

FACTS SHEET – February 2005

Business Succession Planning

Consider some of the following scenarios:

- You are close to retirement and wish to sell your business.
- You become incapacitated through a sporting accident and need someone to take over the running of the business - maybe permanently.
- You get hit by the proverbial bus. What happens to your business?
- If you are male and 35 years of age, the probability of death or total and permanent disability before the age of 65 is 19.25% (ie 1 in 5) according to statistics from ING.

The Problem

Without a comprehensive documented business succession plan any of the above scenarios could prove to be disastrous to the ongoing operations of the business.

If a business succession plan is not documented then how is any survivor to know what to do immediately upon any unexpected need to surgically remove the (former) business owner from the grill of the proverbial bus.

If the business does need to be sold, then surely an operating business is better than one which is not operating.

Why Plan?

A plan allows the principal to consider at their leisure how the business, or their share of it, should be passed on. Creating a plan can create certainty and allow for succession to be handled more smoothly:

- A plan may establish guidelines as to the pricing and terms of the business, or share of business, with little room for dispute;
- A plan may leave the departing principal and/or their family free of the need to run a business that they may know little about;
- A plan may remove the need of a forced business sale;

- A plan may eliminate or reduce the need to increase borrowings to continue the operations of the business; and
- A plan may bring certainty to a deceased's estate and enable a more efficient settlement.

Interim Instructions to Staff

This is usually a much forgotten about thing, and yet so simple to put into practice.

Essentially, if the business owner dies leaving a much distressed family and staff then what do you think will immediately happen the day after?

Some staff may leave because they may not know what is to happen to the business. Some clients may leave because they feel dependent on the professionalism of the principal.

However, if Interim Instructions to Staff are left 'just in case' then the following may be put into action quite swiftly:

- An appropriate letter sent to all clients / customers advising them of what has happened, business is carrying on as usual, and the business is in the process of enacting its succession planning that will involve in the interim xxxx (this may include provision for the business to close for 'a few days of mourning' while it gets its act together).
- To contact the appropriate legal firm for instructions and the appropriate insurance firm for information on policies.
- To contact certain professionals that the departing principal has previously instructed in these eventualities.
- And possibly a restructuring of staff that may allow the business to more efficiently conduct its normal operations until other legal actions are finalised.

And the above may be done without a grieving spouse phoning and having to say "err, carry on please and do your best".

Transfer Agreement

A transfer agreement is one which can be set up which allows for the transfer of the interests of the departing owner if a trigger event occurs.

A trigger event may be retirement, death, a criminal conviction, or other specified event.

The transfer agreement will determine a transfer value or methodology for valuing the interest of the share being transferred, as well as to whom the share is to be transferred.

Funding Agreement

A funding agreement is set up to ensure that the purchaser of the business, or share of the business, can afford to do so. To fund the business interest, the purchaser may be able to:

- utilise personal savings or assets;
- liquidation of business assets;
- utilise vendor funding arrangements;
- utilise third party financing;
- use appropriate insurance policies to finance transfer agreements.

Important: *The information contained in this Facts Sheet is not advice. Many of the comments in this Facts Sheet are general in nature and anyone intending to apply the information to practical circumstances should seek professional advice to independently verify their interpretation and the information's applicability to their particular circumstances. Also please note that changes to legislation may occur quickly.*

For more information, or if you would like assistance, please contact Farmilo & Co.

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