DELAUNAY wealth

Managing risks within your business

How would your business cope with the loss of a key person shareholder?

The basics of business risk management and protection

Legal and General tell us there is a £1.1 trillion business protection gap and this is one of the major potential areas for concern for owner managed business (OMBs). Managing all the risks and fully protecting a business is often thought to be lengthy and complicated. But actually, the principles are similar to any other type of risk management.

Clearly there are many business risks but these are the main ones to consider:

- The loss of key individuals having a serious impact on your profits
- Covering all of your business borrowings
- Succession planning or the death or incapacity of a business partner

A business protection strategy could help a business continue in the event of a key person, partner or director falling terminally or critically ill or dying.

What is Key Person Protection?

It's simply a company insuring itself against the financial consequences it may suffer as a result of the death (or critical illness, if chosen) of a key team member. Key people are the individuals whose skill, knowledge, experience or leadership contribute significantly to the company's profitability and continued financial success.

A key person may be one of a number of people within a company, such as the chairman, managing director, marketing manager, computer specialist or sales manager – anyone whose death could lead to a serious financial loss for the business.

How does it work?

The business is the owner and the policy proceeds, if payable, will be paid to the company as replacement profits. The company then uses the proceeds to work its way through the loss of that key person.

Whether or not the premiums will be tax deductible, or the proceeds taxable, will very much depend upon the circumstances for each individual business and we would recommend considering this aspect closer with your tax advisers before finalising the policy.

What is Shareholder Protection?

The loss of a partner or director will often de-stabilise a business and can quickly lead to financial difficulties.

Partner/Director Share Protection means if the worst does not happen, the remaining directors or partners have the necessary finance to stay in control of the business. This gives them the chance to re-structure and manage relationships with the bank, creditors, supplies and key customers.

How does it work?

In the event of a partner or director dying, falling terminally or critically ill, Partner/Director Share Protection can provide a sum of money to the remaining partner(s) or director(s). This means that in the event of a valid claim, the policy could pay out an amount sufficient to purchase the deceased or critically ill partners/directors interest in the business. This secures the interests of the remaining shareholders without putting the future of the business at risk. In addition, the surviving family of the deceased have converted shares in a company, that they have little understanding or involvement in, in return for cash which is likely to be much more appropriate for their needs.

"Effectively it puts money in the right hands at the right time – when it's most needed"

Case Study – Shareholder Protection

Here we examine in simple terms how shareholder protection with "cross options" might work.

The company

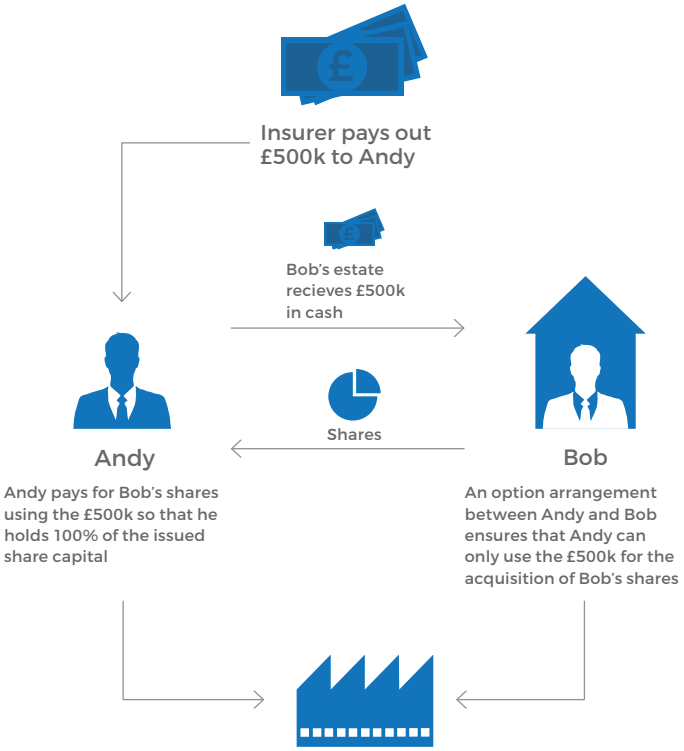
AB Controls Limited is a thriving electronics business with two equal shareholders Andy and Bob. Both are married with families and rely on the income generated by AB Controls Limited. The company is thought to be worth £1m.

The scenario

Bob dies and the insurer pays out £500k to the policy holder Andy. Under the terms of the option arrangement Andy is require to use this cash to acquire Bob's shares from Bob's estate. This leaves Andy with full control of their business, and Bob's estate has cash rather than shares in the business.

The benefits

Without this structure Bob's estate (i.e. family and loved ones) would be left with an asset they may not understand and with no cash during a period where cash may be needed. In addition, Andy would be in the position of having to work with another major shareholder (Bob's wife Sue, for example). She may not be interested or alternatively, might wish to take the business in a different direction – but without the funds to buy Andy out.



What can Delaunay Wealth Management do?

- Advise you on the most appropriate policy to be fully underwritten
- Work with your tax advisors to undertake a business valuation for these purposes
- Ensure the Business Risk Plan is regularly updated to reflect the value of the business
- Introduce you to a legal firm experienced in drafting the documents to go with such a transaction

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