

# **BUSINESS CONTINUITY PLANNING FOR SOLE-OWNER BUSINESSES**

## **WHITE PAPER**



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Owning a business without co-owners can be great: You get to make all final decisions and reap all profits. But sole ownership has its disadvantages. One of the biggest is that, without a successor owner standing in the wings, your business may not continue if something happens to you.

Let's look at the common sole-owner-dies scenario.

*Ralph Cabrini was married, had two young children, and owned a thriving general construction company. He relied on a couple of key employees to manage his company's projects. After multiple conversations, Ralph's insurance advisor finally convinced him to create an estate plan.*

*During their first meeting, the estate planning attorney suggested that Ralph consider doing something (from a lifetime planning standpoint) to ensure that his two key people would stay with the company for the long haul. Ralph, with a wave of his hand, dismissed the idea. "I don't worry about them leaving. I pay them plenty."*

*Two months after signing his wills, trusts, powers of attorney, and related documents, Ralph died. Upon hearing the sad news, Ralph's insurance advisor and estate planning attorney assured his widow that Ralph's estate plan left her in good shape. But they were wrong.*

*Shortly after the funeral, Ralph's two key employees realized that the business could not survive without him. Though they felt badly for Ralph's family, their first responsibility was to support their own families. They*

*quickly found jobs with two of the many companies that had tried to recruit them before Ralph died.*

*Once these employees left, there was no one to manage the work, company projects faltered, construction contracts fell into default, and the bond company foreclosed on Ralph's company assets. To add insult to injury, the bond company then threatened to file suit against Ralph's estate for the bond default. Three months after Ralph's death, the business and his estate were bankrupt. His family was left with nothing.*

If the only measure of success is the proper transfer of assets to intended beneficiaries at death, Ralph's estate plan worked. The problem, however, was that Ralph and his advisors failed to ask:

- If Ralph dies, can the business continue?
- If Ralph dies, will his family's income and lifestyle continue?

They didn't explore the likelihood or the consequences of the business failing if Ralph died. Consequently, the value of Ralph's estate evaporated, leaving only liabilities.

## **WILL YOUR BUSINESS CONTINUE WITHOUT YOU?**

If you are a sole owner, can you avoid this personal and business disaster? Yes, if:

- Your business has transferable value. If it does not have transferable value, you can minimize the adverse consequences to your

business and family by taking steps today to make sure your company can continue until it can be properly liquidated.

- You incentivize key employees to stay with the business and fund these incentives.
- You create Business Continuity Instructions.

## **Transferable Value**

In lifetime exit planning, transferable value refers to the ability of a business to continue with minimal interruption to its cash flow should its owner depart permanently. Buyers are seldom interested in acquiring businesses that are dependent on exiting owners. This means you need to have a strong management team in place that will remain with your company after you leave by a lifetime or at-death exit.

When owners die, management team members who have no financial incentive to stay may leave. And why not? They don't know what will happen to the business, who will own it, or even if the business can survive without its deceased owner.

To prevent your management team from walking out the door, you should create a business continuity plan that:

- You discuss and provide to your management team, so they know that there's a plan for an ownership transition.
- Provides management team members with cash or ownership incentives that motivate them to remain with the company.
- Arranges funding to make cash available to fund the incentives.

- Puts in place the means to adequately capitalize the business without your personal guarantee.

To protect your family, your continuity plan should be communicated to your family via the Business Continuity Instructions that we describe in this White Paper.

In the ideal world, businesses that can thrive without their owners' involvement can also provide financial security to their owners' families. Most solely owned businesses, however, resemble Ralph's: They lack transferable value. Without Ralph, his business could neither continue nor produce the income necessary to maintain his family's lifestyle.

