Business Succession Planning

Issues for Partners

Introduction

People often have a lot of their wealth tied up in a business. However when two or more people own a business, more often than not, the departure of one of the owners has not been clearly and properly dealt with in a business succession plan.

In practical terms, an exit by one of the partners is inevitable - sooner or later someone will leave. These reasons could include retirement, a disagreement or even a divorce as part of a financial settlement. And of course, worse still, what if a departure is forced on someone due to death or illness?

So if one of the partners in your business is either forced to exit or they decide the time has come for them to leave - what happens then?

The need for appropriate legal agreements between partners may seem painfully self-evident - but some sources indicate that as many as 95% of businesses may not have the right kind of agreements in place.

In addition, issues such as how a buy-out will be funded should be considered.

Not having a plan in place can lead to immense problems not only for the departing proprietor, but also for the business and the remaining business owner(s).

Irongroup have agreements available to deal with the exit of a partner from a business. Whether it's to cater for an immediate involuntary departure or perhaps a future retirement, we have an agreement to suit.

There are a number of issues to consider in these scenarios including:

- Who the buyer will be (more often than not the existing partner).
- How much will they pay - what is the business worth?
- How will they pay for it and over what time frame? Is it possible to get insurance to help pay for it?

Irongroup works with Advisers and Business Owners to put Business Succession Planning legal agreements in place. Using our experience in this area we have put together this paper on some of the questions you should consider around protecting your investment with a business succession plan. We hope you find it useful.

You get a call on the weekend. Your partner has been killed in a car accident. Once the shock of that subsides and immediate issues are dealt with, how will you feel if your partner's spouse wants to come in and run the business in their place?

You may get along very well with your partner's spouse, even socialise with them occasionally but would they be suitable as a working business partner?

Do they have the skills to do the job your partner is doing? If not, what would they actually do?

Will their contribution equal the share of profits they will be receiving from the business?

How will you feel about them taking out the same amount your partner was receiving from the business? Would you need to pay for a replacement as well?

Your partner is ill and can no longer work - he wants to get out of the business. His wife doesn't want anything to do with it - they need to sell.

Are you prepared to buy their share? What if they offer it to someone else? If you do want it, how will you pay out your partner's family for their share? How much should it be? Will you borrow it? Will you be able to borrow it?

And don't forget you might need to replace your partner with a new employee. How easy will that be? How will you pay for that while they are on their learning curve?

Your partner has cancer and you don't know how long it will be before she can come back to work, if at all.

How long would you be prepared to fund them their share of the business profits without them actually contributing in any way?

Someone can have a heart attack and be back at work in three months. You may be happy to provide financially for them for that long. Perhaps longer. However some

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people are not so lucky. Cancer for example, can take months of treatment and whilst some survive, many don't.

What is your plan for dealing with this possibility? Do you have key person insurance in place to cover a replacement? Or life insurance to fund their share of the business if they die?

What if you die and your spouse is left to deal with your share in the business. How would they go negotiating with your partner to sell that equity?

Is your spouse skilled at negotiating? Would your accountant be able to help? Perhaps you and your business partner have the same accountant. How easily could they negotiate between the two competing interests?

What would happen to the business in the meantime eg. if one of you was not there would it suffer a downturn?

Would there be any value left in the business to negotiate for? How much would your family actually be able to realise from a sale if the negotiations dragged on. How would they survive financially in the meantime?

For a lot of people their investment in their business is a considerable part of their total assets. Why put it at risk?

But I trust my partner!

We all trust our partners or we wouldn't have gone into business with them. This is about sensible planning for possibilities. Avoiding negotiations in fraught times. A plan put in place now between partners who trust each other is going to be much easier than dealing with solicitors if it all goes wrong.

I want to retire at some stage. I'm just not sure how to bring it up and negotiate a deal now that suits.

Irongroup Lawyers can help put an agreement in place now that covers off the agreed terms. Many people have decided for example, that they would be happy with say 80% of the value of the business, paid out over time from cashflow. You can choose to make that a voluntary right to buy or a compulsory position, which is proving by far the most popular.

Whilst no insurance is available for these scenarios, once one partner has left the remaining partner(s) has access to the remaining cashflow and can use this to pay the other one out. The terms can be adjusted according to the available cashflow.

If I want to do something completely different with my life? I would love the option of getting out if necessary but with a fair return on my investment.

Same as the above, you can have an agreement drawn up now, to be used only when one of you wants to get out. The important issue is to agree on the terms now while there is a level playing field.

I'm thinking of taking on a new partner over time. One of my employees will be buying in. What do I need to do?

You need to agree the amount of equity they will be taking and how much they will pay for that. The timeframe for the buy-in will determine the payment terms. These conditions can all be documented in a Sale Agreement.

These are an ideal solution for business owners who want to provide an incentive for an employee to stay whilst putting in place their own long term exit strategy.

Where to from here?

As mentioned, for involuntary departures such as death, total and permanent disablement or critical illness, you have the option of funding it with insurance. Similarly if you need to cover a key person in the business.

Your Risk Adviser or Financial Planner can advise you on how much cover you need including catering for potential CGT liabilities as part of organising your plan.

Irongroup Lawyers can help with the legal agreements for these insurance funded departures (called Buy Sell Agreements) including covering off options such as whether you want to allow for an additional top-up payment in case the insurance cover is not enough, or whether a partner with a critical illness should be able to be forced out after a period of time.

With the "voluntary" departures where the partner has the option of deciding it's just time to go, Irongroup can put in place Exit Agreements. The funding for these usually comes from the business cashflow as mentioned. Again, these terms are tailored to each partnership and the Irongroup solicitor will work with you to reach an agreement on these.

In Summary...

Whenever two or more people own a business it is essential to have a well-thought out business succession plan in place to help ensure your investment is protected.

These should ideally be implemented while neither party is under pressure, to maintain equal negotiating power.

Agreeing to these terms and putting the appropriate documentation in place is not an expensive or insurmountable task.

For more information on Buy Sell Agreements, Exit Agreements and Sale Agreements, please contact your Adviser or call Irongroup Lawyers on 03 8621 9000 and we will work with you develop a solution that meets your needs.