

Are You Leaving Hidden Profits on the Table? Here Are the 4 Areas to Examine.



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With tax day now in the rearview mirror, profits and losses are likely to be uppermost in the minds of business owners – people who get up every day trying to make payroll. Small businesses are the powerhouse of the economy, the mitochondrial DNA of our economic body, converting effort into the energy that fuels the country.

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What's more, all of those small businesses were started by entrepreneurs making use of their skills, passions and

interests, and doing something so important to them that it gets them up in the morning. Still, entrepreneurs aren't infallible: Most have areas and functions that they studiously avoid, prompting them to hit the snooze alarm on tasks they dread.

Yet avoidance behavior like this can lead to neglect and missed opportunities. Financial planning is one of them.

Over the last 20 years, I've met with hundreds of small-business owners in my line of business, offering financial planning services. And, while I've heard from those clients many incredible stories about how they turned their dreams into businesses, *never have I heard* anyone say that he or she couldn't wait to deal with accounting, human resources, risk management and taxes.

Yet, those are exactly the tasks these people *should* be dealing with. It has been my experience that a review of neglected areas offers the best opportunity for increasing profitability and making improvements – because almost every business can use a little help in identifying hidden potential.

Here are four areas where almost every business owner can find immediate improvement – meaning real money.

1. Entity/tax planning

In the United States, more than 2.4 million small businesses are set up as a limited liability company (LLC) for the purpose of limiting personal liability and protecting the owner's personal assets in the event of business failure. The downside to an LLC, however, is that it forces the business owner into higher tax liabilities, as distributions from an LLC are taxed as ordinary income with rates as high as 37 percent, at the federal level, and 13.3 percent at the state level, for a combined federal/state tax of 50.3 percent!

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That's the reason to look at the often-overlooked planning opportunity of electing to be taxed as a corporation. For example, most small-business owners do not know that they can elect to have their LLC taxed as a corporation and also make the S-corp election, which allows for a portion of earnings to be treated as long-term capital gains.

In 2018, long-term capital gains are being taxed according to your tax bracket, at either 0 percent, 15 percent or 20 percent. If you are paying yourself a salary and choosing to distribute capital gain income, this strategy could save you a lot in federal and state income taxes.

Working with entrepreneurs and small-business owners who are generating \$300,000 in revenue, I've seen that their decision to have their LLC taxed as a corporation and make the S-corp election cuts their total tax liability by one-third. Typical savings to a business owner in that bracket are \$10,000 per year, adding up to real money over the life of a business.

Regardless of whether you have a pass-through entity such as an LLC or a corporation, it is important to understand that your entity structure has tax-planning opportunities, and it is always prudent to seek the advice of a tax lawyer or accountant on the best way to pay the lowest legal tax.

2. Accounting/vendor management

Another good opportunity for finding money within a small business is to examine how much you spend by vendor. A good place to start is to list your expenses by vendor from highest to lowest.

Think about each vendor, what he or she does for you, how

satisfied you are with the service and whether there are other options available in the market for a lower cost. My experience is that most entrepreneurs are more focused on getting customers and on selling their products and services, and less focused on scrutinizing expenses and vendor relationships.

Entrepreneurs can often find money and additional profits by simply putting out for bid line items such as commercial loans, cell phone contracts and insurance premiums.

During a recent review for a client in the employee-leasing business, we discovered that this company was paying an annualized rate of 14 percent to finance its payroll of roughly \$1.2 million per month. Since the client was showing a profit on its P&L statement, we were able to find another lender that would provide similar financing, but at a rate of 10 percent – which will save our client an estimated \$48,000 per year. Again, real money.

3. Risk management

One area where entrepreneurs can often be penny-wise and pound-foolish is in risk management and insurance. Entrepreneurs typically only purchase the insurance coverage(s) that's required by law, such as workers compensation insurance or general liability insurance, because it is required pursuant to a contract.

Purchasing only basic coverage(s), however, can expose the entrepreneur to gaps in coverage at the time of a claim. Uncovered losses are typically paid out of pocket by the business owner. If the cash on hand is insufficient to satisfy a claimant, the gap can result in bankruptcy and business failure.

During a recent review of a luxury spa client's risk and insurance programs, we found that the insurance broker had not

reviewed the current experience modifier, which reflects claims experience during the past three years. Our client had been claim-free for the previous three years, and this dramatically lowered the required premium for workers compensation insurance by more than \$11,500 per year.

Next, during our risk management review, we discovered that the client was looking to raise capital to expand his business. We also noticed that the client did not have employment practices liability (EPLI) coverage, which protects against the major drivers of litigation in the workplace.

