MyLife
Managing Your Lifestyle
Income & Future Expenses

Focus on Business Succession Planning

Business Succession Planning is essential for most businesses.

Call 03 9017 4114 or
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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.

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; and
- 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 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.

Case Study

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. Unfortunately, ten months later Tony falls from a ladder, 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 cannot 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 $400pa*. The insurance funds could then provide a cash injection into the business upon Tony's injury, allowing the business to show a strong financial position and attract a replacement for Tony.

* Premium illustration prepared by TAL on 22nd March 2012, based on a male aged 27 next birthday, non-smoker, roof-tiler living in SA.

To fully understand the various options available for protecting your business and your family's financial future, it is essential to seek professional advice from a qualified financial planner.

This way, you can look at the various ownership options, such as individual, corporate and trust structures, and alternatives that will suit the personal needs of your family and your business.

To find out more about your business protection options, contact MyLife Financial Planning today on 03 9017 4114.