The Corporate Divorce: Tactics for Dissolving a Business Partnership

By Rocky Fiore

Your business partner suddenly decides he wants to leave the company you both started twenty years ago so he can live his life-long dream. Or perhaps he has simply lost interest in the company and wants you to take over. In the worst-case scenario, you realize your personalities do not mesh after all and your business relationship is beyond repair. You both know it's time for a corporate divorce – but how do you move forward without destroying the business you have worked so hard to nurture and grow?

As the remaining business owner, your first step is to determine if you are prepared to run the business by yourself. Do you have a management team in place to help ease you through the transition? How easily can your partner be replaced? If the thought of flying solo sends your stomach on a downward spiral, then you might want to consider selling the business to a third party, facilitating a management buyout or selling to your employees via an Employee Stock Ownership Plan (ESOP). But if you're excited about the possibility of taking complete control of the reigns, then purchasing your partner's shares of the company stock might be the right alternative for you. All you'll need to do is write a check and the company will be solely yours, right?

If only it were that simple. Most business owners do not have the capital at hand to buy out the disaffected partner upfront. More often than not, a leveraged buyout will be enacted, which essentially funds the takeover using a combination of equity and borrowed funds (loans), often using the company's own assets as collateral. Or, the seller has to take back a note and therefore will not receive any cash upfront.

Each possibility presents its own unique challenges and potential problems. You don't want the company to borrow money to the point where it can't fund growth initiatives and you'd prefer it if your partner wasn't a debt holder with a vested interest in how the company is doing. The temperature gauge on these types of transactions always spikes when the partners begin talking about where the money is coming from. And the negotiation process gets progressively more complicated as you get further into the restructuring possibilities, especially if there is acrimony involved.

It is highly recommended that you engage the services of a trusted and objective financial advisor, who will help you navigate the rough waters of the entire buyout process, from valuation to structuring to implementation. There are various ways to structure an ownership buyout. The best decision making tool for the shareholders is to value the company using live numbers. That way they'll realize the consequences of each possibility and how the transaction will not only affect the company, but also the shareholders personally.

This is especially critical if there are more than two shareholders or if ownership is unevenly distributed. When you have more than two owners and one wants out, then there is always the possibility that not everyone will be interested in buying shares pro rata or helping to fund this individual buyout deal.

Of course, the transition will be infinitely easier if you've prepared for it ahead of time and have a defined exit strategy in mind. Every business partnership should have a buy-sell agreement in place – a pact that essentially obligates one partner to purchase the other's interest (and obligates the other to sell) upon the occurrence of some event stated in the agreement, such as disability, death or the partner withdrawing from the business. Without this, you could end up wasting a lot of time and money in dispute – and might permanently affect the vitality of the company in the process.

It's almost like having a prenuptial agreement. A buy-sell agreement addresses the particulars of how the business partnership will be dissolved before it reaches the crisis point.

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