“What you can do as an entrepreneur is nowhere near the same thing you can do as a fiduciary with somebody else’s money.”

Paul Adams: Hello and welcome to Your Business Your Wealth. My name is Paul Adams, your co-host, and CEO of Sound Financial Group. I am joined, as always, with my co-host, Cory Shepherd. Cory, so glad you could be with us, as always.

Cory Shepherd: And it is particularly good to be here with everybody today. I don't know why, I don't have a reason, maybe it's 'cause I was doing a little travel and I missed a couple of weeks, but it's exciting to be back in and dig in.

Paul Adams: Right on, right on. Well, we're... And I know the audience is super glad to have you back Mr. Shepherd. I want to tell our audience that I can't wait for the topic today. Our topic today being entrepreneur versus fiduciary. Fiduciary versus entrepreneur. This idea that as an entrepreneur there's all kinds of risks you have to take, work that you have to do, to produce the outcomes you wanted from your business. But here's the problem, you did all of that work to create the autonomy, freedom, etcetera, but then one day you have to be somebody handling a bunch of investments that are no longer your business. How do you prepare for that transition and how do you build along the way? We're gonna dive deeper into that, because what you can do as an entrepreneur is nowhere near the same thing you could do as a fiduciary with somebody else's money.

Cory Shepherd: I think just like they had to make a big change from who they were before they were an entrepreneur, they've got to think about who they are after an entrepreneur. I think that's how huge. But first we've got this weekend planning, and I think you found a really great article.

Paul Adams: Yeah, I did, I found a great one. Let me bring it up on the screen for all of our viewers that can see on YouTube. This article is from entrepreneur.com, and, Want to Retire Rich? Don't Make This Common Mistake. Now, this is kind of a sleeper article, it doesn't really say anything in its main title. So unless you click into it, you don't notice this one. The subtitle of this one is, "More than a third of entrepreneurs have no retirement plan, it's time to build one." Now, for those of you that have been listeners for a while, we don't love the term retirement. We think the word retirement, the way it was built into us, was built on this philosophy of, "One day I'm no longer going to work, and I'm going to sit back and do nothing." Like to retire an old plow, to retire an old horse. Or to...

Cory Shepherd: Maybe plain out in the desert rotting away in the sun. It's just not a great feeling if we actually think about what it's saying.

Paul Adams: And for all of you, you didn't go in to the work that you're doing simply because what you wanted to do was one day not be worthwhile to anybody else in society. So how do we solve that? Well, one is, we talk about a need to be definite financial independence, so that you have a work optional lifestyle, that's key. Not to

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"retire." Let the rest of society use that term, you don't need to. What you want is definite financial independence. But even that having been said, in this article they cite that only a third or little over a third of all entrepreneurs have no "retirement plan." And the reason this is so key is that... And what we're gonna talk about in the episode, is that as a fiduciary for yourself, we've talked about this in past episodes, the importance of being your own fiduciary, but as your own fiduciary, you have to make plans for the you you've not met yet. And if...

Cory Shepherd: Future you.

Paul Adams: Your future you. What's the show that I always miss quote, what show it was?

Cory Shepherd: It's How I Met Your Mother. It's a future Ted problem, future Ted will deal with that.

Paul Adams: That's right. Yeah. And I think people don't say it's a future Ted problem, but they do say, and the article even talks about it, is that you are saying future business will take care of that. Future business sale will take care of that. The enough money to get on my business, everything's gonna be fine, and as we're gonna talk about in the rest of this episode that may not be the case. So we're thankful when the big financial media press comes out with something good that can maybe create a little context for people to change their behavior, we'll have a link to that show in the... That article in the show notes. But let's kick off on our issue today. Cory, could you just give our audience what the definition of a fiduciary is?

Cory Shepherd: Sure. So just the dictionary definition, the noun relating to law is a person to whom property or power is entrusted for the benefit of another. Now, in a financial advisor kind of setting, in this world, it's making decisions that are in the best interest of the part of your advising without consideration for your own current benefit. And I think that's the important piece, it's always in the best interest of the other. And there is a secondary standard in the financial world, one notch down called suitability, that just means, is this product strategy choice a reasonable fit for someone who's in this situation where they are now, the amount of risk they can take, the amount of money they have? Is it a reasonable fit for someone in that realm? And I think those are two really important distinctions that we'll come back to.

