LOOKING FOR MR. GOODPARTNER

What do you look for in choosing a partner? A compatible business outlook is more important than a compatible personality.

By Guy Wilcomb

We’ve all heard of the proverbial marriage that seems to have been “made in heaven.” And we’ve probably all seen business partnerships that function in much the same way, partnerships where the co-owners’ talents, personalities, and degree of dedication mesh to form a smoothly functioning unit. Unfortunately, we’ve also seen the emotional and financial havoc that can be wreaked when a business partnership goes sour. All of which suggests anyone thinking of going into a partnership should let reason light the way. Here are a few suggestions:

Take a good look at your reasons for selecting a partner. Don’t take a partner to reduce your risk—an unsuitable partner could actually increase your risks. And loneliness is not a good reason to select a partner.

Have specific goals. Know what you expect the partner to help you achieve, whether it be introduction of new products or services, expansion into a new geographic area, or greater economy. Make those goals quantifiable, so that you can measure the success of your partnership.

Look for someone whose business goals match yours, rather than someone with whom you feel personally compatible. A good personality fit is great, of course, but surprisingly, it’s not a prerequisite for a successful busi-

Marriages may be made in heaven, but business partnerships should be made through formal legal agreements which provide for division of profits in the event of a split-up.
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It’s more important that you be compatible in your business outlook and that both of you are willing to go the extra mile to achieve whatever it is you’re after. If one of you is expending a lot more energy than the other, a parting of the ways is probably inevitable.

Make sure that you really want a partner. Many operations are, in effect, one-man-shows. If you never delegate, and if you make even the smallest decisions yourself, maybe a subordinate with special skills would be more in your line than a partner. You may have grown so accustomed to total autonomy that you’d find a partnership too constraining.

Look for capital and/or skills as essential attributes in a potential partner. Capital in the form of cash, equity, or new business; skills that can supplement you own, such as financial or marketing ability or familiarity with a new field you’re interested in entering.

Take a look within your own organization. Joining up with someone in your own shop has several advantages. You know the person’s strengths and weaknesses in advance. And promoting within can provide a boost for general employee morale.

Leave yourself an out. A handshake does not make a legitimate business contract. Far more sensible is a formal agreement drawn up by your attorney, with provisions for every eventuality you and the attorney can think of—especially the division of profits in case of a split-up. Business relationships don’t usually end when everything is going well; they usually end in times of stress when goodwill may count for very little. The formal agreement should cover the death, retirement, or incapacitation of either partner, with buyout arrangements possibly financed by insurance. Much grief and expense could be avoided if more business owners had buy-sell agreements. Insurance advisors, whose insurance policies finance the majority of buy-sell agreements, estimate that up to 95 percent of new partnerships haven’t established a buy-sell by the end of their first year. This can be a serious oversight.

A buy-sell agreement safeguards a business against the death or disability of a co-owner or a minority stockholder. It provides that when an owner withdraws from a company for any reason—death, disability, or retirement—the remaining owners will have an opportunity to buy his or her interest in the business. This kind of pro-
vision is a crucial one. Too many owners’ plans go awry because the right precautions weren’t taken. This is especially unfortunate because the right agreement, if fairly negotiated by knowledgeable persons on both sides, can be slanted toward protecting the remaining owners, the departing owner, or the estate.

Here are four variations on buy-sell agreements:

1. Transfer of interest required: The buy-sell contract may require that the remaining owners or the corporation buy the departed owner’s interest (stock, if a corporation) at a fair price; his estate must sell it to them.

2. Remaining owner’s choice: The agreement may give the remaining owners or the corporation an option to buy the departed owner’s interest; if this option is exercised his estate must sell.

3. Owner’s estate choice: The buy-sell agreement may give the estate the right to offer the stock to the remaining owners or to the corporation. If it does so, they must buy.

4. Right of first refusal: Though this type of agreement does not obligate the remaining owners to buy the stock, it does call for interest in the stock to be offered to the remaining owners before it is offered to an outside party.

**Using Life Insurance**

The cash drain on a business can be considerable when a stockholder’s interest must be purchased. And just as it’s risky to assume that individual owners will have enough cash to finance a cross-purchase plan, it’s also risky to assume that funds to finance a corporate purchase of stock will be easy to come by. Insurance on the life of each owner, however, can supply the needed cash.

If the corporation sets up a stock-redemption plan, it buys the insurance and is the beneficiary. This will supply the cash needed for the purchase of the stock. One caution: the insurance may increase the value of the stock, especially if the buy-sell agreement uses a book value formula. An example would be if three stockholders each own one-third of a corporation. When one dies and the corporation buys his interest, the remaining two stockholders will each own 50 percent, substantially increasing the value of their stock. This should be taken into consideration when determining the buy-out price.

**How Much Insurance to Buy**

The shares covered by insurance for each owner should represent a specified percentage of the corporation’s value at the time the insurance is purchased. It’s almost as important to maintain an accurate valuation of the company as it is to use a valuation formula that can determine both the correct amount of cash needed to buy shares now and the amount that would be required at some future date when the per-share value may have increased. Formulas to determine this value, however, should be used with extreme caution. Look at the value of the company every year, and make adjustments. The amount of cash needed to purchase shares should be adjusted annually, along with the amount of life insurance, to reflect increases in the value of stock.

Another possibility to consider, when all owners have approximately equal shares of the company, is first death insurance. This type of policy covers the entire group, but pays life insurance when any one of the group dies. Proceeds can be paid to the company or to the others in the group, depending on who paid the premiums.

Buy-sell agreements should also specify ways to compensate for any shortfalls in insurance proceeds that may occur. Some possibilities: promissory notes, mortgages on corporate assets, or additional insurance policies. Provision should also be made for the use of any excess proceeds.

Tax reform has redefined the terms of buy-sell agreements, so any existing or new agreements should be drawn up with the aid of a competent tax advisor, estate planner, and insurance agent.

Consider starting a new company as another option. A new, separate firm that doesn’t work out can simply be discontinued without jeopardizing the original company. If you expand by taking on a new partner, the whole operation may fold if the enterprise doesn’t work out.

Don’t leave the success of your prospective partnership to chance and goodwill. A well-thought out plan that takes the above considerations into account is a much better foundation for a successful partnership.

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