

# The business owner's personal balance sheet:

## What to track beyond net worth

As a business owner, your personal finances are likely closely linked with your company's success. While your net worth (assets minus liabilities) can provide a quick snapshot of your financial picture, it may not always be a true reflection of your financial health.



In order to gain a more in-depth understanding of your financial progress and potential risks to your long-term security, it's important to consider factors such as liquidity, debt and risk concentration.

## Why net worth isn't enough

Net worth is one of the most basic calculations of wealth, and it can be useful for tracking your progress over time. However, it can often be a misleading metric for business owners because your business assets could artificially inflate your assets on paper.

For example, a current business valuation of \$3 million looks great on paper, but that value isn't realized until you sell your company. If the actual sales price is \$2 million, you may not be able to access the capital you expected to fund your post-sale needs.

Often the focus on the sale of a business is determining an acceptable sale price, but an important question for planning purposes is: How much will you get to keep from the sale? Long before negotiations on the **sale of a business** begin, a owner's financial, tax and legal advisors can add value by identifying strategies to produce income tax and estate savings.

## There are several key issues with relying solely on net worth as a measure of financial health:

- **Static measure:** Net worth ignores the impact of cash flow. If your business revenue dips, you could struggle to pay your monthly bills but still have a high net worth.
- **Valuation challenges:** Business assets are dynamic and can be difficult to accurately assess. Market fluctuations, internal issues or economic shifts can result in major valuation swings. Many business owners have a significant portion of their wealth tied up in their company, yet don't have a clear estimate of what their business is worth.

Even if the owner is not planning to exit anytime soon, they may benefit from having a business valuation. A **business valuation** helps identify key risks in the company and evaluates the attractiveness of the business to an outside party. By identifying areas of weakness, the owner can begin to formulate a plan for improvement. At this stage, a simple estimate of value is enough.

- **Ignores opportunities and risks:** Net worth doesn't account for a business's growth potential or potential downside risk.
- **Ignores personal investment:** Many business owners reinvest a significant portion of their earnings back into their business, which can result in stagnant personal assets, even when the business is growing.

### Liquidity: How accessible is your wealth?

Liquidity offers you an idea of how quickly you can turn your business assets into cash without losing value. This is a critical metric to track, especially if your wealth is locked into illiquid assets such as shares of company stock, inventory, business real estate or operations.

A key question to ask yourself is, "Will I be able to access cash in an emergency without disrupting business operations?" To answer that question, consider the value of assets you hold that are liquid vs. illiquid. High-liquidity assets include cash reserves, marketable securities and short-term investments, while low-liquidity assets include business ownership stake, specialized equipment and business real estate.

To offset the risks of liquidity, it is generally wise to maintain at least six to 12 months of living expenses in a liquid emergency account. Note that this is higher than the typical three to six months of expenses generally recommended for salaried employees. That's because business owners tend to face additional risks and can often have a more difficult time accessing liquidity without diluting ownership control or triggering tax liabilities.

### Debt: What it's costing—and what it's enabling

Debt is not always a bad idea for business owners. In fact, it can provide important leverage to expand your operations. However, it must be carefully tracked and monitored on your personal balance sheet, especially if you've agreed to any personal guarantees for business loans. It's important to carefully evaluate both the costs and the benefits of your business debt.

### What your debt may be costing:

- **Interest and fees:** High-interest debt, such as credit card debt, has the potential to erode your profits. For example, a \$50,000 equipment loan with a 7% interest rate would generate about \$3,500 in interest in the first year (though the actual interest cost typically declines over time as the loan balance is repaid).
- **Cash flow strain:** Monthly debt payments can reduce the cash flow available for personal savings or reinvestment in the business.
- **Amplified risk:** If you take on debt with a personal guarantee, you could be risking your home, retirement savings or other personal assets if unexpected circumstances result in you being unable to repay your loan.
- **Opportunity cost:** Owing assets to someone else means that your capital isn't available to reinvest in your business or jump on opportunities as they arise.

### What your debt may be enabling:

- **Growth:** Low-interest Small Business Administration (SBA) loans can provide critical funding to fuel business expansion.
- **Tax savings:** Interest on business-related debt is often tax deductible, which may result in tax savings.
- **Inflation protection:** Because fixed-rate debt becomes cheaper over time as inflation rises, it may serve as a buffer against inflation.
- **Equity:** Mortgage debt on commercial property can allow you to continue building equity.

It is generally wise to monitor debt levels relative to assets to help avoid excessive leverage and consider refinancing high-interest loans when appropriate.

### How much concentration risk is tied to one outcome?

Business owners often have a significant portion of their wealth tied up in their companies, which can lead to concentration risk. While this approach offers high return potential if your business is a success, it can be devastating to your long-term financial security if the business fails.

Your balance sheet can provide valuable insight into the level of concentration risk you may face. If you have more than 30% tied up in a single asset, it may be wise to diversify. It's also important to consider whether you are overly reliant on a single supplier, key clients or even your own health as a business owner. All of these factors can increase your risk.

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Consider the following risk levels as a guideline to determine whether diversification is necessary.

Percent of assets invested	Risk level	Action
Less than 20%	Low	Monitor and maintain
20%-50%	Medium	Gradually diversify
Greater than 50%	High	Prioritize diversification

### Using your balance sheet as a planning tool

Your personal balance sheet provides valuable insight to help guide your decision making. It's important to regularly update it to ensure it aligns with business events, tax projections, growth and inflation. The following tips can help you make the most of your personal balance sheet.

- **Separate business and personal assets:** It's important to carefully track business and personal assets as separate line items on your personal balance sheet. Failing to maintain separation can expose your personal assets to business risks and your business assets to personal risks.
- **Run projections and forecasts:** Use modeling software to stress test various financial scenarios. This can help you understand the potential impact of the different risks you may face.
- **Integrate with business planning strategies:** Integrating your personal balance sheet with your company's financials can provide you with a holistic view of your wealth, investments and risks.



- **Regularly review and adjust:** Your wealth manager and accountant can help coordinate an annual review of your balance sheet to identify opportunities and make any necessary adjustments.

### How Mariner can help

Optimizing your personal balance sheet requires a proactive, holistic approach that seeks to maximize both your personal and business outcomes. Yet, as a busy business owner, it can be difficult to find the time to manage it all. Your advisor can help you streamline, integrate and optimize your personal and business finances so your wealth strategy works as cohesively as the business you've built.

For more information visit: [mariner.com](https://mariner.com)

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