

BUSINESS SUCCESSION: PLANNING FOR TRANSITIONS

How To Ensure The Survival Of Your Business

Are you prepared for the future? As individuals, we save for the college education of our children, build a retirement nest egg, buy life insurance, and write a will.

But what about the future of your business? Have you prepared for the time when you're no longer around to run things, or when your partner is no longer around?

Most small business owners don't take the time to plan for their retirement, death, or disability. In fact, 66% of small businesses don't have a succession plan in place, according to *The Wall Street Journal*.

It's easy to see why. Running a small business—meeting the payroll, covering overhead, providing income for yourself and your family—can be totally consuming. "Succession planning is the kind of thing that small business owners often don't think to do early enough because they're busy running the day-to-day operations of their businesses," says Erskine Bowles, administrator of the U.S. Small Business Administration (SBA).

Bowles says that "orderly transition planning is crucial." Without it, the chances of the continuation of the business decrease. As it is, an estimated 70% of family-owned businesses don't survive the transition to a second generation, according to the SBA.

Without succession planning, those businesses that do survive may find themselves in an unpleasant or difficult situation. You may, for instance, get stuck with partners you didn't bargain for, such as the spouse or surviving children of your current partner, says Michael J. Amato, a CPA and CFP (certified financial planner) for Independent Tax and Financial Planners of Holland, Pa., which helps family-owned businesses prepare succession plans.

Without a succession plan, another possibility is that you or your family might be forced to sell the business, or to buy out your partner's heirs at an unfavorable price, says Brian Titus, a lawyer for Connecticut Mutual Life



Insurance Co., which recently cosponsored with the SBA six seminars on continuation planning.

START EARLY • The sooner you start planning, the better. The first thing you should do with a small, family-owned business, is determine if the business is going to stay in the family after your retirement or death, says Amato.

You need to answer these questions: Are there children or other relatives who want to take over the business? Do they have the entrepreneurial or management skills to succeed?

If you want the business to be managed the same way you manage it and customers to be treated as you treat them, you'll have to groom your successor. "It's better to give your successor hands-on experience now, rather than waiting until you're no longer around to give advice," says Amato.

Make sure you relinquish responsibility gradually. Let your successor work up through the ranks, starting in the mail room, for instance, and slowly taking on more managerial tasks. This way, not only will he be better able to manage the business later, but other employees will have gained respect for his skills.

One common way to help ensure a smooth succession, whether the business is family-owned or not, is to set up a buy/sell agreement beforehand, says Amato. Typically, a buy/sell agreement, also called a business continuation agreement, uses life insurance for funding. "Even among skeptics of life insurance, this is considered a solid reason to buy life insurance," says Titus.

Here's how it works: Say an owner eventually wants to turn over his business to an adult child. The father first determines, with the help of his accountant or another expert, the market value of the business, which is often based on annual revenue or profits. With the father's consent, the child takes out a life insurance policy on the father and pays the premiums. The amount of the insurance—the death benefit—is generally

equal to either the market value of the business or a down payment on it. If the father dies, the child then uses the life insurance benefits to buy the business.

Disability insurance can also be used for the same purpose. If the father becomes sick or is injured and can no longer work, the child uses the disability insurance benefits to buy the business over time. In this case, the monthly disability benefits should be equal to or greater than the monthly payments for the business.

Here's another example: Say two people co-own a business. They first agree on the business's market value. Then each partner buys life insurance for the other. If one partner dies, the other uses the life insurance benefits to buy the part of the business now owned by the estate of the deceased.