If your company has little transferable value, there are several tools and plan designs we can use to minimize the consequences to your business and family if you don't survive. These include:

- Stay Bonus Plans for key employees
- Business Continuity Instructions for family and advisors
- Life Insurance
- Creation of transferable value

## **STAY BONUS PLANS FOR KEY EMPLOYEES**

The immediate cause of Ralph's company's failure was that his key employees left the business soon after Ralph's death. They left because they knew the business wouldn't survive without Ralph, and they had families to support. They would likely have stayed had they received a substantial bonus for staying and were confident that their compensation

would continue. Had they stayed long enough to orchestrate an orderly closure of the business, Ralph's family would have enjoyed a very different future.

Generally, if capable management stays for a year or so after an owner's death, it's possible for a business to continue and even be transferred to a buyer or management. In either case, the deceased owner's family isn't hung out to dry.

To motivate employees to stay with your business if you leave unexpectedly (whether during lifetime or at death), promise money. We suggest you create a written Stay Bonus Plan which pays a bonus to important employees who stay with your business for a predetermined period (usually one to two years) after your departure. To be effective, that bonus must be substantial: Most such bonuses are approximately 50% of a key employee's current compensation. Bonuses are usually paid quarterly beginning on the date of the owner's departure.

Typically, life insurance on an owner's life funds both the Stay Bonus and the named key employees' salaries. Having life insurance on your life puts everyone's minds at ease because the insurance proceeds demonstrate that cash is available to pay the covered employees' compensation and Stay Bonuses.

## **BUSINESS CONTINUITY INSTRUCTIONS FOR FAMILY AND ADVISORS**

If an owner dies or becomes incapacitated, Business Continuity Instructions are crucial to a successful business transfer or liquidation. Instructions give managers, advisors, and family members guidance on what to do, whom to call, and how to delegate responsibilities following an owner's sudden death or incapacitation.

For example, Business Continuity Instructions:

- Give specific people specific and actionable responsibilities necessary to continue and supervise business operations, make financial decisions and oversee internal administration.
- Name advisors and others (e.g., a friendly competitor) whom family members should consult throughout the ownership transfer process.
- State whether an owner wants the business to be sold. If so, the Instructions list any parties that have expressed interest in acquiring the company or that the owner thinks would make appropriate successors.
- State whether the owner wants the business to be sold to key employees, kept in the family, or liquidated.

Incentivizing key employees to stay with the business via a Stay Bonus and creating Business Continuity Instructions are the first two critical steps in addressing the

consequences of a sole owner's sudden death or incapacitation. Please contact us if you would like to know more about these key designs and tools.

## LIFE INSURANCE

A third tool we can use to continue your family's income and lifestyle after your death is life insurance on your life. It is the easiest, fastest, and usually least expensive solution to the problem of lost income. An experienced life insurance professional can help you determine the death benefit amount necessary to replace your income.

## CREATION OF TRANSFERABLE VALUE

The long-term solution to the problems your unexpected departure could create for your business and family is the creation of transferable business value.

Having best-in-class, seasoned management is indispensable to transferable value and a company's long-term growth. The reason is simple: Management is responsible for the creation, direction, and rate of growth of all other factors that drive up your company's value.

If you are the person most responsible for the creation or maintenance of your company's value, you are not maximizing your company's growth potential and, without you at the helm, it is unlikely to survive without you.

## CONCLUSION

We see too many Ralphs. If you have not used the four tools we've described here to mitigate the consequences to your family and business in the event of your untimely demise or incapacitation, you are not alone. Please let us know if you'd like to learn more about how to take the steps necessary to ensure your family's financial security.

## TAKEAWAYS

- Buyers are seldom interested in acquiring businesses whose health and growth depend on their owners.
- Businesses with transferable value have strong management teams whose members are motivated by cash to remain with should owners leave.
- The purpose of business continuity plans for sole owners is to increase the likelihood that a business can continue after its owner due to a lifetime or at-death exit.
- Business Continuity Instructions communicate owners' wishes regarding the disposition of their companies (should they die or become incapacitated) to their families. These Instructions should be prepared and discussed with appropriate family members when completed.
- Sole owners should inform key employees that a business continuity plan is in place and set up and fund a Stay Bonus Plan to encourage them to remain with the business.

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