The Stay Bonus, How to Keep The Value of Your Business High

by Josh Patrick

Learn some simple steps that you can take to make sure your key people stick around if the going gets tough.

Introduction

Most businesses are owned by one person. If they can't work, the value of the business significantly decreases. Below are some of the reasons this happens:

- Your key people move on to a new company.
- Key Customers leave your company.
- The bank calls notes that you have outstanding.
- There is no one around who can do the significant things that you as a business owner bring to the party.

In addition, when it comes time to leave the company you must consider what this effect will be on the key people and Customers you have. For this reason, I strongly recommend you consider putting together a stay bonus and funding mechanisms for these bonuses with the key people in your company. A stay bonus is a program where you compensate key people for staying with the company if you die, become disabled or sell the company.

When the worst happens

The Aardvark Services Company was on a roll. For the past several years they had a profit margin of 7% of sales. As a food service provider, the competition was brutal. Most of the Success of Aardvark came from the hard work of it's owner John. Unfortunately, John recently got into a car accident and was not able to come to work for six months. During this period he lost three of the five key people in the company and was in danger of having his notes called because of the large losses in the business that had happened since John could not work.

The above situation happens too often. A great company comes under severe stress because the key person, usually the owner is not able to work anymore. The first problem appears when your best people leave to go somewhere else to work. It's completely rational that our employees are going to first think about themselves and then your company. If your key people see that you can't work anymore, they will take a hard look at your company and see if it can continue to exist. If they believe it can't then they will look to other avenues for employment.

In our example above, the very worst thing that could happen has happened. Most of us carry some sort of life insurance for death, but very few of us carry disability insurance to help us through difficult times. In addition, we have often done even less planning for this possibility. John could have bought personal disability insurance as well as disability overhead insurance to help him through this problem.

When you become disabled, you are still alive and kicking but often don't have the funds to continue living or funding your company. So, if you have a serious disability that keeps you from working, you could very easily find yourself in a position where your business, cash flow and life style could all turn incredibly negative. For this reason, I strongly suggest instituting a stay bonus for key people and funding mechanisms to protect you.

The stay bonus is a program where you go to your key people and have a special bonus program that would be implemented if you die, are disabled or sell the company. All three of the above issues could cause serious harm or decrease the value of your business when it comes time to leave.

This bonus can be funded in three ways: First, by purchasing disability insurance on you, second purchasing life insurance that is owned by the company and third putting documents in place to reward managers who stay in the event of a business sale.

If John had placed a stay bonus in place, he could have funds available for paying managers through the hard times of his disability. In addition, he could have a funding mechanism in place to keep the business going while he or his advisors tried to sell the business or come up with a continuation plan.

What about my family

The Aardvark Companies had a tragedy. John Aardvark, founder and President was recently killed in an auto accident. His wife of ten years was at a complete loss of what to do. Unfortunately, the bank had just contacted her and let her know that she was on the hook for one million dollars that the business owned as a co-signer on the business note. When she signed the note, she never thought about what she was doing. She did have five hundred thousand dollars of life insurance which the bank was threatening to attach. She was in total panic about where she was going to get the money for the bank as well as pay for living expenses for herself and her two children.

Often business owners like John will have to personally guarantee money they owe the bank. In addition, they often will have their spouses' sign, never thinking about what would happen if they were not around anymore. So, the first rule of dealing with any lending institution is making sure your spouse is not on the note.

If the bank requires that you put your spouse on the note, make sure you have adequate life insurance in the company to not only pay off the note, but to fund the stay bonuses for your key people. Think about what would happen if you were not around and your key people all left the company shortly after your death. In most businesses, this would cause a liquidation sale of your business for pennies on the dollar.

To protect your family, it's important that you think about how to maintain the value of the business for their use after you're gone. This is especially true if you have young children and have not saved a significant amount of money outside your business.

If you fund a stay bonus for your key people, your spouse will have the funds available to pay these key people to have an orderly dissolution or sale of your company. You might even have put together a program where your managers would purchase the company if you weren't around to run it anymore.

In the situation of a sale or your managers purchasing the company, a stay bonus program will reserve the value of the company for your family. Doesn't it make sense to have programs in place that can improve the ultimate value of your business by a factor or four or five if you aren't around anymore? The stay bonus for your key managers can help in this matter.

Under this scenario, you would have a bonus program put together for key managers that would be paid upon the completion of certain duties if you were not around anymore. This could include the liquidation of the business, a sale to a third party or a internal sale to someone in the company. In the case of a sale to a third party or managers, you will want to make sure the stay bonus is for at least six months to a year after the sale is completed. This way, you can assure the new owners of an orderly transition to their operation.

Sale to an outside party, the real payoff of a stay bonus

Aardvark Services has had a long and successful run. John finally has had it and wants to sell *the company. In negotiations with the new owners he found that they were not especially interested in having him stick around, but were very interested in knowing his management team would still be at work. Because he had not made arrangements for this to happen the potential buyers decided to make an offer 20% less than John had anticipated.*

When it comes time to sell your business, the new owners of your company will not be interested in having you stay, but will want to have your key people in place. Having a stay bonus put in place will help the orderly transition of your company and will add value when it comes time for you to leave.

Whether you sell your business to an outside party or pass the business to insiders, there are often managers who are not involved in the transaction who are important to the success of your company. You want to make sure these people stay while the new owners transition the business to their method of operation.

You will want to have a program in writing that covers what happens to your managers if the business is sold. I often suggest that you budget about six months to a year of salary for the key people in your company as a bonus for them to stay while the new owners integrate the business into their own operations.

This arrangement not only guarantees continuity in management, but also gives the new owners the opportunity to examine your team and decide who if anyone is important in the future of the company. I often find that companies are very interested in middle and senior management of companies they acquire and are very uninterested in the owners staying. Using a stay bonus for your management team helps the new owners make decisions about their team in a manner that won't hurt your company or the amount of money you will ultimate earn from your sale.

Conclusion

A major part of protecting yourself, your family and your financial independence is through an understanding of how to keep the value of your business high. There are things that can happen to your business that can have very negative consequences for your personal financial independence as well as the ability of your family to function if you're not around.

To put an adequate stay bonus program in place you will need to have a planning team that understands the issues you face. At a minimum the people on this team should be an accountant, a business lawyer and financial advisor. All of these players should understand exit planning strategies and spend a great deal of their time working on the strategies that help business owners maintain their wealth, under many different circumstances.

If John had retained the services of professionals who specialize in working on exit planning issues, they would have coached him with the proper legal papers, insurance needs, corporate structures and bonus programs to protect him, his family and his business. Make sure you retain the right people to help you with these issues.

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