



# SHAREHOLDER AGREEMENTS

INFORMATION BROCHURE

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WHY YOU AND YOUR  
BUSINESS PARTNERS **NEED A**  
**SHAREHOLDER AGREEMENT**

A shareholder agreement can play a vital role in any business with more than one owner, whether large or small. It should confirm how you and your business partners want to own and run your business, but is a simple idea that is often overlooked by business owners particularly at the start up stage.

A shareholder agreement deals with fundamental issues that relate to long term business success, including: decision making, management, division of profits, succession planning and the valuation of shares. Importantly, it can assist in avoiding future disagreements that, if left unresolved, could use up valuable time, money and resources and lead to business failure

## WHAT IS A **SHAREHOLDER AGREEMENT?**

This is often the very first question that our clients ask us. A shareholder agreement is a generic term used to describe an agreement or Contract between the shareholders (or owners) of a business venture.

In all cases, a shareholder agreement needs to be tailored to suit the particular business structure that is used, whether it is a company, unit trust, partnership of trusts or individuals.

As you can imagine, a shareholder agreement can be quite complex as it needs to accommodate the collective intentions and individual circumstances of all the shareholders.

## WHY USE A **SHAREHOLDER AGREEMENT?**

Some of the benefits of a shareholder agreement are that:

- The business partners are able to record exactly how they want the business to operate. It is a useful tool in evaluating the compatibility of everybody's goals, objectives and capabilities.
- It normally remains private and confidential between the parties. It does not need to be made public, unlike the company constitution which may need to be notified to various public authorities.
- It is relatively easy and cheap to modify or amend. This can be important for changing circumstances of the business and for tax planning purposes.
- It can help owners plan for retirement and exit from the business and ensure a smooth transition;
- It can assist in raising finance from banks or creditors;
- It can ensure shareholders are able to afford to purchase the stakes of co-owners in the event of death or disability, by funding such a sale through linked life and trauma insurance; and
- It can reduce the cost and uncertainty surrounding a business break up.

Some of the key elements of a shareholder agreement are discussed in more detail in this brochure

## DECISION MAKING



In the absence of formal agreement, the obligations and rights of participants in a business venture are derived from the Corporations Act 2001 and the documents used to create the business vehicle, for example the company constitution or trust deed.

Generally, decisions are effectively made by the majority stakeholders. This has the potential to expose the investment of minority participants to commercial risk, which may not be justified if the minority participants bring substantial contributions or skills to the business (not necessarily) financial contributions.

A shareholder agreement should spell out which participants have the right to appoint directors to the board, and what participants' voting entitlements are (both at board and shareholder level).

There also may be a need to reserve matters of fundamental importance to a higher than usual majority of participants, or even require their unanimous approval. For example, who has the right to determine if the business should be sold, if a new owner/investor is to be introduced, or if new finance is to be obtained and on what terms.

## WHAT TO DO WITH BUSINESS PROFITS



People invest in business ventures for different reasons. Some are more interested in achieving long term capital growth which might require funding for business expansion, whereas others look for a regular short term source of income

Obviously, a shareholder agreement should set the ground-rules on issues such as how much business profit should be reinvested into the business, and how much should be available for distribution to participants in the venture.

Profit investment and distribution policies should also be subject to regular ongoing review. Failure to agree on and properly document these matters at the outset leads to disputes and the failure of what would otherwise be successful businesses.



## GOODWILL, STAFF & CLIENTS

The essence of successful businesses (particularly small and medium enterprises) is the goodwill, reputation and know-how that is generated by key individuals and strong client relationships. Without a shareholder agreement it would be very difficult to prevent a former owner/shareholder from starting a competing business elsewhere, poaching key staff and clients, and using commercially valuable information for the benefit of the competing business. A properly drafted shareholder agreement can address this issue with non-compete and confidentiality clauses which bind not only the investor participants, but also the key individuals associated with those investor participants. The clauses may not prevent someone from doing the wrong thing, but should at least give an aggrieved participant the opportunity to seek an appropriate remedy in that eventuality.



## DEATH OR INCAPACITY OF INDIVIDUALS

Participants in business ventures often fail to properly consider the consequences of death or incapacity of key individuals in terms of the ongoing ownership and control of the business.

It is often wrong to assume that interests held or controlled by a deceased or incapacitated participant will revert to the continuing participants. This will all depend on how the interests in the business are held, for example by other entities or trusts.

It is often the case that ongoing business owners are forced to deal with other people (such as family members) who have no interest, desire or knowledge on how to run the business.

A shareholder agreement should consider these eventualities, and set out clear procedures for the transition and succession of ownership and control of the business to the continuing participants. One of the ways in which this can be achieved is by the shareholder agreement requiring each owner to take out life and trauma insurance to the benefit of other shareholders, which then provides finance to buy out the stake in the event of death or incapacity. The death or incapacity of a key individual should not lead to the failure of the business.

## VALUATION OF SHARES

It is important that there is an agreed mechanism for valuation of the price of the interest in the business venture.

A large number of disputes between business owners (or the outgoing or estates of a deceased owner) occur due to a disagreement or misunderstanding as to how to value the interests in the business venture. Such disputes can become quite complex, distracting and often debilitating for the business.

## OTHER ISSUES

A shareholder agreement can also be used to address the following issues:

- Limiting or defining the kinds of commercial activities that the company can undertake;
- How and who should own the business assets;
- The terms of any loans made to or by the business;
- The terms and process for accepting new investors;
- The resolution or mediation of disputes;
- Ethical or environmental practices;



## CONCLUSION



A properly drafted and tailored shareholder agreement should serve to ensure that each participant in the business venture knows where they stand in relation to each other, and what mechanisms exist to deal with future events that might impact on the business or the relationships between participants.

M A Legal would be happy to negotiate and draft a shareholder agreement tailored to your requirements or answer any questions or queries you may have.

Please feel free to contact us on **1300 88 73 91** or **email [info@malegal.com.au](mailto:info@malegal.com.au)**





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