How Buy-Sell Agreements Can Help Prevent a Messy Business Divorce

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Just like any kind of relationship, not all business partnerships are built to stand the test of time. They can sour just as easily as a romantic partnership or friendship as vision and long-term goals diverge, financial stress comes into play, or personal issues enter the business relationship. When these kinds of factors arise, it can often result in a “business divorce.”

A business divorce has the potential to be just as messy, emotionally charged, and costly as a marital divorce, particularly when there is no established plan in place to outline how the two parties will separate. This is why buy-sell agreements can be critical, helping to ensure a smooth and fair process in the case of a business divorce. It is always best to agree on buyout terms in advance while everyone is getting along and not leave it to the expense and risk of legal proceedings before an arbitrator or judge who does not understand your business.

What is a Business Divorce?

A business divorce occurs when two or more parties decide to end a business partnership, and it is estimated that anywhere from 50-70% of business partnerships will fail. There can be numerous contributing factors that lead to the dissolution of the partnership. As stated earlier, there are typically differing visions for the company’s future, the strategies used to achieve long-term goals, financial disagreements, or even personal issues that begin to impact the partnership. However, there can also be actions taken by a partner that reflect negatively on the company or even an illness or death that would require the partnership to dissolve.

No matter the root cause of the divorce, there are several avenues that can be taken when the partners make the decision to split. This could be one partner buying out the other, fully dissolving the business, or some kind of restructuring that occurs. It is at this stage of deciding which path to take where emotions can start to come into play, and lawsuits and other disputes can arise if there is not an agreed-upon method to end the partnership. This is where buy-sell agreements can be a game changer.

Why Buy-Sell Agreements are Critical

Think of a buy-sell agreement as a prenuptial agreement for business owners. When a married couple has a prenup in place, it provides a roadmap for how to divide the assets if they divorce. Buy-sell agreements provide the same kind of roadmap for a partnership, outlining a course of action should one partner want or need to leave. As with a prenup, these are typically negotiated when the partnership is established; however, it is never too late to negotiate this in a partnership if one does not already exist.

These agreements allow for a smoother process and minimize conflict, as they provide an established business valuation methodology as well as liquidity and exit plans, including the terms of the payout to the departing partner, which could be over several years so as not to impair the business cash flow. They can also prevent a spouse or heirs from attempting to assume a partnership role in the case of a partner’s death or disabling illness, and they can help stabilize the business during what can be a chaotic time.

When considering structures for a buy-sell agreement, there are several options. These can include one or more owners buying out a departing owner’s stake, the actual business buying the departing partner’s stake, or some of combination of the two. In the case of death, the buy-sell can provide for the purchase of life insurance on the deceased partner. The structure of a buy-sell agreement is specific to the individual business and partnership and must be agreed upon by all parties involved.

At the end of the day, a buy-sell agreement can save a great deal of heartache and expense if you find yourself in the middle of a business divorce. A little bit of additional planning on the front end could be the key to an amicable split that allows for the continuity of the business and avoids a legal mess.