Exit Planning Institute™

THE IMPACT OF UNPLANNED CONSEQUENCES ON BUSINESS VALUE

How to Prepare Your Business for the 5 Ds

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LETTER FROM EPI PRESIDENT, SCOTT SNIDER

The Impact of an Unplanned Exit

Did you know that 50% of businesses fail because of unintended consequences?
These consequences can lead to bankruptcy, layoffs, and ultimately an unplanned exit as the business is forced to shut down or transfer at a price much less than what the owner wants, needs, or even deserves. Exit Planning Institute refers to these factors as the 5 Ds. Divorce, Disagreement, Disability, Distress, and Death.

Without preparing a business should it be impacted by one of these stressors, owners are risking their livelihoods. 80% of an owner's wealth is locked in their business, and by failing to create detailed contingency plans and legal safeguards for their business, they stand to lose the majority of their wealth in an unplanned exit.

To best mitigate the impact of the 5 Ds on a business and the owner's life, owners must first fully understand the negative consequences each can have on their organizations. We interviewed business experts, Certified Exit Planning Advisors (CEPAs), and trusted exit planning thought leaders to gain a deeper understanding of the 5 Ds that influence every business.

This whitepaper will dive deep into the impacts these 5 Ds can have on business value, how professional advisors can help mitigate the risks associated with the 5 Ds, and provide a checklist to prepare owners for their eventual business exit.

Scott Snider
President, Exit Planning Institute

According to Marriage.com, “Divorce lawyers estimate that the entrepreneur divorce rate is five or ten percent higher than the regular one. If we take that divorce rate in the USA is about 38% that would mean that the entrepreneur divorce rate varies between 43% and 48%.”

Why do you think that is? What characteristics account for this increased risk of divorce? And what can you do to limit that risk?
While divorce may not be the direct cause of your business failing,
it does impact your business more than you think.

DIVORCE

Spouse Involvement in Business

If you and your ex are in business together, the negative impact on your business could be widespread. According to Forbes, "What if your spouse has held a pivotal role in the day-to-day workings of the business but decides to quit in light of the divorce? Now, others may have to pick up the slack".

Additionally, if your former spouse decides to stay at the company, how will you manage the unavoidable tension between the two of you? Business.com says, "Suppose your spouse is currently or was ever involved in the business, especially in a senior capacity. In that case, the situation gets even more complicated, as they still have a say in the day-to-day operations. They may have received a portion of your stock, as well, increasing their position".

How will you ensure that your employees do not choose sides and negatively impact the working environment? These are the questions you must ask yourself when working with an ex-spouse, or your business could crumble from the negative disruptions.

Marital Property Laws

Marital Property is defined as "all income and assets acquired by either spouse during the marriage". This includes money in a savings account, stocks and bonds, and other assets – like your business. Marital Property can be either separated as Community Property or through equitable distribution. Nine US states currently distribute Marital Property as Community Property. That means, that every asset is split between the two parties evenly, 50% to one party and 50% to the other. The remaining states utilize equitable distribution, and the final disbursement of assets is determined through a lengthy court process until the former couple decides what is fair.

Depending on how your assets are distributed, you may end up with less stake in your business. For example, if you were a majority shareholder with 51% of the business in your name, through Community Property distribution, your ex now has 25.5% control of the business, and you have lost the majority shareholder position within your company. Someone who previously had no stake in the business now controls more than a quarter of it.

Tim Young, Managing Partner of WealthPoint, shares three questions business owners should address regarding their business ownership, shares, and title.

1. **DO I LIVE IN A COMMUNITY PROPERTY OR A SEPARATE PROPERTY STATE?**
2. **IN THE EVENT OF A DIVORCE, DO WE HAVE OTHER ASSETS THAT CAN BE SPLIT?**
3. **HOW IS MY OWNERSHIP OF MY BUSINESS TITLED?**

According to Business.com, "If your ex receives a substantial portion of your stock during the settlement, they could become an uninvited partner, throwing the business into chaos. Further to this, your interest has been diluted, possibly causing your status to change". Not to mention the stress that comes from working with your ex-husband or ex-wife.

