ADVICE

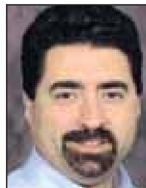
The IE Business Doctors

Ted Collins

Are you ready if a business partner dies?

No one wants to receive a call that a business partner has died. Such a call would result in a flood of emotions and uncertainty compounded by a million unanswered questions.

Adrenalin fueled endurance kicks in as the owner begins a triage trudge to keep the business alive. Notifying employees, vendors, customers, figuring out how the additional work load is going to be managed all the while recognizing the emotional void of having lost a good friend. Set in the midst of this turmoil will be a conversation with the surviving spouse or family that things will be made right regarding the ownership value of the business.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The question facing every multi owner business today – Are you prepared to make things right regarding value for the surviving spouse? Will your spouse and family be made right? How do you truly know? The answer to that question that all too often exists is no one knows. Yet this does not need to be the case. A rather simple legal agreement called a shareholder agreement or buy/sell agreement is all that is needed to have a definite answer and to avoid trying to figure out what is fair in the midst of a crisis.

A shareholder agreement defines what will happen in the event of death but also should address other transition events such as disability and incapacity. It should define clearly how a value is to be determined and how the buyout will occur with expected timeframes. Unfortunately, what should be a straightforward process often results in a document that is vague and imprecise, with language used that has significant implications on value to be determined.

Including a business appraiser in the conversation will provide valuable insight as to how value will be calculated and ensure that the owners' intentions are reflected in the language used.

All too often survivors discover that the value agreed upon in a document is not reflective of the true fair market value. A case that illustrates this involved language which defined using book value as the buyout conditions. At time of death the surviving shareholder paid book value per the balance sheet of $300,000. This amount was based on historical cost and ignored the fact that the real estate holding appreciated significantly in the 20 years since the agreement was drafted.

The true fair market value of the shareholders interest was closer to $1.2 million. As a result, the shareholders family was short changed through an oversight by the shareholders to update and review the buyout terms as the company grew and became successful. At the very least, this type of situation builds resentment and increases the potential of costly litigation.

Clearly the first step is to ensure a buy/sell agreement is in place between shareholders. The second step is to not ignore it. At a minimum it should be discussed annually to ensure that the agreement reflects the owners' current thoughts and the economic reality of the business.

Particular attention should be placed upon how the business value will be determined and how the surviving shareholders will fund the buyout. Undergoing a test run with a qualified appraiser of the buy/sell agreement will bring to light any assumptions that might need clarifying and ensure that a fair resolution is agreed upon by the owners rather than decided upon by the courts at a future date.

About The IE Business Doctors

The IE Business Doctors, founded and managed by Eugene Valdez, are a strategic alliance of 15 predominantly Inland-based business experts from a variety of disciplines who meet twice monthly to mentor each other and share best practices. This column is geared toward sharing information with small business owners. For more informaton about The Business Doctors, contact Valdez, Vice President-Senior Relationship Manager of Community Bank in Ontario via evaldez@cbank.com. Opinions expressed by the authors are their own personal opinions and not the opinions of Community Bank.

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