

Enhancing Your Business's Future: Revisiting Organizational Structure and Buy-Sell Agreements



ARTICLE 06.13.23 JOHN HERING

When planning for the future, business owners often are engaged in forecasting, reflecting on past performance, and setting goals. While budgets, financial statements, and tax returns may be part of this process, it is equally important to devote attention to your business's organizational structure, corporate governance, and potential sale considerations. Often overlooked, these elements can significantly impact your business's success and long-term viability.

It is important to begin this process **early** often years in advance if possible.

In this article, we emphasize the importance of revisiting your organizational structure, delve into the types of buy-sell agreements, and explore considerations for a potential sale of your business.

1. The Importance of Revisiting Organizational Structure

Your business's organizational structure serves as the foundation for its operations, decision-making processes, and growth trajectory. Outdated structures can impede progress, hinder adaptability, and limit your ability to attract potential buyers. By reviewing and updating your organizational structure, you can:

- **Streamline operations:** Assess whether your current structure aligns with your business goals and objectives. Clearly define decision-making authority and accountability within your organizational structure to limit exposure to a key-man discount.
- **Attract potential buyers:** A clean corporate structure and buy-sell agreement can make future exits much simpler. Messy ownership structures can scare away potential buyers. If you believe selling to an outside party is a likely exit, planning this process earlier is paramount to ensure you maximize value.

2. Types of Buy-Sell Agreements

Buy-sell agreements are essential for privately-held businesses, especially during ownership transitions or potential sales. Good agreements safeguard the interests of owners and their families, ensuring a fair and orderly process. Poorly structured agreements can create headaches and strip value from your business. In his book, *Buy-Sell Agreements for Closely Held and Family Business Owners*, Chris Mercer identifies commonly used buy-sell agreements:

1. **Valuation agreements** — The business value is determined by one or multiple valuation appraisers. The buy-sell agreement defines key aspects of the valuation process such as the standard of value, level of value, application of discounts for lack of marketability and control, etc.
2. **Fixed-price agreements** — Owners agree on a fixed price for the business value. Price remains static over time which may or may not represent a fair and reasonable price depending on changes in the business, industry, and economic environment.
3. **Formula agreements** — A formula agreed upon by the owners will determine the business value typically based on financial metrics (e.g. stated multiple of earnings or book equity value). Similar to a fixed-price agreement, the formula may or may not result in a fair and reasonable price over time due to the changes in facts and circumstances of the business.
4. **Shotgun agreements** — A triggering event results in an owner tendering a price to buy **or** sell an ownership interest in the business. The owner receiving the offer has the option to buy at the offered price **or** sell at the same price. A “fair and reasonable price” is anticipated as each owner could be the buyer or seller. However, the financial circumstances and personal employment status of each owner and their family can influence the offering price and related decisions or implications.

Each type of buy-sell agreement has many nuances, advantages, and disadvantages. The “right” type of buy-sell agreement often depends upon the circumstances of the business, owners, and the owner family dynamics.

3. Considerations for a Potential Sale

In addition to reviewing your organizational structure and buy-sell agreements, it is crucial to consider the potential sale of your business. Factors to evaluate may include:

- **Business valuation:** Assess the current value of your business, taking into account its assets, revenue, market position, and growth potential
- **Market analysis:** Understand the market conditions, industry trends, and potential buyer profiles that may influence the sale process. Identify opportunities to position your business strategically to maximize its attractiveness to potential buyers.
- **Exit strategy planning:** Develop a robust exit strategy that aligns with your personal and financial goals. Consider the timing, [succession planning](#), and potential [tax](#) implications of the sale. Who is your target buyer? A family member, someone interested in your business' legacy, or private equity?

Conclusion

Remember to allocate time and resources to review your business's organizational structure, buy-sell agreements, and potential sale considerations.

Dean Dorton's business advisory and [valuation group](#) has assisted many business owners with transitions and structuring their buy-sell agreements. Let us become part of your advisory team to review your business organizational and governance and help you ensure a smooth and rewarding journey as you navigate the future of your business.