

7 Gaping Holes in Business Continuity Plans

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A business owner tells her [Exit Planning Advisor](#) that she has a Buy-Sell Agreement. After signing it, she checks “solve business continuity problems” off her list and resists the Advisor’s request to review the agreement. She sees the request as a thinly veiled opportunity to generate fees. This Advisor knows that too many of these agreements create more problems than they solve and only partially solve business continuity problems. So, why is it important to constantly update Buy-Sell Agreements?

Let’s start with a quick review of the seven most common holes in a typical Buy-Sell Agreement.

Hole 1: Ignores Threats to Business Continuity

Most Buy-Sell Agreements don’t address the challenges that the business, surviving owners, and deceased owner’s family will face after an owner exits. They only address the transfer of ownership upon an owner’s death or permanent incapacitation. For example, if the surviving owner does not have enough assets to satisfy the [personal guarantees](#) previously made by the deceased owner, once that financing is pulled, the business may not be able to continue. Likewise, if the deceased owner was the company’s rainmaker or COO and no one can [step into those roles](#), the business may be unable to survive.

At best, a Buy-Sell Agreement dealing with the transfer of ownership at death (and sometimes permanent incapacitation) only ensures that (a) the surviving owners own all of the company and (b) the deceased owner's estate receives fair value, in cash, for the transfer of ownership. It leaves other major issues unaddressed.

Hole 2: Ignores Common Lifetime Exits

Does the agreement [cover an owner's lifetime exit](#)? An owner's incapacitation, divorce, bankruptcy, termination of employment, or retirement, along with business disputes among owners, can trigger the need to transfer ownership and are more likely to occur than the death of an owner. Most Buy-Sells fail to consider these conditions.

Hole 3: Neglects the Decedent's Family

Most Buy-Sell Agreements focus exclusively on the benefits they provide to the surviving owner rather than on providing for the [needs of the decedent's family](#). Even if the deceased (or incapacitated) owner's family receives Buy-Sell proceeds for the full value of their loved one's business interest, that amount is rarely enough to support the family at the same level as did their loved one's lifetime income. The fundamental Exit Goal for every business owner (i.e., maintaining financial security after exiting the business) is rarely achieved from the proceeds received via a Buy-Sell Agreement.

The financial shortfall for the deceased owner's family is caused by the transfer of ownership (and with it the right to a continued stream of income from the business) and the loss of the deceased owner's compensation. Buy-Sell Agreements aren't designed to address these problems. In fact, they can cause more problems because the decedent's income rights end after the ownership transfer. The [question that advisors must ask](#) and help owners resolve is, "If you die, what will replace your income stream for your family?" There are many possible answers to this question that may involve restructuring the Buy-Sell Agreement.

Hole 4: Isn't Up to Task

Many Buy-Sell Agreements are [too simplistic](#) to manage the personal complexities of the individual owners who sign them and their relationships with each other. For example, companies with multiple owners often don't want to treat all owners similarly, or one owner subject to the agreement may be uninsurable. In family businesses, non-business considerations may affect the design of Buy-Sell Agreements.

Hole 5: Cookie-Cutter Valuation Formula

The valuation methodology (e.g., agreed-on value or book value) is too simplistic. While such a formula may be adequate when a business first forms, it does not adjust sufficiently to account for business growth.

Hole 6: Outdated

Buy-Sell Agreements may not have sell-by dates, but they should. When they lie at the bottom of dark drawers, un-reviewed in the context of current business circumstances and the changing desires of owners, they can yield ugly surprises. Owners rely on Buy-Sell Agreements to manage emotionally charged situations, and if those agreements don't account for changes in the business, they cause huge problems for everyone involved.

Hole 7: Poorly Implemented

If insurance funding is lacking or insufficient, or information about the beneficiary and ownership of insurance is incorrect, there is no way that the agreement can serve its purpose.

How Advisors Can Help Owners (and What Owners Can Expect)

1. When advisors offer to review an owner's Buy-Sell Agreement, they should describe the gaping holes that they think might exist. Advisors should offer a "second opinion" on the suitability of any existing Buy-Sells. This will allow owners and their advisors to begin addressing holes, putting the owner in a better position to plan.
2. [Using questions to frame the discussion](#) of the buy-sell review provides a terrific gateway to an owner's Exit Planning goals. For example, advisors might ask, "Have you given thought to someday leaving your business?" If the owner answers, "Yes," the advisor may ask, "How much income do you want post-exit?" If the conversation moves forward, advisors can get into deeper questions, such as, "If you died today, would the proceeds from your current buy-sell plus your existing personal assets allow you to reach your post-exit income goals?"
3. Even well-drafted agreements are often drafted too narrowly (e.g., trigger events include only death and perhaps incapacity) and do not consider all, or even the most likely, transfer scenarios. Advisors can explore and help [create effective solutions](#) in such situations.
4. Owners generally do not consider the consequences they face if they become the surviving owner. Thus, for any owners who co-own their businesses, advisors should discuss what each owner wants to happen if either owner exits, whether voluntarily or otherwise. Advisors may find that the remaining owner does not want to be a sole owner, which is fertile ground for a frank discussion about Exit Planning for all involved.
5. Because comprehensive continuity planning involves professionals not ordinarily consulted in the preparation of Buy-Sell Agreements, owners must have the following collaborators (and potential referral sources) on their Advisor Teams:
 - Exit Planning Advisor
 - Valuation expert
 - Business consultant
 - CPA
 - Financial planner

Conclusion

Buy-Sell Agreements, at best, provide partial solutions for surviving and deceased owners (and their families). Few owners are aware that even well-drafted agreements (a) only provide a partial replacement of the deceased owner's income stream or (b) protect the business from the loss of the personal guarantor (or the owner indispensable to business operations).

Buy-Sell Agreements typically focus on the death (and perhaps incapacity) of the owners and ignore the likeliest transfer event: retirement or another lifetime departure for one owner.

We will discuss each of these holes in future articles. Watch for case studies that will illustrate how using The BEI Seven Step Exit Planning Process™ highlights the challenges and crafts solution.

