BARRETT WALKER

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Do you need an agreement with your business partner?

Going into new business with other people is exciting and can be extremely rewarding. A formal agreement can set the ground rules and stop owners getting caught out if things don't quite go as well as planned.

Whether your firm is structured as a partnership or a company, you and your business partners need to agree on the terms of your professional relationship. This will be a partnership agreement, a shareholders' agreement or, where you are operating a trading trust, a unitholders' agreement.

There are many businesses out there that do operate without this agreement, however if you decide that it would be prudent to have one, the agreement can set out salient points, such as:

- the agreed responsibilities of each participant in the operation of the business
- what contribution each participant is bringing into the business — skills, know-how, access to funding and connections
- profit and loss sharing formulae
- consequences of failure to deliver one's responsibilities
- future funding options
- exit mechanisms
- decision making process, including day-to-day business operations and internal matters, such as the remuneration of directors (where there is a company structure), reinvestment of dividends/profits into the business
- short and long term business plans, and
- procedures when one participant becomes incapacitated or dies.

What to expect if you choose not to have one

All relationships start with a "honeymoon" period where everything looks rosy, and everyone puts in their best efforts to make a combined vision a reality. When partners have their blinkers on to create a firm from scratch, they put 100% effort towards a clear common goal.

This common goal, however, may morph into a slightly different creature for individual partners over time. The once clear common goal can become blurry and takes on a different meaning to different partners. Disagreements can surface about how the firm is being run and future plans for the firm, and these can affect the priorities of the business on a day-to-day basis.

It's difficult enough to gain or just maintain market share in today's market, so no business owner can afford the time to deal with internal disputes with partners. These disputes are not only time consuming, but are emotionally draining for everyone involved.

What can go wrong?

Below are some examples of problems that business owners encounter:

- a major participant whose asset to the business is his/her skills in the trade/profession decides to set up shop in competition but refuses to relinquish his/ her shares in the original business
- a shareholder/partner refuses to inject much needed funds into the business and its expansion is put on hold

Continued overleaf

- a director refuses to attend board meetings, which makes it impossible for the remaining director(s) to make time-sensitive decisions
- directors refuse to disclose company books to shareholders
- minority shareholders hold out on a potentially profitable sale of the business
- disputes regarding the valuation of shares/interests in the business when a party seeks to sell out
- a partner/director wants to spend more time with family and cash in on his/her efforts, but there is no ready market for a portion of an interest in the firm and pressure is placed on the other partner(s)/shareholders to sell the whole business
- a director misuses information for his/her own benefit to the detriment of the company
- one partner/director takes up the role of major "fee earner" and the others focus more on business development, and so the question arises as to what is a "fair" split of income/profits, and
- one partner/shareholder is offered a premium for the firm, but the other partners/shareholders hold out with some refusing to consider a sale.

What happens then?

Without a partnership, shareholders' or unitholders' agreement, the parties cannot refer to an agreed way to resolve the dispute. The only resort is to apply for a court order to achieve a desired outcome.

Court orders can be sought for (and this list is not exhaustive):

1. the dissolution of a partnership
2. the winding up of a company
3. injunctions to prevent a party from dealing with the assets of the business
4. directions as to the conduct of the company's affairs, or
5. one shareholder to purchase the other's shares/ interests at a price to be determined by the court.

More often than not, parties cannot agree on the way forward and hence any court order obtained will only seem to serve the purpose of one of the parties, rendering the parting of ways less than amicable.

Needless to say, initiating proceedings in courts involves legal costs to obtain advice, and most important of all, your business is left in limbo while you are sorting out your issues with your business partner who now has more important concerns/interests than the business that you created together.

It is invariably the remaining shareholders/partners/ unitholders who want to continue with the business in such instances who will suffer the most.

While no-one can anticipate all dispute scenarios that can crop up, it's always best to have the ground rules set right with your business partners before taking the leap together

Next steps

It is worthwhile spending the time with your potential business partners to discuss at least the following:

1. the vision, mission and values of the business (sounds cliché, but really these underpin all business decisions to be made)
2. the initial set up costs, ongoing financial requirements
3. marketing plans to create your niche in the market, put your services in front of your target audience to elicit engagement and response
4. possible strategic alliances with other professionals
5. whether employees will be recruited and, if so, pro forma terms need to be averted to
6. the partners' respective roles in the business, perhaps setting initial KPIs
7. remuneration of the partners
8. contingency plans when one or more partners become incapacitated
9. create "liquidity" by setting out exit procedures
10. have tag-along and drag-along clauses so that the business/company can be sold upon the occurrence of a triggering event
11. business succession planning
12. restraints that will apply upon termination of the relationship, and
13. how the business will be valued upon termination (a valuer or a firm can be nominated in the agreement).

Once the foundation of the professional relationship is laid out, the agreement should be documented and signed by all parties.

No one wants to think that a partnership will sour or that anyone's focus will shift from the common goal and doing what's best for the business. However, there's rarely anything that's guaranteed in business. Putting an agreement in place straight up could save a lot of time, cost and emotional drain down the track.

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