



YOUR MONEY: How To Add An Equity Partner

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Recruiting a new partner can accelerate your company's growth and help you achieve financial security—if you do it correctly.

PART I

(This is Part One of a Two-Part Series. In the next edition of Small Business Review, Guy McPhail will spell out the essential steps for creating an equity partnership.)

Adding a partner can be an excellent way to help grow your business. It's also a good strategy for getting cash out of your business and diversifying your asset base. And a partnership can also establish the mechanism for you to sell your remaining equity down the road.

Adding a partner (or multiple partners) can also serve non-financial goals: After devoting years to establishing your business, maybe you would like to work less. Maybe you want to start thinking about retiring altogether. Adding a partner can be a good way to help fund these goals. At Zdenek Financial Planning, where I am a partner, we use this very approach.

Here's an example: Let's say you need an additional \$1 million to become financially independent. You think your small business may be worth around \$2 million. So, an outright sale would set you up. Only, you don't want to sell right now; you want to continue to run and grow your business. A new equity partner can help you accomplish both goals.

Before you start thinking about the financial issues, however, you need to think about your options. Are there candidates within your business who might be good candidates to become partners? Can you hire someone who would? Is there an ideal equity partner from outside who would bring needed expertise—in addition to capital—to help your business grow? Don't rush this decision or you may find yourself ending up with the wrong candidate.

For the sake of our example, though, let's say you have a general manager who you think would be a potential partner. What should be your first step?

Get a current appraisal of your business by an expert in your field. Without an up-to-date valuation, you can't determine how to fairly structure the financial contracts with your new equity partner. Let's say the appraisal comes in at \$2,000,000 and you are willing to sell 20% of your business to your general manager. That would give you \$400,000 toward the \$1 million you need to fund your independence and you'd still maintain control of your business. You probably would tell me your general manager doesn't have \$400,000 in hand to pay for his twenty percent. You could offer him a note for the \$400,000 over 10 years at 6%. That would cost him a little less than \$4,500 per month. You could also offer to take this \$4,500 per month from him in the form of a salary reduction. In essence, part of his salary gets allocated to help fund your financial independence.

This specific example may not be directly applicable to your business. So, meet with your CPA and financial planner, run the numbers and figure out how to make it work for your personal situation.

Personally, I like this type of arrangement. It provides you with immediate cash flow and a great way to bring on one or more partners. Equally important, it puts in place what can become an incentive plan for other employees. The ambitious ones will see that there is an opportunity for them to become equity partners if they continue working for you and helping the company grow.

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