Paul Adams: Well, and one that, Cory, we didn't talk about ahead of time, but you're used to me bringing up stuff we didn't talk about ahead of time, which is...

Cory Shepherd: Practically every time, yeah.

Paul Adams: Yeah. The definition of an entrepreneur. The definition of an entrepreneur is a person who organizes and operates a business or businesses taking on greater than normal financial risk to do so. Let me say that again, taking on greater than normal financial risks in order to do so. So if you're an entrepreneur or founder here, guess what, you're already likely blowing the fiduciary standard, at least with the portion of your capital that's in the business. Now, that is okay. That is normal. We all take risks in order to get to where we're going. But what's easy to lose sight of is the fact that you don't... That you are taking more risk than the average bear in having started and launched a business, and then continuing to build it. That doesn't mean the business is ineffective, it doesn't mean that you shouldn't be owning your business, it doesn't mean you should sell your business right now and go get a job.

"We need to start setting money aside, getting it on your personal balance sheet, and getting it into an investment strategies that would pass muster if what you had to do was manage the money for somebody else."

Paul Adams: I think too often, it's the fault to the financial services industry that has said, you should buy this product, whatever product they're selling, and get the money out of your business in order to do so. In fact, even that article, if you get a chance to read it, talks specifically about buying a 401k pension plan. Putting things in your business that are products, that you are then going to build with instead of simply building with strategy, like you would if you were a fiduciary for somebody else. So we have to begin by asking what is the goal with your money? What is it you want your money to do?

Cory Shepherd: And that's often the biggest unasked question of not only a business owner's business, but of almost anyone's life in our country. Like, we just go out with all of the inspirational self-help media saying, "Just think it and dream it and you can have it," but we don't stop to ask, "What do we want, what do we wanna have? What is... What does this business need to do for me to be happy for the rest of my life?" Because knowing that answer changes so many steps along the way, and so many new risks that we might have to take.

Paul Adams: Well, if you look all the way back to episode 57 where we laid out sufficiency, surplus, superfluence, the idea of there's different levels of financial security. And by simply knowing what that is you create the opportunity to actually produce a different understanding of what your personal balance sheet needs to look like when you want to be a definite financial independence. So you gotta start by asking that question, "What is my sufficiency number? What is my surplus number?" Now, sufficiency is that minimal amount required for you to have financial independence, where you're taking no... You might have other compromises, but no untenable compromises. No compromises that will be unacceptable to you, no compromise that'll be unacceptable to your family, and consider it needs to be not acceptable to future you, not today you.

Cory Shepherd: And when you first started your business, we were probably under-sufficiency, so more was the only answer we needed at that point, right? That's like, I'm doing this 'cause I need more, and this is the dream for more. But eventually we get over that hump and more is a exhausting treadmill [chuckle] to be on for the rest of our life. So refining that into something specific starts to open up that path for you to take.

“What we want you to be able to do is to be in a position, for yourself and your life, that what you will have the ability to do is build your personal balance sheet while building that business balance sheet.”

Paul Adams: Yes, and here's what we find most of the time, as people start making more money, now they have some surplus coming from their business, meaning their lifestyle is not eating up all of it. Now people tend to do one thing all the time is that, "Well, I'm just putting more money back in the business, more money back into the business," which is fine, many years that needs to happen. But you reach a point in the future where you have to consider this business' job is to be profitable for its owner, and that's you. So if the business' job is be profitable for you as an owner, and I'm gonna make a one caveat here, if you're somebody who has successfully built four or five businesses, you already have a really strong balance sheet, you might be able to run a business, like a good friend of mine did down in Southern California not too long ago, where literally the whole business was burning, crashing, and running out of money, and that was the object. Because literally what they're doing is taking the business into a nose dive, as they collect revenue, to be able to sell it upon a multiple of revenue. Because the buyers don't care at all about the overall profitability, because he knew he was building it for a strategic acquisition.

