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Shareholders Agreement All You Need To Know

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Do you need a Shareholders agreement?

As a business owner or shareholder partner, planning for the worst possible scenario can never be underestimated or taken for granted. As in all businesses, changes will inevitably happen and with that comes the possibility of disagreement and sometimes even conflict between the owners, management, directors or partners of a company. Having a shareholders' agreement in place allows you to carefully plan against any circumstance that questions the shares, ownership or major decision-making in a business.

What does a Shareholders Agreement do?

What a shareholders' agreement does is effectively and legally grant the protection to anyone who is a shareholder of a firm or business should a negative scenario happen that affects the ownership or profit shares of a company.

Are Shareholder Agreements specifically intended to protect just minority shareholders?

Not at all, shareholder agreements are designed for all parties no matter what stake they have in the company in question. Let's say for example, a majority shareholder or founder of a business may discover that a minority shareholder who is no longer working within the business, wants to sell their shares. There is no principle, or agreement in place, to say that those shares can't be sold to an outsider or, even worse, a competitor. A shareholder agreement protects against this scenario happening and ensures your business is secured against any potential detrimental effects arising related to conflict between shareholders.

What is the main purpose of a Shareholder Agreement?

A shareholders' agreement is a contract signed by all, or some, of the shareholders in the company which essentially sets out how the shareholders want the company to be run and governed.

Shareholder agreements basically protect the shareholders of a company, no matter how much stake they have, granting what extent they are involved as well as determining how much power is given to the directors to run the company.

What does a Shareholder Agreement guarantee for the person or persons who enter it?

An agreement can provide clarity and insurance for many possible sequences of events including the financing of a company, the management of a company, the dividend policy, the procedure to be followed on a transfer of shares, deadlock situations and valuation of the shares.

The absence of a shareholders' agreement opens up the prospect for disputes and disagreements between the shareholders. Shareholders' agreements contain provisions that predict and cover disagreements, drawing up applicable and sensible ways for disputes to be addressed and rectified.

A shareholders' agreement can be taken out by anyone involved in the share of a company, who wish to protect their assets as well as any further bespoke aspects of the agreement which are not covered in the articles.

There have been countless times over the years where people have started a business with friends or personal relatives and haven't considered protecting their interests in the company, believing that a strong bond of trust as well as the articles of association are the only foundation needed.

Are there any disadvantages to entering a Shareholder Agreement?

There are virtually no disadvantages to protecting yourself against any negative scenarios that may arise with other shareholders. In the same way an insurance policy is seen as a highly positive action taken to cover you, defending and preserving your share in a business gives you peace of mind if certain eventualities take place.

If you're already in business with others, or are looking to enter a business partnership, it's highly recommended to put a shareholders' agreement in place for the long-term stability and health of a business as well as your assets.

How does it work?

Let's assume shareholders A, B, C and D enter into a shareholders' agreement. The agreement says that any decision to issue new shares to people outside the company must be unanimous. The Companies Act says that 75% of shareholders must agree to this, therefore the shareholders' agreement has increased the threshold for approval. The shareholders (who each own the same percentage of shares in the company) hold a meeting to approve the issue of shares to E. A, B and C vote in favour of issuing these shares, whilst D votes against. Under the Companies Act, the vote has validly approved the issue of the new shares to E. However, D has a contractual right to sue A, B and C under the shareholders' agreement as they did not adhere to its terms as they had agreed.

What can go wrong with no Shareholders Agreement in place?

Scenario one: Your end-game of selling the business is blocked by a minority shareholder.

If your ultimate aim is to sell, then you need to be absolutely sure that your shareholder colleagues can't block your ambitions. After all, they may be quite happy with the way things are and would like to continue receiving dividends and the like. The fact is without a shareholders' agreement, a minority shareholder could block a sale.

The way around this is to agree 'drag along' or 'tag along' provisions in an agreement, so that if the majority of shareholders want to sell, the minority will do so too. That way, a buyer gets to acquire all of the company's shares. Tag along provisions protect your minority shareholders by enabling them to sell on similar terms. Drag along provisions force your shareholders to sell if you've agreed a great deal but they want to hold out for more money or want things to stay as they are.

Scenario two: Your shareholders know your business inside out and swiftly leave to set up a competing company.

Unless you have a shareholders' agreement that would stop them, any of your shareholder colleagues could exploit their insider knowledge of your business to set up a competing company. It's common sense to have everyone agree that they'll do the decent thing, and a shareholders' agreement can help you achieve that.

A shareholders' agreement can:

- *Stop your shareholders setting up in competition with you*
- *Stop them poaching your customers or staff*
- *Make sure they don't interfere with your supply chain*

Scenario three: A dispute arises that derails the business

Sure, you're all getting along fine, and that's great. If however, there's an issue with the business and you can't all agree, the last thing you'll want is a costly dispute that might distract you from your business.

A shareholders' agreement can pre-empt these kinds of circumstances and set out a clear path for resolving disagreements that will smooth the way to an amicable resolution, saving you time, money and effort in the process.

Scenario four: You've given shares to your employees, but they now want to leave, and you have no provisions in place to stop them from taking their shares (and their company knowledge) with them.

Employee share schemes are a great way to incentivise and reward your best performers. But if you part company, you'll need to ask them nicely to return their shares.

You can adjust your shareholders' agreement depending on if they're 'good' or 'bad' leavers, so that this is fair to both sides, and also include provisions to make sure that they don't take clients with them.

Scenario five: A shareholder is contributing less to the company but there are no standards set and they continue to receive the same dividends and voting rights as those who contribute more.

The standard Articles of Association only envisage one class of shareholder who has an equal right to dividends, voting rights and a share of the company on a liquidation.

With a shareholders' agreement, you can modify these rights if there are some shareholders who are contributing more than others, tailoring the contract to ensure hard work pays off and you're not short changed.

Scenario six: One of your shareholders sells their shares to a stranger and you risk losing control of your vision for the business.

Unless you have a shareholders' agreement, any of your shareholders can sell to someone else, even someone you don't know.

While your Articles of Association may give you rights of pre-emption, you may need to tweak these so that you maintain maximum control over who obtains shares in the company. A shareholder agreement sets this in stone, securing against any meddling from external sources.

Scenario seven: You have ambitions to grow and expand but investors are wary that you don't have the right agreements in place to protect their interests.

If you're serious about your business, even if you're at an early stage, you'll know that you may need to borrow or seek extra funding to expand. Investors and lenders, such as banks or building societies, will want to see that you're working as a team with your shareholders.

Putting a shareholders' agreement in place demonstrates that you take a professional approach to running your business and have considered all the ways in which you can smooth the path to new investment. It will give you control over the growth and evolution of your business, should any interference occur.

The risks of not having a Shareholders Agreement in place

The risks of not having a shareholders' agreement in place can certainly throw up questions about how you want to take your business forward, and what your ambitions are. Generally speaking, if you have two or more shareholders, then you should have a comprehensive shareholders' agreement in place. It will reduce the risk of shareholder disputes having a significant impact on your business, whilst giving you the control you want so that you can take your strategy in the direction that you envision, and also help you to govern the rights and obligations of your shareholders clearly yet fairly.

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