Continuing the Business
Providing the Cash
By Bill Brumett PE, LUCF
President, *NewLife Marketing*, an Agency Building Company

"Mr/Ms Business owner, if your partner dies do you realize his/her spouse will be your partner? Is that something you will be excited about?"

Few business owners have given much thought to what will happen to the business if they or an associate dies or becomes disabled. The death or disability of a business owner has an immediate and drastic impact on the owner's heirs, the surviving owners, the business and employees. If they do not have a plan, these interested parties will face significant uncertainties and problems without the guidance of a deceased owner.

The heirs must decide whether to:
- Sell to surviving owners. At what price? Where do the buyers get the money?
- Retain the decedent's business interest and participate in management of the company. Are they qualified? Will there be conflict with the remaining owners? Will there be sufficient income to pay them and at what salary.
- Sell the business to an outsider. Is there a buyer? How can the value of the business be determined?

The choices the surviving owners face include whether or not to:
- Continue the business with the heirs as co-owners. Are the heirs knowledgeable about the business? Are they experienced, motivated or compatible?
- Buy out the heirs. At what price will they make the purchase and where will the surviving partners get the money?
- Sell out to an outsider. At what price? Where will they find a buyer?

The death of the owner means the company also suffers a loss of key management talent. How will this talent be replaced and at what cost? Banks and other creditors may restrict credit lines until heirs and/or the surviving owners can demonstrate their ability to run the company successfully. Can the business survive such a liquidity crunch? Employee morale may be impaired. Customers may turn to competitors. Employees and customers need assurances.

The Solution
The best way to avoid these problems is through an insured buy-sell agreement that provides cash to the decedent's heirs for the business and gives the surviving owners complete ownership as well as control of the company.

For the heirs the agreement provides a qualified purchaser, a fair price, cash to buy out the heirs, reduces time needed to settle, and provides cash to the heirs when needed most.

The surviving owners are assured full management control of the company because the heirs must sell to them instead of outsiders. The credit issues are resolved, since creditors are assured the continuation of the business will be fully funded.

There are three alternative to fund financial obligations at death. They are:

1. Life Insurance
2. Cash
3. Borrowed Funds

Using a financial evaluation method called "Discounted Dollars", it is possible to compare the three strategies mathematically in order to establish the preferred choice.

Life Insurance
With life insurance, the sum of the policy's premium, divided by the policy's death benefit, gives a "cost-per-dollar-of-benefit" solution that is useful when analyzing the insurance option.

For example, if the premium for a $100,000 life insurance policy is $1,200, the Discounted Dollars calculation divides the $1,200 by the $100,000. The result of 1.2 cents indicates in the first year for each $1.00 of benefit the cost is 1.2 cents.
Each year can be calculated using this formula.

Cash and Borrowed Funds
In all years, $1.00 of cash costs $1.00. Furthermore, each $1.00 of borrowed funds costs more than $1.00 due to interest.

Conclusion
The study will show that life insurance is consistently the most efficient mechanism for funding the dollars required. Life insurance funding leaves existing assets intact for heirs and the buy-out occurs as predetermined, with no lingering disputes or further incurrence of debt.

Final Comments
Without a funded buy-sell agreement a company will be faced with challenges that may spell disaster in the future. With a funded agreement all parties can get on with their lives when death of a partner occurs without a cloud hanging over them.