The Importance of Mitigating Risk

Insights from MassMutual's 2023 "Planning For the Unexpected" Research Report

The goal of every business owner is to build and grow a successful business. And when owners view their businesses as an asset, they have the ability to build something with tremendous value that can one day be transferred or sold and monetized for themselves or future generations. However, the one thing that can get in the way of this potential reality is risk.

Risk is defined as an event or circumstance, oftentimes unforeseen, that has a prolonged negative effect on the business. Types of risk vary from business to business and industry to industry. You must decide how much risk you are prepared to take on in your business, and potential acquirers will value your business based on how much risk they will have to assume when you leave.

As a business owner, you should consider the four risk pillars

Your Family

Helping to ensure that your protection planning extends beyond the business and to your family and heirs, including:

- Protecting your income stream
- Being fair and equitable regarding the distribution of your estate
- Managing debt

Your Business

Understanding the steps you can take to help mitigate some of the risks that can threaten the viability of your business, such as:

- Drafting and properly funding a buy-sell agreement
- Protecting against the loss of a key employee
- Eliminating owner dependencies inside the business

Your Team

Understanding the importance of encouraging top talent to stay loyal and attracting new talent to the business by:

- Offering employer-sponsored retirement plans
- Providing selective benefit packages to top performers
- Choosing and grooming the appropriate successor to the business

Your Future

Helping to ensure that the income and lifestyle you've become accustomed to as a business owner can still be achieved when you leave the business by:

- Building a retirement income strategy
- Focusing on growing enterprise value
- Understanding available exit options

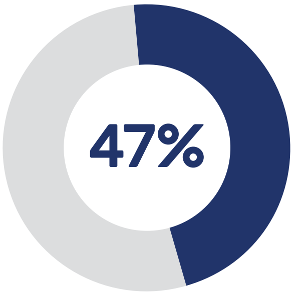
Mitigating all or at least some of these risks can go a long way toward achieving your goals as a successful business owner.

The risk of losing your income

Your ability to earn an income is your greatest asset — not your business. However, the reality is that one in four 20-year-olds will become disabled before reaching age 67*— the typical retirement age.

One of the ways to protect against this risk, and the loss of income a disability may cause, is through disability income insurance. Unfortunately, only 38% of business owners have this type of insurance in place. The majority of business owners (56%) state that if they were to become disabled, they would simply stay on the payroll and continue receiving their salary. Furthermore, nearly half (47%) of business owners say they would run out of income if they were forced out of the business for more than a year.

Receiving a salary while not contributing to the success of the business puts a tremendous strain on the business itself and those who are running it in your absence. Having an emergency fund in place is a great first step but may not last for the duration that you are unable to work. Disability income insurance products can help replace your income, cover the operating costs of the business, provide the funds for partnership buyouts, and protect your ability to save for retirement.



say they **WOULD RUN OUT OF INCOME** if they were **FORCED OUT OF THE BUSINESS FOR MORE THAN A YEAR.**

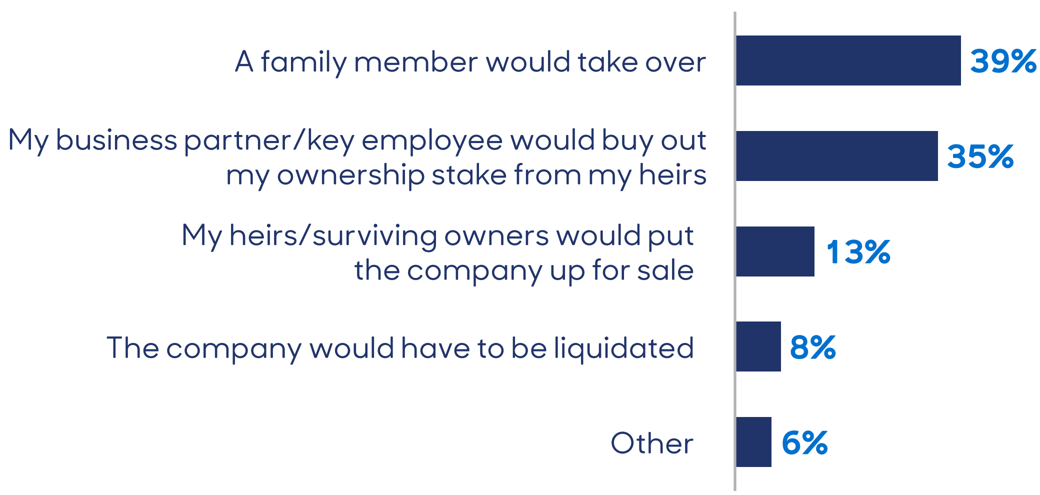
*Social Security Administration Fact Sheet, 2023

The risk of losing the business

Unfortunately, when a business loses its owner, it can mean the end of the business. That's because it's been estimated that 95% of small to medium-sized businesses are too dependent on the owner.* This risk manifests itself in the owner being too involved in sales or operations, having too heavy a hand in customer or supplier relationships, and not having a deep enough bench of management talent. Owner dependency is one of the biggest risks that exist in businesses today.

