Identifying Key Employees When Buying A Business

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One of the most important components when evaluating a business for sale, is investigating its employees. Typically, the smaller the company, the less depth in the layer of management below the owner, so a buyer needs to know exactly who is in place and their potential contribution, or the impact if they leave. Often, this is the result of an owner who is in charge of far too many components of the company. For a buyer who is going to become the owner-operator, it is critically important to determine who, if anyone, is in place to help operate and grow the company. Moreover, if the company is thin at the top, is there adequate cash flow to bring on new staff if any key ones leave?

Sellers will often discount the reliance on certain key employees as they do not want to scare off potential buyers. Conversely, how does a buyer deal with a situation where the business is highly reliant on certain key employees? The initial reaction may be to try to tie up these key employees through the purchase agreement. However, the seller cannot contractually bind any employees to remain; you must negotiate employee agreements directly with the employee.

As a first step in your due diligence process for employees, determine who, if any of the employees are key to the business. My metric has always been to measure the potential impact of any departing employee, do any hold licenses the business needs to operate, how easily they can be replaced, what damage can they do if they go to a competitor, and what is my assessment of their performance.

Sellers and their intermediaries (business broker, investment banker) may be apprehensive to let a prospective buyer meet the employees before closing as they fear that word will get out and they could lose staff. It rarely happens, but it is understandable. An employee's job is probably safest when there is a change in ownership as the new owner really needs them. In a simple business with low-level staff whose skills can be easily replaced, there may not be a worry with not meeting them prior to closing. But clearly not so in larger businesses, or in any that require highly skilled and/or licensed staff. You must meet them. The question is when and how? Adding a contingency to the offer that you must meet them can be tricky, but an effective way is to have that as a final deal condition, a last hurdle once all other conditions have been met.

When meeting them, get a good sense of their commitment, and while you never want to be held hostage by staff, consider whether you want to enter an employee agreement with them if at all. While it can tie them to the business, it also ties you to them. If staff wants to leave, they will. Alternatively, you may want to have a test period whereby you can evaluate them for a few months post-closing and then decide whether to have a formal agreement. All employees are important of course, but the key is to determine which ones either must stay (i.e. because if certain skills or licenses) and which ones would just make the transition easier but can be replaced.