

Tips for Structuring A Profit-Sharing Deal

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Question: I just met a guy who liked my idea of a becoming a multisite franchisee for a restaurant chain, and he wants to sign a joint-venture agreement. I won't be putting in much equity; rather the capital will come from him and his family. I would supply the sweat equity. Can you recommend a way for us to structure the profit sharing?

-- Jason, Washington

Answer: Profit-sharing arrangements between a capital partner and a so-called sweat-equity partner can be set up in countless ways. What matters most is that both partners feel the deal is fair.

"The sky's the limit as long as they both agree" says Judy Gedge, a West Hartford, Conn., small-business attorney.

What frequently happens is the working partner gets paid a regular annual salary, says **Billy Ellyson, a small-business attorney in Richmond, Va.** On top of that, he or she also gets a prenegotiated share of the ownership that usually hinges on how crucial the capital partner feels that person is to the business's chances of success. It could be anywhere from a 5% slice of profits to 30% or more for those partners deemed as irreplaceable.

As the sweat-equity partner, it's wise to wait for the investor's offer before volunteering your own proposal, Mr. Ellyson says.

Often, the sweat-equity partner's profit share is vested over a number of years to keep him or her on board and motivated. For instance, it could be set up that you receive a 5% slice of the business each year, increasing every year until you hit 25%.

Sometimes, a sweat-equity partner ends up taking over the entire business because the capital investor needs an exit strategy. There also might be a performance-tied component: If the return on investment is over a certain percentage -- say, 25% -- the sweat-equity partner receives a bonus 5% share.

Mr. Ellyson suggests you set up a limited-liability company, a business structure that offers the legal protection of a corporation but with fewer formalities. An LLC will provide more protection to your new venture along with allowing more flexible allocation of profits and losses.

The partnership agreement also should spell out ground rules, such as that neither partner can loan out the business's money or give equity to other investors. In addition, you should agree on terms if one partner eventually wants out. Don't assume that's impossible: Partners break up all the time.