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Perfect Partners

It takes careful planning to create the kind of good partnerships that make for great business

By Reed Richardson

This business needs both of us.” That’s what Bob Sole, co-owner of Express Blinds and Draperies in Victorville, California, was thinking nearly 14 years ago when his pregnant wife Trish’s part-time decorating business suddenly took off. Originally started as a way for her to stay home and earn extra money while caring for their children, Trish’s side business had suddenly started expanding rapidly. “It just got bigger and bigger,” Bob recalls, “and by the sixth month it was bringing in more than \$20,000 a month.”



This rapid growth had quickly overwhelmed Trish, however. “As sales started pouring in, it became very difficult to handle it all,” she explains. Consequently, Bob decided to put his 10 years of experience working for a major blinds manufacturer to use in his family’s new business. “I went to work for her,” he says proudly.

But to really transform the business from spare time to full time required a true team effort. To achieve their ambitious goal of funding their start-up without going into debt, they each squeezed every last ounce of cash out of their personal and combined assets. He liquidated his prized baseball card collection, while she notes, “I even sold off some of our kids’ unused

toys to raise money.” As for the operations side, the Soles’ decided to divide and conquer. Trish assumed control of the finances and occasionally hit the streets delivering company brochures door-to-door (pushing her

inant son in a stroller), while Bob tapped into his network of industry contacts to market and sell their products.

Since then, Express Blinds has been converted into a C-corporation (Bob and Trish are the only shareholders), doubled in staff size several times, and, last year, brought in nearly \$2 million in annual sales. By all accounts, it's a thriving business. And although Bob and Trish—now ages 47 and 43, respectively—make a point of never bringing their business home with them at night, they admit there have been times where the stress of being co-owners of a small business has taken its toll. Still, they both agree that becoming partners was, as Bob puts it, “the best decision we ever made.”

Two Heads Might Actually Be Better Than One

At first glance, the headstrong, go-your-own-way spirit that infuses most entrepreneurs might also appear to make them naturally predisposed against the idea of building successful business partnerships. But whether it has been Allen and Gates or Daimler and Benz or Henry, Mayer, and Emanuel—the brothers Lehman—many of the business world's most well known success stories of the past two centuries started when just the right mix of individuals joined together to form a company. Today, that cooperative fire burns brighter than ever. More than five million small business partnerships in various forms, involving well over 20 million individuals, currently make up a significant chunk of the U.S. economy.

“The enthusiasm for partnering is rooted in a down-to-earth fact: You're much more likely to succeed in business with a partner than without one,” writes David Gage in his 2004 book, *The Partnership Charter*. “Entrepreneurs who have succeeded by pooling their strengths far outnumber those romantic figures, the lone entrepreneurs who have triumphed over all the odds.”

As an example, Gage cites a study conducted several years ago by the Center for the Study of Entrepreneurship at Marquette University that examined the growth of more than 1,700 small companies in the Midwest. It discovered that companies founded by multiple owners made up an overwhelming majority—94 percent—of the fastest growing companies in the study whereas sole proprietorships comprised nearly half—42 percent—of the slowest growing businesses. “Opportunities open up when people combine forces,” Gage says, summing up the study's findings. “If you pit three co-owners against a solo entrepreneur, the three coowners are going to out-think and out-strategize the single owner in most cases.”

Partnerships, when they work well, can also offer advantages far beyond just that of raising capital and lowering each partner's workload, however. Bringing in a partner can add valuable new skill sets to a company, providing a quick way to jumpstart moribund growth or venture into a new market. As the Baby Boomers march into retirement over the next 25 years, small business owners are increasingly expected to bring in partners as part of their personal exit strategy as well as a way to ensure that their companies survive for another generation. Finally, partnerships can help a small business owner hedge risk—both financially and emotionally—by shielding their personal assets from liability and giving them a sense of shared purpose and improved morale.

Play to Your Strengths, Know Your Weaknesses

“I'm not a businessperson, I just happened to own a small business with someone,” says 35-year-old Manhattanite Cindy Greene, coowner of the chic young fashion label and limited liability company, *Libertine*. “I'm more interested in creating and designing, so, psychologically, I needed the support of someone else to do this with.”