DIVORCE

Estate Planning Considerations

Not enough business owners consider the impact trusts and proper estate planning will have on their life prior to their exit. Kevin Entwistle, Family Wealth Director, Private Wealth Advisor, and Vice President at Morgan Stanley Private Wealth Management says, “From a financial standpoint when one spouse owns or co-owns a business, the other is often entitled to a payout or some allocation to that ownership interest, which is based on the non-owning spouse’s employment in that company or contributing some value to the operation of the business, or their indirect efforts offering support in a way that provides the owner spouse to help the business succeed.”

For high-net-worth individuals, estate planning often includes minimizing the impact of estate taxes. As such, business owners and their advisors must ensure they are planning for all possible outcomes that may occur to the owner, including divorce.

Kevin continues, “When it comes specifically to spouses, and closely held businesses that are worth more than the gift and estate exclusions, we sometimes suggest the spousal lifetime access trust (SLAT) as one estate planning tool that may address the issue of minimizing tax implications. A SLAT is simply an irrevocable trust created during a spouse’s lifetime and allows the married spouse to remove assets from her estate (the business owner for example), such as a closely held business interest, while still benefiting from trust income indirectly through the owner’s spouse.”

DIVORCE

Exiting the Business Due to Divorce

A divorce could lead to dissolving your business. Forbes says, "if your spouse is entitled to a big cash payout for his or her share of the value of your business and you don't have the liquidity, you may be forced to sell or close the business in order to pay your spouse. Another scenario could include a culmination of negative events: disruptions to your operations and team resulting in poor communication with customers and business partners, bad press that damages your brand reputation and discourages people from doing business with you". It is important to have an exit plan in case of a divorce.

Tim Young stresses the business and financial impact of divorce in addition to the strong personal impact. He shares, "Besides the emotional and mental impact, the business owner should be mindful that their attention may be shifted to navigating personal issues as opposed to being 100% focused on the business."

To limit the chances of your business failing because of a divorce, follow some of these tips.

1. Create a Pre-Nuptial or Post-Nuptial Agreement
2. Separate Personal and Business Finances
3. Make a Well-Organized Exit Plan

Create a Pre-Nuptial or Post-Nuptial Agreement

When you are young and in love, asking your future spouse to sign a pre-nuptial agreement does not seem like a necessity. If anything, it seems like a surefire way to an argument starting with, "Why would we need this? Are you planning on leaving me?" and ending with you sleeping in the doghouse. A pre-nuptial agreement is one of your first lines of defense in protecting your business from being split in two.

Joseph Strazzeri, Counselor and Attorney at Strazzeri Mancini LLP, and Partner at The Founders Group, shares that a pre-nuptial or post-nuptial agreement is created to address the nuances that are not covered under state marital property laws. He says, "An owner must ask themselves, 'Am I willing to sign and agree on paper that I disagree with the state law on how to separate assets in the event of a divorce?' Some states are Separate Property states where what you bring into the marriage or have inherited stays yours. Others are Community Property States, where everything is built to become 'ours' and does not stay 'mine or yours.'"

Two things to consider while drafting a pre-nuptial agreement are whether the company should be considered as joint marital property or an individual's property and the company's agreed value at the time of divorce and whether any appreciation of assets gets passed on. Tim Young explains, "Both pre-nuptial and post-nuptial benefit business owners as they would dictate how assets are held as it relates to community property or separate property. They also dictate the financial responsibilities in the event of a divorce so the business owner can lessen the impact of the divorce on the business."

Without a pre-nuptial agreement, assets could be separated allowing for a non-employed spouse to gain ownership over their ex-spouse's business. Kevin Entwistle shares, "The last thing you want is to be separating assets in divorce and have a non-employed owner gain ownership and either steer the business down the wrong path or start to divest and break the company up by finding ways to liquidate their ownership if there are such routes to doing so built into the operating agreement."

DIVORCE

Separate Personal and Business Finances

Even if you are not going through a divorce, it is important to have completely separate records for your personal finances and your business finances. Separating your finances will allow you to have accurate statements when it comes to expenses and assets.

