily have to work there on a daily basis to be entitled to a portion of the profits. Of course, many clients at retirement age are thinking of travel and golf — not owning a business where

they have to worry about payroll, employees and operating expenses.

For the right kind of investor, however, becoming a business owner is pretty straightforward and typically comes about in one of five ways:

- Starting the company and running it for three to five years, but having little or no day-to-day responsibility. This is probably what most people have in mind when they think of owning a company. It's easy to picture a founder turning over day-to-day operations of his or her company to a third party while continuing to collect a share of the profits.

- Inheriting all or part of a family-run enterprise. Inheritance is a common — if not obvious — way to obtain ownership in an operating business. Many of these businesses can be managed so that the owner need not show up for work to generate income.

- Buying or otherwise receiving an ownership stake in a company after working there over time. Ownership in this scenario may be achieved through a stock purchase program, acquiring equity through partnership or as a reward for performance.

- Buying all or part of an existing company. While there are a variety of ways to accomplish this, it is typically done directly, through friends or family, or as part of an investment group.

- Investing in a private-equity fund. If an investor doesn't have an opportunity to participate in one of the other scenarios, he or she can achieve proportional ownership in an operating business or businesses through a private-equity fund. But

remember, the further away the investor is from the company's decision makers, the more the investment behaves like a paper asset.

If your clients invest in an operating business, they must understand how to maximize the benefit of their participation. Make sure clients understand or enjoy the business or industry they choose (but I suggest staying away from independent restaurants and retail). The business must be privately owned, which guards against dilution of ownership and supports income growth.

The investor must have proximity to and influence with the decision makers who run the company, since a client's industry expertise or general business acumen can have a positive effect on profitability.

Finally, the business must produce income immediately. Since the priority is income, it's not enough merely having a chance to sell the business for a profit later.

Before they invest in an operating business, help your clients by running a pro forma to make sure the investment makes sense. How much to pay depends on the industry and the client's situation. As a rule of thumb, a client should not invest more than one-third of his or her total net worth in a business.

Like any investment, business ownership presents risks that must be carefully evaluated. But as part of an overall asset allocation, ownership can help investors build a better foundation for a healthy retirement.

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