Paul Adams: If you've got some experience, you've done that before, you can ignore this part about your business needs to work for you, supply your lifestyle and build your personal balance sheet, because your personal balance sheet is the only place you're gonna have financial independence. So it does better, and then you say, "Well, we should probably have 401k. The employees want it any way, I need to get one." And then you have a little bit more money, and there's some extra on side, and somebody refers you to somebody who's slinging equity indexed Universal Life or some other product and you're like, "Oh, that sounds pretty good," and you just add it. Because we're in this cycle of doing things with our surplus. One other major thing happens to most entrepreneurs that you might not even think about. In fact almost always by the time somebody talks to us, when they've gotten themselves to $300,000 to $2 million income realm, not revenue, but actually income from their business...

Cory Shepherd: Right.

Paul Adams: They've almost all recently acquired a much bigger house. Now why is that? Well, because going into this you knew two things. Almost every business owner who's ever done, they've all bought cars, they've all bought real estate, at least a primary home, and then they built their business. And they were head down, butt up, working hard, getting to the point where what they could do is have enough money to then be able to do other things in their personal balance sheet. But the only things that they knew were buying real estate, buying cars. And so you often find there's a couple of new cars and a new bigger house. That's not a problem in and of itself, but it's an awareness that we do what we're familiar with. And so other things that will happen is, I've got extra money, and I'm gonna buy a bunch of gold, 'cause it looks like gold is doing really good right now. Or I found a real estate deal, or I bought another business.

Cory Shepherd: You know, I see this pattern, all these things adding and it strikes me the non-additive nature of reasonability. You make a bunch of not unreasonable decisions over time, they don't necessarily add up to the sum total of reasonability and good results. Just 'cause it's like, "Oh, let me turn the water up a little bit, let me turn the water up a little bit." And then you're boiling yourself like the frog. You know, that's...

Paul Adams: Yes.

Cory Shepherd: It's a big problem, because it's never stitched all together pointing to that future you and what they're gonna be facing.

Paul Adams: And given the amount of risk, you already encountered as an entrepreneur, right? Just going out in the marketplace, working hard, nearly losing everything, like almost has happened to every entrepreneur, and now you come out the other side, and you've got this enormous "risk tolerance." And it's like the person that was an operator overseas working for our military and they come back and be like, parachuting is no big deal to them. Their risk threshold is so high, it's similar for you. You look at your balance sheet and you say, "You know, I've got this great asset that's my business and I'm just gonna keep driving money back into that." And it is until some day it's not. And, in fact, like many entrepreneurs and founders as you're listening to this, you have probably shut out anybody who worked for the most part for any of the big box financial retailers or financial advisors, because the way you've heard their message.

Paul Adams: When you had to laser focus and concentrate to build your business, you heard all of their messages, something deluding you from going that direction. But even after there's enough surplus, again, something we find often, is people will have some amount of money invested with that big box financial retailer and they're sending money on a consistent basis, not a problem, but to somebody else who's an employee, at that big box financial retailer, who doesn't understand the overall concerns of a business owner, coupled with the fact that they don't know where all the other pieces are. Because you as the business owner transacted with them as a vendor, maybe appropriately, but not as an advisor.

Cory Shepherd: Right. I think moving on to our next point, which is a question I'll pose to you, Paul. Being a fiduciary, you have to have a set of knowledge to be able to point to what is prudent, what comes first, what comes next, what's gonna work for the future? What are some of the things we need to know to know that we're building a solid strategy, a solid fiduciary strategy? If the business owner is saying, "What do I do now?"

Paul Adams: I'm gonna share one that I hope scares the heck out of everyone that they don't know the number, and that is what does your household even spend every month? If you've got a successful business, there's not a listener here where you have not looked at your business financials and know what the outgo is. Because if you let your outgo exceed your income, your upkeep will be your downfall. You guys have heard me say that before. But when you look, you can't avoid the fact that you may not even know today what the outgo is on your personal balance sheet. That's one of the first pieces of information you do know. What are we actually spending as a household? Maybe just go as far as getting a three-month number. Go to your spouse, sit down, do the hard math, don't get mad at anybody because of how much they've been spending, or let them get mad at you for what you've been spending, like, open it up, set context, this is an exercise. In this exercise, we are going to discover what we actually have going out on a monthly basis.

Cory Shepherd: And don't forget to include the things the business is doing for you that actually support your personal balance sheet, because many business owners, very legally, very above board, it's perfectly fine in the IRS' eyes, you're giving yourself some benefit by some of the spending you're doing that can also be written off. And if we forget that, we might think we have a much smaller monthly number, sell that business and, "Wait, where's my cell phone, where's is my car? Oh, wait, the business was paying for that."

