One of the first things any business owner needs to consider is how to protect against events that may threaten the future of the business, like the death or disability of a proprietor, partner or key employee.

Individual Life Insurance

Let's start with the worst-case scenario, the death of one of the business owners. What will happen to your business if you die? Many small business owners take out loans to help grow their businesses, and often secure these loans with personal assets. If you have business loans and were to pass away before they were paid off, you might think your family could sell or liquidate the business to cover the debts and provide financial security for them.

In reality, this rarely happens. When the family is forced to sell the business quickly, they may have to sell at a discount or during market conditions that make the business less attractive. In other cases, the business may be worth very little without the proprietor or partner. Individual life insurance can protect your family by providing funds to cover debts, ongoing living expenses, and future plans in the event that something happens to you.

Buy-Sell Agreements

Life insurance also can be structured to fund a "buy-sell" agreement. This is an agreement among owners to buy a deceased owner's share of the business at a previously agreed upon price in the event of death, disability or retirement.

Why are these agreements so important? You might think that if you die, your family could maintain their income by running the business themselves or by hiring someone to handle the day-to-day management. The fact is, your loved ones may not have the skills or the desire for the job, and your co-owners may not welcome the idea of an unintended partner. With a properly structured and funded buy-sell agreement, your business partners won't have to scramble to come up with the money to buy out your share of the business and you'll be guaranteed that your survivors will be compensated fairly and promptly.

Buy-sell agreements are typically funded by life insurance policies purchased on the lives of each of the business owners. The amount is usually specified in a contract created with the help of an attorney. You can enter into a buy-sell agreement at any time, but it often makes sense to do so when a business is formed or when new owners are brought into the business. Because business values can fluctuate, it's important to review the contract with your accountant at least once per year or to include a calculation method in the agreement. Also be sure the insurance coverage funding the agreement is up to date.

Though not as common as insuring against death, business owners can also insure against the risk of becoming disabled and unable to work. In this case, disability income buyout insurance would fund the buy-sell agreement, allowing the disabled owners to be bought out, typically after a one-year waiting period.

Key Person Insurance

Key person insurance is another essential component of a smart business continuation plan. Key person insurance is life or disability insurance purchased by the business on the life of such an employee and payable to the business. When a "key person" dies or becomes disabled, insurance can help make up for lost sales or earnings or cover the cost of finding or training a replacement.