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Preparing for the Worst: Business Continuity Planning for Sole Owners

Contemplating one's own demise is never high on anyone's "to do" list, but is paramount to sole owners and their businesses. Consider the fictional Harry Withers, the 54-year-old owner of Withering Hikes, a chain of seven retail apparel stores for outdoor enthusiasts on the Western Slope of the Rocky Mountains. One day, Harry disappeared while scouting new hiking trails.

After several months of fruitless searching, Harry's family opened probate proceedings only to find that Harry's once-thriving business also had disappeared. However, Withering Hikes's disappearance was far more typical than Harry's. Because Harry had dreamed of selling his company at 60, he had given little thought to what would happen to his business if something happened to him. Thus, Withering Hikes died of all-too-common causes—human error and neglect—setting off a chain reaction of ever-worsening consequences for Harry's family and business:

1. *Harry's key employees left the company for jobs with more certain futures. They feared that neither Withering Hikes nor their salaries would continue without Harry at the helm.*
2. *The departure of key employees meant that there was no one to manage the business. Total chaos reigned, and revenue took an immediate and irreversible nosedive. Longtime customers grew uneasy with what they perceived to be a rudderless ship and took their business to Harry's competitors. Further, the company's vendors demanded cash payments, cash that the company no longer generated.*
3. *Harry's bank saw the drop in revenues and decided to call in the company's debt, debt Harry had personally guaranteed.*
4. *Because Harry left no instructions or recommendations about who could run the business, who could offer advice, or even what to do with the business should something happen to him, both his business and family suffered.*

Withering Hikes didn't just wither away; it fell off a cliff. It could not survive without its top employees or Harry's leadership.

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The Baldwin & Clarke Companies have served New England entrepreneurs for over 45 years. Services include business valuation and consulting, M&A, executive benefit, wealth transfer and business continuity planning, investment management and retirement plan design and consulting. Our membership in BEI's Network of Exit Planning Professionals provides access to The BEI Seven Step Exit Planning Process which has enabled thousands of business owners to develop and execute successful exit strategies.

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The point of reviewing this list of mortal blows is to demonstrate that business-continuity planning is vitally important to owners' companies and families. Without a well-considered business survival plan, the consequences for owners' employees, customers, and, most importantly, family and estate are dire (estates rarely escape the notice of business creditors).

Most of this article will focus on strategies to provide for business continuity in the event of the owner's death. Of even greater importance however, is to provide financial security for the family. The first step in any continuity plan should be to create an insurance funded "One Way Buyout Plan" to provide the family with as much of the business' value as is needed to secure the family's financial security, irrespective of the success of the business continuity plan.

Fortunately, there is a process that sole owners can quickly and easily use to help avoid the type of business collapse that Withering Hikes experienced.

First, sole owners must motivate top employees to stay on after their demises by creating financially meaningful incentive compensation plans for them that vest over time. Creating a plan that provides these employees a substantial bonus (called a *stay bonus*) for remaining with the company beyond an owner's demise is a strong strategy. The company can usually fund the stay bonus with life insurance on the owner's life. This funded stay bonus provides designated employees with a cash bonus (usually about 50% of annual compensation) and a salary guarantee if those employees stay (typically 12–18 months) after the owner's death. The sole owner's job is to communicate these actions to these employees and assure them that he or she has made additional plans to ensure the continuation of the business.

Second, sole owners should alert their banks about their continuity plans. Meeting with a banker to discuss the arrangements made and showing him or her that the necessary insurance funding to implement these plans is in place can allow an ownership transfer to proceed smoothly. Additionally, it is wise to determine whether major creditors are comfortable with the succession plan. Sole owners should ask major creditors which arrangements they would like to see in place.

Third, create a written plan that does the following:

1. Names the person(s) who will take on the responsibility of running the business.
2. States whether the business should be continued, liquidated, or sold (if so, to whom).
3. Names the resources heirs should consult regarding the company's sale, continuation, or liquidation.

Finally, sole owners should work closely with a capable insurance professional to assure that the necessary insurance is purchased by the proper entity (the owner, the owner's trust, or the business) for the right reason and the right amount.

Creating a contingency plan for your company should you depart unexpectedly is a vital part of your overall Exit Planning process. Failing to do so invites the kind of disaster that befell Withering Hikes, Harry's employees, and his family.

Our expertise in crafting business-continuity plans that work can help you be prepared for the unexpected. Contact us today to learn more about how to begin creating a contingency plan for your solely owned business.

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