Making a Partnership Work for You
By Michael Neidle, President of Optimal Management

OVERVIEW

Having partners can be a blessing or a curse, so think out your options carefully as the stakes can be very high. When you own a company you own all of it. When you have a legal partnership or a company with other active shareholders, you have partners. Having consulted with hundreds of staffing companies over the years, we noted that half of them operated in some form of a partnership and about half of those have worked out quite well. The remainder either had poor performance, were dysfunctional, or resulted in a buyout. This does not mean that being the sole owner is better, only that when you give away part of your company that is a very expensive decision, so think it through carefully.

RATIONALE FOR A PARTNERSHIP

Partnerships are typical for staffing companies for many reasons, and are not just vehicles reserved for the founders of the company. A partnership can be created for whoever wants to join forces, be they principals, staff, outside investors, family members, etc. There are pros and cons of a partnership. But first and foremost a partnership is a personal relationship, similar to a marriage. And the key factors in any successful relationship are trust and evenhandedness in everything from financial obligations to workload. And no amount of care in the wording of a contract can make a partnership work if confidence in each other evaporates. The rationale for a partnership typically includes:

1. Bringing together people with complimentary skill sets
2. Having evolved out of prior relationships and camaraderie
3. Providing access to key people and businesses
4. Locking up key employees
5. Sharing financial obligations and risks

Things tend to work best when the principals compliment each other's strengths and weaknesses. One person is outside handling clients and sales and the other person is inside handling recruiting and operations. One person may be technical and oversees IT, medical or biotech, and the other person may handle commercial staffing. Things don't work out well when both parties want to do the same thing and other responsibilities are ignored. It is not a good idea to form a partnership based on a prior relationship or friendship. An employer/employee relationship might be more suitable here and a partnership could evolve if the situation warrants. Similarly, having key contacts may be worth either being offered a job or having part of the company, depending on how critical and long lasting those relationships are. It is more prudent to pay someone for their services or to put them on the Board, then to give them equity.

As to item four, the concept here is to create "golden handcuffs" to retain key employees who might go to a competitor or even set up their own shop. We have often used "equity equivalents" at times, which avoid the legal encumbrances of stock but provides all of the financial benefits.

Regarding the last item, we favor debt over equity whenever possible. Stock should be provided when no other form of payment will do. Equity should be used when you need the full attention of the other party as having money at risk really tends to get ones

attention. People start their own company because they don't want to answer to others. In addition, debt tends to be cheaper then equity (see example below).

MAKING A PARTNERSHIP WORK

Once you have determined a partnership works, the trick is to make it function over the long haul. Problems will invariably develop and must be dealt with or the company will become dysfunctional and will fail. Here are some of the keys to making it work.

- Develop sound contracts. It is said contracts are made to be broken, but that only means do your best so that if it is broken you can walk away in one piece. The basics of a contract include: defining duties, grounds for termination, severance packages, non-competes, financial obligations, valuation and buyout terms, board membership, buy-sell clauses, voting control, remedies, jurisdiction, severability, etc. Seek good legal counsel, but remember your attorney is not a businessperson. He is there to protect your legal interests, but should not be weighing business risks let alone understanding the staffing industry; these items are your responsibility.

- Deal with each other's strengths and weaknesses. A good partnership needs well-defined roles and having an ethical, let alone a financial responsibility to each other. Things will not change and evolve, but when burden is not fairly shared and one party feels put upon or not adequately compensated for their extra effort, tensions develop. At the end of the day one party has to make the final decision on key issues and after hearing everyone's opinion one person has to be the CEO and steer the ship.

- Compatible personalities and management styles. It takes continued effort to make a partnership work and not all people like each other, can get along, or should be partners. This does not mean partners should be clones, in fact complimentary skills and personalities work quite well if the chemistry and respect is there, i.e. a gregarious person to represent the company outside and an analytical person to keep inside operations running smoothly. But chemistry can be a tricky thing and the pressures of running a business have to build up before an explosive reaction takes place. Give the relationship time to simmer before jumping into a partnership.

- Don't take ethical or legal shortcuts. Be honest with your clients, your staff, the government and your partners. Be sure you are in business to make money and maximize your profit, but evaluate this over the long haul. The company's reputation rides on how you and your partners deal with each other. Know what everyone is doing to avoid another Enron.

- Have sound operational and financial controls. There is no substitute for strong operating controls and checks and balances. Although trust is important, remember President Reagan's words when conducting the arms control agreement with the USSR, "trust but verify".

- Plan ahead. Strategic and tactical planning are crucial. If you understand the factors that impact your business you will minimize partnership conflicts. Deal with problems head on and be prepared to extricate yourself from the partnership if it is no longer working.

CASE HISTORIES

- Company A is a staffing operation with 2 offices in business for 10 years. The majority owner planned to sell the company in a few years, but was making questionable legal decisions and had poor financial and operating controls. Her sister ran one of the offices and was averse to taking legal risks and was a strong advocate of management controls. That sister received an equity position and was able to exercise a positive influence on her sister. As a result of her participation sales, profits and equity all rose.

- Company B also has 2 offices, but was somewhat smaller. The business thrived after weathering the recent recession. The 2 partners held equal equity and had similar backgrounds, interests and socialized. They had a buy-sell agreement and due to early retirement by one of the partners it was precipitated. We valued the company and structured the buyout with an upside potential for the remaining owner. The agreement was approved by both parties and they were happy with the results.

- Company C has 4 offices. The Company had intellectual property, which was converted into value-added systems, which set themselves apart from the competition and generated good margins. As in Case A, the owners are siblings, but unfortunately they were polar opposites. Furthermore, one party took on most of the workload as her sibling took more and more time off. This resulted in conflict and recriminations, which retarded the implementation of value-added programs and the work atmosphere, became toxic, resulting in staff attrition. With no buy-sell agreement in place, arriving at a satisfactory buyout solution became very difficult.

- Company D had 8 offices and was a strong player in their regional market. The father built the company and retired. The father retained 60% of the company, gave his son 30% and made him President and gave 10% to his daughter. Other family members were active in the company. Unfortunately, none of the family was capable of running the company and it became dysfunctional. The company's performance slid and was sold at below market price and all of the family was replaced.

EQUITY VS. BORROWING

A company had $3 million in sales, a 5% return for $150,000 in profit. It needed $100,000 to support another $1 million in sales and $100,000 in accounts receivable. It could get a loan for 10% which would cost $10,000 or get the money for a 10% stake in the company. The company was valued at a P/E multiple of 3 or $450,000 currently, or $600,000 with the additional funds, so growth made sense. But giving away 10% of the company would have cost it $60,000 or 6 times the cost of borrowing. As long as loan covenants were maintained and profits held up, the loan would be paid back and debt was the way to go.

CONCLUSION

A partnership can be a great way to share the responsibilities of a business. But a partnership is like a marriage, so think about it very carefully before entering into it and reflect on your reasons for entering into it. If you go ahead, make it work for you and refer to the items and case studies above.

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