THE "COMPLETE SUCCESSION PLAN"

The purpose of a Business Succession Plan is to pre-agree a strategy that will enable a Business Person to exit a Business upon retirement or the occurrence of an insured event.

The traditional approach to insurance-funded Succession Planning has focused primarily on the funding of the Purchase Price of a Business Person's Equity in the Business.

It often overlooks the need to extinguish personal liabilities (i.e., personal guarantees and mortgages over personal property) with respect to any Debt or other Liabilities of the Business.

Business People also have Personal (or Estate Planning) needs as well as Business (or Succession Planning) needs. The Purchase Price of their Equity might only meet part of these needs. Personal cover meets the shortfall.

The "Three Needs"

A Complete Succession Plan should identify and prioritise three separate needs:

Buy/Sell or Equity Insurance (Asset Needs)

The purpose of Buy/Sell or Equity Insurance is to:

- fund the Purchase Price of any Equity that needs to be sold by an Outgoing Proprietor (and any Related Parties) to the Continuing Proprietors upon the occurrence of an insured event with respect to the Outgoing Proprietor;
- ensure that the Vendors receive full value for their Equity; and
- enable the Purchasers to purchase the Equity without having to borrow from a bank.

Debt Reduction and Key Person Insurance (Liability Needs)

The purpose of Key Person Insurance is to:

- allow the business to repay any external debt, (so that the Outgoing Proprietor can be released from any personal guarantees and securities over personal assets for business debt);
- repay loan accounts owing to or by the Outgoing Proprietor;
- compensate the Business for any loss of income (revenue) resulting from the loss of the Key Person; and
- compensate the Business for loss of goodwill (capital) resulting from the loss of the Key Person.

Personal or Estate Planning Insurance (Personal Needs)

If your Personal Needs exceed the Purchase Price of your Equity in the Business, it may be necessary to obtain additional Personal Insurance to meet your needs.

The following issues should be taken into account in determining your Personal Needs:

- the personal debts and liabilities you wish to repay;
- the anticipated living expenses of your family after your death;
- any income from other sources (salaries, wages, rental, dividends, other investment returns) would contribute to meeting this need;
- the amount of any income shortfall;
- the amount of capital that would be required to meet the income shortfall;
- any capital from other sources (the sale price of your Equity in the Business, the repayment of any loan accounts, superannuation, other investment strategies) would be available to meet the capital need; and
- the capital shortfall that could be funded by additional Personal Insurance (if appropriate).

Retirement Strategies

Similar issues arise in the case of retirement. However, funding mechanisms other than insurance are required (e.g. Bank or Vendor Finance). It is helpful to estimate or pre-agree the Sale Price of the Retiree's Equity. For example, if its value is now $400,000 and might be $600,000 at the time of retirement, the Proprietors can examine the cash flow implications of a future Loan or Vendor Finance when there is less emotion involved.

The Purchasers can also examine the commercial implications of taking out a significant Loan shortly before their own retirement. If they can't identify a Purchaser for their equity (now 100%) before or after their own retirement, it might be more feasible to sell the whole Business at the time of the first Proprietor's retirement.