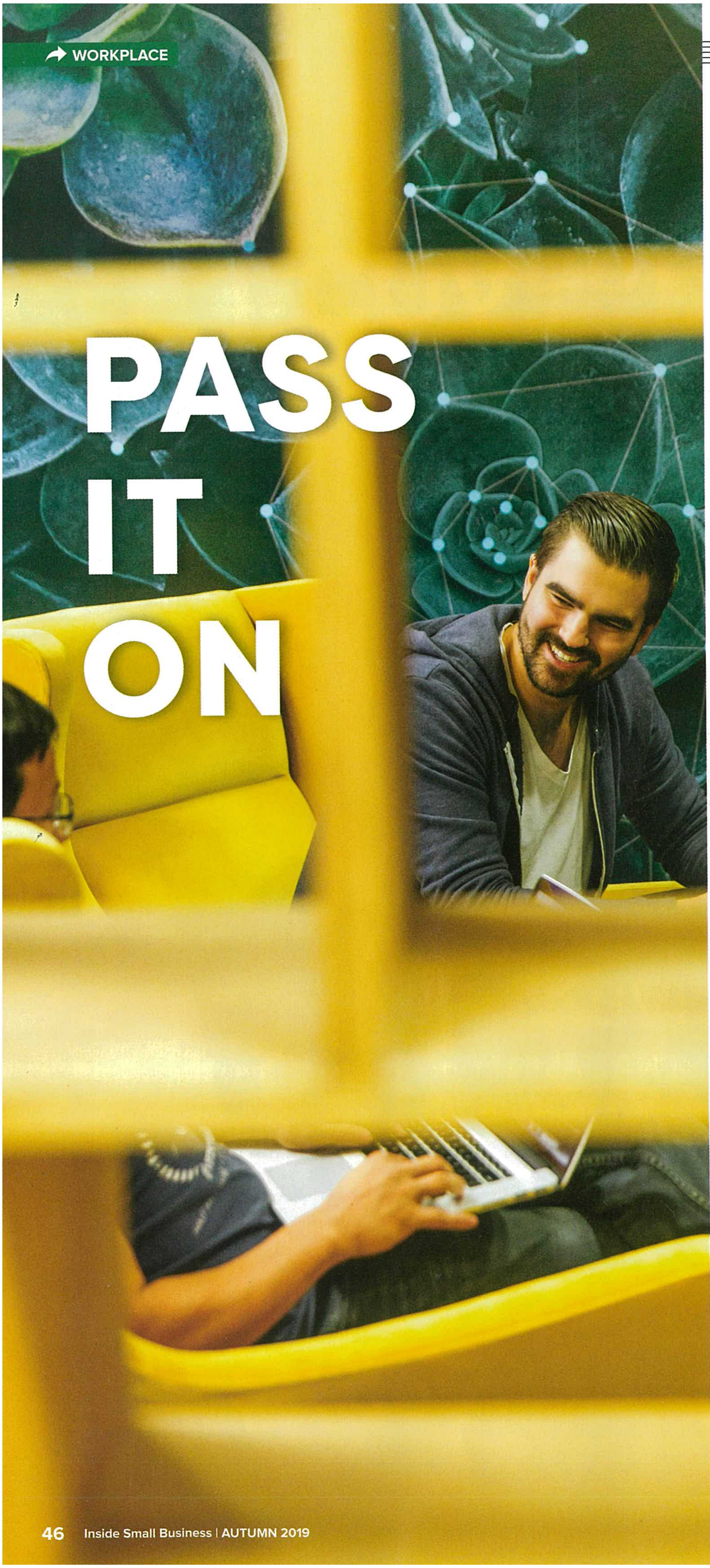

PASS IT ON

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The succession planning documents every small-business owner needs.

Succession planning is important for many reasons, including making sure you maximise the value of your estate that passes to your family if you should suddenly die. For small-business owners, your personal assets are tied up with your business. So, succession planning is even more important, because it becomes part of your personal estate planning.

BUY-SELL AGREEMENT

At the beginning of a business relationship, everything is rosy and exciting. There is so much potential, everyone is working hard and on the same page, and (let's face it) the business is probably not worth much yet. As businesses grow, things change and contingencies should be in place from as early as possible.

If you are in a business partnership with someone, or you run a company or unit trust with another person, then you should have a buy–sell agreement.

We need buy–sell agreements for two main reasons. First, for financial reasons. We usually don't know when a death or traumatic event will occur, and there is often not enough money for the remaining partner to buy out the exiting partner's family without a degree of financial pain.

