Preserving the Future of Family Businesses

2020 and 2021 were challenging years for owners of family businesses due to COVID-19 pandemic-related shut-downs, cashflow and credit squeezes, supply chain issues and the difficulties in attracting and retaining qualified workers. 2022 and beyond, however, holds much hope and promise—provided that appropriate planning is implemented.

PricewaterhouseCoopers (PwC), the international consulting firm and one of the "Big 4" accounting firms, released their 10th Family Business Survey – North American Edition in 2021*. Regarding U.S. businesses, the firm discovered that 96% of survey respondents anticipated growth in 2022, exceeding the 2021 forecasts. "When asked to name their top priorities for the next two years, family businesses list expanding into new markets or client segments (57%) as their top priority, followed by introducing new products or services (50%). The other priorities that fill out the top five are pursuing strategic acquisitions or mergers (45%), increasing the use of new technologies (43%) and rethinking or revising the business model (43%)."

Surprisingly, however, "only one-third (34%) of US family businesses say they have a robust, documented and communicated succession plan in place." Coming out of the COVID-19 pandemic, you would have expected that business owners learned that a continuity and succession plan is vital to the ongoing success of the business. PwC concluded that businesses without a comprehensive succession plan "could be vulnerable to significant risks—risks such as fractured family relationships, a successor who doesn't have the capability or credibility to lead and reluctance from external stakeholders, who may not want to work with an organization that isn't governed by a good succession plan."

A business succession plan usually includes a standalone agreement commonly known as a buy-sell agreement. Alternatively, appropriate buy-sell provisions may be incorporated into a shareholders' agreement, partnership agreement, or LLC operating agreement. These agreements address the continuity and succession of the business in the event one or more of the business owners retires, becomes sick or injured, dies, or some other event that causes a business owner to depart the business voluntarily or involuntarily. These agreements may also address situations where the business is to be sold to key employees or left to family members who are involved in the business.

A solid continuity and succession plan is required for myriad reasons. First and foremost, it reassures investors, lenders, suppliers, customers, and employees of the company's stability. A stable outlook is vitally important since no one wants to deal with or be associated with a company that has no planned future.

Since a business is often one of the largest, if not the largest asset that the business owner has, the succession plan may also help to address the owner's estate tax planning. Properly drafted buy-sell agreements may help to establish the value of the business for estate tax purposes, provided that the agreement complies with Internal Revenue Code Section 2703 and the various court cases and IRS rulings interpreting that statute.

The plan may also help to ensure the financial security of the business owner and his or her family. It is not uncommon for a business owner to rely upon the proceeds from the sale of the business for retirement income. When selling the business, however, the business owner must also factor in the loss of cash flow from salaries, dividends or K-1 distributions, that supported the owner's and family's lifestyle. Rarely does the sales proceeds fully replace that cash flow source.

Family issues may be resolved by a comprehensive continuity and succession plan. That's particularly true when one or more children are involved in the business but not all. The plan may help to ensure that the uninvolved children are equitably treated. It may also be the cornerstone of a sound estate and financial legacy plan for the children and future generations.

Of course, a plan is only as good as its funding. As a result, business succession plans are typically funded with life insurance and disability buyout insurance. A buy-sell agreement that is fully funded with insurance and triggered because of the death or disability of one of the owners is self-completing. In contrast, an agreement triggered by other lifetime events will typically rely upon the need for outside funding through loans or third-party investors, neither of which is guaranteed to be readily available or at favorable terms.

The worst-case scenario is an agreement that relies solely upon the ability of the remaining or succeeding business owners to continuously and successfully grow company revenue and profits sufficient to continue operations, make payroll, hire replacements for the departing owner, and still have enough to repay the purchase price on an installment basis.

At Security Mutual Life, our life insurance advisors are trained to work with a business owner's tax and legal advisors to properly structure and fund a business succession plan. Contact your Security Mutual Life insurance advisor today to get the process started. Your advisor will assemble your team and coordinate with your attorney and tax professional to review your situation and to determine a business succession plan that is appropriate for you, your co-owners, your business, and your family.

For More Information Contact:

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*PricewaterhouseCoopers. 2021 Family Business Survey: US Findings. An approach for lasting family business success. Pwc.com. https://www.pwc.com/us/en/services/trust-solutions/private-company-services/library/family-business-survey.html (accessed February 17, 2022).

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