That someone else is 35-year-old Johnson Hartig, *Libertine*'s other co-founder and business partner. Hartig, a former actor who lives and works in Los Angeles, had been running his own small clothing line



Angeleno, had been running his own small clothing line for a couple of years when Greene sent him a silkscreened T-shirt as a gift in late 2001. After he hand-tailored it, he wore it out to a party and the buzz that it created convinced him that there was a lucrative market waiting to be explored.

“It all happened organically,” Hartig recalls of the partnership’s beginning. “I called Cindy up afterwards and asked her ‘Can you teach me how to do the printing?’ Instead, she said, ‘No, but I’ll do it with you.’” Hartig agreed and when their first batch of hand-made shirts sold out of L.A. fashion boutique Fred Segal in 45 minutes, they knew they had a hit.

Right away, though, they had to start making as many business decisions as they did fashion choices. Some have paid off, like their unorthodox decision to stay geographically separated—he in L.A., she in N.Y.—which has enabled Libertine to better market to retailers in the two most important U.S. fashion markets. Others, however, have not worked so well. “Initially, we didn’t spell out exactly what our roles in the business itself would be,” acknowledges Hartig. “We consulted a lawyer but, still, we found some kinks had to be ironed out.” Greene remembers that this became evident when, after several months, neither one of them had yet to go to the bank to set up an account for the business. “Checks were just sitting around on desks, sometimes for months,” she says. “That’s when we realized that neither one of us wanted to be involved in the day-to-day running of the business. Instead we wanted to delegate this task to someone we could trust.”

Rob Cummings, a partnership advisor from Orange County, Calif., says this is a common problem facing many of his small business clients. “It’s like two salesmen becoming partners, but there’s no one to bake the muffins. There’s a key piece missing,” he says. The reasons behind this oversight can be varied, he explains, but most of the time he finds it’s because prospective partners never take the time to thoroughly look at every aspect of the business as well as their personalities prior to starting the business. “It’s like falling in love,” he says. “The partners get caught up with the business idea and they don’t ask enough questions before getting married. Then, when they inevitably have problems, they don’t really know how to talk about them and they keep going on and on.”

Hartig and Greene were eventually able to solve their operational problems a little over a year ago thanks, in part, to a fortuitous decision that they made when starting out. Because Libertine had formed as a LLC, they were able to hire an outside business management firm part-time to run their company’s office functions, without having to give up any kind of ownership stake. This strategy has allowed them to focus on their strengths—designing, marketing, and selling their clothes—rather than getting bogged down in other details. As a result, their sales have taken off and their vintage designer clothes are now sold in two dozen stores around the world. “Thanks to our new business manager, we’ve now set up an insurance program, health benefits for our four employees, and we even pay quarterly tax estimates,” says Hartig. “Everything now runs remarkably smoothly.”

Look Before You Leap

Libertine’s experience illustrates the importance of addressing early on the very basic question of what form



Husband, Wife, Partner
Trish and Bob Sole became business partners after Trish’s interior decorating business grew too quickly for her to handle on her own..

the partnership should take. Daniel Sitarz, an attorney and small business self-help writer from Carbondale, Illinois, says that this key decision has wide-ranging implications on any partnership's long-term success.

Which structure is right for you?

General Partnership One of the simplest and most common ways for small businesses to bring in additional capital or someone with sought-after complementary skills is in the form of general partnerships. In these types of partnerships, stakes are evenly divided among each partner unless otherwise specified in a partnership agreement. All gains and losses in a general partnership are routed directly through to the individual partners' personal tax returns and the business is typically not taxed as a separate entity, although it must still file a return detailing the revenues and expense of its partners (Form 1065). And because payroll isn't required for general partners, if a company consists entirely of partners and has no employees, the paperwork requirements can be much simpler than that of a corporation.

However, general partnerships have some distinct disadvantages. The most important of these involves the risk exposure to the partners, who are jointly and individually liable for any debts or judgments against the company, which means the partners' personal assets (home, car, investments, etc.) could be vulnerable to creditors. Also, many state laws mandate that if any one of the partners leaves or dies, the partnership is immediately dissolved, which can make succession planning more difficult and legally tenuous.

