

John Brown:

When it comes to the transfer of the entire business, where an event happens, a sale to a third party, a death, transferring the business to the management team or the children, the spouse really needs to be involved.

Elizabeth Mower:

Hello, this is Elizabeth Mower, president of BEI.

John Brown:

And I'm John Brown, the founder of BEI.

Elizabeth Mower:

Each episode, we take you into the world of exit planning, sharing the stories, struggles, and opportunities of business owners and their advisors. We'll get into this episode's conversation right after this.

Speaker 3:

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Elizabeth Mower:

We've been talking, yesterday and today you and I have had some conversations, John, about what happens when our business clients don't think everything through, aren't able to get enough planning in place. And someone told us we were having these morbid conversations, but it's really important to talk about contingency planning and the what ifs because there's so much at stake here.

Elizabeth Mower:

That reminded me of a scenario with a business owner that I worked with several years ago, and she was a very savvy business owner, very thoughtful, and she had successfully built and sold a couple of businesses. And I came on scene as she's with her most recent business. It's growing, it's profitable, there are a lot of employees. She's just really, really an excellent business person, and really quite thoughtful, and actually naturally inclined to plan because she had seen, again and again, the real benefits that she got from thinking into the future and putting action steps in place.

Elizabeth Mower:

So the work that I did was really in thinking through bringing other top level people into ownership of the company. She wasn't really sure what she wanted to do with the business, whether to take the whole thing and sell it, or maybe to transition more ownership over time to the top management people. And she wanted to leave those doors unlocked and wait and decide, but really thought that there would be a benefit either way to having the top managers participate in ownership. This is a lot of aligning everyone's interests, getting everyone focused on growing business value, things like that.

Elizabeth Mower:

So we did a lot of work to work through, who are those people, what's a good and thoughtful and effective way to bring them into ownership. Got a lot of that done. We included contingency planning in that effort. If you're going to bring these other people into ownership, we did talk about, okay, well what if something happens to you, what would you like to have happen with this business? Where do you see it going? How will your family be affected?

Elizabeth Mower:

We do all of that planning and we get a lot of it in place, and we think that we've really actually done a pretty good job on the contingency planning side. What if you die, here's what will happen with the ownership. We've talked it all through with the top managers. They're all on board and everybody's very excited and we implement.

Elizabeth Mower:

Well, maybe a year or two go by, it wasn't that long. And her spouse calls me up and lets me know that this business owner has passed away unexpectedly. So there was an accident, and she was killed, and no one saw it coming. There wasn't an illness or anything. So no time to prepare. Very unexpected, very tragic. And now we just have to rely on the planning that was already in place.

Elizabeth Mower:

And the spouse had gone into the offices, found the documents that we had put in place, was generally aware and had really had to educate himself. By the time he called me, he had read through a lot of the documents, and there were some summaries included in our written plans and things like that, and said, here's my understanding of what's in place and what's going to happen next with the business. This is a very smart guy. So it turns out he's pretty much got it right.

Elizabeth Mower:

But the part that I found that we had completely missed in doing all of this very thorough planning was that we didn't talk to this business owner's spouse or family, when we put all of these things in place. We didn't let them know what was going to happen. She didn't even tell him where to find any of these documents or summaries or outlines or resources. So this was a spouse coming in, dealing with a lot of grief. There are children involved. There's all of these employees, this whole community is very upset by this business owner's death, and the spouse having to come in and try to piece it together and figure it out on his own. And I realized that that was something that we had really left undone and that if I had it to do again I wouldn't go exactly the same path. I would've brought the family, at least the spouse, into the picture. There really wasn't anybody who had the information that they needed to manage the process if the business owner was going to be completely gone.

Elizabeth Mower:

So documents were good, legal arrangements were good, employees and managers knew what was to happen, but there wasn't anybody to take charge, and the family did not know. And that was really a problem for them. And I regretted not having taken those extra steps.

Elizabeth Mower:

And the lesson that I learned in that case was to make sure that you've communicated planning. Doing planning is really not enough. Communicating the planning decisions that have been made, and we've talked about this before, at the right time, to the right people, communicating it in the right way, leaving written explanations as well as having verbal conversations is really important to the success of a plan. Because had this spouse not been as astute as he was, had he not thought to go in and find the documents, to find my name and number, things could have been much more difficult.

Elizabeth Mower:

And I know you've had situations with clients who have maybe successfully planned for a contingency event, and it's gone really well, and you've had clients who have not planned and things have gone maybe not as well. And how did you address these kinds of things in your practice? Either those situations where you get into a contingency event, a death or a disability, or a situation where you're able to plan for it, so that you've covered all of those bases. What was that like for your clients?

John Brown:

Well, a couple of things. The first thing, a lot of owners, when we do exit planning for owners, they're going to say, well, my wife, my husband, my kids, they're not involved in the business. They don't care about the business.

Elizabeth Mower:

They don't care. Very common.

John Brown:

It's my deal. We don't have to keep them apprised of what the heck is happening. That, when we deal with the operations of the business, the day to day stuff, absolutely is the case almost all the time. Not all the time. Sometimes the spouses are involved. But when it comes to the transfer of the entire business, when an event happens, a sale to a third party, a death, transferring the business to the management team or the children, the spouse really needs to be involved because that is a decision that directly affects the spouse and the rest of the family. It might be fairly high level just so that they have a good idea of what it is, where documents are kept, and again, part of our planning process, We have a process that does that now, that we can find all of the documents, not just the [inaudible 00:08:50] documents, but all of the important documents that relate to that person.

Elizabeth Mower:

Yeah, they need to all be together. In one place.

