

Focus On Business Succession Planning

Transferring the risk.



Business Succession Planning is essential for most businesses. Three common components addressed in business plans are business ownership, how debt will be dealt with and how your business will manage the death or serious illness of a key member. This article examines some of the planning and insurance solutions that may form your Business Succession Plan.

Buy-Sell Agreements - A will for your business

A buy-sell agreement is created when business owners negotiate and agree what they will do with their respective interests in the business if an owner dies, is seriously ill or injured or simply wishes to retire or exit the business. It is just like putting a will in place for your business.

As the name suggests, buy-sell agreements often include mechanisms for the sale of an owner's share in a business if they die or are incapacitated. Not only will this detail who has first rights to purchase the business from their dependants - and at what price - it can also include funding mechanisms. In most cases, the funding mechanism used is personal insurance. This might include life insurance, total and permanent disability insurance and income protection insurance.

The structure of how these insurance policies are owned and paid for is extremely important. Getting the structure right can save you, your dependants and your business partners a great deal in tax. Having the correct set-up may also help with getting faster insurance payments and easier distribution of your estate.

Legal agreements should always be put in place for buy-sell agreements to ensure everybody is aware of their rights and obligations. With the right buy-sell agreement in place, multiple benefits can be achieved:

- Certainty about what will happen and when;
- Stability for your business, owners, employees, even your suppliers and creditors.;
- An agreed sale price;
- No need for additional borrowings for a business buy out; and
- The value of your business is preserved.

Key Person Insurance - Protecting the brains trust!

Most businesses take out insurance cover for assets that do not actively contribute to profit, such as plant, equipment, vehicles and buildings. But what about your most valuable assets - the people who manage the business, drive profits, pioneer technology?

A key person is someone whose continued association provides your business with a significant and direct capital gain. This doesn't just mean profits but also includes cost savings, capital injections, client and credit access and goodwill. In addition to business owners, other key persons within your business may include:

- Managing directors and working directors
- Sales managers who have personal relationships with your main customers
- Financial controllers
- Computer programmers who drive technology within your business
- Specialists whose unique skills are used to provide your business' services

Even the largest listed companies have strategies in place to manage risks such as the death or serious illness of key employees such as CEO's and chief financial officers. Many companies won't allow all of the senior executives to travel on the same flight for this very reason!

Key person insurance can compensate your business for losses from the death or incapacity of a key person. Insurance proceeds can compensate your business for the loss of two different qualities.

The first is business profitability (revenue purpose). Insurance proceeds can be used to replace the revenue the key person would have generated and pay the extra costs of recruiting and training a suitable replacement.

The second quality is the capital value of the business (capital purposes). Proceeds could be used to reduce the impact of lost goodwill and credit standing as well as enabling debts to be repaid, easing the financial burden on your business.

Business Expenses Insurances - Keeping overheads under control

In the same way that income protection insurance can protect your income, business expenses insurance is designed to protect your business. This kind of insurance is designed to reimburse your regular business expenses in the event that an illness or injury prevents you from working.

Insurance claims are paid as a monthly amount that helps to pay the day to day running costs of your business, such as employee salaries, rent, mortgage repayments or utilities.

You will usually need to wait around 30 days before making a claim on your business expenses insurance. Your claim can be paid for up to twelve months, allowing you some breathing space to employ somebody to take your place or to sell your business at a reasonable price (instead of a fire sale!).

Guarantor Protection - Hold on to your house!

Often business loans will include a personal guarantee by the business owners. More often than not, this guarantee is over the business owner's home. Does this sound like you? Did you know that if a business owner dies or is incapacitated, the lender may call on that guarantee.

Guarantor protection - or debt reduction - insurance allows for the repayment of business debts guaranteed by a person who dies or suffers another insured event. By ensuring that all business owners who have made personal guarantees are adequately insured, you can reduce the chances of lenders laying claim on your home.

So with this protection in place, two potential disasters can be avoided:

1. Your family, and the families of your business partners, will keep their home if you or a partner dies.
2. The financial burden on your business is reduced as debts can be cleared and guarantors can be released from the bank's security over their assets.

Key Person Insurance - Peter, John & Tony's story

Roof Mates Pty Ltd is a business based in Adelaide and has three employees.

Tony (26) does all of the installation of the roofing, Peter (42) does the accounting and administration, while John (31) does the sales and marketing to attract new clients. Business revenue quickly builds up to \$30,000 per month.

Regretfully, ten months later Tony falls from a ladder, becoming a paraplegic, and can no longer work.

Peter and John do not have the expertise to install roofs. Consequently, they have to find a skilled employee to replace Tony; however, they are unable to attract an experienced person, as the business is relatively new and potential employees do not want to risk moving across to such a new venture.

As a result, Peter and John have to advise clients that they can not complete the roof installations they have booked in. Clients go to competitors to get their jobs done and, within a few months, Roof Mates closes down.

Could this have been avoided?

If Roof Mates had undertaken contingency planning, a total and permanent disability policy may have been taken out over Tony's life. The sum insured should have been enough to cover revenue losses for say six months (\$180,000) at a cost of around \$300pa*. The insurance funds could then provide a cash injection into the business upon Tony's paralysis, allowing the business to show a strong financial position and attract a replacement for Tony.

* Premium illustration prepared by Comminsure on 10 January 2007, based on a male aged 27 next birthday, non-smoker, roof-tiler with 3 years+ experience living in SA.

What next?

When looking at the various options for protecting your business and your family's financial future, it is essential to seek professional advice.

Together with a qualified adviser, you can look at the various ownership options, such as individual, corporate and trust structures, and issues that will meet the needs of your business and your family.

To find out more about your business protection options, contact your Infocus financial adviser today.

Group Head Office & QLD State Office
Level 1 Kawana House, 1 Innovation Parkway
Birtinya QLD 4575

Call 1300 infocus

or visit infocus.com.au

infocus
Money Management

For Life

This document has been prepared for general information purposes only and not as specific advice to any particular person. Any advice contained in this document is General Advice and does not take into account any person's particular investment objectives, financial situation and particular needs. Before making an investment decision based on this advice you should consider, with or without the assistance of a securities adviser, whether it is appropriate to your particular investment needs, objectives and financial circumstances.

Infocus Securities Australia Pty Ltd trading as Infocus Money Management ABN 47 097 797 049 AFSL No. 236523