

# irongroup lawyers

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## Business Partnership Break-ups: Challenges & Solutions

### Background

When people start up in business together usually the last thing on their mind is what will happen if one of them either wants to, or is forced to, leave the business. Over time however, the inevitability of that will dawn on them and they will be confronted with the reality, and the consequences, of that happening.

It can be awkward for a partner to raise this issue, particularly if they are the one in the vulnerable position. This is where a professional adviser such as yourself has an opportunity to take the lead and help put agreements in place before these problems arise.

### The Need

The relationship between business owners can end for a number of reasons and fall into one of two categories. The first involves an involuntary departure ie one where the partner is forced to leave the business due to their death or incapacity which means they can no longer contribute to the running of the business.

The second category is more common and involves a voluntary departure which can occur due to the retirement of an older partner or perhaps a difference of opinion over where the business should be heading.

Whatever the cause, one partner can suddenly find themselves with their back to the wall and very little room to manoeuvre.

The flow-on from this is that not only does someone's value in a business suddenly look difficult to extract, but if the relationship has soured, the business can start to go 'off the rails'. Their investment suddenly looks even more vulnerable.

### The Solution

All of this can be avoided with an agreed plan supported by legal agreements. Timing is of the essence though, as these need to be put in place long before they are needed.

Irongroup Lawyers' Business Succession Planning service has been designed to help business owners through this process. At the core of the solution lies the need to lead the owners through a discussion where the potential scenarios are acknowledged and acceptable solutions identified and agreed.

The accountant can take the lead in bringing this about, as you are in the ideal position to identify those clients who need these agreements. (We have also done many of these for Accounting practices!)

When it's an involuntary departure a Financial Planner or Risk Adviser may also be involved as these buyouts are often funded by insurance.

The funding of the voluntary departure however, must be managed differently and exploring the optimal way to do this is an integral part of the discussion that is facilitated by the lawyer.

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phone: 03 8621 9000

email: [info@irongroup.com](mailto:info@irongroup.com)

Irongroup Lawyers Pty Ltd ACN 102 794 249

fax: 03 8621 9001

web: [www.irongroup.com](http://www.irongroup.com)

Level 4, 45 William Street Melbourne VIC 3000

# Business Partnership Break-ups: Challenges and Solutions

Here at Irongroup we have worked with hundreds of business owners and are able to present a range of typical scenarios as a guide to help clients arrive at a solution that suits them and their business.

We have covered the issues surrounding Buy Sell  
● Agreements for death or incapacity in earlier editions so following is more information on the other (more likely) possibility ie a voluntary departure from a business.

## Non- Compulsory Buy-out

Most partnership agreements provide for a buy-out by a partner. The usual terms involve a first right of refusal, a market valuation and possibly payment terms. These are known as non-compulsory buyout agreements.

Whilst these can help, in a practical sense they are not always satisfactory.

On the one hand it's not always easy to find a buyer for  
● what is usually a half share (or sometimes less) in a business so the remaining partner is often the only option. The price may suffer accordingly. On the other hand the remaining partner may be forced to endure a partner they really don't want if that share is sold externally.

In response to these concerns, Irongroup has developed a variation on these agreements that is proving very popular.

## Compulsory Buy-out

The Irongroup agreement provides the option of a compulsory buyout. It has been designed so that when one partner decides to leave the business voluntarily they can force the other partner to buy them out.

Now it sounds attractive to be able to walk away from a business whilst extracting value, but there is a trade-off!

By way of disincentive, a discount to valuation is usually applied. Most business owners consider this fair in that the departing partner is causing a disruption to the business and should be penalised in some way.

The amount of the discount is a matter for discussion but most opt for an 80% of valuation figure ie if a half share is worth \$500,000 they will get \$400,000 if they leave.

## But wait there's more...

The other critical element to this is how this purchase  
● amount is to be funded as not everyone has ready access to cash.

The solution lies in funding the payment from the cashflow of the business and the ability of the business to fund regular payments will drive the payment terms. Effectively it is often the amount the departing partner was taking from the business as profit above a wage. (They will probably need to be replaced so the leftover cash for funding the buyout will be their share of the profit after wages.)

For example if a business is making a 20% margin, the  
● remaining partner should be able to pay down the debt over 5 years without impacting on his or her current cash flow.

## Summary

We all know clients appreciate proactive advice and this is a great opportunity to do just that and help head off a minefield not only for them but potentially for you.

If you would like a copy of our Insights on Business Succession Planning please send an email to [info@irongroup.com](mailto:info@irongroup.com).

If we can help you sort out this issue for your clients give us a call on 03 8621 9000. We'd be pleased to hear from you.