

ADVISORPRACTICE

Taking the Risk Out of Business

Helping business owners manage the "Big Three" business risks

GUEST COLUMN

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In a lot of ways, owning and operating a business is all about getting comfortable with risk. From the day they make the decision to strike out on their own, business owners must confront and overcome a variety of risks almost on a daily basis.

Perhaps because of this familiarity with risk, many owners can become complacent when it comes to the bigger, longer-term risks surrounding exiting a business. But as an advisor, it is your duty to break through this casual attitude and help your clients prepare for these longer-term risks. Failure to do so could one day result in a financial crisis that destroys the years of work your client poured into the business.

In my experience working with owners and self-employed professionals, there are three long-term risks that owners tend to ignore as they go about building their businesses. I've come to label these as the "Big Three:"

(a) the premature death of a shareholder or partner;
(b) the permanent or temporary disability of the owner or partner; and,
(c) the retirement of the owner or partner.

Consider the following scenarios and questions the advisor might raise with their clients on this topic.

SCENARIO 1: DEATH OF A SHAREHOLDER

The premature death of an owner or partner can mean doom for a business. Without a proper buy-sell agreement in place, business value could be in jeopardy as well. All this can mean stress, hardship and legal hassles for the owner's family, to say nothing of employees, partners, and other stakeholders.

Questions to ask:

- Is there a clearly defined successor in place to take over in the event of a premature death?
- Is that successor ready to assume a leadership role now? Or would it be necessary to find and hire an interim or temporary leader?
- Who will purchase the deceased partner's shares from the deceased's spouse? And at what price?
- Will other owners/partners/prospective buyers have the necessary funds to make such a purchase?

Solutions to discuss:

- Urge the client to write a clear buy-sell agreement and to outline an appropriate selling procedure in the shareholder's agreement.
- Explain the benefits of a life insurance policy to provide funding for the buy-sell agreement. This will ensure the business and/or remaining partner has the funds available to buy the deceased owner's shares.
- Ensure the client's will and power-of-attorney document are coordinated with the buy-sell

agreement.

- Explore a key-person policy for the owner. This can provide the business with funds to search for and hire a replacement to take over the owner's responsibilities in the business.

SCENARIO 2: DISABILITY OF AN OWNER OR PARTNER

Disability is another serious risk to a business, particularly for younger owners, who are more likely to suffer from a long-term disability than premature death. Without a proper contingency plan, a long-term disability can result in financial chaos.

Questions to ask:

- If the disability is permanent, is there someone prepared to purchase the owner's interest in the company?
- If the interested party is a partner, is there cash available to fund a purchase?
- If the disability is temporary, is business overhead being covered while the owner is absent?
- Is the owner's income being replaced without drawing on business revenue (which could be used to hire a temporary replacement)?

Solutions to discuss:

- Insist on critical illness and disability policies for all shareholders. These policies can quickly and easily minimize or even eliminate the risk of disability, and should be the cornerstone of financial planning for business owners.
- Suggest a business overhead insurance policy, one that is specifically

designed to cover eligible business expenses while the owner/operator is unable to work. Used in conjunction with a critical illness or disability policy, a business overhead policy can allow business operations to continue in the event of an emergency.

SCENARIO 3: RETIREMENT OF AN OWNER OR PARTNER

To most Canadians, retirement is something to look forward to, but for the business owner, retirement can be a significant risk. Creditors, suppliers, key employees and other stakeholders will need to be assured about the capabilities of new ownership. Left unaddressed, these issues could reduce the value of the business, thereby jeopardizing the security of their retirement.

Questions to ask:

- Is there a clearly defined successor in place to take over when the owner retires?
- Is that successor ready to assume leadership now? Or is additional training and/or mentoring required?
- If family members will continue to be involved in the business after the original owner departs, will ownership of the company be distinct from management of the company? If so, how?
- Have creditors, suppliers, bankers, managers, and others been informed of the succession plans?
- Does the owner intend to maintain a role in the business after retiring?

Perhaps as a part-time employee or consultant?

- How will the owner's retirement be funded?
- Are there retained earnings "trapped" in the corporation?

Solutions to discuss:

- Urge the client to write a formal succession plan.
- Encourage open communication of that plan with family members and other significant stakeholders.
- Explain the benefits of a corporate-owned life insurance policy. Insurance proceeds received by a private corporation on the death of the life insured can be credited to the corporation's capital dividend account (to the extent the proceeds exceed the policy ACB immediately before death). The corporation could then distribute tax-free capital dividends to its shareholders, up to the balance in the capital dividend account. This is an extremely attractive strategy.

In a lot of ways, the key for the advisor is the shareholders' agreement. Understanding the terms of the client's agreement can help you deliver value to business owners. Working as a team with your client's accounting and/or legal advisors, you can formulate a winning solution that protects your client's wealth for the long term. **AER**

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