How to Reduce Owner Dependence Before a Sale

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CEOs: What would happen if you went on vacation for a month and left your business to run itself?

If your answer is "everything would fall apart," or "what's a vacation?" chances are good that your business is highly dependent on you. This may not seem like a problem now, but when it comes time to think about selling your business, it may well be.

"Contrary to popular belief, buyers are highly risk-averse," says Steve Raymond, Managing Director of New Jersey-based investment bank The DAK Group. Owner dependence (or dependence on any key person) is a major driver of risk, and as such can mean sellers don't get the price or terms they want during a transaction.

Robert Rough, Managing Director of Dallas-based investment bank Telos Capital Advisors, says that smaller companies tend to be more owner-dependent. There are also certain types of businesses — e.g., dentists' offices, insurance agencies, or law firms — where "the owner is almost always a major rainmaker. It all comes down to what role the owner plays, for example how involved he or she is in customer relationships and sales," says Rough.

If you're thinking about selling your business, here are a few suggestions to help mitigate the risk of owner dependence.

1. **Make moves well in advance of a desired sale.**

When Jim O'Keefe, the founder of Wisconsin-based commercial millwork manufacturer O'Keefe, started thinking about planning for an exit, he had a clear life goal of being completely out of the business by the time he was 65 years old. "He'd started the business when he was in his early 20s and built it out of his garage," says Dan Mulvaney of Sunbelt Midwest Business Advisors, which advised O'Keefe. Five years out from his desired sale timeline, "he brought in professional management and went from running the business to being an absentee owner, which added a lot of value to the business."

O'Keefe ended up selling to Ninth Street Capital Partners, a middle market private equity fund based in Cleveland. The connection was made on Axial. The process was highly competitive in large part due to Jim O'Keefe's prudence in stepping back early. "When we bring a business to market that has a management team in place that will stay post-closing for a long time, that broadens the market dramatically amongst buyers. A lot of buyers have the cash, but they don't have the talent or operator who can jump in full-time and take over for the business owner," says Mulvaney.

2. **Bring in an independent board.**

"Generally speaking, if you're going to be selling a business within a year, you don't have enough time to bring in a board," says Raymond. But for those with enough lead time, creating a board is a great way to mitigate risk for a potential buyer by ensuring long-term business continuity. Board members also bring in outside perspectives and experiences that can improve business practices and help owners and existing management identify and address any challenges in the company. While there may be resistance to the idea, independent boards can be particularly helpful for family businesses, where long-established dynamics and a lack of outside experience can sometimes obstruct a business's full potential.

3. **Build out the management team.**

"A lot of privately held businesses operate without a true CFO, somebody who understands treasury and sophisticated financial reporting. Bringing in a CFO is an easy step that can be done in a short time frame," says Raymond. Bringing in a COO is also an option, although sometimes that can be done concurrently with the transaction. "Buyers, particularly PE buyers, will sometimes want to bring in an outside expert as part of the deal to help mitigate the risk, usually referred to as operating partner."

In some cases, the business may not be large enough to justify bringing in either a CFO or a COO. In these cases, Rough recommends working on addressing areas of the business that will directly impact revenue first. "Customer relationships and sales are probably the most worrisome areas for a potential buyer," says Rough. "Most buyers will be able to find someone to manage the books and keep the trains running on time. But they want to make sure that they won't lose revenue. You want to make sure that there's someone in the company who will be staying and can ensure continuity for key relationships."

In general, think about delegating and distributing responsibilities. "If the owner just decides to replace themselves with a younger version of themselves, that doesn't necessarily solve the problem," says Rough.

4. **Document key information.**

Business processes shouldn't just live in your head. If you go to Tahiti for two weeks, your team should know how to keep things running and have all the information they need to make informed decisions. Prospective buyers will want to see that these processes are well-documented to make knowledge easier to transfer post-close.

Owner dependence is just one issue in a business, but it's often tied up with other risks that buyers discover in due diligence — lack of a true management team, a shaky handle on financials, intellectual property concerns, problematic legal agreements with customers or vendors, etc. As a seller, the more you think through these problems and take steps to address them in advance of a sale, the more likely you are to achieve the valuation and terms you're looking for. Consulting with an investment banker or advisor before you want to bring your market is the first step and can help you evaluate where you are and what areas you should address first. "The more a company professionalizes their business and looks internally before a sale, the more interest they'll get from buyers and the more likely they are ultimately to close a deal," says Raymond.