

Continuity of Ownership

The First of the Business Owner's Continuity Concerns

Most, if not all, business owners have been approached by at least one of their advisors with the ever-popular question, "What would happen to your business if you died or became disabled?" Few business owners fail to recognize this question for the thinly-veiled pitch to buy insurance that it is.

Our goal is not to discourage you from buying life or disability insurance. Far from it. Purchased in the proper amounts and for the correct reasons, life and disability insurance proceeds will, indeed, help your business to survive your sudden absence. Insurance alone, however, cannot resolve all of the three primary issues that face every business when owners go AWOL. Let's identify the three primary continuity issues and examine possible solutions.

Issue 1: Continuity of Ownership for Co-Owners

The most obvious business continuity issue is: Who will succeed you in ownership? If you co-own your company, an up-to-date, adequately funded, buy/sell agreement that completely addresses all of the possible transfer issues can solve this problem. Please pay careful attention to all of the qualifiers in that last sentence. First, "up-to-date" means that the agreement reflects the current value and structure of your business. It also means that you and your co-owners don't sit down once, discuss continuity, and shove the resulting agreement in a bottom drawer, never to be removed again. Second, "adequately funded" means that one of your advisors has analyzed what the company's financial needs would be in your absence and has made sure that adequate funding is in place. Third, your agreement must fully address a list of "possible transfer issues." This list includes:

- Death
- Disability
- Transfer to a Third Party
- Termination of Employment
- Retirement
- Involuntary Transfer Due to Bankruptcy or Divorce
- Business Dispute among Owners.

Issue 1: Continuity of Ownership for Sole Owners

If you have no co-owner, your ability to ensure continuity of ownership in the future depends on your ability to create and to implement a continuity plan today. Vital to that plan, is the

involvement of your key employees. You must create a plan that motivates your important employees to stay with your company even though you do not. One of the best ways to accomplish this goal is to create a stay bonus plan.

A stay bonus is a written, funded plan providing monthly or quarterly bonuses and salary guarantees, usually over a twelve- or eighteen-month period, for employees who remain with the company during its transition from your ownership to new ownership. (New ownership may be a third party, a transfer to employees or a continuation by family members.) The stay bonus provides a cash incentive for your important employees (perhaps 20 to 50 percent of your workforce) to stay, hence its catch name.

The stay bonus plan is typically funded with life insurance in an amount sufficient to pay the employee bonuses over the specified timeframe. The life insurance may be owned by the company or outside the company in an estate tax-sensitive trust. You must tell your important employees that you've put a stay bonus plan in place so that they know you've put thought, planning and money to pay salaries into ensuring the survival of the company.

Your ability to ensure the continuity of your company also depends on your willingness and ability to communicate your continuity wishes to those who will be affected.

Company's Loss Of Financial Resources *The Second of an Owner's Business Continuity Concerns*

The first issue was the continuation of ownership. The second issue is the company's loss of financial resources.

Issue 2: Company's Loss of Financial Resources

Problem for Co-owners. If you co-own your company and you, personally, are a principal source of financial funding (bond guarantees, line of credit guarantees, etc.) your death can put enormous pressure on your company to perform. There is a very real risk that third parties may refuse to lend or to make guaranties on behalf of your company.

Problem for Sole Owners. Unless you can replace the financial strength, represented by your financial statement, your sudden death or incapacity may cause other "stakeholders" in your company to reconsider their relationships to your company. For example, if you have personally guaranteed the company's line of credit or permanent financing, expect your bank to reexamine its lending relationship. If you have used your financial statements to obtain bonding, expect the bonding company to refuse to extend its services unless the financial statements of those left behind are as strong as yours. Similarly, the lessor of any leased space or equipment may be unwilling to renew leases without your successor owner's guarantee backed by his or her

personal assets. Finally, remember that your pocket has probably long been the source for your company's capital needs over the years. Should you die or become disabled, exactly where will your company secure adequate and ongoing capitalization?

Solution for Sole Owners and Co-Owners. There are two ways to prepare for the loss of financial resources that your death will create for your company. First, you can use life insurance proceeds to fund the anticipated need. You must place enough cash in the company's coffers (upon your departure) to calm the nerves of your company's bankers, lessors and bonding companies. That amount of cash must also satisfy your company's need for on-going capitalization. In a co-owned business, a buy/sell agreement simply buys out the deceased owner's interest. It does not put one penny in the company's coffers. For that reason, few companies (whether solely or co-owned) survive an owner's death. Understand, however, that life insurance proceeds are only part of the solution. If your company is to succeed long term, it needs more than cash. It needs successor management, motivated by ownership or cash (both current and deferred). The only way to make sure that your business continues without you is to make sure that your business is more than just you. If your company is all about you, no amount of life insurance will cover your absence.

The Loss of Key Talent—You! *The Third of an Owner's Business Continuity Concerns*

The third issue is the company's loss of key talent — you — and the cascading affect on employees and customers.

Issue 3: Company's Loss of Key Talent (and subsequent loss of employees and customers)

Problem for Sole Owners. Your death will likely have the same impact on your company that the death of any one of your key people would have. Your talents, experience, relationships with customers, employees and vendors may be quite difficult to replace (especially in the short term). Once you are gone, expect employees to jump ship (unless the plans suggested in the First Part of this Series have been made). Without employees, your company is likely to default on its contractual obligations. Without planning, few businesses have the financial resources or successor management to weather this storm.

Problem for Co-Owners. Multi-owner companies experience the same loss as solely-owned companies, if the remaining owners do not have the experience or talent to replace you. If you are the person who generates new clients, heads operations or maintains most of the company's key relationships, your death or disability will jeopardize, if not ruin, your company's survival.

Solution for Sole Owners. As described in the First Part of this Series, sole owners should create written stay bonus plans to motivate their key employees to remain with the company



after the owner's death. Additionally, you should create a succession of management plan that names the person who will assume your duties. Finally, you should decide now how you want your company to ultimately be continued. Do you want the company to be sold? Continued? Or liquidated?

Solution for Co-Owners. If your co-owners do not have the skills and experience to replace yours, you must put in place a plan to give them the skills and experience they lack. If your employees are confident that the surviving owners have the skills necessary to bring in new business, run the operations or maintain key relationships, they are unlikely to jump ship.

Successful business continuity requires cash—usually in the form of life insurance proceeds. But continuity requires more than cash. Your company will need to fill the talent void created by your departure. To do that, you must encourage (perhaps with cash through a stay bonus plan or perhaps through ownership) existing management to stay. If your business does not currently have, in place, management capable of assuming the reins, you must make it a priority to find and hire that management now.

This article is an excerpt from *The Exit Planning Review™* newsletter published by the Business Enterprise Institute, Inc. and provided by O'Hara & Company, PC

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