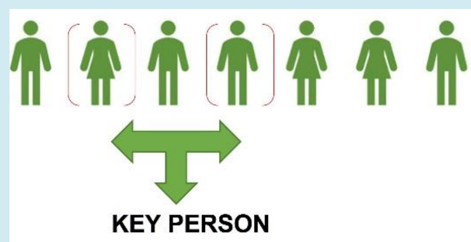
MADELEINE BRITZ
LEGAL ADVISOR ADVANCED | PERSONAL FINANCE LEGAL

FABASA

"If we lose the people we love, the way to have them live on is to never let their dreams die with them.

André Diederichs

&



PROTECT YOUR FAMILY BUSINESS AGAINST THE LOSS OF A KEY PERSON.

André Diederichs shares his experience and a solution from MADELEINE BRITZ, PERSONAL FINANCE LEGAL, of Old Mutual

FAMILY BUSINESS TIPS

CAN YOU PROTECT YOUR FAMILY BUSINESS AGAINST THE LOSS OF THE OWNER, SUCCESSOR OR OTHER KEY PERSON?

What happens to your family business if a key person, who may be the existing owner-manager, or another key person, dies or cannot continue working because of an unforeseen disability and there is no immediate successor available?

Succession planning needs to address all life events and not only who will succeed when the family business owner retires and hands the management over to the incoming generation. Consider the following scenarios:

SCENARIO 1

I compiled a succession plan for a family farmer in the Western Cape. At that stage, his son (successor) was ten years old. I asked him what will happen if he dies today to preserve the family farm for the incoming generation? He looked at his wife and replied: "Well, my wife will have to take over the management of the farm." His wife's reaction was: "Are you out of your mind? I know nothing about farming!"

SCENARIO 2

I also learned the importance of a plan B years ago in Pretoria. It was an easy succession plan because the client's financial adviser structured his business in a tax-efficient manner. His oldest son, who will take over the management of the family business, was already involved in the business. A week later, his son died tragically in a motor car accident.

Both examples taught us you must always have a plan B in place. This is vital to safeguard your business for future generations if something happens to the owner-manager or his/her successor. In both examples, we then identified a competent person who could take over the management of the family business until a competent blood relative becomes available to take over the reign of the business again.

The lesson is obvious. A family business does not have to collapse if a blood relative is not immediately available. However, plan for such an event and plan for the cost of finding and appointing a professional manager in the interim.

I spoke to MADELEINE BRITZ, Personal Finance LEGAL ADVISOR, of Old Mutual to learn how their industry offers a solution for the above scenarios, through KEYPERSON INSURANCE.

QUESTION:

Madeleine, family businesses face many risks. One risk is if a family business loses the owner-manager, successor or another key staff member. How does a business determine which staff members are key to the continued success of the business?

ANSWER:

A key person is usually an individual who is important to the generation of profits and the sustainability of the business or the company. A key person can therefore be best identified given the financial risk that will materialize if the person is no longer part of the business or the company.

QUESTION:

I believe that you have a solution for a business to safeguard itself against the loss of a key person. You refer to this solution as keyperson insurance. Please explain this solution.

ANSWER:

The purpose of keyperson insurance is to compensate the company for any financial losses it will sustain when a key employee, or similar key person such as a shareholder, member, director or another employee, collectively referred to as a key person, was to die or become permanently disabled. The proceeds of the policy may be used to absorb any disruptions to the company, protect credit facilities, and provide funds for the training of a replacement or to recruit/appoint a replacement.

The company will be the owner of the policy, will pay the premiums and will be the beneficiary of the proceeds, with the employee being the insured life.

QUESTION:

How do you determine the value of the key person? Is there a formula or how does a business determine the amount of insurance they need to replace a key person?

ANSWER:

Three possible methods can be applied in establishing the value of a key person:

- Five to seven times the annual salary of the key person; or
- The time (in years) it will take for a replacement to reach the person's present level of profitability multiplied by the loss in profits due to the replacement of the key person, or
- Itemizing the cost of replacing the key person, given the direct cost of replacement (e.g., advertising, resettlement etc.) and how much the person contributed to net profits.

A qualified financial adviser can do a financial needs assessment at no cost and will suggest the best way to address your needs. The adviser can offer a policy that keeps pace with inflation so that if you pass, suffer from a severe illness or get impaired, the payment benefit will be enough to cover your business and those left behind.

BEWARE!

Losing a Key Person can be detrimental to the sustainability of family businesses. It is therefore vital to plan for all possible life events, because **IF WE FAIL TO PLAN, THEN WE PLAN TO FAIL.**

For more comprehensive financial advice, contact your financial adviser, call 0860 60 60 60, visit Old Mutual's website (www.oldmutual.co.za/business) or email rgrobler@oldmutual.com

Disclaimer

The material is not intended as and does not constitute financial or any other advice. The material does not take into account your personal financial circumstances.

For this reason, it is recommended that you speak to an accredited broker or financial adviser to consider all your options and draw up a plan to achieve your financial goals.