Limited Partnership Similar in nature to general partnerships, limited liability partnerships (LLPs) simply allow some of the partners to decrease their overall risk in exchange for giving up an active role in the day-to-day management the company (there must still be at least one general partner, however). Limited partners retain the same profit-taking benefits that general partners do and must file these gains (and losses) on their personal tax returns but they also enjoy legal protections that prevent them from losing any more than their investment stake in the company. But because limited partnership agreements are much more complex than general partnerships, they often take more time and require substantially more legal advice to set up.

Limited Liability Company (LLC) Started nearly 30 years ago as a hybrid between corporations and traditional partnerships, LLCs have proven to be an increasingly popular strategy for small business owners. LLCs allow multiple owners of a company to directly share in profits as they would in a sole proprietorship or general partnership while shielding their various personal assets from liabilities or debts incurred by the business, protections normally found only in fully incorporated companies. A simple Operating Agreement, which is filed with the state business authority, establishes the LLC and sets up the rules for governing the company as well as the rights and responsibilities of each partner, or "member." As part of an LLC, members have the flexibility to choose whether to pass-through company profits to their personal tax returns or to have the business taxed as a separate entity. Two caveats to be aware of though—LLCs cannot, by law, exist for more than 30 years and most states require unanimous approval by all other members before one member can sell or transfer their stake in the company..

S-Corporation Similar to traditional C-Corporations in every way except for a different tax structure, S-Corporations have become quite popular among many small business owners. This is because S-Corporations offer the same tax advantages of sole proprietorships or partnerships—where all income is passed through to the shareholders' individual tax returns—as well as offering the liability protections inherent to a corporation.

The downside of S-Corporations includes increased administrative costs, a much more extensive set of rules and by-laws to follow regarding corporate governance, and closer scrutiny by the IRS. Also, federal regulations require that all S-Corporation shareholder-employees are paid prevailing wages (subject to Medicare, FICA, and any applicable state income taxes), before any profit distributions can be made. In addition, about a half dozen states, despite the federal exemption, still levy corporate income taxes on S-Corporations. —R.R.

General partnerships, limited liability companies, and corporations—the three most common small business partnership structures—each offer various advantages and disadvantages (see sidebar), he explains, but what works for one company might not work for another. "Whichever structure is chosen will have an effect on

what works for one company might not work for another. whichever structure is chosen will have an effect on how easy it is to obtain financing, how taxes are paid, how accounting records are kept, whether personal assets are at risk in the venture, the amount of control the owner has over the business, and many other aspects of the business,” Sitarz says. Therefore, he advises potential partners to seek legal advice and thoroughly weigh the benefits and drawbacks of each structure before finalizing any deal.

Even if the proposed venture will be a straightforward 50/50 general partnership between two people, where a “back-of-anapkin” written agreement is legally sufficient, it’s still wise to speak with a lawyer. This is particularly true if an existing business is bringing in a new partner. “Sole proprietors stand to lose a great deal if they don’t understand the ramifications of a new partnership,” he cautions.

The process of making this one critical decision also pays much larger dividends in the long run. “It usually forces the partners to ask the other necessary operational and financial “What if?” questions,” Sitarz notes. “Things like how and when any profits will be paid out, what steps will be taken if the partners come to an impasse or want to leave, and how the stakes in the company will be divided in the first place.” Even if the partnership involves only two people or a married couple like the Soles, not thinking through this last question might result in missing some golden business opportunities. For instance, when the Soles incorporated their decorating business, Trish was given a 51 percent stake rather than an equal share. This meant Express Blinds now qualified as a minority-owned company and could enjoy easier access to many small business loans and government contracts.

Still, partnership advisor Cummings says that discussing the business’s future is only half the battle. “Many partners, while they thoroughly discussed the nuts and bolts parts of their business prior to starting it, never shared the goals and expectations about their personal lives with each other,” Cummings says. “Working on weekends, vacation time, leaving early to pick up the kids from school, these things can turn into big problems later if they were never addressed.” he says. And just like with a marriage, Cummings says when a business partnership sours because of personal issues, emotions can get very raw.

“The things they complain about can get down to the real nitty-gritty, like the other partner always eating pizza in the office,” he notes. “In all, I’d say 80 to 85 percent of the partnerships I see fail do so because of personal problems rather than from any issues with the business plan.”

