EXIT CONSULTING GROUP | EXIT ENGINEERING

April 29, 2022 | Insights

NAVIGATING A PARTNERSHIP BUYOUT OF PARTNER: KEY STEPS AND CONSIDERATIONS

Even the best business partnerships end eventually. In a perfect world, all business partners could continue to work together amicably until retirement, forgoing the rigors of partnership dissolution. But in business, as in life, circumstances can change quickly.

A partner buyout may become necessary when a business partnership ends, but one partner wants to retain control of the company. This process can be tricky without the right strategy in place. Knowing how to buy out your business partner properly can save time and money and help maintain business profitability following a partner's exit.

Figure Out What You Want From A Buyout

Before any legal or financial considerations are considered, it's important to consider the buyout comprehensively. Why is a buyout necessary? What exactly do you intend to achieve from buying out a business partner? Maybe you feel the company needs a change in direction that can't be reached with a current partner. Maybe your working relationship has been badly soured, and it would be best for all parties to exit the partnership.

Whatever the reason, knowing what you want from a partner buyout now can help set the parameters for buyout negotiations later and deliver the best outcomes for all parties involved. An established partnership buyout agreement can guide starting the process.

Make Your Expectations Clear

It's imperative that you and your partner have an open discussion about buyout expectations as early in the process as possible. Hopefully, you began the business with well-defined partnership agreements and maintained a respectful, mutually beneficial working relationship throughout your years together. But even if the partnership is precarious, clearly communicating expectations can benefit partner buyouts.

Be receptive to feedback and expect to answer queries, especially the all-important question of why exactly you want to buy out departing partners. Try to document the findings from your conversation, where you agree and where you don't, so that all small business owners can enter buyout negotiations on equal footing.

Agreeing on the Valuation of the Business

Business valuation is essential for the buy-sell agreement. The goal is to find a satisfactory price for all partners involved and, ideally, a middle ground to financially benefit both the remaining partners and exiting business partners. Perhaps unsurprisingly, business valuations can be contentious and often cause conflict in partnership buyouts. For example, suppose one business partner's expertise is especially valuable to business operations. In that case, they may demand a higher price that the buyer disagrees with.

With the help of an independent valuation expert, fair market value can be determined by quantifying your business's worth, including the company's tangible and intangible assets. Expected profits, sales, revenue, equipment, market share, and a business partner's creative and operational contributions are all considered.

Agreeing upon the company's valuation is essential before any deal can be reached. Because of the likelihood of disputes and contentions, it's typically a good idea to involve a law firm, accounting firm, and other business advising professionals at this stage.

Buying out a partner can be challenging. Contact us today for all the consulting services you need to achieve a successful buyout.

Formalizing the Structure of the Payment

A mergers and acquisitions lawyer can help ensure that partners meet all legal requirements and that the buyout agreement minimizes potential disputes.

Like a prenuptial agreement preceding a marriage, having a standing partnership buyout agreement can expedite the process when things end. If stipulations regarding buyouts and determination of buyout amounts are drafted ahead of time in a partnership agreement, deciding on a defined deal structure is easier.

A buyout payment can be structured in a few different ways. With sufficient cash on hand or through small business loans, a lump sum buyout can be made to the bought-out partner. Structured long-term payments are also possible. These payouts can be structured as monthly or quarterly payments with payment terms extending for three or eight years.

However, long-term payments may depend on the state of the relationship between partners. If relations have become malignant, departing partners may insist on a lump sum structure if for no other reason than to cut ties decisively.

Determining the Best Way to Finance the Partnership Buyout

Settling on the terms of the buyout agreement can be a herculean feat. Even after reaching an agreement and formalizing the structure of the payment, financing the buyout remains a challenge.

The preferred method of financing the partnership buyout is self-funding. As previously explained, this involves using available capital to pay departing partners in a structure defined by the buyout agreement. Payments can be made in installments or a lump sum.

Suppose cash flow problems are burdening the business. In that case, applying for small business loans from the Small Business Administration (SBA) is possible to fund partnership buyouts. However, this option does require substantial planning. The application process can take several months, and the purchasing partner will need to demonstrate their ability to effectively continue operations on their own and meet other criteria.

You could also invest in capital gain by selling your partner's shares to private investors to fund your buyout with equity financing. However, this method shifts the partnership to private investors, essentially replacing one partner with another. Borrowing money with a small business loan to increase your ownership stake with debt-funded financing is another option, although the money may be difficult to qualify for.

Clarify the Terms of Your Buy and Sell Agreement

The financial aspects of the buy-sell agreement are understandably the main concern for most partners. However, the terms of the partnership buyout agreement should be forthcoming about the non-financial consequences. It's important to be as clear as possible about each respective partner's responsibilities and roles in the company following the buyout.

Buyout terms may need to include non-compete agreements and trademark rights clauses. Suppose the selling partner intends to continue working elsewhere. In that case, it's important to protect your company's intellectual property, business contacts, and proprietary processes to remain competitive.

Finalize the Buyout

After you've taken the appropriate steps to reach a buyout agreement with your former partner, the last step is ensuring that all necessary paperwork is completed, including any non-compete agreements or other legal addendums.

Buying out your business partner is challenging, but it doesn't have to be painful. With expert services from Exit Consulting Group, you can buy out your partner in a professional manner while preserving the integrity of your business.

Ready to Navigate Your Partnership Buyout With Confidence?

Buying out a partner is one of the most pivotal decisions you'll make for your business. Don't go through it alone. We have the expertise to guide you through valuations, negotiations, and financing strategies while protecting your company's future.

Contact us to schedule a consultation today and let us help you turn this transition into an opportunity for growth.

Practicing What We Preach: Our Story

At Exit Consulting Group (ECG), we understand that navigating a partnership buyout of a partner can be a complex and emotionally charged process. As a professional services firm built upon the experience of experts who have started, grown, managed, and sold multiple companies of their own, we specialize in developing roadmaps for businesses going through transitions, including partner buyouts.

Our team of Exit Engineering® professionals brings a wealth of experience from working in day-to-day business operations, leading corporations, and running their own businesses. We are well-versed in finance, strategic planning, operations, transactions, and everything it takes to guide your business through a partnership buyout of a partner.

Our purpose is to create alignment and bring peace of mind. We work hand-in-hand with our clients to define what success looks like and establish a plan of action to achieve those results while ensuring that the organization continues to thrive.

We are committed to helping our clients envision, pursue, and achieve rewarding exits. As we navigate the same journey with you, we bring our own day-to-day internal dealings of succession to our clients. Exit planning, including partnership buyouts, is part of a good business strategy and should always be considered in both short-term and long-term business goals and growth.

You are not alone in working through your partnership buyout of a partner, and we would love to partner with you as you navigate this road ahead.

FAQs

How does buying out a business partner work?

Buying out a business partner can be done in several ways. In the best case, it involves partners amicably deciding to end their partnership and using available capital to pay departing partners for their shares in the company. In more complicated situations, the process may involve equity financing, applying for small business loans, or paying the selling partner in installments as stipulated in a buyout agreement.

How do you value a partner buyout?

You can value a partner buyout by consulting a business valuation expert or by multiplying the percentage of ownership by the appraised value of the business.

What happens when a partnership buys out a partner?

When one partner leaves the business, another partner may decide to buy their share of the company. With the help of legal and financial advisors, a buyout agreement is drawn up, and a deal is made regarding how much to pay the exiting partner.