Business Succession Planning

By Angie Smucker, Founder, CTI Insurance

When a company is investigating vendors, preparing to do a significant amount of business with the right vendor, there’s usually a set of criteria for that final selection. Price, quality, service, warranties, reputation, location, and financing are most of the factors that go into important decisions between businesses. But, another important factor is the contingency plan that should be in place to ensure a business’ continuing ability to fulfill its contractual obligations when and if the business owner or a highly valued employee becomes disabled or dies. This contingency plan is called a “Business Succession Plan.” Proper planning involves a written agreement but it also involves funding of the plan. Without a written agreement, the plan is nonexistent. Without funding the written agreement, the plan is ineffective.

Let’s use a hypothetical example of a local business with 100 employees. The name of the company is Acme Explosives, a c corp, and the face of the company is James, the CEO. He’s not a “behind-the-desk” kind of guy as he meets and solicits business just as much as anyone else at the company. Many of their clients only do business with James and virtually everyone in the local business community has met him. If James were to die or leave, the company could be devastated. Replacing him would be time consuming, costly, and could take months.

The executive team at Acme wants to keep James with the company, rewarding him so other companies are not likely to attract him. They talk with three recommended financial advisors about establishing a succession plan that will serve several purposes including:

1. To encourage James to remain with the company until his retirement.
2. To fund the necessary costs to replace James in case he leaves or dies unexpectedly.
3. To provide for James’ family to demonstrate that he is an important part of the team
4. To add to James’ retirement fund in a way that rewards him now and into the future.

After interviewing the financial advisors, the executive board of Acme selects Michelle Michaels CLU ChFP, LUTCF, to provide guidance. Michaels has been a financial advisor for more than 10 years and specializes in business services and qualified plans. She works with a few large life insurance companies. After answering some questions, the board receives her recommendations and a business succession plan template. The ABC Life Insurance Company is financially strong and their attorneys provide a template for the plan, designed specifically for Acme that serves several purposes, at no cost to Acme. When Acme agrees to do business with Michaels and ABC, the template is theirs to take to their own attorneys. Using the plan template will drastically reduce Acme’s legal costs and expedite the process for the executive board. Michaels and ABC recommend a $1,500,000 whole life insurance policy. Here’s why:

If James stays with the company to retirement:

A. His retirement will include the $500,000 cash value accumulation in the life insurance policy. This is referred to as his “golden parachute”.
B. Acme will receive $250,000 cash value to fund finding a replacement and paying James a consultant fee for 2 years to train the replacement.

If James is killed accidentally before retirement:

C. His family receives a $1,000,000 death benefit. This shows James and his family that the Acme executives sincerely care about them. This is referred to as “golden handcuffs”.

D. Acme receives a $500,000 death benefit to fund finding a replacement and to replace lost income from clients who may leave because James is no longer representing the company.

All involved parties meet and hammer out the details of the plan. When she gets a question that cannot be easily answered, Michaels makes a conference call to the ABC attorneys for more guidance. After two hours of discussions, during which they also had lunch, the final details are approved.

Michaels takes a life insurance application with James and schedules his medical exam. Knowing about James health and history enables Michaels to project the monthly premium at $300. Following Internal Revenue Service rules for corporate owned life insurance, the payroll service must show $50 of additional monthly income for James but the company also gives him a raise which equals almost exactly his additional taxes. Finally, James can let his family know that they will not be relocating. His stress level is reduced and he becomes even more effective as the face of Acme than he was previously. And, James’ wife is convinced that her husband and her family are exactly where they need to be.

This is a basic explanation of Business Succession Planning and it can be adapted for an infinite number of choices a company and it’s highly valued personnel may make. In addition, similar opportunities exist to protect a company and its employee in case of a disability. Whatever situation may feel unique to a company, to a business owner, and to an executive board, there are solutions available when asked. Your experienced financial advisor and insurance companies are waiting for you to communicate your concerns so they can design a solution that fits your unique needs.

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