Consequently, Cummings advocates trial periods for many of his clients who are starting new partnerships, a tactic born out of his own personal experience. “At one point, I joined forces with a partner who always wanted to have three-day weekends,” recalls Cummings. “I okayed this, but I also had a provision written into our agreement that if I was unhappy after 90 days I could leave with no questions asked.” Not long into the partnership Cummings found himself fielding call after call on Fridays and his partner still refused to change his schedule, prompting Cummings to terminate the deal. “Since I had a built-in exit strategy, I could just walk away. Otherwise, I would have been stuck with paying for half of our vehicle leases and half of our five-year office rent.”

In fact, he points out that the most unpleasant topic for small business partners to consider—What if this doesn’t work?—is also the one that most often goes unmentioned. “Entrepreneurs are naturally optimistic people, even when they’re pessimistic,” Cummings says. “So, the furthest thing from their minds is failure or how they might end the business. But they really must talk about it beforehand or it can make exits very messy.”



Letting Go, Leaving a Legacy

“If I get hit by a truck, what happens to my company?” Bill McKendree asked himself three years ago, and he didn’t like the answer. “I realized how much risk



not only my company was in, but my employees and my clients as well,” recalls the 53-year-old McKendree. As founder and president of The Clarion Group, a small management advisory firm in West Hartford, Conn., he says from that moment on he started planning for a new generation of partners to take over his business.

However, when McKendree founded his small business thirteen years ago, his attitude was much different, he admits. “I was thinking ‘This will give me

a good income until I want to retire and then I'll just close the doors,’” he says. And for the first ten years, that’s how he managed. “Everything was very Bill-dependent and Bill-led. I was doing it all, which is pretty typical for most small businesses.” But after years of more than 20 percent growth, his company had expanded to 12 employees and cultivated several large, high-visibility customer relationships. “I decided I had a responsibility to put an organization in place that would continue on no matter what happened or who left,” McKendree says.

So, he developed an extensive multiyear plan that will eventually turn all 12 Clarion employees into part owners of the company—a subchapter S corporation—and still leave him with a 10 percent stake. “We’ve spent two years getting prepared for the changeover, taking one day a month to talk about the transition so everyone can personally understand the risks,” he says. Undergoing this major change in Clarion’s ownership structure, while, at the same time, maintaining all the current client tasks has been tricky, though. “It’s like trying to change the wheels on a car and keep it rolling at the same time.”

One of the Clarion’s future partners, 43-year-old Wendy Helmkamp, says she never considered ownership in the company when she came on board six years ago. “When Bill announced his plan, initially, I couldn’t imagine myself in that role,” she says. “But then I concluded that pretty much the same risk scenarios exist in jobs everywhere else and now I have embraced the opportunity to step up and help lead.”

Not everyone has felt the same way, McKendree acknowledges. “I’ve had to let some people go whose values as owners wouldn’t have aligned with the spirit of our company,” he says. In the future, however, when everyone is part owner, it won’t be as easy as firing someone if there is a major disagreement over performance or the direction of the company. Because of this, McKendree has installed a “lack of confidence” clause into the new partnership structure, where a majority vote among the company’s 13 shareholders triggers an automatic buyout of the partner in question. “It’s important to not just look at a potential partner’s compatibility with the company but their intentions, as well,” McKendree notes. “We stress a strong service philosophy here over everything else—even over our profits—so someone who wants to ‘get as much money out of this as I can,’ isn’t going to fit in.”

Overall, McKendree views the new partnership as a way to ensure the company survives while allowing him to ease into something he calls “restment” rather than retirement. “I’ll probably stay involved until I die, but this will allow me to dial work down to three to four days a week,” he says. And already, he says the new partnership plan is paying dividends. “I don’t wake up in the middle of the night anymore, sweating about things like payroll and staff,” he says. “I now have a community of people to help me with that. It’s very nice.”

Conclusion: Five Points to Ponder on Partnerships

1. Find the yin to your yang—partner with someone who complements your skills rather than mirrors them.
2. Talk all about the 9 to 5 AND the 5 to 9—make sure you know your partners’ personal goals as well as your own.
3. Consult the experts—seek legal and tax advice beforehand to ensure your new partnership starts off on the

3. Consult the experts—seek legal and tax advice beforehand to ensure your new partnership starts off on the right foot.
 4. Test drive before you buy—try a trial period to see how the partnership withstands day-to-day pressures and decisions.
 5. Think about the end at the beginning— discuss and build into the partnership retirement, buyout, and succession plans.
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