GRYPHON VALUATION CONSULTANTS, INC.

Shareholder Agreements: Preparing for the Unexpected

Think of it as a prenuptial agreement for a family business -- a mechanism to reduce hard feelings and provide for an equitable distribution of assets. Officially, it's called a shareholders' agreement and it lays out the ground rules of a family business in terms of governance, succession, the transfer of assets, liquidity and other issues.

Here are six issues that are often included in the shareholder agreements of family-run businesses:

1. Board composition, which can take into account representation for each sibling -- or spouse -- and whether to bring in outside, independent directors.

2. Voting requirements, including the number of votes needed to approve key business issues. For example, do you need a simple majority or unanimous approval?

3. Management positions, including provisions about whether jobs are filled from inside or outside the family and what training or experience is required.

4. Participation in the business. The agreement should address the rights of family members who don't want to be involved, as well as those who do. It should also set the rules for levels of experience, training and education.

5. Profit distribution. The agreement should set out a dividend policy that could, for example, determine a set percentage of profits to be paid out, unless the board decides to make a change. This can help defuse tensions between passive owners who may want as much cash as possible and active members who may want to preserve or reinvest cash.

6. Compensation for active owners that is separate from profit distribution. Again, the board should set compensation levels, strategic goals and levels of experience required for certain salary levels.

Ownership and Succession

A shareholder agreement should address ownership and succession to help ensure the business stays in the family. Here are some issues to consider and questions to answer:

Family transfers of ownership - What if a shareholder wants to leave the business? Who can buy the shares? What happens to the shares of an owner who dies or becomes disabled? What should you do in the event of a divorce in the family?

Partial redemptions - What are the policies for letting the business buy back some percentage of an owner's shares annually?

Outside transfers - Are there restrictions on transferring shares outside the family or using shares as collateral for anything other than family business financing?

Sale of the business - What if majority shareholders want to sell but a minority opposes the idea? Is there a provision to offer the minority the right to buy the business within a specified time at set terms and financing?

Non-compete clauses - If a shareholder leaves the company, is he or she prohibited from starting a similar business within a specified geographic area?

Contingency succession plan - What if something happens to the designated successor or the heir apparent decides to go another route?

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