Paul Adams: Yes. Yes, exactly right. So kinda two-fold, one is, what is your household household spending? Second is going to be, what are the additional benefits you're getting from being a business owner, that's not necessarily counted for in the household spending. Then you gotta figure out what does it take in capital at work in order to make that number happen on a consistent ongoing basis leaving you financially independent and able to operate in a work-optional lifestyle? Well, the math is not complicated. We've talked before on the podcast about the 4% rule, this is a simple equation where what you can do is take whatever amount of money that you want to spend as a household. Now, for instance, here, what I think we'll do, is just use $400,000. You wanna support a $400,000 a year lifestyle? Divide $400,000 by 0.04, that's 4%, and you have $10 million of capital at work required. Now, if what's required for you is $10 million capital at work, then what you need to know is, you through money you set aside... We've talked about the wealth coordination account before, that's money you put aside to only buy assets, and you built up your capital at work, that's money on your balance sheet outside of your business giving you the capital required to no longer have to depend on the business to produce income for you. 4% rule.

Paul Adams: Then you have to figure out, where am I currently putting money that's not in the business, every year? What am I setting aside to investments? What am I setting aside to real estate? What am I setting aside to... Maybe I do have a retirement plan in the business, and what is my spouse setting aside if they're working? And take a look at that number. Now, you guys could either reach out to us info@sfgwa.com, reach us all the ways you can reach us, LinkedIn, email, call us. So how much are you currently setting aside and where, because then you have to figure out what's that gonna grow to? But then here's the big one. I want you guys to really reflect on how much is your business going to sell for really? Not your future state, not what you hope to build it to. If you were gonna sell it today, what would it sell for?

Cory Shepherd: Yeah, I was just thinking about this. And I wanna go really slow here, 'cause it's important. How much would you buy a competitor's business for that looked like yours that you wanted to add to your business? Would you buy it for 25x, what they were making in profit? 'Cause that's what you would need to sell yours for to totally replace your income all in one fell swoop. And, in that context, looking at the deal from the other side, you're not gonna find the same answer.

Paul Adams: And not only you're not gonna find the same answer, but this is the sobering truth. You're gonna go out sell your business. Most businesses, if they're good enough size, are gonna get five to six times EBITDA. Now, what that means is, just think about what you make every year, EBITDA and your annual income don't match up depending on industry, etcetera, but they're close, they are a reasonable substitute for one another. Here's what I want you to think about, if all somebody gave you is five six times what you're making right now, would that be enough for you to live the rest of your life? No. In simple terms, after tax, it'd be enough to live about four-and-a-half more years. So you have to build the rest in your balance sheet. So if what you need is enough that a 4% distribution will get the job done, then you have to have another 20x somewhere on your balance sheet of your earnings, plus the 4x after tax you got from the business, to then have a stack of money high enough that you get to be in a position to have enough money in your old age to continue to have your work-optional lifestyle.

Cory Shepherd: And with that I think it's a perfect time to go to commercial. Message from Sound Financial Group. And when we come back, our final thought for you, as we wrap up the episode. And welcome back to Your Business Your Wealth. As we wrap up this episode on your business being an investor versus a fiduciary, there's a big question you need to ask yourself, what are you investing in, and if you were the fiduciary, would it pass that fiduciary standard? Are you making a series of choices right now that are a reasonable fit for someone in your position and risk tolerance, or are you making decisions in the best interest of the future you?

Paul Adams: Let's take out for instance... This is a simple one. Let's say, what you wanna do is enter into some kinda private equity deal, series A funding, things where you put money in you can't take it back out and what you're then gonna do with that money for the remainder is you're going to have to live off of it, make choices with it, etcetera. But the problem is, all of those investments have enormous locks on them. They prevent you from accessing them, they're incredibly illiquid. We had a client that had a private equity deal brought to him by a big box financial retailer person, and he started off with $150,000, and then the way he heard it was, "Well, you might have to put in up to a quarter million dollars more over the next X amount of time. Your money's not liquid." He says, "Okay." But then he ran into a position in his business where he needed liquidity. And guess what? He went to the person, he says, "Hey, no, you can't take the $150,000 you started with, but you also need to add another $100,000."

