THE FOUR BOXES OF FINANCIAL INDEPENDENCE

What you need for economic independence

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STAGE 2 SOLUTION

HELPING BUSINESS CREATE EXTREME VALUE

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What you need for economic independence

One of the questions I always ask when a business owner walks in our office is when do you want to leave your business? Often the owner will laugh, and then say, "Yesterday." I might then ask, "When do you think you'll be able to leave?" The answer I hear the most is "5 years from now."

Five years sounds like a nice number. It's long enough away that you dream that you might be able to leave your business. Here's the problem. If you don't have specific actions you're willing to take, that five years will remain five years everytime I ask.

I've even coined a term for this.....it's permafive. That's when you know you need to do something, but you don't know what. You think that whatever it is that needs to be done will happen over the next five years. But, lo and behold, a year goes by and it's still five years. Then, another two years goes by and it's still give years.

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Why your business by itself is not financially enough

Let's say your business makes $250,000 per year after your salary. Let's also assume that the salary you live on is $100,000 per year. Of the $250,000 your company makes, you draw $75,000 for living expenses and leave $175,000 in the company for growth and tax purposes.

It's now time to sell. You have a buyer who is willing to pay you enough money for you to net after tax, $1,000,000. This, you learn is a usual multiple for your industry and gives you after tax, four times your average profits for the last three years.

You go to your financial advisor and ask he or she how much you can spend of this money every year. They tell you that a prudent investor would not want to spend anymore than 4% of their capital.

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Here's your basic problem. You used to get $175,000 per year of income from your business. After your sale, you will only be able to spend $40,000 per year by taking 4% from the after tax proceeds of your business.

The Four Boxes of Financial Independence

I have a tool that we use for measuring financial independence with our business owner Clients called "The Four Boxes of Financial Independence." This tool is almost too easy to use.

The boxes are:

CAPITAL	RETIREMENT	REAL ESTATE	INVESTMENTS
The capital income value of your business. In our example above, the capital income value is **$40,000 per year.** (4% of $1,000,000)	The value of your 401(k) and qualified retirement program.	The income value or capital income value of investment real estate that your business uses and you own.	The income value of any other investments you might have.

As you can see, if the only asset the owner has is his business, there is no way he can sell his business and walk off into the sunset. In fact, this is the main reason I see owners always be five years away from leaving.

Let's take a look at how this might work with our above example. In this case, our hypothetical owner is only 50 years old. This is a very good thing. It means that our owner still has time to fix his financial problems and put himself or herself in a position to actually someday retire.

Below are the steps that could get this owner to retirement:

CAPITAL	RETIREMENT	REAL ESTATE	INVESTMENTS
Use value building activities in his business to increase the free cash flow by another **$100,000 per year.** This would increase the value of the business by **$400,000** when it came time to sell. This means the owner would have to change how they run different parts of their business to create the extra net profit.	Establish a 401(k)/profit sharing program where he or she **saved $46,000** per year in his account.	Purchase a building that **costs $900,0000** and **creates $90,000** per year in rent. When the owner turns 60 years old, the building would be paid off and would **produce $90,000 per year** in net cash flow from rent.	Take **$50,000** out of the increased profits and save it for retirement purposes in other investment accounts.

The Four Boxes doing its work

We now have a ten-year program that can get our owner to financial independence. Assuming a 6% return on the money the owner invests, the asset and income possibilities from the four boxes would be as follows:

CAPITAL	RETIREMENT*	REAL ESTATE	INVESTMENTS*
Our business value after taxes has grown to **$1,400,000.** This allows the owner to spend **$56,000 per year** from this pot of money.	**Saving $46,000** for ten years in a profit sharing or 401(k) plan at a 6% return would give the owner a capital value of **$606,000** or the ability to draw **$24,000 per year** for income purposes.	Owner retains ownership of building and **receives $90,000** in net rent.	The other savings account would produce a capital value of **$660,000** and provide an income value of **$26,500 per year.**
$56,000 per year	**$24,000 per year**	**$90,000 per year**	**$26,500 per year**

If our owner decides to follow all of the advice above, he or she could have an income of $196,500. This would provide more than enough income for our owner to retire in style.

**This is a hypothetical illustration and does not represent an actual investment. There is no guarantee similar results can be achieved. If fees had been reflected, the return would have been less.*

The key here is that for you to actually leave your business there is a very good chance you're going to need more than what your business can provide by itself. You're going to need to learn about how a 401(k)/profit sharing plan can be used to your advantage. You're going to need to find a place to buy to operate your business from. And, you're going to need to learn about investing in general

The investing part is an important skill for you to master. You're going to have to depend on solid investments to pay for your lifestyle when you retire. It's best to start learning while you still have your business. This will allow you to make mistakes, learn from them and then become competent before you sell.

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After you sell, you're not going to be in a position to learn by making mistakes. After you retire, a major mistake in your investment strategy could take a solid plan and put it at risk.

Be smart about how you're going to leave your business. Learn what's going to get in your way and make changes while you still have time.

About The Stage 2 Solution:

The Stage 2 Solution is a group who focuses on helping their clients create extreme value in their business. The focus of our help is on Registered Investment Advisory firms that do over $2,000,000 in gross revenue per year.

We help our clients manage revenue, create a memorable reputation and work with owners on strategies that will create sustainable value in their firms as well as for the owners of the firms.

For more information please contact:

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