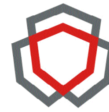

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4 Ds THAT COULD DESTROY A BUSINESS

DEATH, DIVORCE, DISABILITY AND DEPARTURE - These events, by no means unusual or uncommon, can instantly throw a small company into disarray.

The 4Ds are unpleasant to consider but when one of them befalls a business that doesn't have a plan for dealing with the fallout, the result can be catastrophic disorganisation, loss of business opportunities, loss of customer or market share and a decrease in employee morale and productivity may be the least of the repercussions. Family or partner discord, heirs left unprovided for and the demise of the business are very real possibilities.

DEATH

Particularly in family businesses, the death of an owner can trigger a business disaster. Death can leave the heirs financially unprotected. Hoping the surviving partners will "do the right thing" may prove optimistic, especially where big money and personal interests are at stake. Where a partner has died without leaving any written plan outlining their ownership rights and what is to happen to their stake, it's not unknown for the surviving partners to cut the family out of the business without recompense.

Even where there is an agreement, if it has not been properly structured to take into consideration all the contingent issues then it's as good as useless. Fatal disputation can arise around issues like; Is the business required to buy out the heirs? If so, what price should they receive for their share of the business and under what terms? And, who is to be the purchaser – the business itself or the individual owners? Personal matters can arise; are all partners happy to work with the respective heirs of the other partners?

If an agreed procedure for dealing with these issues has not been nailed down in a formal agreement, or set of agreements, then litigation is a likely recourse by the disgruntled party and that will inevitably eat into the value of the business.

Case Study

- An owner's family pays for his neglect.

The owner of a stake in a closely held paper-making machinery manufacturer died suddenly six months after the business was launched.

There was no documented plan outlining ownership rights among the partners. The deceased's family was cut out by the other partners. These owners later sold the business for a handsome profit, pocketing the funds themselves. After 11 years of litigation the deceased's family came away empty handed.

At death, a tax liability may arise to the market value of the owner's share. If a method of minimising tax liability has not been factored into a transition plan (for instance by willing shares to a spouse or a tax efficient succession plan to pass the business to your children), then it can mean hurriedly trying to raise finance to cover the amount. But in many instances, banks are not prepared to come to the party when the business has lost its major asset – the owner. The business may have to be sold to pay the tax liability.

Simply put, an owner/partner needs to understand that failing to properly plan for what happens to their equity in the business after their death, such as with a buy-sell agreement, will have consequences for their family and any co-owners of the business.

DIVORCE

Rarely do you see divorce listed as a cause of business bankruptcy, but with nearly one third of all marriages ending in divorce, in circumstances that frequently turn ugly, divorce litigation has destroyed many a privately held business. In the absence of any type of divorce planning, such as a pre-nuptial and a buy-sell agreement, all assets may be legally required to be divided 50-50. To come up with the cash to pay the divorce settlement owners have had to sell their business. That may not be the final, or worst part, of the story. In a court enforced sale, the owner may have to accept a discount price.

Case Study

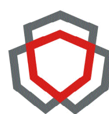
- Fire Sale as a result of divorce.

As a result of divorce the owner was forced to put his business up for sale. With offers from two potential buyers to choose between, he was forced to accept the lower bid because it was for cash on the spot. The judge agreed with his ex-wife and her solicitor who argued that it was not fair for her to have to accept whatever financial risk might be attached to the higher bid, which had provisions for an extended payout.

DISABILITY

The chance of becoming disabled during one's working life is anywhere from one in four to one in three - far greater odds than the probability of dying before retirement and statistics show that a disability that lasts beyond more than a few months will likely continue for several years or longer.

Owner/partners need to think beyond simply replacing lost personal income, because for them there is more at stake, such as long-term obligations they have contracted into (for example, a lease). Forced retirement of a partner due to ill health can jeopardise the likelihood of continuing partners getting their fair share out of the business or of preserving their interest in it. After a year to two, continuing to carry a disabled owner on the books gets to be an unacceptable expense for many small businesses.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4 Ds THAT COULD DESTROY A BUSINESS

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A disability buy-sell agreement can take care of these issues by specifying the types and amounts of insurance partners should take out to cover the contingency of health related forced retirement. It can extend to specifying disability buyout insurance to provide a means for co-owners or an outside entity to buy the interest of the disabled owner, generally over a period of years, once it is evident they are not going to return.

DEPARTURE
Partners can decide to leave for a number of reasons. They may decide to take up another opportunity or simply to take life easier. Here the issues revolve around determining what is owed to the leaving partner and where the money to buy them out is coming from.

Without proper planning, it can be a real challenge for the retiring owner to extract, as cash, the value they have locked up in the business; and for the remaining owners to compensate for his/her removal without recourse to methods that could damage the business viability. An announced departure should not trigger panic - it should trigger the provisos laid down to handle the situation in an established buy-sell agreement.

Provisos that have ensured there is an agreed procedure for dealing with the situation.

PLANNING FOR THE 4Ds
Unpleasant and emotionally charged as it may be to contemplate the 4Ds, planning for them should be an integral part of overall business and personal financial planning for business owners.

The last thing an owner needs is to be forced to sell their business in a hurry because of unforeseen circumstances or to leave their business or family in dire position when they die. Though circumstances may occur unexpectedly, that does not mean they cannot be envisaged and planed for. A succession plan, a buysell agreement, a pre-nuptial agreement - all can feed into an overall transition plan to protect the business and its dependents in the eventuality of one of the 4Ds.

For more information
contact: +353 (0)61 400 515

Email: info@ohbconsulting.ie

OHB Consulting Limited
26 Barrington Street,
Limerick City, Ireland