Try not to use collateral in your home to invest in your business to limit confusion in what belongs to whom during asset distribution. Additionally, if both you and your ex-spouse work in the business, make sure you are both being paid fair market salaries so there is no question about support obligations due during the divorce proceedings, i.e.: alimony and child support.

Make a Well-Organized Exit Plan

The best way to ensure you are prepared for an eventual business exit is to create a well-organized Exit Plan. An exit plan that includes your business, personal, and financial needs will provide you with the stability you need in case of an unexpected exit from your business. Building value in your business is not only a good business strategy but a good security net in case of a divorce.

Having proper governance standards in place will be critical, and having other successors being groomed in the meantime is important because if one or both end up stepping down as leaders, it will be a messy transition for the next owner to step into their shoes if not yet fit for such a role or capable of handling the responsibility.

DISAGREEMENT

Partner conflicts may appear sudden and unexpected. However, they often build to a climax gradually, over time. This is because conflict is frequently rooted in fundamental differences between the partners. Conflicts may stem from differences in the partners' leadership styles, goals, client or customer approaches, communication styles, and other differences. Yet serious conflict is inherently personal. Partners can quickly fall into a pattern of criticism and blaming as a result.

This pattern of criticism can undermine the partners' ability to make decisions, agree on recommended value creation strategies and actions, erode trust, keep them from operating together effectively, and take the necessary steps to prepare to transition away from the business. One of the reasons why conflict is so personal is that most partner relationships are personal to begin with.

DISAGREEMENT

> "Successful business partnerships usually start well. Close relationships, shared values, family ties, and positive work and personal experiences bring two or more individuals to want to go into business together. Yet the things that brought them together are inevitably met with the realities of operating a company. Business formation, financing, marketing, hiring and managing employees, purchasing, product design and distribution, and business development activities can be stressful, and may raise red flags about the strength of the partnership."
>
> MARK HAMILTON, PRESIDENT OF VERSA CULTURE LLC

Focus on the Problem

What is the business problem or challenge? Getting the partners to agree on the problem first before looking for a way to fix it is a great way to start. For example, is the conflict about cashflow? A business expansion? Customer relationships? Bring the partners to agree on the business problem by asking them what needs to be solved.

Joseph Strazzeri explains, "Some business owner's partnership agreements create tools for rules to follow not for alignment on business processes. By finding what works best for all partners, the business wins, not individual partners."

Agreeing on the business problem to be solved can help to reduce conflict by re-focusing the partners on common issues and moving them past blaming, criticizing, name-calling, and other negative responses.

Effective Communication

Kevin Entwistle has a client who owns a landscaping company with his business partner. The two owners had not been on great speaking terms, and their communication had slowly broken down over time. This led one owner, Kevin's client, to consider exiting the business because he did not want to be in the business together anymore. The other owner then began to accuse him of wanting to break off and start his own company.

Kevin shares, "In reality, our client really needed a break from business ownership before his next act, and eventually used the awkwardness of their disagreement over the next steps to address larger concerns. This led them to bubble up their concerns, face their fears of restarting communication, and finally make a mutual agreement to move on, which was healthy and financially more sound for both of them."

DISAGREEMENT

Remove Personal Issues

When partner conflict arises, the focus is most often on personal, rather than professional, issues. Partners may disagree with each other over a lack of communication, management missteps, employee turnover, or other challenges. However, they may express these issues by blaming each other over what they consider to be each other's character flaws or bad habits.

Mark Hamilton says, "Partners may use words such as, 'unfair', 'irresponsible', 'stubborn', or 'foolish' to describe one another. Reduce the tension by taking these words out of the conversation. Set ground rules for the partners to talk through issues in non-personal ways while bringing them to focus on the business problem."

Establish Goals for Measuring Progress

Ask the partners what outcome each of them would like to see. Have them focus on business metrics rather than any changes they want to see in each other's character or behavior, things that an advisor may be hard-pressed to resolve. Get them to agree on at least one, tangible outcome. Ask them how they will measure their progress toward achieving this outcome.

Joseph Strazzeri emphasizes the importance of quarterly and annual meetings to clear the air on potential problems and discuss tangible ways of mitigating the issues.