John Brown:

And they're all together. So that is really a beneficial thing. And I have to say I was probably guilty of, okay, you don't want, your spouse doesn't need to be involved. Okay, we'll move on.

Elizabeth Mower:

They should. [crosstalk 00:09:08].

John Brown:

Well, they soon learn that in a family transfer scenario, that was always a terrible idea.

Elizabeth Mower:

Agreed.

John Brown:

But at least from an awareness standpoint, I think your point's really well taken. We need to let at least the spouse know what's going on. I had a situation that was similar to that in many ways. We had done, as part of the planning process, we had two brothers probably in their 60s, equal co-owners of a successful company. And we did a buy-sell agreement for them, fully funded it with life insurance. And let's say the business was worth \$1 million. I don't know what the actual value was anymore.

John Brown:

So we had \$500,000 of insurance on the life of each owner, owned by the other brother. Well, sure enough, one of the brothers died. We had a fully funded buy-sell agreement at a fair market value. And so brother A, who was the survivor, paid \$500,000 to brother B's estate in return. Got the ownership of the company.

John Brown:

Case closed, thought everything was, boy, we did a good job. Everything was done right. Well, about four months later, brother A, who was a client of the law firm that I worked at, was a partner, calls up and said, I've got a real problem on my hands. I said, really? What's that? He says, it's with my brother's wife. And I said, what's the problem? Well, didn't she get the \$500,000 of proceeds? Yes, she did. So what's the problem? Well, she said, I've got \$500,000 but before my husband died, we were living on at least \$250,000 of income every year. That's gone because he died. We had S distributions of a hundred or \$200,000 a year, every year. That's gone. And all I've got is this \$500,000.

John Brown:

Buy-sell agreement worked perfectly. Didn't take into consideration the ramifications of that transfer of ownership, not just on the owner's lives, but on the lives of their spouses and maybe other family members.

Elizabeth Mower:

Right.

John Brown:

So one thing that we learn in exit planning is, as we've been talking about all along, is to take this broader view of the consequences of an ownership transfer. It's not just your client, it's not just you, business owner. It's the business, it's the key employees, it's your family members, it's the other owners, family members. We have to at least consider that, weigh perhaps the consequences and then choose to deal with it or not.

Elizabeth Mower:

I agree. Yeah. And this is in any number of cases, if we want to think through what are the consequences of selling ownership and retiring? Same issues arise. If we want to think through an unexpected death or a disability even, in which a business owner is not able to participate in the business anymore, what are the consequences for the family? What are the costs that are likely to be incurred?

Elizabeth Mower:

I know of another owner who, after a disabling event, had, I don't know, hundreds of thousands of dollars of renovations done to their house in order to make it wheelchair accessible. These are things that people need to think through and say, okay, in any of these potential scenarios, retirement, death, disability, mental issues, slowing down, getting old and tired, deciding we don't want to do this anymore, finding a buyer, not finding a buyer. What will the consequences be for myself, my family, my employees, maybe my customers, maybe my community, any kind of group or individual or entity or charitable organization that's going to be affected? Have to think all of those things through.

Elizabeth Mower:

So I will say, to circle all the way back to my client who died unexpectedly, one of the things that I maybe could have done differently, her spouse was able to connect with a competitor to the business who was a friendly competitor. So they knew each other well and knew each other's business as well, were in the same industry. And the competitor agreed to help the spouse of the deceased owner work through the process of implementing a lot of the things that we had put in place and making a few decisions that just hadn't been made or we didn't realize would come up.

Elizabeth Mower:

Had we maybe realized sooner, I probably would have identified who that person should be, asked them if they'd be willing to step in if something happens to this business owner, and on what topics and for what reasons and with what outcomes. So I think there were some maybe instructions or conversations that could have been had that really would've smoothed things out for this spouse who had quite a lot to deal with after the death of the owner.

Elizabeth Mower:

And it would not have cost anything. That particular part of it wouldn't have required any new agreements or contracts or anything like that, but it just would have been communication and conversation, and it would have made a significant difference. So in planning after that we did a lot more of that kind of thing, and I think with better outcomes.

John Brown:

Well, today in our exit planning process, business continuity instructions, not just the transfer of ownership, but what happens after the business was transferred, who do we contact, what do we need to do? That's all part of the exit planning process.

Elizabeth Mower:

Agreed, it should all be in place in a complete exit plan.

John Brown:

So even if your client is thinking of, I want to sell to a third party on Friday, which won't happen quite that quickly. It might take a year or more. We still want to deal with that loose end.

Elizabeth Mower:

Yep. Do some emergency action planning. You do disaster planning in your business all the time. We have it in our business. We have disaster recovery plan. We know what we're going to do if something

happens, if there is a terrorist attack or if there's a big weather or climate event, if there's some electricity difficulty or anything like that. So it's important to carry that kind of planning through all aspects of the business ownership and the family, so that we can be more complete. You don't have to do it all at once. You can do it in pieces.

John Brown:

It doesn't take time. And if you do it once, you want to review it occasionally, but if you just do it one time when you're doing the rest of your planning, it's a pretty simple thing to do.

Elizabeth Mower:

I agree. Updates are easy. So at the end of the day, it turns out that's why we plan. We plan so that we can get better outcomes under any circumstances. Right?

John Brown:

That's why we plan.

Elizabeth Mower:

Thanks everybody for listening.

John Brown:

Thank you.

Elizabeth Mower:

We'll see you again next time.

Elizabeth Mower:

Thanks for listening. Join us for our next episode. For more content like this, please visit exitplanning.com.