



Mary Hanson



About the BusinessAdvisor

The Business Advisor is written and published by Mary Hanson, a business attorney in Torrance, California.

Mary Hanson has a law degree from the University of Wisconsin and an MBA from the University of Southern California. She has practiced business law exclusively for more than 30 years.

She provides legal services related to owning, operating, buying, selling, and structuring businesses. Her clients are business owners in many different industries. She handles corporations, LLCs, new businesses, new ventures, and a broad range of contracts and business decision-making.

Her interests include flying and World War II.

Her law office is located in the Del Amo Financial Center, 21515 Hawthorne Blvd. #885, Torrance, California. She can be reached at (310) 543-1355 or by e-mail at mhanson@bizadvisor.com

BUSINESS PLANNING: BEYOND THE DEATH OF THE OWNER

by Mary Hanson

Can you plan for your business to survive you? Can you improve the likelihood of survival and a smooth transition after your death?

If you own a business you owe it to your heirs to develop a plan for continuation or disposition of your business in the event of your death.

You as the business owner need to assess whether the business can continue without you. You are probably in the best position to determine whether the business can continue without you, and, if it can't, to recommend how the business should be sold in the event of your death. You are also in the best position to determine what key changes would be necessary to enable the business to continue without you.

No matter what the circumstances are, the business owner should have a plan, and this plan needs to be communicated to the heirs or trustees who will be charged with taking action upon the death of the owner.

Spouses and successor trustees often do not know what to do with the business without guidance from the business owner. They lack the necessary knowledge of the business, of the business plan and the key challenges, and of key employees, professional contacts, and industry contacts.

Key employees may have the necessary knowledge of the business,

but may not be consulted adequately in the event of the business owner's death. A key employee typically has no idea what to expect after the death of the owner and doesn't know what his or her future prospects with the company are. The most capable and key employees of a business are the most likely to leave after the death of the owner, whether due to being solicited – recruited by competitors – or due to the employee's desire to seek a more secure employment environment.

If a business does not have the ability to survive without the business owner, the heirs or successor trustee must be made aware of this. Solid advice regarding sale of the business must be set out for the individuals who will have control over the business assets in the event of the business owner's death.

The successor (ideally the trustee of a trust holding the business stock or assets) must be aware of the importance of selling the business immediately and made aware of the key contacts for doing so.

Many small businesses fail to generate the value they might have upon the death or disability of the business owner, because the value was allowed to deteriorate between the date of death or disability and the time the trustee finally acted to sell the business or dispose of the assets.

By the time the trustee is ready to take action, little value may remain. Even if the business has not been closed, if

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customers and employees have departed, the business value is impaired.

A business almost always has a greater value being sold as “a going concern” rather than being sold as a liquidation of assets. If there is still activity in the business and employees are able to continue generating revenues, there is greater value in the business as a whole. An operating business supports the value of all the assets, including the telephone numbers, customer lists, websites, and trade names, as well as the value of the stream of income. If the business has closed, the business loses value and the the sale of the assets typically generates much lower dollar amounts. A business that generates good profits should have a significantly higher value than businesses that don’t, but it is all the aspects of a particular business and a potential buyer’s expectation of being able to utilize the tangible and intangible assets profitably that determine what a buyer is willing to pay.

Profitability is key to the viability of a business without the business owner. If a business is not generating profits, there must be a determination of where funds will come from to cover losses (and for how long).

The Importance of a Trust in the Event of Death

A trust serves a valuable purpose in the control and management of a business after the death of the business owner. Quite separate from any tax or estate planning benefits, a trust is very valuable in providing a successor trustee all the powers he or she needs to take action regarding the business. Because the trust owns the corporate stock (or assets), there is no change in

ownership. Only the trustee changes in the event of the business owner’s death.

The trustee normally has all the powers necessary to sell the assets or make necessary changes in the business or management. The most common situation is that a business is operated as a corporation and the corporate stock is held by the trust. If the corporation is owned by one individual or a couple (with no other shareholders or directors), upon the death of the key person, the successor trustee merely needs to name himself or herself as the director to replace the deceased individual and to name himself or herself as an officer to replace the deceased individual in any vacant offices. The trustee should be advised that he or she will need to take these steps.

Note that if the business interest is a minority interest, the trustee continues to control that interest but typically lacks the power to make changes in the Board or the officers.

