Coaches Corner

The Curse Of Small Business: Partnerships!

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I once worked for a company, now public and very successful, where the owner sold 40 percent of his ownership interest so he could access the financial resources required to grow that very capital-intensive business. The new partner brought access to capital, board-level advice, and the desire to have a disciplined approach to running the business, while we brought the domain expertise, winning moves, and hustle that grew the business dramatically. Although not without some confrontation, especially in the early years, this became a successful partnership where both sides made each other better in addition to making each other a lot of money. The partner learned a lot about the realities of running a growing business and used this experience to make other successful acquisitions. We learned the intricacies of how to scale our business from founder centric to professionally managed and globally focused.

However, I've found that type of successful partnership is rare.

I have been coaching for more than a dozen years and have come to view partnership issues as a major impediment to scaling a business. When I facilitated CEO peer groups, it was the most common issue we dealt with in our monthly forums, and it's often an issue in my current coaching engagements where I work with entire leadership teams. Sometimes the partnership issue is so subtle that people have accepted it as "how things work around here." Other times there is obvious dysfunctionality, even outright conflict. Neither is acceptable and both need to be corrected if the business is to grow.

I'm referring to two different types of partnership situations, each with its own potential challenges. The first, like the personal experience I described above, is where there is an external partner—typically financial—who is not active in the day-to-day operations of the business. The second and more common source of partnership issue is where there is more than one owner and these partners also work in the business in management or leadership roles.

In the first scenario, the issues tend to stem from different expectations. The financial investor has done his or her due diligence and made an investment in the company. The investor wants profit growth or at least no negative surprises. Generally, the investor lacks strong operating experience; however, he or she expects to add value by providing sound financial management and strategic advice. The investor is often surprised by the other partner's lack of operating discipline including timely and accurate financial reporting. Sometimes margins erode and some hard conversations inevitably follow.

The operating partner, on the other hand, has welcomed the investment, yet naively expects to be left alone to run the business as usual, often resisting the financial partner's well-intentioned efforts to help the business improve. Nowhere are all the adages about resistance to change more prevalent than when an outsider tries to get the operating company to improve or change things! The solution to this mismatch is finding the alignment in the goals of both parties. Generally, both sides want to grow so that's a good starting point. With some patience from the financial investor and some openness to new ideas from the operating company, a successful, executable, growth plan can be created. As a coach, I've been able to help facilitate both sides of these partnerships to find this common ground and move them forward.

I find the second partnership scenario, where partners (minority owners) are working in the business, leads to more problems and the solutions are trickier. This type of company structure is common not only amongst formal partnerships like engineering companies or other professional services type firms, but also in contracting businesses, software companies, in fact, in virtually any type of company. The following are some of the issues I've encountered and some suggestions on how to work through them:

ISSUE: EQUAL OWNERSHIP AND EQUAL PAY BUT UNEQUAL EFFORT AND ACHIEVEMENT.
It's a common mistake for owners with equal ownership shares to pay themselves the same amount of salary. Although perhaps a well-intentioned attempt to be fair, it's never fair to all partners as invariably, one has a greater impact on the business than the others. The fair thing to do is to treat partners as employees and benchmark each partner's salary to those performing a comparable role in an external company. You can adjust the salaries annually according to the partner's performance in the role, just like you would with any employee.

The principle is that when you are in a management or leadership role, you get paid a salary for the results you produce. When you're an owner, you'll receive a dividend based on what you own. The two shouldn't be confused but often are. Also, paying market-level salaries has the additional benefit of removing an all-too-common financial distortion from your results. Many owners pay themselves a below-market salary which only distorts the reality of their business. With a market-level salary, you'll be better able to interpret and use your financials for good decision making.

ISSUE: CONFUSING ORGANISATIONAL STRUCTURE.
Often the partners share roles or, even worse, reverse roles on an ad hoc basis. This leads to employee confusion over who the boss is and whether a partner who is not officially the boss must be consulted or listened to when the partner voices an opinion. It's hard to be an effective employee when your boss has trained you to do things a specific way and a minority partner who is normally not involved in your work weighs in with a differing opinion. If this is the issue, the solution is to have clear functional accountability, understood by both partners and employees, that clarifies who is in charge of what function. Each partner must accept that ownership doesn't entitle the partner to a vote on every management decision. Partners need to wear their ownership hat the same way shareholders of public companies do. Their job is to measure management's effectiveness and work to support and enhance it or, if necessary, have management removed following proper governance procedures.

ISSUE: POOR DECISION MAKING.
Frequently the partners haven't mapped out how decisions will be made amongst themselves. This is often a source of frustration for employees, particularly when there is no managing partner who is empowered to lead the firm day-to-day on behalf of the partners. An unclear decision-making process slows things to a crawl and looks like gridlock at the operational level as everyone stands around waiting for a decision. It disempowers employees. Top performers won't accept it for long.

> **"Partners need to wear their ownership hat the same way shareholders of public companies do."**

The solution is to clarify functional leaders' decision-making authority with the goal of developing them and delegating increasingly important decisions to them. Doing this will leave only partnership decisions at issue; these can be dealt with at regular directors' meetings.

ISSUE: ATTITUDE OF ENTITLEMENT
This arises from a partner's attitude of "I'm an owner, therefore, I no longer have to work hard and I can't be fired." I've found this attitude to be very prevalent, and it's certainly very damaging. It hurts the credibility of the leadership team and undermines those who are working hard at trying to build the success of the company. It leads to lower personal effort and more inequality between owners and non-owners. I believe minority owners must hold themselves to a higher standard than others. They must model the culture and the work ethic of the company. To avoid experiencing this issue, the partners need to agree on the culture they want and agree to be held accountable for being a role model to such a culture.

ISSUE: DIVERGING GOALS
At a certain point in time, owners' interests always seem to diverge. Sometimes some have enough money and become risk averse while others want to keep growing the business. Sometimes there's an age gap and those close to retirement are opposed to reinvesting in the growth of the business that younger partners want to pursue. The theory of loss aversion is alive and well in companies, and success seems to create more caution. Clearly the solution to diverging goals is to plan for it as a certainty. Professional advisors like lawyers and accountants recommend entering a partnership only when there's a clear method of dissolving it or allowing for the fair exit of each partner. A good shareholder's agreement will contain this method and is an extremely important document for all partners. ◆