We were able to use the savings to purchase directors and officers liability and employment practices liability coverage to protect the business and business owner from frivolous employee and investor-related lawsuits.

In the years following the placement of the additional coverages, the client had several employment-related lawsuits filed against the company, all of which proved baseless. The legal defense costs were fully covered under the new policies.

Higher-end insurers like Chubb, CNA, Travelers and Philadelphia have insurance programs tailored for specific types of businesses and the unique risks that they face. The best companies will have risk-management expertise and internal resources that can help identify potential coverage gaps and key exposures.

That move will make it possible to better plan for the moment when bad things happen. These companies are also very knowledgeable about claim trends and the issues that are driving litigation within the industry you are in. And this information can help you train your employees for the kinds of things that could put your business at risk.

4. Human resource planning

Finally, human resource planning is an area where an entrepreneur can often find areas for improvement and financial impact. As businesses evolve over time, it's important to examine whether your human resources and staffing model is optimized in support of your current and future needs.

Are the dollars you're spending on wages producing the desired results in sales revenue and customer satisfaction? Are there opportunities to outsource services that might be available at a lower cost or in a shared services model?

One trend that has a lot of value for small, closely held businesses is the hiring of an outside business management firm to cover the accounting, bill/pay, human resource management and risk-management functions needed to run a successful small business.

As the following chart shows, adding accounting personnel, human resources and financial expertise to your payroll can be very expensive. Moreover, high-quality business talent will require healthcare and retirement benefits, which can be very expensive for a small business. Outsourcing some or all of these functions to a business-management firm can save tens of thousand of dollars annually.

An analysis of the data suggests that entrepreneurs and small businesses with revenue under \$9 million (the break-even point) should take a hard look at outsourcing these key business functions.

2018 Compensation Statistics for Key Business Functions

<i>Professional Category</i>	<i>Median Income</i>	<i>Total Compensation</i>
Certified public accountant (CPA)	\$63,243	\$44,741 – \$109,913
Chief financial officer	\$127,646	\$69,908 – \$255,060
Human resources executive	\$64,059	\$40,790 – \$94,097
Accounts receivable manager	\$54,119	\$32,431 – \$75,987
Accounts payable manager	\$56,541	\$34,545 – \$81,888
Risk manager	\$83,509	\$53,878 – \$139,886
Total(s):	\$449,117	\$276,293-\$756,831

Business Management Expense (the standard fee is 5 percent of revenue) applied against various revenue levels

<i>Revenue</i>	<i>Median Expense</i>	<i>Expense Range</i>
\$1M-5M in annual revenue	\$125,000	\$50,000-\$250,000
\$5M-10M in annual revenue	\$375,000	\$250,000-\$500,000
\$10M-15M in annual revenue	\$625,000	\$500,000-\$750,000

Financial technology ,along with the rise of hybrid professional employer organizations (PEO), allows for dramatic cost reductions in basic business functions. For example, City National Bank offers an incredibly robust integrated banking and accounting platform through Datafaction, which automatically populates an accounting entry with each check submitted for payment, and with each swipe of a credit or debit card.

The efficiency of this system allows for an accounting manager to support multiple business clients for a lower shared cost.

Actors, athletes and entertainers for years have hired business managers to deal with financial matters. Physicians have opted to outsource back office, administrative functions and insurance processing because it is cheaper to hire a shared services firm that can handle these functions more cost-efficiently. Entrepreneurs can similarly benefit for the same reasons.

Conclusion

According to Deloitte's 2016 *Global Outsourcing* survey, approximately 3 in 10 of companies surveyed that used outsourcing wanted access to intellectual capital and saw outsourcing as critical to meeting business needs and enhancing service quality. Almost 6 in 10 saw the benefits beyond a simple cost-cutting tool; businesses saw outsourcing as a tool that enables focus on the core business itself.

Rather than focus on the thing that distracts, entrepreneurs should focus on the thing that makes them unique. My experience working with entrepreneurs is that they wear too many hats within their company. They are often distracted as a result and by things they are not great at accomplishing. And anything that distracts from the thing that makes money is a liability.

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My advice for harried entrepreneurs is to view themselves as rock stars, talented at the thing that got them into business; that should be their focus. The most successful business owners keep building on their core strengths, and successfully delegate the rest. Fortunately, there is an embarrassment of riches when it comes to effective service providers today, who stand ready to take dreaded items off a business owner's endless to-do list, letting the owner focus on what really matters: profits.

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