In addition, only 35% of business owners have begun the process of drafting a succession plan that outlines what happens to the business in the event the owner dies.** This means the surviving owners or family members need to make some tough decisions about what to do next with the business.

HERE'S WHAT BUSINESS OWNERS SAY WOULD HAPPEN TO THE BUSINESS IF THE OWNER DIED:



Having family members take over the business can work if they have the interest, passion, and aptitude to assume the ownership and leadership of the business. Internal buyouts can be a sound succession plan assuming the necessary funding is available to pay the surviving heirs. Regardless of the chosen strategy, there needs to be current, documented, funded, and signed agreements in place that state what happens to the business if an owner passes away. Otherwise, the business may not survive the transition.

* ClassVIPartners study of CoPilot assessment reports, 2020

** MassMutual Business Owner Perspectives Study, 2022

The risk of losing a key employee

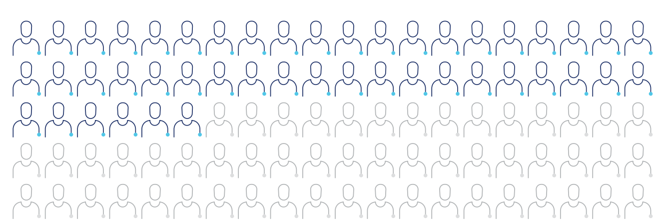
Your key employees are a major factor in what makes your business successful. Whether it's their sales and marketing acumen, their relationship building skills, or the specialized knowledge and expertise they bring to certain tasks, they are the most valuable asset of the business. Unfortunately, one-third of owners say their businesses would suffer if a key employee were to leave the company. In addition, less than half (46%) say they have other employees who could step in and cover the loss of revenue felt by the key employee leaving.

One of the ways to protect against this risk is by having key person life insurance and disability insurance in place. Key person insurance can help protect the financial stability of your business in the event a key employee dies by providing proceeds that can help replace the lost revenue and cover the costs to find and train a replacement employee. Only 26% and 21% of businesses have key person life insurance and disability insurance in place, respectively.

Another way to guard against this risk is by having employee benefit plans in place that attract and retain your top talent. The last thing you want is to lose a key employee to a competitor because the benefits you offer aren't what your employees are looking for. And while over half of today's business owners offer qualified plans (54%) and health insurance (53%) to their employees, there are other benefit options you may want to consider to stay ahead of the competition, such as supplemental life insurance, supplemental disability income insurance, and nonqualified deferred compensation plans.

46%

say they **HAVE OTHER EMPLOYEES** who could **STEP IN AND COVER THE LOSS OF REVENUE** felt by the key employee leaving.



The risk of not having enough retirement income

Many business owners don't ever truly leave their businesses out of fear of not being able to maintain their current standard of living in retirement. And while 84% of business owners believe they could sell their businesses at a premium or for market value, one-third say they could not maintain their current lifestyle if they sold the business today. Furthermore, only 54% say the proceeds from the sale of the business would afford their lifestyle for more than 10 years.

A great place to start in an effort to mitigate this risk is by determining your "income replacement value" — what you need the business to be worth to maintain your current standard of living after you leave. Unfortunately, only half of today's business owners have determined what their future financial needs are.*

From there, it's best to build assets outside the business to supplement your retirement income strategy. Of course the proceeds from the sale of the business will be a major source of your future income, but it shouldn't be your only source. What if you decide not to sell or you sell at a price lower than you expected? You need a safety net in place. Only 52% of business owners have identified assets outside the business (qualified plans, investments, Social Security, real estate, etc.) as major sources of their retirement incomes.*

54%

say the **PROCEEDS FROM THE SALE OF THE BUSINESS** would **AFFORD THEIR LIFESTYLE FOR MORE THAN 10 YEARS.**

* MassMutual Business Owner Perspectives Study, 2022

Your business isn't just your largest asset; it provides income for your family and the families of your employees, a legacy for the next generation, and is a pillar in your community. And while starting and running a business is inherently risky, with proper foresight and planning, you can be proactive about protecting what you've worked so hard to build.

Begin the process of de-risking your business, personal, and financial picture today to help ensure the growth and transferability of your business for tomorrow.

SB1163 723

MM202605-305705