Second, for control. The remaining partner will want some control over who their partner will be. The original partners were happy to work together, but if one partner dies or exits, you may not want your partner's husband, wife or partner – who might not be suited

to running your business at all – to be involved in a significant way. You also don't want the exiting partner to sell their share to someone else who you don't want to work with.

There are also some other benefits, like dealing with the valuation. If you've already agreed on a process of valuation, which can avoid disputes that might come up when buying out the exiting partner.

Basically, the remaining partner will usually want first option to buy the other half of the business. There will need to be a way to afford this, and there will need to be a way to work out how much is paid. If the exiting party wants to sell to someone else, and the remaining partner doesn't want to work with this new person, there also needs to be what's called a tag-along clause. This can force a third party to buy all the shares instead of just the shares of the exiting partner.

FUNDING

The buy–sell agreement should also include a way of funding the buyout. If this hasn't been pre-arranged, the partner who wants to keep the business could be left with a sudden decision about how to buy the other partner out.

There are generally three options for funding a business succession plan: selling assets, borrowing capital, or using an insurance policy. For an emergency exit, such as death, disability or trauma, insurance is often the most efficient means to ensure adequate funds are available to the remaining owner.

If you have life or disability insurance in place without a buy–sell agreement, you run the risk of the insurance proceeds being paid out to the wrong person. The buy–sell agreement will determine who owns which policy, so that the funds are paid to the person who wants to retain control of the business. This way, they have the funds to pay for the transfer of the business.

CASE STUDY

Karen and Fiona have run a florist and gift business together for 12 years. They operate as a company with 50 per cent shares each, and were smart enough to have a buy–sell agreement and insurance policies put in place about four years into their business.

Tragically, Fiona was killed suddenly when a drunk driver ran a red light and T-boned her at an intersection. Amidst the grief, Karen needs to continue running the business, but she is not in turmoil because she knows that they have their plans in place.

Without the buy–sell agreement, Fiona's husband would have owned Fiona's 50 per cent of shares. Although Karen thinks Fiona's husband is a lovely man, he is certainly not someone she wants to be in business with.

"IF YOU ARE IN A BUSINESS PARTNERSHIP WITH SOMEONE, OR YOU RUN A COMPANY OR UNIT TRUST WITH ANOTHER PERSON, THEN YOU SHOULD HAVE A BUY-SELL AGREEMENT."

The business owned an insurance policy over Fiona's life, so that amount is paid to the business a couple of months after Fiona dies. Under the buy–sell agreement, Karen needs to pay Fiona's husband a pre-determined amount, so that Karen will retain all the shares in the company. With the insurance money, Karen can easily afford this, and neither Karen nor Fiona's husband are forced into a business relationship together.

POWER OF ATTORNEY

Having a Power of Attorney is as important as a buy–sell agreement, because in the case of an accident you are more likely to be seriously injured than killed. You will need to appoint someone to be able to act in your place – to make financial and legal decisions, and make sure the business stays open until you can get back to it.

If you are in hospital for months, relearning how to walk or in a coma, someone needs to ensure that your staff are paid, and that your clients are still serviced.

Routine is important for business, and when you appoint someone to make decisions for you, you need someone who has an understanding of your business. Your spouse might not be the best person. Using Karen and Fiona as an example, if Fiona had just been injured and not killed in the accident, she had a Power of Attorney agreement appointing her husband and Karen as her attorneys. Karen had the power to run the business, and make all decisions in relation to that, and Fiona's husband had powers over Fiona's personal affairs.

FAMILY TRUST

If your business operates in a family trust, you need to consider how the control of that trust will pass on to the next generation. It is often best if a family succession of a business can be started while you're still alive, but contingencies are always important in case of an accident.

You may want all your children to still be beneficiaries of your trust, but you want the business to be run by a particular child. You need to make sure certain powers are transferred and directions are made, so that the trust continues to operate the way you want it to.

WILL

Last but not least, your will is so important as a business owner for a number of reasons. The first is that you need to appoint an executor who can maximise the value of your business. Your executor may have to continue to run your business until they sell it, so you want to select an executor whom you trust to do this.

Second, you will have the comfort of knowing that the rewards of your life's work will be distributed and managed in accordance with your wishes. Having this all set out with a valid will not only minimises the time to administer your estate, but it can avoid other legal challenges such as doubts and disputes.

Keeping your family and business out of court can be done with some attention to your succession planning. It can also increase the value of your estate by making sure your business can keep running, and that the right people can keep running the business. ■