

# Preserving Value

*Planning for When an Owner Becomes Disabled or Dies*

By Thomas M. Edens



In today's uncertain world, planning for the unexpected has become increasingly important. Through the catastrophes in New York, Washington D.C. and Oklahoma City, we have seen how events that were once unimaginable are now presenting themselves as reality. Crisis planning can prepare businesses for a wide range of possible events that could affect a company's well-being. In addition to terrorist attacks, there are acts of nature, such as windstorms, earthquakes, floods, storms and hurricanes could significantly affect your company. Power outages, fires or employee sabotage are other possibilities.

The contents of a complete business continuity document are out of the context of this article. The focus of this article will be on planning ideas that small- to medium-sized business owners should consider to properly plan for continuity in the event of the owner's sudden death or disability.

One of the most significant unplanned events that could have a catastrophic effect on a company is the sudden death or disablement of the primary shareholder and CEO. Without proper planning, chaos could prevail and quickly erode the value of the business. Erosion of goodwill value built over the years is not the outcome an owner wants, especially if effective execution of a succession plan could prevent such loss of value.

The business does not have to be caught off guard by sudden unplanned changes. A framework for planning for the owner's unexpected death or disability would ideally

be segregated into at least three components: assess the risk, prepare for the crisis and have a plan to mitigate the crisis.

## **Stakeholders affected by crisis**

There are invariably numerous parties that have a stake in the continuity of a business if an owner becomes incapacitated or dies. The stakeholders often include employees, family members of the owner, clients, banks and vendors.

Regarding employees, it is obvious that many families' livelihoods are dependent on the salaries earned at the company. A business continuity plan should prepare for near-term payroll obligations as well as addressing the emotional concerns of the workforce. Family members of the company's owner are also usually dependent on the paycheck the owner was bringing home.

Clients, on the other hand, have entrusted the company with their past-due receivables and have an interest in the firm's continuous operation to safeguard their trust balances while continuing to collect their assets.

Banks, especially if they loaned the company money, expect prompt repayment of debt obligations.

## **Valuation implications**

The value of a service business (such as a collection agency) is at risk of eroding precipitously when the driving force is absent from the executive leadership. Therefore, crisis planning is really about value preservation. Value preservation will

center on maintaining the cashflow of the business, which translates to client retention and sustaining employee productivity. And more importantly, the company is probably the largest singular asset of the former business owner's estate. Therefore, the heirs will likely depend on the company to sustain its value for their future economic well-being.

## **Management continuity**

Most business continuity plans should specify who would replace the owner if he or she suddenly were not available. The new CEO could be someone within the organization, if the talent is there. Alternatively, an outside executive could be brought in to run the company until a permanent CEO is hired or until the company could be sold. Another family member could also provide stewardship of the firm until it is sold.

The value of the company can erode quickly if effective leadership is not installed soon after the executive owner is absent. If it is determined that the best value preservation mechanism is to sell the company, then a prearranged agreement could prove advisable. The management continuity plan should be in writing and addressed to the person who will be responsible for executing the plan.

## **Client considerations**

Protecting client relationships is very important, as they are the economic force driving the company's revenues and

cashflow. Probably the most important aspect of early client retention is communicating with the clients and assuring them that a succession plan is being executed and very little will change after the post-crisis event. This would typically include assurance that their accounts will be collected in the same efficient manner as before, and reassuring the client that the trust account is fully funded and not affected by the owner's death or disability.

### Advisors

Professional advisors most likely will be needed to implement the required value preservation steps. Usually a team comprised of an attorney, CPA, financial planner, valuation expert and M&A advisor (if the company is to be sold) is involved in the continuity plan. Ideally, the advisors are apprised ahead of time that they will be utilized in their expected capacity in the case of a catastrophic event. This will be beneficial for several reasons. They will be better prepared to serve the owner's heirs, and you may be able to negotiate fees and other arrangements in advance to reduce the stress on heirs. This would also serve to accelerate the effectiveness of their professional efforts. The sooner the professionals can perform their services, the greater the value preservation can be realized.

### Buy-sell agreements

Buy-sell agreements are important documents that provide guidance regarding who will purchase the deceased shareholder's interest. The document should also address what value is appropriate for the transfer and the mechanics of transferring the owner's interest. The agreement usually includes the terms (if any) that will be utilized to accommodate the price. Ideally, funding for the buy-sell agreement has been established through insurance policies, an internal funding plan or otherwise.

For a full discussion and analysis of buy-sell agreements, see the article titled "Buy-Sell Agreements," published in the March 1998 issue of *Collector* magazine or visit <http://www.MarionFinancial.com> to download a copy of the article.

### Planning checklist

The accompanying checklist itemizes certain business concerns (in no particular order or importance) that should be addressed when a company encounters the sudden death or disability of an owner.

### Summary

Planning for a crisis is the best way to minimize its impact. Common reasons for not planning include denial that it could happen to you or ignorance of the extent and impact that lack of planning can have on the value of a business. A continuity plan for small businesses can be summarized in a

single document that could greatly reduce the chaos and value—diminishing risk created by the sudden death or disability of the owner. **CM**

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## Crisis Planning Checklist

✓	Topic	Actionable Item
	Banking Information	Make arrangements for any change required for signing privileges—operating, payroll and trust accounts.
	Personal Calendar	Notify people who had future appointments scheduled with the owner.
	Passwords Safe	Obtain ability to access relevant computer files, storage areas or previously confidential areas.
	Employees	Communicate with all employees regarding actions to be taken to stabilize the firm and ensure their employment.
	Liquidity Plan	Implement plan to ensure payroll and other critical disbursements are funded and met on a timely basis.
	Business Advisors	Notify appropriate advisors so they can implement their part of a continuity plan. Advisors may include: attorney, CPA, financial planner, valuation expert, M&A advisor.
	Management	Have interim CEO take charge pursuant to wishes of owner.
	Key Client Communication	Determine what message is appropriate for clients and who will communicate that message.
	Buy-Sell Agreement	Review with counsel the implementation of the buy-sell agreement.
	Key Vendors	Advise key vendors who need to know of changes.
	Banker	Determine which covenants may be breached by the unplanned event and communicate plan to mitigate.
	Insurance	Notify insurance carrier of claim.
	Employee Benefit Plan	New trustee may need to be named if owner acted in that capacity.
	State Licensing	If owner was operator of record, licensing amendments may be necessary.