Business challenges that turn into partner conflicts can quickly propel the partnership into a state of crisis. The crisis itself keeps the partners from resolving their differences until the problem or challenge is solved.

Clearly Define Roles and Responsibilities

Ask each partner what they will do to help the partnership to achieve the desired outcome. Make sure these roles and responsibilities are tied to actions and measurable outcomes. Once the partners agree on their respective roles, responsibilities, and actions to be taken, have them plan to review their progress. Mark Hamilton explains, "Putting this plan in writing can help them to track their progress while minimizing the chances that conflict will take hold."

Not All Conflict is Bad

Disagreement is not a bad thing, but running from the conversation or not addressing the disagreement is what causes concern. The days of "my way or the highway" are over. Owners must learn to communicate openly with each other and not assume how the other owners feel. Kevins Entwistle shares, "My favorite quote is that the problem with communication is the illusion it has taken place."

There must be intentional time set aside to update each other on where they stand, what concerns they have, and come up with a plan to either improve upon them or figure an exit strategy out together.

Dr. Fred Johnson, Founder and CEO of InitiativeOne, shares, "For most leaders, conflict carries a negative connotation; less conflict is good and more conflict is terrible. Such a view of conflict robs cultures of opportunities for constructive conflict to increase creativity, collaboration, and deeper trust. Rather than viewing conflict as an ill to avoid, measure cultural health by the effectiveness of your conflict leadership."

Unfortunately, disabilities and illness are a part of life. Are you aware of how an illness, disability, or other medical concern can impact your business value? Without proper plans in place, a sudden medical emergency could cause your business value to plummet.

DISABILITY

What Happens to the Business if the Owner Faces a Medical Condition?

In a business that is dependent on the owner, should the owner face a medical condition or disability, it could cause the business value to decrease. Without clearly documenting business processes, organizing responsibilities for employees and partners, or informing family members of important financial matters, an owner effectively sets the business up to lose value after their exit.

Dan Heinrichs and James Stinson of the Niemann Group worked with one of their owner clients who planned well ahead of their disability worsening. They share, “We were brought into a deal where a business owner had a degenerative eye disease, where he needed software to read all of the documents, and the day-to-day became overwhelming. The spouse and children were not interested in continuing in that line of business, and the owner decided to sell the business while he had still been maintaining a great track record for several preceding years. We accomplished planning to help maximize his net after-tax proceeds while creating a tax-free stream of income for multiple generations.”

Disability Insurance

The Niemann Group team shares, “Disability insurance protects business owners by providing them with an income stream if they become disabled and unable to work, which helps maintain the value of the business. Without disability insurance, the owner may have to dip into their personal savings or sell off parts of the business to cover living expenses, which can negatively impact the value and stability of the business.” Having disability insurance helps ensure that the owner's income and the value of the business are protected in the event of a disability.

Additionally, a disabled business owner may struggle to keep up with the responsibilities and day-to-day operations of the business, which can further harm the value of the business. Even with disability insurance, the value of the business can still diminish. Tim Young worked with an owner who contracted Lyme disease and was unable to manage her customer relationships and lost approximately 10% of her business.

While she was covered by the insurance, the rest of her team was not prepared to take on her responsibilities in her absence. Tim shares, “However, it also forced the company to re-evaluate their best practices and internal succession plan to focus more on long-term growth and value creation. As a result, even though the company took a step backward upon the initial diagnosis, they grew and developed better internal processes due to the necessity of doing so.”

Disability insurance is crucial for a business to have to provide security to the business and its owners. Disability coverage can provide a benefit to the company to help with a shareholder buyout as well as provide a monthly stipend to the disabled shareholder’s family. This is crucial as both parties will need the cash flow if the business becomes less profitable.

DISABILITY

The Financial Impact of Disability on a Business

For a business owner impacted by a disability, the financial impact can be widespread to both their personal finances and business financial success. Owners must ask themselves if their medical condition will invoke a purchase of their shares, how the shares are to be paid, and who has a right to vote on their shares. Owners must spend adequate time selecting and informing their medical and financial Powers of Attorney of their wishes for their personal finances as well as their business responsibilities.

