

## Why have a Shareholders' Agreement?

When we start out in business, we're full of hope, aspiration and ambition, and we don't give a second thought to what will happen if the business grows, other than plenty of holidays in the sun, buying a shiny new car and a big house on the hill!

These days forming a limited company couldn't be easier or cheaper; simply go on-line and for a very modest fee you're instantly a director and shareholder. But what if there's more than one shareholder? Have you given any thought as to what would happen if you or one of your fellows got into personal financial difficulty, got divorced, lost the capacity to speak or act for themselves, or suddenly died. Could the business continue to function, would the bank call in its guarantees and how will your families crystallise the value the business represents? And, the more successful the business is, the bigger the problem gets. One thing to remember is that the Memorandum & Articles of Association (Mems & Arts) don't usually cover what shareholders' can and can't do with their holdings; instead, they simply deal with what the business can do. Likewise, whereas at a board meeting each director has an equal vote, at a shareholders' meeting voting is in proportion to equity, which is more formally known as *pare passu*.

Without a valid shareholders' agreement things may not run as smoothly as you hoped. For instance, can a shareholder: -

- freely transfer their shares to their spouse, children, associated company, family trust etc; and, if they can, will the new owner want to be involved in the business or will you want them to be?
- sell or transfer their shares to an outsider without first offering them to the other Shareholders (*Pre-Emption Rights*), and would you be happy if those shares went to a competitor?
- be obliged to sell in the event of death, bankruptcy or the loss of physical or mental capacity?
- value the shares; if so, is it by a formula established in advance, a value assessed by auditors or by auditors in default of agreement and should that calculation be treated differently depending upon the circumstances, (*e.g. on death, disability or bankruptcy*)?

What about the day-to-day running of things?

- are there any matters requiring the unanimous approval of the Directors, Shareholders or Partners, as opposed to majority approval, or requiring the approval of a specific Director or specific class of Shareholders or Partners?
- are bank guarantees capable of being called in on death, disability or personal bankruptcy and what would that do the business and families?
- who can commit the business to a specific course of action or borrow money on its behalf?

Other questions to ask yourself: -

- what can you do if you fall out or can't agree?
- who will run or work in the company if a working shareholder dies?
- how will profits be distributed?
- what if I'm a minority shareholder?

If you can't easily answer those questions or, those answers have not been formalised in a document signed by all the shareholders, then you need a shareholders' agreement. Don't forget that the existence of a shareholders' agreement: -

- can assist in raising finance from investors
- demonstrate the stability of the business to potential trading partners
- prevent situations where changes in one shareholder's personal circumstances can affect the company or other shareholders
- protect the rights of minority shareholders and the investment value of their shareholding. FYI, without a shareholders' agreement, majority shareholders may force issues that are not in the minority shareholders' interests such as not paying dividends etc..

A shareholders' agreement can only be amended with the agreement of all of the shareholders, whereas the Mems & Arts can be changed by a 75% majority.

**Planned Succession Limited - Suite 6, 43 Bedford Street, London WC2E 9HA.**

**Switchboard : - 0203 303 0963 Email: - [info@planned-succession.com](mailto:info@planned-succession.com) Web: - [www.planned-succession.com](http://www.planned-succession.com)**

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