THREE STEPS TO SUCCESSFUL CONTINUITY PLANNING

Continuity planning is not just a "best practice"—it is a must practice for independent advisors in order to protect the equity of their businesses in the event of an emergency.

KEY POINTS

1. *The first step of successful continuity planning is to complete a formal valuation. The valuation process and the results are essential to implementing a plan that can be properly set up, funded and executed.*
2. *The best continuity plans rely on internal business partners or key employees for protection; if at all possible, consider setting up an internal ownership track for this purpose*
3. *One of the key benefits of establishing an entity structure (such as a corporation or LLC) is the ability to have minority owner/partners who can best address the challenges of a founding owner's temporary disability event.*

Millions of dollars of clients' assets under management and their related income streams often revolve around only one person: their independent financial advisor. If the advisor dies—or, what is far more likely, suffers a temporary or permanent disability—without a continuity plan in place, then the advisor's clients will have no one to serve them. The trust that has been painstakingly built over the course of a career can be lost in a heartbeat. The clients will have no choice but to find another advisor on their own, and will take the cash flow and equity value of the advisor's business with them.

A sound continuity plan can prevent these unfortunate results using a variety of sophisticated strategies: (a) the plan can transition the disabled or deceased advisor's clients, value and ownership to one or more business partners within an ongoing business enterprise; (b) the plan can trigger an expedited sale of the business to a designated third-party buyer upon the emergency event, or to a "best match" buyer located using a competitive, open market listing approach, or; (c) it can provide for a third-party advisor whose role is to temporarily manage the business in the event of the advisor's temporary disability, permanent disability, or death, until the founder returns to work, or a third-party successor can be put in place.

There are three steps that advisors need to take to set up an effective continuity plan: (1) Valuation; (2) Contract Execution, and; (3) Funding. Even if this is the first time that you have seriously considered setting up a formal continuity plan, you can learn about the basics and execute a successful continuity plan for your financial services practice by utilizing and building on the foundation outlined below:

VALUATION

In order to protect the equity of your business, you need to know what that equity is by the use of an accurate measurement tool - namely, a professional valuation. The endgame strategy of a continuity plan includes, among other things, the realization of the business's equity value in a sale to the best qualified internal or external buyer. Although finding a buyer may seem like an easy task—financial advisory businesses sold on the open market through FP Transitions receive an average of 50 buyer inquiries—finding a qualified buyer is what matters. The process of selling to a business partner within an existing entity or enterprise structure is usually much quicker and easier, but, ironically, the foundation often takes many years to successfully establish in advance of a continuity event. (See FP Transitions' study entitled Building a Business of Enduring and Transferable Value.)

The most decisive factor in determining whether a buyer is qualified to purchase a seller's business is the size and quality of the buyer's business as measured by its equity value. A larger business—usually 1.5 to 2 times the size of the seller's business—is always a preferable buyer, especially in an emergency sale. Larger buyers are more likely to have the capacity to take on new clients and key staff members. For that reason, they present less transition risk and a greater likelihood of a successful deal for both parties. The best way to determine these metrics is to compare valuation results (as well as the valuation inputs, such as revenue sources, client demographics, payroll expenditures, profitability, etc.). In continuity plans that involve a sale of the business to an internal buyer, a valuation serves the basic but necessary function of determining an authoritative and objective sales price that is fair to both parties.

CONTRACTS

Once you have valued your business and used the results of your valuation to identify a suitable continuity partner, you and your continuity partner will need to agree upon a continuity plan. It is important that you put your continuity plan in writing, and draft and execute it so that it is legally binding. FP Transitions offers the following types of formal, legally binding continuity plans:

Buy-Sell Agreement: *In this agreement, the seller commits to sell the business to the buyer, and the buyer commits to purchase the business from the seller, upon the seller's death or disability.*

Enterprise Agreement: *Used by corporations or Limited Liability Companies (LLCs), an enterprise agreement controls the disposition of the owner's interests in the business upon death, disability, or termination of employment. It is a streamlined document—one contract that applies to all of the owners of a single business.*

Guardianship Agreement: *A guardianship allows a third-party advisor, or "guardian," to manage an advisor's practice temporarily in the event of the advisor's disability. The guardian provides and is compensated for the service until the advisor is able to return to work, or until the practice can be sold to a third-party.*

Practice Emergency Program (PEP): *This is a service exclusive to FP Transitions. Advisors who have not identified a suitable buyer for a buy-sell agreement can enroll in the PEP and permit FP Transitions to sell the advisor's business on the open market upon the advisor's death or disability to the best qualified successor.*

Keep in mind that continuity planning is a dynamic process, and that the three steps mentioned here need to be regularly observed and evaluated over the life of the plan – all part of an equity management system. Continuity Agreements should be reviewed and re-executed every 12 to 24 months.

FUNDING

The third and final step can determine the ultimate success or failure of your plan. Buyouts pursuant to continuity plans are often seller-financed on promissory notes for an extended period of time (5 to 8 years) because of the circumstances of the transition. The process can be significantly aided by proper funding mechanisms. For buyouts triggered by death, a life insurance policy held by the buyer on the seller can be an effective option for funding either a down payment or the entire purchase price. Lump sum disability insurance is also an option for buyouts triggered by disability, but the policy is generally aimed at providing a significant down payment (relying on the acquired cash flow to pay the balance).

Finally, a formal valuation is the best method for determining the amount of insurance coverage needed to support the continuing planning process (consider both life insurance and lump sum disability insurance).

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