Tim Young shares that a strong succession plan can lessen the financial impact of an owner or key employee's disability on a business. These strategies can help to protect the value of the business in the event of a disability. He says, "Owners should focus on an internal succession plan to ensure it has the right people in place to step in if someone can no longer work. This would involve ensuring all processes are documented and performing cross-training so multiple employees know how to handle all facets of the job and requirements."

The Legal Ramifications of A Workplace Injury or Disability

There are a few legal implications that can negatively impact an owner and a business in the event of a workplace injury. These include financial payments and legal fees if an employee should sue the organization for their injury. Tim Young shares, "The result of an injury will most likely result in an insurance claim which can increase the ongoing premiums and cost to administer the plan. Additionally, there is a risk of additional implications in terms of dealing with regulatory agencies depending on the workplace injury."

With the appropriate insurance policies and contingency plans in place, the financial implications due to legal action may be minimized. One approach is analyzing the risks of a disability event occurring, defining how the current situation would play out, and then proposing some planning strategies to help alleviate any issues with the current planning. Advisors should also discuss the proposed planning with the company's other service professionals and evaluate the risk on financial, operational, and relational fronts to ensure we have properly defined the risks associated with a disability.

DISTRESS

Good contingency planning includes risk reduction strategies and policies to protect against everyday disaster situations that lead to distress. These situations include, but are not limited to, data breaches, property disasters, supply chain disruption, work safety incidents, legal battles, and critical employee loss.

To limit the impact of these stressors on a business, owners must incorporate contingency plans into their business processes. Joseph Strazzeri emphasizes this point by saying, “Most people don’t deal with distress until it reaches a critical level. By dealing with the root of the distress early, it is more manageable and less of a detriment to the business’s value and success.”

DISTRESS

Legal Distress

Unexpected legal battles can take up much of a business owner's already extremely busy workload. Whether from a competitor or an internal employee, a lawsuit can greatly diminish business value if not handled swiftly. Additionally, a lengthy legal battle can quickly reduce an owner's reserved funds and result in bankruptcy or the business closing.

Kevin Entwistle worked with a client who has previously successfully exited their business but is navigating legal battles in their current business that could hinder their exit. He shares, "Competitors in the space have decided to come after this owner with everything they have, because the moats they thought existed around their business models, were faulty and not strong enough. While the owner is not being pushed to exit, it is seemingly his goal to do so, and with that comes a lot of discussion around protecting not only his company but his family as well."

Legal battles may force an owner into an undesired exit if not managed effectively. Kevin continues, "We have been working with the owner to lay out the roadmap of planning required before, during, and after the exit to make sure his family is comfortable and taken care of, no matter the legal battles that exist at the moment. It is about controlling the controllable and focusing the owner on making appropriate decisions when it comes to harvesting their company's values on their terms. We ensure the owner will not accept a forced exit because of external pressures."

External Stressors

The global COVID-19 pandemic in the past few years has been one of the largest external stressors impacting business value and unfortunately led to the closure of countless businesses and extremely high unemployment rates. For those businesses that did not close during the pandemic, they were still met with the financial implications of layoffs, revenue, supply chain issues, and in some cases, decreased demand for their products or services.

Kevin worked with a client that had to borrow funds from the government in order to continue to pay their employees. While they did not have to lay off any employees, they did have to get creative with their burn rate and consider altering their business models to meet new market needs. He shares, "We worked with owners who were more opportunistic during this phase of the pandemic and were onboarding clients into their virtual spaces, pivoting their business from a previous industry to an entirely new one."

Addressing Distress

One of the greatest mistakes an owner can make, according to Kevin, is failing to address the causes of distress in their business. For example, consider if a product fails, but the company fails to recall the products, resulting in a lawsuit, distrust from customers, and ultimately negative financial implications. By simply addressing the main cause of the distress, the faulty product, the owner could have limited the resulting negative impact it caused on their business.

Creating open lines of communication and a forum to discuss possible stressors in a business can help foster creative solutions to these stressors before they become unmanageable financial detriments to your business.

DEATH

What would happen to your business if you were to die today? Would your family be financially secure? Are your estate plans and life insurance up to date with the correct beneficiaries listed? Do you have a documented plan for all those impacted by your death? What obligations does your business have to your estate for the value of your shares?

