Business Planning Succession

"Planning for the most unwanted event"

When a shareholder leaves a business suddenly; if they're seriously injured or die or develop a life-threatening illness, it is of course an unexpected loss. The financial chaos and stress which ensues can bring down a business and cause stress-related illness for not only the other share-holders, but their families, too.

That chaos and uncertainty do not have to be inevitable, though.

Business Succession Planning is an incredibly effective damage-control tool for businesses. It's a concept which has been around for many years, and nowadays it has evolved to provide a better range of protection for shareholders.

Two or three-partner businesses are popping up everywhere in vocations we'd never heard of before, and many of them are growing quickly. A clear and fair Business Succession Plan ensures there is a clear exit strategy that's been fully documented and agreed by the parties, and there is a funding mechanism which avoids using cash reserves or borrowing money. The outcome is certain and predictable.

The levels of cover should be regularly reviewed to ensure they reflect the true value of the business, particularly when it's going from strength to strength and gaining value.

There are great psychological benefits, too, in having financial certainty in your life - whether you're the surviving business partner or the family of the exit-ing shareholder.

A most memorable example in recent years is two of my clients formed a computer technology business together and it was hugely successful, very quickly. Five years on, they'd got three-quarters of the way to their goal and were just about to take the next step, which was extremely likely to make their business a lot of money. Then, one of them died in a motor vehicle accident. It was exactly the unthinkable event both men never wanted to happen – yet, it was everything for which they'd so carefully planned.

In establishing their company five years earlier, they had sat down with me and worked out a Business Succession Plan right from the outset.

They not only had the foresight to insure each other for the value of their shareholding in the business, but they also made sure the cover they had in place was a true reflection of the value of the business, and we got together to review that on an annual basis, because the business was growing so rapidly.

The whole purpose of a succession plan is that if one person in a business partnership dies, the other receives the money, but the key is there's a legally binding agreement which spells out what is going to happen with the proceeds of the policy and what will happen with the shares.

In cases such as this, the surviving business partner gives the insurance money to his partner's widow and she gives him the shares. This makes him the sole owner of the company.

There have been many situations over the years when a person has died, and their business partner is not obliged to hand over any funds to the bereaved widow. There are also situations when a widowed partner decides to keep the business shares and get involved in a business, despite knowing very little about how to run it. They simply become an anchor around one's neck. And, even more tricky, they can re-marry and their new husband (or wife) decides they want to be involved in the business.

Realistically, having faith in mutual respect, verbal assurances and a good old-fashioned hand-shake rarely works out well these days!

A less happy case I was involved with was when three tradesmen merged their businesses into one and, while we did put a Business Succession Plan in place to cover each of them with equal shares, they never acted on my advice to document a buy-sell agreement. Two years into operating the business, one of the three partners died.

The insurance was paid out to the surviving share-holders, but because there was no established or recorded value for the business, they were reluctant to pay his widow until the business could be truly valued and agreement was reached with her to transfer the shares back to the surviving share-holders.

It took nine months to settle, by which time everyone involved had endured a lot of stress from financial uncertainty. The widow was not only grieving the loss of her husband, but she had no income and had not received any pay-out from the company.

A formal agreement detailing what is to happen and how it is to happen is the most critical aspect of any business succession plan. Ironically, it is often the one task which never gets done.

The angst of financial pressure is one of the worst kinds of pressure anyone can face, and most people instinctively know that. It can so easily be avoided.