Planning Ahead

Buy-sell agreements help protect companies' top assets and ensure shareholders are on the same page when changes occur.

By Katy Zillmer

The start of a new year is a good time for business leaders to review their company's processes, policies and financial documents to ensure smooth sailing in the coming months. As part of this review, owners should dust off their company records for succession planning and discuss any changes from the previous year or modifications to the plan they'd like to make in the coming months.

While it's important to review most pieces of your succession-planning portfolio on a regular basis, the buy-sell agreement is one document in particular company owners should review annually. Buy-sell agreements protect business owners when a co-owner wants to leave the company or passes away. Buy-sell agreements can also be a mechanism for business owners to pass the business or their value in the company on to a relative.

Buy-sell agreements are not unique to businesses specializing in accounts receivables management, but they are recommended for all companies in the industry, especially those with more than one shareholder, according to Brian Greenberg, founder and CEO of Greenberg Advisors in Rockville, Md.

"It's simply a good tool and a logical legal document for any kind of business to have in place to prevent disputes before they occur," Greenberg said. "Given that merger and acquisition activity in the ARM industry is outpacing 2013 activity by far, it's a wise choice to have potential areas of dispute resolved in a buy-sell agreement with your business partner."

In 2013, according to a report from Greenberg Advisors, accounts receivable management market mergers and acquisitions transactions reached $2.1 billion—a 33 percent increase from 2012 and the first time the total value exceeded $2 billion since 2007.

While trends in merger and acquisition activity in the ARM industry may fluctuate from year to year, there are constants in the process of developing a buy-sell agreement that companies can rely on over time.

The Agreement Process

Business owners should consider several factors when entering into a buy-sell agreement, including whom they want involved in the process. Changing the terms of an agreement after an owner decides to leave, for example, can be difficult, and shareholders should be on the same page before that or another change in ownership happens. Owners may want to consult with financial advisors and legal counsel, especially those with expertise in the ARM industry, to help them through the process.

First, there are certain voluntary and nonvoluntary events that could impact a business' ownership and should be considered when developing a buy-sell agreement, said Paul Becht, a partner at Baker Tilly Virchow Krause LLP in Melville, N.Y.

Common events that would cause the provisions of a buy-sell agreement to take effect, and that business partners should consider when developing the agreement, include one of the owners leaving the business or the death, disability, divorce or retirement of an owner.

"The owners need to have a buy-sell agreement in place for one or more major events," Becht said. "Succession planning is important because there are many events that an owner cannot foresee that could negatively affect when and how the owner intended to pass along ownership of his or her company."

One of the first steps in developing a new buy-sell agreement is to have the company assessed to determine a valuation, which helps establish the buyout price included in a buy-sell agreement.

"The valuation is either a dollar amount or most likely you'll see a methodology about determining the valuation," Becht said. "You may see something as simple as the co-owners agreeing on a valuation formula or they would agree on hiring an independent appraiser to determine the fair market value of the business."

A company's valuation must be at fair-market rate, and can be incorporated into a buy-sell agreement in different ways.

"We've had owners hire us to perform a valuation for their buy-sell agreement and others who have written us into the agreement so that in the case of any valuation dispute, the parties would turn to us for advice on the valuation," Greenberg said.

Some company shareholders opt to include their life insurance policies in their buy-sell agreements, which Becht noted can be more effective than a standard legal document. Financial advisors can assist with that process.

"That's an effective way of funding the acquisition of a co-owner's shares or a co-owner's ownership units," Becht said. "The co-owners could structure the buy-sell agreement so that upon the death of one of the owners, the proceeds from the life insurance could be used to purchase the shares of the owner who passes away."

Including life insurance policies in a buy-sell agreement when it is established can also help families of business owners avoid making those important decisions during emotional times, such as when a shareholder decides to leave the business.

"If you have members of your family on board with your plans and you've made them aware of your plans, then it should make for a smoother transition once that transfer of ownership occurs," Becht said. "In those circumstances, the advice of a financial advisor and the use of life insurance become important aspects of that buy-sell agreement."

When a buy-sell agreement is complete but not finalized, companies should have their legal counsel review the document to make sure it still protects their business in the ways they initially intended.