The death of an owner, key employee, or business partner can substantially impact the value of the business if a succession plan is not properly defined and in place. For a succession plan to be successful, you have to ensure the future success of the business is independent of the key person or owner.

DEATH

Thinking about your eventual death is bleak, but for the future of your business and your family, proper planning is paramount.

The Impact of An Owner's Death on Business Value

As a business owner, you are responsible for the livelihoods of your employees, your family, and yourself. The death of an owner can have a significant impact on the value of a business. After an owner's death, there is a loss of important skills and expertise that are critical to the organization's operations and success. This can ultimately lead to a decline in revenue, profitability, and overall value.

Not only does the death of the owner impact the business financially, but emotionally as well. Joseph Strazzeri shares, "When an owner dies, the employees are left to figure out how to move on in the business while mourning the loss of their leader. It is unfair to your team to not plan for their future without your presence. The strongest companies are built of teams that can survive and thrive without dependence on the owner."

As remaining partners and employees work to fill the void in the deceased owner's responsibilities, they may have to shirk their job duties. The Niemann Group explains, "This can lead to a decline in customer service and satisfaction, which can negatively impact the business's reputation and value." Customer relationships can weaken and uncertainty about the future of the business can lead to a lack of trust in once-secure partnerships.

Estate Planning Considerations

Estate planning should be done in tandem with an owner's exit planning to ensure they have a complete view of their family's future and the future of their business. Kevin states, "For example, there are federal and state lifetime and gift exemptions to allocate properly. Without creating trusts for such windfalls that occur during an exit, much of the proceeds from selling the business can wind up in the hands of the government instead of the owner, or their beneficiaries."

One of the main priorities advisors should discuss with owners is structuring the sale in a way that mitigates taxes not only up front but throughout their life. For example, using a grantor trust, grantor retained annuity trust, or sale to an intentionally defective grantor trust, are ways that an owner can freeze their estate value, saving estate taxes on the back end of their life. Kevin says, "While the owner of such a trust still is on the hook for paying income taxes, the benefit is that such a payment is not considered a gift."

The Niemann Group shares, "A properly structured estate plan can help ensure that the business is passed on to the owner's desired beneficiaries in the event of their death. This can include creating a will or trust and naming beneficiaries for any life insurance policies. Without an estate plan, the business assets may be distributed according to state laws, which may not align with the owner's wishes."

DEATH

By having an estate plan in place beforehand, the owner's estate would have the means to transition the business if they were to die. Estate plans offer reassurance that family members would be taken care of, especially if they do not work in the business and are incapable of stepping into the deceased owner's role.

Joseph Strazzeri shares, "Practitioners and owners believe that estate planning is just a will and trust that kicks in when you die. But it acts as a wingman for financial planning. By thinking of your financial future while still alive, you have a more detailed view of how to improve your current finances to reach those goals for your family's future."

Life Insurance

Life insurance can be used as a way to provide financial security to the owner's family in the event of their death. In addition, life insurance can also be used as a way to buy out the interest of a deceased owner's spouse or partner. This can help ensure the continuity of the business and avoid disputes over ownership or control.

Joseph Strazzeri explains that not only is life insurance a benefit for the owner's family in the event of their death, but if they receive a disability diagnosis as well. He says, "What owners do not realize is life insurance plans for a disability diagnosis. They may not know whether they have a long-term or short-term disability and how it will impact their ability to work in the business. 'What would my business look like if I wasn't standing here?'"

In this regard, life insurance ensures you and your family are covered should you need to take an extended leave of absence.

Life insurance can also be incorporated into a business owner's exit plan. The proceeds from a life insurance policy can be used to buy out the interest of the deceased owner from their partners or shareholders.

Death of a Family Member

The death of a loved one can significantly impact an owner's next act planning. An owner looking to spend their life after business with a spouse or go into a new business venture with a relative will be forced to rethink their post-exit plans in the event of their family member's death.

