

Perfect Partners

02/12/07

My partners and I are thinking about bringing another member of our staff on board as a junior partner. Ours is a small service firm, and our assets, our employees, ride the elevators. We have under 10 employees, including one individual who we want to be sure we keep around – he is productive, engaged, and has potential to help our firm grow significantly. Our questions center around how to do this? What kinds of partnership arrangements are out there? What do we have to look out for? What happens if things don't work out, and we later want to ask him to leave the firm?

Bringing an employee into the ownership ranks is a big decision, and not one you want to take lightly. Many early stage business owners make the mistake of thinking they need to offer partnerships in order to attract or hold key employees. On the other hand, once you're sure you have a key player, it's worth some time and effort to figure out how to reward and connect that person with your firm.

You want someone who is already fully committed to the business, someone who is as passionate about the business as you are. When you ask what makes this person get out of bed in the morning, the answer includes something along the lines of, "the fun, opportunity and challenge of working to grow this business". You also want to be

sure that this person has skills you can use, to further the growth and development of the business.

Think of partnership as the allocation of scarce resources. You are giving up a portion of ownership. What will you get in return? How will giving this person equity in the firm help to make the firm stronger, more capable, worth more? What would happen if this person were to leave, how replaceable is this person? How likely is it that this person might leave? How much are you and this person in tune, seeing the macro picture of the business from the same point of view?

When considering sharing ownership, negotiate from a position of strength, never from weakness or fear. If an employee is threatening you, for example, saying if you don't give me equity, I'll leave – watch out. This person is already saying they don't have the best interests of the company at heart, they're negotiating out of self interest – which is okay for an employee, but not necessarily what you want in a partner. I'd rather hear an employee say, I like this business, I want to be further involved with the business; I want to have more involvement in building something greater, participating in the risks and rewards of that adventure.

Share a small amount of equity at first. Start with 5%, for example. Decide how much equity you

want the person to hold, ultimately, and work up towards that amount over time. Establish a price at which you would buy back any stock, and have an agreement that defines what the person has to do if they leave the company. Personally, I like the requirement that the person has to sell back, or give back, shares if they leave.

Look at your current ownership structure. If you are an S-Corp or C-Corp, you can distribute shares. Check how many shares sit in Treasury, how many shares you currently own. If you need to create more shares, talk with your attorney or accountant about how to do that. If you are a partnership, talk with your attorney about language and structure for adding a partner, and whether / how you can add a junior or minority partner.

Talk with the potential partner about ownership consequences. Most employees don't think enough about, or know enough about what it means to be an owner. For example, owners of S-Corporations have to pay taxes on the profits of the company, since profits are distributed at year end. Most owners, at one time or another, have had to put money back into the company, or sign loan guarantees. Often, employees haven't been exposed to, and don't think about those kinds of responsibilities.



Trusted Advisor to Business Owners

Perfect Partners

02/12/07

As a founding owner, you probably want to retain control, by holding over 50% of the shares of the corporation. Unless you intend to fully share the decision making control with your new partner(s), you have to be sure that you can make the final decisions, and make them stick. Don't take the need to have control too lightly – when things are going along smoothly it doesn't matter so much. When problems arise among partners, it's the person with the majority shares, or the ability to get votes from the majority, who makes the final decisions.

Looking for a good book? Try *The Partnership Charter: How to Start Out Right With Your New Business Partnership (Or Fix the One You're In)*, by David Gage.

Business owners regularly turn to Ask Andi and Strategy Leaders for advice on how to grow profitable, successful companies. They find what they need time after time. Specific advice is available at www.AskAndiBlog.com. Ask Andi is also published weekly in the Westchester and Fairfield County Business Journals and Hudson Valley Business. Written by Strategy Leaders President, Andi Gray, the Ask Andi column is a rich source of advice for owners of established, privately held businesses.

If you are a business owner and you have a question or would like to discuss some aspect of your business, call [1.877.238.3535](tel:18772383535) or send an email to AskAndi@StrategyLeaders.com.

O: 914-238-3500. • F: 914-238-2529
AskAndi@StrategyLeaders.com • www.StrategyLeaders.com
Strategy Leaders, Inc. • 5 Crossways, Chappaqua, NY 10514