Paul Adams: And this was at a time where he was in a cash crunch, he says, "No big deal, you've got three months to do it." That kind of thing happens all the time. Now, can you do that kind of investing if you're a fiduciary? Yes, absolutely, with little tiny pieces of the overall asset base. You could take and make a bet on an existing stock that's out there and say, what I'm gonna do is my best to make this stock really pay a nice dividend for the person I'm holding the money for. And you can do it with little tiny bits of money. But you can't do it with the largest amount of assets. Now, today, for most of you, you're building your business balance sheet, and how you're building your business balance sheet is that one of the only things that's happening to build your personal balance sheet is, one entry, it's your business or your businesses if you have more than one. The thing is, that would not meet the fiduciary standard if it's currently making up 80% of your net worth.

Paul Adams: So what do we need to do? We need to start setting money aside, getting it on your personal balance sheet and getting it into an investment strategy that will pass muster, if what you had to do was manage the money for somebody else. Because here's the thing, you are managing the money for somebody else. You're managing the money right now. You're building your personal balance sheet right now to care for your future you, who doesn't look like you. Your future you that cares a lot more about grandkids graduations than you care about the cool party that you're gonna go to with a bunch of your other entrepreneur friends. You're going into a phase of life where you're gonna care much more about dependable income that pays the bills and keeps you and your spouse secure in your old age, than you're gonna care about some high flying return, getting in on the latest IPO, expanding a business unit.

Paul Adams: All of those things are exciting. We don't say people shouldn't do them, but we have to do them all with the question of, does this solve... As my friend of Aveev Shahar would say, are we solving for the future state? That we have to build this balance sheet, we have to build your future based upon caring for future you, not today you. So, you could get sued. When we see most of the balance sheets we see every day, if they were managing the money for somebody else, they will get their pants sued off, which is simply by making the decisions they've made. Why? 'Cause they're uncoordinated. They didn't have the end in mind. They didn't know how much money it was gonna take. And yet, we're all setting aside money for the future. This isn't bad, what we're just trying to do is to call out from the background what everybody accepts as reality. We've just talked about a few simple steps here today.

Paul Adams: Know how much it's gonna take to have financial independence, which means you gotta know what your household is spending, which then means you gotta know what the 4% rule is, and how much capital it takes to produce the amount of income that's important to you and your family. And then get your business to become a part of that capital at work that you're building for the future, not the thing that is 100% counted on to produce those outcomes. What we want you to be able to do is to be in a position, for yourself in your life, that what you will have the ability to do is build your personal balance sheet while building that business balance sheet. Doing those two things simultaneously puts you in the best possible position to maintain work-optional lifestyle, to be in a position that you don't have to be dependent entirely on the sale of your business, one single transaction of one single stock that you own, called your business. Then in fact, you might have more options, liberties, when you get there.

Paul Adams: Maybe the thing to do isn't to sell the business, maybe the thing to do is hire a really key executive that's gonna run the business for five more years, because maybe the economy is in downturn. But if we're not needing to rely on the business for our income, because we've already reached the work-optional lifestyle, it changes everything. Changes everything. We always encourage all of you to reach out to us at info@sfgwa.com to see if we can be of help to you. We're always happy to have a short conversation and see if we should talk any further. Always, no obligation there. But, second, take on the steps in this podcast. Know what you're spending, get an idea of how much capital at work it takes, and then take a real assessment of your business' value. And one more thing I didn't talk to Cory about before this, but we're going to do for all of you, is allow you if you want to email us at info@sfgwa.com. We have an analytics-driven valuation tool, and we'd be happy to give you a valuation for your company, just by being a listener of this podcast.

Paul Adams: Now, we can't leave this one out there indefinitely, but if you reach out to us before the end of August 2019, we will definitely do it. After August 2019, we may have to put people in queue, or we may have to decline you. So if you think that business valuation would be valuable to you, to have some idea of what your business might actually be worth in the marketplace, we will give that to you for free. Some people value this as over $2000. What I would say is, we just want you to be in the best possible position to know what that business is worth so that you and your spouse can build the future that you want.

Cory Shepherd: I love that, I would love to do that for any listener, so great idea, Paul.

Paul Adams: Well, we hope, Cory and I, is that this has been a contribution to you being able to design and build a good life.

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