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Two Owners Then One, Now What?

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For many years, two business partners worked hard to build their privately held company while, at the same time, providing for their families. Both owners worked well together. They agreed to equal salaries and agreed on all corporate expenditures including the purchase of equipment, computers, software and other improvements. Their goal was to grow their business and improve their stockholder's equity each year.

Over the years, the owners talked about preparing a Buy-Sell agreement several times but never had an attorney actually write up the document. Unfortunately, one of the owners had a stroke and was suddenly unable to work. It became clear, very quickly, that the two owners now had very different goals and needs for and from their company.

The disabled owner needed some immediate cash, an annual income, and a way of providing for his family. The other partner was forced to work harder to maintain the company's cash flow and profitability. He eventually needed to hire someone to help with running the daily activities and began to find the company less profitable.

The disabled stockholder and his spouse began to have other questions and concerns:

- What are my shares in the company now worth?
- Can I convince my partner and the company to buy my stock?
- Is there enough cash flow in the business to purchase my shares?

If these two partners had worked with a business advisory team before all this happened, they could have solved many of these problems and questions through the use of a Buy-Sell agreement. The agreement puts in writing what both stockholders agree to while they have the same objectives and goals for the company.

To begin working on a Buy-Sell agreement, I try to tell business owners to write down on a piece of paper what they think should happen if a "triggering event" occurs. Triggering events that stockholders of a privately held business need to address are death, disability, divorce, personal bankruptcy, termination and retirement. It doesn't matter if the business has two or ten owners. The same triggering events can happen to anyone.

Next, I recommend getting your business advisory team together to talk about the Buy-Sell agreement. The team can provide you with good options on how to deal with each of the problems you identify. While meeting with your team, talk about the triggering events and let them write down your comments and answers. All this information will feed into the new Buy-Sell Agreement.

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Finally, to make your Buy-Sell agreement really worthwhile, you will also need to agree on a current value for the company and come up with a formula for valuing the company in future years. If you don't have a way of re-valuing your company, one partner could find themselves paying too much, or too little, to buy out the other partner.

Most business owners will try to use some practical solutions to deal with different triggering events:

- Partners will purchase life insurance on each other to fund the buy-out of a deceased shareholder. In some cases, the company will own the policies and in other cases each partner or shareholder will own the policy.
- Owners will decide if a salary should be paid for three, six or twelve months after an owner is determined to be disabled. When the salary stops, the non-disabled owner or the company will then have the ability to buy out the disabled owner's stock at a pre-determined price.
- If an owner is divorced or goes through bankruptcy, both owners will agree on when and how the shares of the company will be protected. The buy-sell agreement will make sure the owner not getting the divorce or not going through bankruptcy can buy out the shares and keep the business together.

A public corporation can last for 100 years, never get sick and never become disabled. Those of us who own closely held businesses know that isn't true for a small business owner. We can spend 30 years or more working at growing a company. We have to put plans in place to keep our companies going by using legal documents. This will not only protect us, but it will protect our families and employees.

If you are reading this article, chances are you already have some well trained personnel that can run the business if you were gone for two-three days. Think what would happen if you were not able to work at your business for six months? Who would be authorized to make important daily decisions like purchasing inventory, authorizing payroll checks or handling bank deposits?

I recommend you start answering these questions now while both of you have control and the ability to make good decisions. If you put this off, you may be forcing a spouse or a partner to work with advisors you didn't choose and asking a completely different set of questions.

Gary Pittsford, CFP®, is President and CEO of Castle Wealth Advisors, LLC. Castle specializes in helping families and closely-held business owners with valuations, succession planning, estate and income tax analysis and retirement income projections. Castle's senior partners work with clients throughout the country in making logical decisions that help them fulfill their personal and business financial goals. For more information visit www.Castle3.com, call 1-888-849-9559 or e-mail Gary directly at Gary@Castle3.com.