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Should business owners boost their asset protection?

Executives & Entrepreneurs

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- In an environment where volatile, external economic and geopolitical factors may seem out of control, business owners may naturally focus their efforts on directing what they can—their operating companies.
- But in their efforts to pivot their operating business, cut costs, or secure new sources of supply, there is a risk that business owners overlook the safety of their assets—and ways to protect them.
- In this report, we discuss how business owners might consider asset protection plans for:

1. The entrepreneur's business
2. The entrepreneur's personal wealth
3. The entrepreneur's family wealth (especially in the context of business exit and succession plans).

Source: Getty Images

Today's world feels particularly uncertain to many entrepreneurs.

In such an environment, where volatile, external factors may seem out of control, business owners may naturally focus their efforts on directing what they can—their operating companies.

The factors driving business owners' concerns include the war in Ukraine, inflation, the ongoing lockdowns in China, supply chain disruptions, and uncertainty about the pace of interest rate hikes.

One measure of global economic policy uncertainty suggests the number of unknowns entrepreneurs face today far exceeds the 25-year median, with the outlook almost as uncertain as at the start of the COVID-19 pandemic (**Figure 1 overleaf**).

But in their efforts to pivot their operating business, cut costs, or secure new sources of supply, there is a risk that business owners overlook the safety of their assets—and ways to protect them.

So how can business owners review and recalibrate their asset protection plans for their business, their personal wealth, and their wider family?

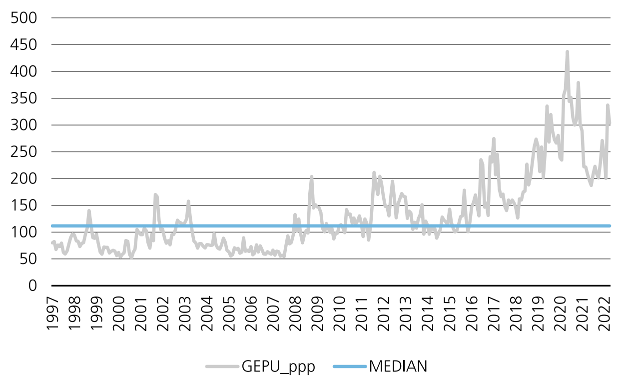
1. Asset protection for the business

One of the first steps that business owners can take to protect their business is to scrutinize their value chains and identify any weak links as soon as practical.

Tight job markets and high input costs may have already put smaller business partners under pressure. The early identification of such suppliers and a pro-active approach, such as adapting intercompany credit policies or invoice payment terms, may prevent financial distress becoming contagious.

Figure 1: Measures of global economic policy uncertainty remain historically high, confounding business owner visibility

Global Economic Policy Uncertainty Index; line indicates the median since 1997



Source: Davis, Steven J., 2016. "An Index of Global Economic Policy Uncertainty," Macroeconomic Review, October, UBS. Data as of April 2022.

Entrepreneurs can also take a fresh look at key person risk and whether their firms are suitably insulated against the loss of a key employee.

Life insurance may be one approach that may warrant exploring for business owners considering how to build financial resilience in case a business partner or a key person were to be unable to work.

If the insured employee were to die, the sum paid out could be used to buy out the former owner's family (a buy-sell agreement) or provide funds that support business continuity. For key persons, a condition could be made that the company pays for a life insurance policy whose value eventually passes to the key person, provided they continue to work for the company for a certain number of years.

Business owners may want to re-examine their cashflow management strategies to ensure they keep a suitable amount of cash on hand to cover unanticipated cost hikes or lost demand.

Lastly, entrepreneurs may want to consider whether their business and its assets are insulated from longer-term sustainability threats. They might also look at how they are best placed to take advantage of sustainability opportunities. It can be easy to lose sight of multi-year sustainability trends when short-term business conditions are fast changing.