If there are other shareholders and directors, but the trust holds the majority of shares, the trustee typically has all the power necessary to change the officers and directors of the corporation. However, the successor trustee needs to be briefed on how to do this in compliance with the corporate by-laws and state law. Here are some of my recommendations for the successor trustee:

1. Hold a shareholders meeting to remove the old Board of Directors and name a new Board of Directors. It may be necessary to give formal notice of the meeting to shareholders who otherwise would not attend, in which case the notice needs to strictly comply with the

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corporation's by-laws and state corporation law.

2. Hold a Board meeting to elect new officers (filling the offices of President, Secretary, and Treasurer). You will need these properly elected officers in order to take action on behalf of the corporation. This step is often needed just to make changes in the signature authority on bank accounts.

3. Have the Board authorize the sale of the business, if that is the plan.

4. Take steps to sell the business, if that is the plan, or take steps to continue the business, if that is that plan.

If the successor trustee's plan (which should be the same as the key business owner's plan) is to continue the business, it is important to communicate this to employees, customers, vendors, and others. Without adequate communication about the continuation of the business, confusion and insecurity can lead to a loss of value and ultimate closure of the business.

Employees and others will need to have confidence in the proposed business, in any new management, and in the decision-making and leadership of the successor trustee. Employees, customers, vendors, and others may still desert the business if their needs are not met.

Getting a business back on a successful track after the death of the owner is normally difficult and challenging. The business must be profitable and it must have continuing customers, continuing vendors, and employees who can and will continue to run the business profitably. If the business requires a contractor's license, a replacement employee holding the necessary license must be

hired in a very short period of time. Other employees may be needed to fill gaps left by the loss of the business owner. Bringing in new employees (as well as keeping existing employees) in this environment can be difficult. Even with replacements hired, will the business really have anyone with the necessary vision and leadership for successful operation of a small business?

The business owner who wishes to have his or her business continue after his or her death needs to build the business with that goal in mind, and needs to effectively communicate elements of the plan to trustees, employees, vendors, and others whose co-operation and support would be needed in the event of the owner's death.

Need for Oversight

After the death of a key owner, successful continuation requires additional oversight. It is imperative that someone with a financial background reviews the business financial information on a constant and timely basis for signs of decline or difficulty.

The organization will be lacking the oversight of the key deceased owner. It will be missing that person as a leader, and it will be missing other attributes of that individual in ways successors may not recognize. The belief that the company is viable without the key person may be in error.

The financial results are likely to evidence decline at the early stages, provided that someone capable of detecting changes in the condition of the business is closely monitoring financial statements and other financial information for telltale signs of decline. By discerning the weaknesses in the business at an early

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Publisher's Note

It is important to note the need for internal controls. Many owner-operated businesses have inadequate internal controls, with the business owner providing a type of oversight and acting as a double-check on bank accounts, payment processing, and other financial matters. Without that key person, good internal controls are of utmost importance.

The truth is that most small businesses are in need of much better internal controls even before any death, disability, or reduced involvement of an owner. The internal controls are essential for the business to have viability after the death or disability of the owner. Internal controls are necessary not only to prevent fraud when the business is in a vulnerable situation, but also to minimize errors and inefficiencies that can mean the difference between profitability and struggling to survive.

Without good internal controls and reliable financial information, it can be difficult for successors to monitor the business performance and continue to assess the need for changes in the business.

Mary Hanson
Attorney/Publisher

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stage after the death of the owner, it should be possible for the successor trustee to make necessary changes in order to continue the business or to change the plan and seek a sale of the business.

Each business is different. Any plan really needs to be the plan of the key people who really know all aspects of the business. The changes in the legal structure depend on the type of entity. If the entity involved is an LLC, the key source of information for the plan is the Operating Agreement. It may be necessary to modify the Operating

Agreement to facilitate a change in control upon the death of the owner. For a corporation, the corporate details will vary depending on the number of shareholders, the number of directors, and the number of shares held by the different shareholders. By considering the business and its corporate structure and preparing a clear plan, the challenges for the business owner's heirs or successor trustees can be minimized. The valuable expertise of the business owner can benefit the business even after the business owner's death.

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FROM THE LAW OFFICE OF MARY HANSON

21515 Hawthorne Blvd. • Suite 885 • Torrance, California 90503 • (310) 543-1355

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