

# Assessing The Impact of a Key Individual When Buying a Service Company

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When it comes to buying a business, a service company can differ significantly from a company that delivers a product. Service companies are often reliant on one or more key individuals to generate a significant portion of their business. When buying a service company, you must consider carefully that a company founder, key individual or other staff may be a major and valuable asset.

This key individual embodies the trust-relationship and goodwill from which the company profits. To a large extent, it is this person's individual skills that drive the success of the company you're trying to buy. You aren't just buying a list of contacts, or set of wrenches (which technically the company owns) - but also the uniqueness that the individual employs in dealing with customers on a daily basis. The likelihood of value resulting from this person remaining with the business should be a primary consideration in your negotiations.

For simplicities sake, we will limit our discussions to that of a key individual, but the situation would be the same for a group of senior managers, a sales team, or a longstanding or highly skilled workforce.

To gauge the value of a key individual you'll need to do a bit of homework. Ask for time sheets, sales records, and any documentation that will enable you to track past performance.

When evaluating this information, ask yourself the following questions:

- How much of the cash flow is this key individual responsible for?
- How many customers actually deal directly with this key individual?
- At what point did this key individual become instrumental in the daily operations of the business?
- How much money is this key individual worth to the business?
- What measurable effects would the loss of this key individual have on the company?
- Does this key individual have an employment contract and/or a non-compete clause?
- Are there any other employees or possible outside candidates who could take over, should this key individual leave the company?

The forgoing questions are not easy things to quantify. You'll often have to go beyond the documentation to get a good handle on these issues.

Once you have actually determined the value of this key individual, you have a number of options. If your findings suggest that this key individual is truly instrumental to the future success of the company, you'll need to make certain that he or she will stay on once you have bought the business. This will likely lead to some form of negotiation.

Consider carefully the kind of package that will make your key individual feel secure, while still proving economical to the business. It might include a pay raise, improved benefits or stock-options, a new company car, a nicer office or a promotion. Alternatively, you may want to include an earnout tied to both key personnel retention and performance as part of the purchase price.

You should also make sure you prepare a carefully drafted employment contract covering all the bases and taking into account as many contingencies as possible. You may also want to consider whether the key individual should

sign a non-compete agreement. This type of agreement is a common provision that insures that your key individual will not go into competition with your company for a certain number of years.

Once you've successfully retained the services of your key individual, and the purchase of the company has gone smoothly, then it's time to start building and planning the future of the business. As part of that process, it's generally a good idea to begin to reduce the company's dependence on a key individual.

To reduce that dependence, consider grooming additional employees to perform the same or similar functions undertaken by the key individual. Better still, have your key individual mentor another employee in his or her way of doing business and providing service. If this process is handled correctly, you'll create a clear line of succession between your key individual and his or her "student". With sufficient time, the student will be able to fill the shoes of your key individual. Should the key individual wish to leave, retire or otherwise becomes unable to work, you've got a replacement that can continue to provide the same level of service.

To the extent that it appears you will have difficulty retaining the key individual on a long-term basis, you have a number of options. A very common approach is to make the key individual a consultant. In this short-term consulting capacity the key individual would still have a positive impact on the business, and it would allow you sufficient time to find or train a successor.

In the final analysis, if you are careful about ensuring the continued service of a key individual, you make sure that his or her impact is accurately reflected in the purchase price, and you take the appropriate steps to retain or find a qualified replacement for the individual, your purchase of the company should not be adversely impacted as a result of the dependence on the key individual.