In our research paper [Three steps to becoming more sustainable…and profitable] we consider how business owners can identify environmental, social, and governance (ESG) risks and impact opportunities that are most material for their firm's financial performance. We also consider how best to measure, monitor, and communicate on sustainability matters with the diligence increasingly demanded by stricter regulation.

2. Asset protection for the entrepreneur

Focusing exclusively on steering a company through hard times may mean that business owners overlook protecting their own personal financial assets. Doing so may be a costly mistake that could put long-term financial objectives at risk.

First, entrepreneurs might consider working with a financial planner to disentangle their commercial and personal assets, which are often seen as interchangeable. One advantage to doing this is to shield personal assets from any claims or legal action taken against the businesses.

Second, entrepreneurs might consider whether their personal wealth is overly exposed to a company, country, or sector that is vulnerable to shocks from today's geopolitical, economic, and sustainability challenges.

In a series of three articles, CIO has examined how entrepreneurs can look at a concentrated stock position, i.e. holding the bulk of their wealth in a single company. We explored the risks of such an approach here, how to approach a concentrated position in the context of financial goals here, and ways to manage a concentrated position here.

Third, business owners can consider changing the composition of their portfolios to include assets that may be resilient in today's more volatile markets. Since the global financial crisis in 2008/09, expansionary central bank policy has tended to buoy growth equities, shares whose worth relies on earnings expected further in the future. However, in today's higher rate and higher inflation environment, value equities in sectors such as energy may offer better opportunities.

Entrepreneurs may also consider whether they are accounting for pricing power and inflation protection in their personal portfolios with the same rigor as they pursue in their businesses. It may be worth reviewing overall personal balance sheet to stress test for higher inflation and interest rates. They may consider asking whether fixing borrowing costs on debt, using cash earning negative real yields to pay down loans, or allocating more to real assets (some of which may have income streams like rents that are tied to inflation) may protect the purchasing power of wealth over the long term.

3. Asset protection for the entrepreneur's family

Uncertainty is dominating the headlines. But business owners looking to transfer their business and financial assets to their families risk overlooking the importance of asset protection against "internal" threats—a divorce or family bereavement, for example.

Fears that business assets will not be protected by family members are a common reason for entrepreneurs to hold off transferring their firm to the next generation. In a 2018 UBS investor Watch Survey, 57% of respondents were highly worried that their heirs would sell their business outside the family, while 55% were anxious their successors would squander the company profits.

To allay concerns and protect family assets, founders can first consider working on a robust yet flexible succession plan covering commercial, personal financial, and family assets. In our research paper Talk, plan, do – a guide to business succession and exit we suggest how open and transparent communication, the establishment of a shared family mission, and financial planning to establish capital budgets for the business, founder, and wider family can all help to protect assets through the delicate succession process.

In some jurisdictions, entrepreneurs may also consider whether the use of legal structures such as holding companies and trusts can help to protect assets from threats such as external creditors, legal disputes within the family, or unstable political regimes.

Last, business owners would do well to avoid intergenerational differences around the importance of sustainability by discussing and devising a sustainability plan across the family's total wealth. In Three reasons why your business might not align with your values, we explored why business sustainability aims are less likely to survive an ownership transition if they are personal, as well as the potential for inefficient use of total wealth if entrepreneurs try to tackle sustainability challenges in their operating company. These challenges may be best addressed through a portfolio or philanthropic vehicle.

The above points suggest the merits of business owners working concurrently with trusted advisors across wealth planning, family governance, sustainable investment, and philanthropy.

Conclusion

In today's times of uncertainty and market volatility, entrepreneurs who are exclusively focused on building business resilience may overlook the safety of their assets and ways to protect them.

Business owners might consider reviewing and revising their asset protection plans for their business, personal wealth, and family succession to maximize their chances of meeting long-term commercial and financial objectives.

As with all plans, founders might consider aiming to build flexible plans that evolve with economic, commercial, and personal circumstances.

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