



Future growth

Pensions and small business



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(ABF), examines SME owners' attitudes to, and preparedness for, their later career relationships with their business

It's been a busy couple of months of political announcements, which will undoubtedly impact small business owners and their advisers.

First, the screeching Budget U-turn on NICS may have helped the 'white van men' and many other self-employed people, but changes to dividend taxation remain. Then, the Cridland report reminded those of us under the age of 40 that we will probably need to wait until we're almost 70 (or possibly over!) to receive a state pension. This will naturally have an influence on how business owners plan for their retirement, and how they decide on their exit plans.

This area particularly interests both Clifton Asset Management (the business behind the pension-led funding product) and the Forum of Private Business (The Forum). We both exist in, and serve, the vibrant community of small and medium-sized businesses in the UK. This level of engagement - dealing with, advising on and resolving many of the issues that perplex business owners - gives both organisations a deep understanding of the aims, goals, worries and concerns of small business owners

nationwide. This is why we set out to examine SME owners' attitudes to, and preparedness for, their later career relationships with their business.

Future planning

And so, this month, we have partnered with The Forum to publish a new report: 'Pensions and Small Business - Ticking Time Bomb or Hidden Treasure?' The report is based on a survey of The Forum's own membership, together with responses from a further 1,000 SME decision-makers from a survey conducted by YouGov. In short, the results highlighted some significant shortcomings in SME owners' planning for the future, and thus also some significant advice opportunities, much of which, since funding plays a central role in these issues, is relevant to the broker community.

In the vast majority of cases, when an SME is looking to secure funding, a lender will want details of their personal as well as business circumstances. This will usually include a look at their own credit status as well as a review of their personal assets and liabilities. It is therefore wholly illogical to try to 'silo' assets such as one's house or pension away from the main business,

since their very existence could mean the difference between achieving funding or not. This is of great importance, since it is no great stretch to understand that a properly funded business is far more likely to deliver its owners' goals than one that is struggling with cash flow issues all the time, or one that can't expand or innovate due to a shortage of financial resources.

Broadly speaking, respondents' replies concerning their long-term lifestyle plans fell into four different groups, but all had serious flaws in their plans. Indeed, the lack of critical analysis by the SMEs concerning their own plans was thrown in stark relief.

Sell to fund

The biggest grouping stated that "my business is my pension", thereby suggesting that their intention was to dispose of the business in order to fund their retirement, or to pursue the 'work until I drop' strategy. Of course, success in both cases is predicated on certain outcomes being achieved. In the first case, the capital sum that would need to be realised on disposal would have to be very significant, arguably north of £1 million, in order to produce a relatively modest £25,000-£40,000pa income, something that is likely to be out of the reach of many small businesses. The only workable strategy in this case is to focus hard on growing the business' profits for five years or more prior to a planned sale, something that is likely to require not just funding, but the right type of funding, which is why advice from an experienced broker is so invaluable in these circumstances.

The next sub-group in this population had effectively taken the decision never to retire, and to continue to work well into old age. Whilst there is evidence that this does have some health and wellbeing benefits, as an active mind is far less prone to the ravages of old age, it is also a super high-risk strategy. Will the business continue to generate the necessary profits over the next 20 to 30 years? Will the owner's health allow them to continue for that long? Once again, an assumption of continued profitability and robust good health underpins this strategy. These are two things which, in reality, absolutely cannot be guaranteed.

Furthermore, this group appeared reluctant to engage with serious pension provision, based on a misunderstanding of the relationship between an SME owner and their pension. Far from being 'tied up' and 'dead money', assets in any accumulated pension can be aggregated

together and used to provide one of the most effective and wealth-building forms of business finance: pension-led funding. A strategy of deploying the pension fund into the business to drive greater profit, then repaying the pension pot with significant interest (thereby reducing the Corporation tax bill) drives up the value of both the business and the pension, thereby doubling the chances of a financially secure retirement.

Brokers' vital role

Surely this is a better bet than the wing and a prayer approach? It is also at the heart of why brokers are so vital in these circumstances. Many other adviser groups, such as accountants or IFAs, have little or no knowledge or understanding of pension-led funding, but commercial finance brokers do, in great numbers, and are thus ideally placed to deliver value not just when it comes to the acquisition of funding, but by providing a strategic solution that assists a client's long-term retirement plans as well.

Another significant group stated that they planned to sell their primary residence and use some of the equity released from it to fund their retirement plans. I'm sorry, but in the vast majority of cases that's just dreaming. For a start, you have to live somewhere, so only a portion of your existing equity will be available as a retirement fund, and, following on from that, the amounts needed to be realised to fund a relatively modest income, say £30,000pa or so, can easily exceed £1 million based on current interest and annuity rates. Add to that the fact that residential property values are clearly cyclical and therefore your retirement fund will be determined by the whim of the market, and you have a properly hare-brained strategy.

The amount of money stuck in pensions where the business owner feels it to be

'dead' money is simply staggering. Enter group four, successful entrepreneurs, who are used to paying themselves well, often more than £80,000 or £100,000 a year, and who regard the £200,000 or £300,000 they may have in a pension pot as a complete waste of time, since the income it is able to produce is tiny when compared to their work-based drawings. And yet, it's a useful lump of cash for almost any business. Two years ago George Osborne sought to remedy this somewhat, by allowing over 55s access to their pension pots without restriction, but at a swingeing tax cost. Again, this represents an opportunity for the savvy broker who knows to ask about pension assets when conducting a fact find. Imagine the customer loyalty and brownie points that can be achieved by steering a customer away from a pensions 'freedom' encashment, and typically a £40,000 or £50,000 tax charge when the purpose of the withdrawal is business funding, towards pension-led funding, where the tax charge is zero.

What is clear from the report is that a lack of knowledge in the adviser community is letting SME owners down. Commercial finance brokers are ideally placed to exploit this and become even more valuable to their clients, especially if they are prepared to take a more holistic approach and discuss customer plans 'in the round', rather than siloing the various component parts that contribute to long-term business and financial security. This doesn't imply that they should advise outside of their skill set, but it does mean that there is great opportunity in being able to spot where advice is needed and being proactive in referring those cases as appropriate.

To read or download a copy of 'Pensions and Small Business - Ticking Time Bomb or Hidden Treasure?', please visit: guides.pensionledfunding.com/pensions-and-small-business/

Business owners that view their business as their pension, and are looking to sell their business to fund retirement.