Death of a Spouse

Tim Young worked with a client whose wife died suddenly. His client was an attorney and took 18 months off work to grieve his wife. Tim shares, "Fortunately, he had life insurance in place to provide enough liquidity for him to navigate that period of his life. This proved to be especially impactful as he was only able to generate revenues for his time if it was billable. Since he was effectively not working for almost 18 months, his monthly cash flow went from $30,000 per month to zero immediately. However, the insurance proceeds gave him the runway to go through the grieving process and eventually return to work when he chose to as opposed to when he was forced to out of a financial necessity."

Death of a Child

The death of a child is an emotional and devastating thing for any parent to experience. For a business owner, it is likely their plans to evolve following the loss, and many times unexpected loss, of a loved one. Perhaps their child was positioned to take over the family business once the parent exited, or served as a key employee in the organization.

DEATH

Kevin shares, “We have come across owners who have lost loved ones who are not employed in the family business. Usually, these sudden realities can be very difficult to come to grips with and can lead the owner to either bury themselves in their company and spend an exorbitant amount of time with the company or may make them question everything they took as fact, like that their business was everything to their life.”

Succession Planning

An owner could have an extremely knowledgeable successor lined up to replace them when they exit their business. They have trained this successor, introduced them to customers as their future point of contact, and provided them with every resource needed to effectively manage the business. But then that successor dies. Even the best-laid plans can be altered and thrown off course due to unforeseen circumstances. The death of a successor can drastically impact business value as it puts the future of the business into question.

Additionally, the death of a family member may cause the owner to take a deep look at their life and decide to make a serious change in their work life. They could ultimately decide to close their business instead of finding a new successor. Kevin says, “The sudden shift in perspective can be jarring, but with the proper guidance from a team of advisors who can listen to the owner's needs and wants, they can get back on the horse and intentionally decide how their priorities have changed and address the pain, discomfort and possibly gap in succession planning.”

Death of a Partner or Key Employee

Key person insurance steps in to cover losses to the business in the event of a death of a Founder, partner, or business leader. This insurance provides the executive leadership team time to recover from the loss. When determining policy value, remember to consider the cost to recruit a replacement and the revenue loss associated with this employee. While this may not replace the full extent of the human capital of the owner or key employee, it does provide a cushion in the interim.

Documenting the processes, systems, and responsibilities of all key employees is paramount to the future success of the business after their passing. Kevin explains, “We always tell our owners to document as much as they can, such as their operating processes. If one person holds the information in their head, and for some reason is no longer serving the company, there is a significant liability to keeping the lights on at the company.”

Business Continuity Planning

The Niemann Group stresses the importance of a Business Continuity Plan should an owner or key employee die. They share, “This should outline the steps the business will take to continue operating in the event of the loss of an owner or key employee. This may include the appointment of an interim manager, the use of outside consultants, or the implementation of a crisis management plan.”

Tim Young recommends businesses go through a “catastrophe plan” process to analyze all risks of catastrophe and define the action items that need to take place to minimize the impact of those risks. He continues, “A catastrophe plan should determine what needs to happen in event of a premature passing or other triggering event and serve as a to-do list of action items that need to take place to ensure the business can continue going forward.”

DEATH

It's important for businesses to have contingency plans in place, such as succession planning and key-man insurance, to minimize the impact of the death of an owner, key employee, or business partner on the business's value. Additionally, having a clear communication plan and a business continuity plan in place can help to mitigate the uncertainty and disruption caused by the loss of a key person.

Contingency Plans for The Death of An Owner or Key Employee

Succession Planning

Outline the process for transferring ownership or management. Include potential successors, training plans, and experience and skills assessments.

Key-Person Insurance

Provides financial resources to help the business continue to operate and find a replacement for a key employee.

Employee Retention Plan

Strategies to retain employees, such as competitive compensation and benefits, to reduce the risk of losing key employees during times of distress and turmoil.

Communication Plan

Outlines the process for communicating the loss of an owner or key employee to employees, customers, suppliers, and other stakeholders.

Business Continuity Plan

Outlines the steps the business will take to move forward after the death of an owner or key employees such as hiring an interim manager or outside consultants.

Legal and Financial Review

A review of any legal documents, partnership agreements, and insurance policies to ensure they are up to date and the business is protected in the event of an owner's death.

