THE 5 D'S

Did you know that 58% of business owners lack a written transition plan, and 9% have made no exit plans at all? [1] Moreover, approximately 50% of all business exits are involuntary, driven by sudden external factors.[1] Having a robust plan in place is crucial to help protect your business as well as mitigate potential impact on your family's future.

Owners need to plan for how they want to walk away from their business not only in a perfect scenario, but also in a worst-case situation. Throughout the exit planning process, it is critical to consider the following scenarios that force owners to exit their business hurriedly, and often leaving value on the table. **They are often referred to as the 5 D's:**

- **Death**
- **Disability**
- **Divorce**
- **Disagreement**
- **Distress**

We often think that a will addresses the needs upon the death of an owner. If your partner or spouse passes, do you have the ability to continue their job at the level they were performing it? If you're put in a position where you need to stay home to take care of a suddenly sick or disabled family member, what will happen if you are forced to exit your business due to your inability to come into work?

It is important to address the tough questions about what you want to happen to your business if you have to exit your business prematurely. Statistics have shown that in the four years following an owner's death, sales declined 60% on average and employment fell 17%, resulting in a decrease of the overall valuation of the business.[2] Additionally, two years after an owner's death, firms are 20% more likely to fail or file for bankruptcy.[2]

It is important to have a plan in place to help reduce the risk of these issues happening to your business in your sudden absence.

What do you want your family, clients and management team to know? What do you want to happen if you were to die or become disabled? What should happen if you or your spouse wants a divorce? What happens if there is a disagreement between business partners? An unplanned exit can not only impact the day-today operations of your business, but can also affect the tax and legal aspects of it, along with the value of your company. You need to create contingency plans for each of the 5 D's to be properly prepared for any unplanned scenario.

While each of these unplanned events will undoubtedly be treated differently, an important step to take is creating and communicating the action plan for each contingency. This can be achieved through a contingency letter, which serves as a playbook that is a shorthand to your operating agreement and your estate planning documents. Your contingency letter should outline what you, as the owner, would like to happen if you can no longer operate the business.

Have you planned for these contingencies? Some of the largest risks to the business can be planned for and some cannot. These are events that are usually out of your control and can inhibit the value of your business.

[1] Exit Planning Institute State of Owner Readiness Report 2023 *(latest available)*
[2] Becker, Sascha O., and Hans K. Hvide. "Do Entrepreneurs Matter?" 2013 *(latest available)*

THE 5 D'S

Have You Planned for These Contingencies?

DEATH

Imagine right now; you are in the middle of an intersection and the unthinkable occurs. What do you want your family, management team, and ownership team to know? What happens to your loans? Are the beneficiaries on your assets and life insurance correct? Who should family and management talk to for advice? Do you have a documented plan for those impacted by this event? What obligations does your business have to your estate for the value of your shares?

DISABILITY

Now imagine that you had a stroke and cannot talk or write. Does your family know where your important papers are? Do you have a power of attorney for financial and medical matters? Do others have essential passwords that enable them to pay your bills or interface with customers, vendors, etc.? Will this event invoke a purchase of your shares? How will it be paid? Who has the right to vote your shares?

DIVORCE

Your spouse announces that he/she has grown apart from you and now wants to end your marriage while the two of you are still friends. How will your shares be valued in a divorce? Do you have a prenuptial agreement? How will the changes in your finances impact the cash needs of the company? Do you know your options in unbundling your financial affairs in a non-adversarial manner that mitigates the impact on your business?

DISAGREEMENT

When multiple partners enter into a business, is it all roses and rainbows? They rarely prepare for conflict with a productive exit clause. Like all relationships, business partners sometimes decide not to co-own a business. How will your interest be valued? How will it be paid?

DISTRESS

2020 taught all of us some painful lessons regarding business interruptions and external threats we could never imagine. Many businesses suffered disruption to their business's productivity and the delivery of their products. What was the strength of your back up system? What insurances did you have to cover business interruption? Good contingency planning includes risk reduction strategies and policies to protect against everyday disaster situations, including data breaches, property disasters, supply chain disruption, work safety incidents, and critical employee loss.