Principal®

Does your buy-sell agreement reflect the business value and transition outcome you want?

Consider these best practices.

Since all businesses are different with unique needs, it's important to have a buy-sell agreement that works for your specific situation. Below are some key questions to consider, based on what Principal® has uncovered over nearly a decade in reviewing buy-sell agreements for business owners like you.

What does your buy-sell agreement say about purchase price?

20% determined annually or based on an annual determination that may be out of date

19% subject to mutual agreement of the parties

9% not addressed or based on Agreement provisions that are blank

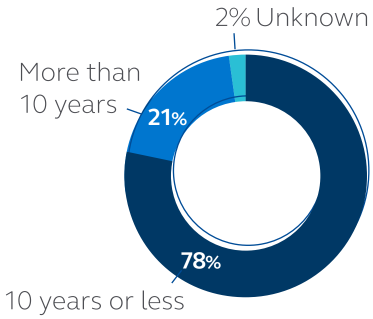
Almost half of the agreements we've reviewed indicate the business should be valued annually, or is based on an annual value that's outdated, not addressed, or subject to the mutual agreement of the parties.

What's the risk? Different approaches to setting the purchase price come with specific considerations. Exiting owners and remaining owners are rarely in the same mindset at the time of a transition. Annual updates may sound good on paper, but they rarely occur in practice. A formula-based price that worked well years ago might result in a price today that's too high or too low.

Take a look at what your agreement says about the purchase price. Would you be comfortable selling your business for that price today? Courts don't generally strike down agreements on the grounds that the price is unfair. It's the business owners' responsibility to be aware of the price to which they agreed.

Have you recently had a buy-sell review?

Over 21% of the agreements we review haven't been reviewed in more than 10 years, or the owners didn't know when it was last reviewed.[1]



What's the risk?

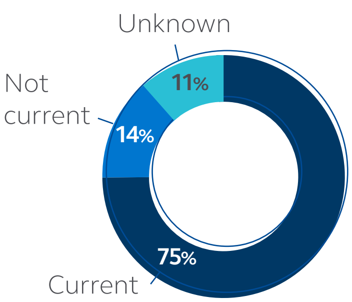
Since circumstances and life can change, an agreement that worked well 10 or more years ago might not make sense today. For example:

- Perhaps a son or daughter has become involved in the business and wants to acquire the parent's ownership interest, instead of it being offered to the other owner. Conversely, perhaps a family member or owner has left the business.
- Perhaps an owner has developed family or financial concerns that could affect the shares and aren't addressed by the agreement. Or the owner has become widowed or divorced and has different priorities for the disposition of the shares.

Most business owners do not remember the details of their agreement many years after signing it. A thorough review can help identify issues that might need renewed attention and potential changes.

Does your buy-sell agreement cover all current owners?

In nearly 26% of the agreements we've reviewed, the roster was either not current, or it was unknown if all owners were listed.[1]



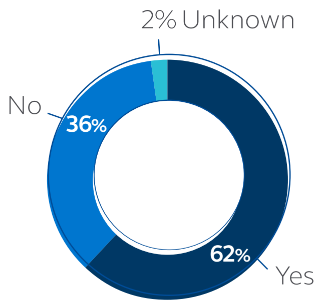
What's the risk?

The design of a well-drafted buy-sell agreement is heavily affected by the number of business owners. An agreement designed for two owners might not work for three or more owners, and vice versa. The risk is that the eventual buyout, or the transfer of life insurance policies to accommodate a change in ownership, could trigger unexpected (and unnecessary) taxes.

It's important for your agreement to include a complete list of all current owners. And each time ownership changes, the agreement should be updated accordingly.

Is the buy-sell agreement signed by all owners?

In our experience, 38% of the agreements reviewed either weren't signed by all owners, or it was unknown if all current owners had signed it.[1]



What's the risk?

An unsigned agreement has no legal effect. This means the questions that the agreement would have answered must either be resolved by the parties during a challenging event or in a courtroom.

Does your buy-sell agreement include spousal consent?

An astounding 76% of the agreements we've reviewed did not include spousal consent language.[2]

What's the risk?

Spousal consent language can prevent a lawsuit in the event that an owner later passes away or goes through a divorce. Including spousal consent language at a time when all parties get along can go a long way toward preventing a later claim where the spouse didn't know about the agreement or later believes it was unfair.

Perhaps even more interesting … of those who included spousal consent language in their agreements, only 42% included the required spousal signatures.[2]

What's the risk?

Just as an unsigned agreement has no legal effect, omitting spousal signatures suggests that the owners' spouses didn't know of the agreement and didn't have the opportunity to seek legal counsel regarding its fairness.

Take steps now to mitigate risks.

Determining the value of your business and reviewing your buy-sell agreement can help bring everything into alignment. Request a complimentary informal business valuation and/or buy-sell review from your Principal representative today.

[1] Based on 956 records of buy-sell agreement reviews completed January 1, 2018 to July 15, 2023.

[2] Based on 2,517 records of buy-sell agreement reviews completed January 1, 2014 to July 15, 2023.

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