How prepared is your business for the 5 Ds?
Review the following checklist to ensure your business is equipped to effectively manage and maintain business value should you face a divorce, disagreement, disability, distress, or death in your business.

HOW TO PLAN FOR THE UNPLANNED

DIVORCE

Have a signed and detailed pre-nuptial or post-nuptial agreement dictating how assets are to be divided should you and your spouse separate.

Do not use collateral in your home to invest in your business as this can cause confusion about what belongs to whom during asset distribution.

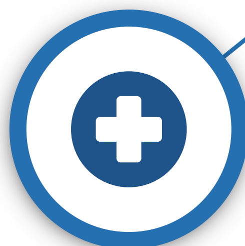
If your spouse has held a pivotal role in the day-to-day workings of the business but decides to quit in light of the divorce, is your team prepared to take over their responsibilities?

DISAGREEMENT

When dealing with a disagreement with your business partner, effective communication is paramount to the ultimate conflict resolution

Review your Buy-Sell Agreement annually to ensure the most up-to-date business valuations have been considered.

Clearly defined roles, responsibilities, and desired actions will limit the opportunities for disagreements to arise between partners.



DISABILITY

Ensure your Buy-Sell Agreement included Disability Insurance as well as Life Insurance

Select your Medical and Financial Powers of Attorney to limit stress and confusion should a disability or medical event impact your ability to manage your finances and business.

Should an owner or employee have a degenerative disability, prioritize strong documentation of business processes to limit the impact on business value and operations when they ultimately exit.

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HOW TO PLAN FOR THE UNPLANNED

DISTRESS

Confirm you have the proper financial contingency plans in place should your business be impacted by an unforeseen financial decline.

Good contingency plans include risk mitigation measures for legal issues, data breaches, supply chain issues, and more.

Review your insurance policies to determine if your business is covered for business interruptions.

DEATH

Ensure you have a Key Person policy in place if you or a co-owner should die as well as the appropriate funds available to hire someone of a similar caliber to fill the role.

Create and update your Estate Plan well in advance of your exit to mitigate tax implications and legal difficulties for your family and dependents.

Strong structural capital and documented processes are crucial for the continued success of a business should an owner die.

THE VALUE ACCELERATION METHODOLOGY:

Meet the Creator

In 2016, Chris Snider, CEO of EPI, wrote the first book on the Value Acceleration Methodology called *Walking to Destiny: 11 Actions an Owner Must Take to Rapidly Grow Value & Unlock Wealth*. This book helped bridge the gap between owners and advisors. Walking to Destiny empowers business owners and provides them with the correct tools, knowledge, and path to effectively position their business and themselves for not only exit options down the road, but more importantly, rapid business growth today. Chris's book expands on the core concepts that are introduced in this whitepaper and highlights businesses that embody the methodology.

Change your outcome and read Chris's book at **WalkingToDestiny.com**

Meet the Community:

The advisors who incorporate the Value Acceleration Methodology into their practice are called Certified Exit Planning Advisors (CEPAs). EPI is powered by our elite and diverse community of top advisors focused on creating a valuable, transferable future for the business marketplace. CEPAs are able to have deeper and more holistic conversations with business owners as members of their advisory team and are often called the most trusted advisor. This whitepaper includes insights from just a few of the over 3,000 CEPAs in the exit planning community.

Meet the Trusted Advisors and explore the Exit Planning community at **BuildSignificantCompanies.com**

Understand the Owners:

Exit Planning Institute has spent over ten years researching business owner exit readiness and analyzing the mind of an owner. **Through this research, EPI has found that owners profoundly regret selling their business if they do not prepare for the personal side of the transition.** An owner with a profitable business might seem ready to transition their business. However, simply because a business is successful, does not necessarily make it significant to its customers, employees, or potential buyers. Highlighted in this whitepaper are some of the key findings from the 2021 New York City State of Owner Readiness Report that continue to support significance over success.

See how ready your business is for a transition and access all State of Owner Readiness Research at **OwnerReadiness.com**

ABOUT THE AUTHOR

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Colleen is responsible for creating engaging and unique content for Exit Planning Institute. She generates organic communication between EPI and the Exit Planning community and conducts targeted market research.

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