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Owner Dependence and Key-Person Risk in Founder-Run Firms

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What owner dependence is and why buyers price it

Owner dependence is the degree to which a business's revenue, operations or legal standing rest on one person who is about to sell. Key-person risk is the broader version: the loss of any single individual (owner, top salesperson, licence holder, lead engineer) would materially impair the business. In an owner-operator business the two usually coincide, because the seller is the key person.

Buyers price it because the thing being sold may partly walk out of the door at closing. Brokers report it as a selection criterion. BizBuySell's Q3 Insight Report, describing an increasingly selective market, says that "Businesses with strong cash flow, clean financial records, and limited owner dependence continue to attract significant attention" (BizBuySell Insight Report). That is a broker-sourced observation, not a measured discount; no public dataset verified for this article quantifies a price effect of owner dependence for small private companies.

Owner dependence shows up in four places:

Dimension	Question	Example of high dependence
Revenue	Do customers buy because of the owner personally?	Top accounts deal only with the founder; no CRM
Operations	Can the business run for a month without the owner?	Owner approves every quote, schedules every crew
Legal and regulatory	Does a licence, permit or certification attach to the owner?	Owner is the licence qualifier
Knowledge	Is know-how documented?	Pricing, supplier terms and processes live in the owner's head

The first two get most of the attention in diligence. The third is the one most often missed, because it is a legal fact that a buyer can check from public records before an LOI.

What academic evidence shows about CEO and founder effects

There is no large-sample study of owner dependence in small private acquisitions. The closest rigorous evidence concerns CEOs, comes from Denmark, and should be read as directional.

CEO hospitalizations. Bennedsen, Pérez-González and Wolfenzon use variation in firms' exposure to their CEOs caused by hospitalization to estimate how much CEOs matter. Their abstract reports that CEOs have a significant effect on profitability and investment; that the effects are larger for younger CEOs, in growing and family-controlled firms and in human-capital-intensive industries; and that "CEOs are unique: the hospitalization of other senior executives does not have similar effects on the performance" (Journal of Finance 75(4), 2020, via University of Copenhagen).

Family successions. In an earlier NBER paper using Danish data, Bennedsen, Nielsen, Pérez-González and Wolfenzon find that "family successions have a large negative causal impact on firm performance: operating profitability on assets falls by at least four percentage points around CEO transitions" (NBER Working Paper 12356, 2006).

What these papers support and what they do not:

- **They support** the idea that the person at the top is not interchangeable, and that the effect is stronger in exactly the settings that describe many founder-run targets: family control, growth, reliance on human capital.
- **They do not** measure what happens when a U.S. owner sells a 20-person services company to a search fund. The samples, governance and transition processes differ. They also do not tell you how much of a CEO effect survives a planned, paid transition with a training period, which is what an acquisition is designed to provide.

Use them to justify taking the question seriously, not to put a number on a specific target.

Observable signals from public sources

Some dependence is visible from the outside before any conversation. None of these signals proves dependence; each is a reason to ask a specific question.

Signal	Where to look	What it suggests	What it cannot prove
Owner's name in the business name or domain	State business registry, domain records, website	Brand identity tied to a person	Whether customers care
Owner listed as the only officer, manager or registered agent	State registry filings	Thin management layer on paper	Who actually runs operations
Owner is the licence qualifier	State licensing board lookups	Licence continuity depends on one person (see next section)	Whether a replacement qualifier is on staff
Reviews that name the owner	Public review sites	Customers associate service with the owner	Share of revenue those customers represent

Signal	Where to look	What it suggests	What it cannot prove
Website "about" page shows only the owner	Company website, archived copies	No visible second tier	Unlisted managers may exist
Owner is the only public face on social or trade association listings	Professional networks, association directories	Relationships held personally	Whether staff hold the accounts that matter
Job postings for a general manager or operations lead	Job boards, company careers page	Owner may be building a second tier, or replacing one	Whether the hire happened

Illustrative example (fictional). A buyer screening Harrow Valve Repair LLC, a fictional California service contractor, fills in the scorecard:

Signal	Observed	Source type	Weight
Name in business name	No	Registry	0
Sole manager on filing	Yes	Registry statement of information	1
Owner is licence qualifier	Yes, as responsible managing member	Contractor licence lookup	2
Reviews naming owner	41 of 60 sampled reviews	Review sites, retrieved on one date	1
Only owner on website	Yes	Website and archived copy	1
GM job posting in last 12 months	No	Job boards	0
Total			**5 of 8**

The weights are the buyer's own judgment, set before scoring so they are applied consistently across a list. The score is a prioritization tool for questions, not a valuation input. A high score on a target that otherwise fits the mandate is a reason to make owner transition the first diligence topic, not a reason to drop it.

Licences held by the owner: the qualifier problem

In regulated trades, the licence often attaches to the business through a named individual. California's contractor law is a clear example, and other states differ, so read each statute.

Under California Business and Professions Code § 7068, an applicant must show the required knowledge and experience through a qualifying person. A limited liability company "shall qualify by the appearance of a responsible managing officer, a responsible managing manager, responsible managing member, or a responsible managing employee who is qualified for the same license classification" (§ 7068(b)(4)). A responsible managing employee must be a bona fide, permanent employee "actively engaged" in the work, defined as "working 32 hours per week, or 80 percent of the total hours per week that the applicant's business is in operation, whichever is less" (§ 7068(c)). And "no person qualifying on behalf of an individual or firm ... shall hold any other active contractor's license while acting in the capacity of a qualifying individual," except as § 7068.1 allows (§ 7068(e)).

The transition rule is in the next section. If the qualifier "disassociates from the licensed entity," the licensee or qualifier must notify the registrar within 90 days, the licensee has 90 days to replace the qualifier, and on failure "the license shall be automatically suspended or the classification removed at the end of the 90 days" (Cal. Bus. & Prof. Code § 7068.2(a)).

What this means for a buyer of a California contractor whose owner is the qualifier:

1. The owner's departure starts a 90-day clock on the licence, regardless of what the purchase agreement says about consulting.
2. A replacement qualifier must be qualified for the same classification, and if they hold another active licence they generally cannot serve under § 7068(e) unless § 7068.1 applies.
3. If the buyer plans to qualify through an employee, the "actively engaged" hours test applies.

The diligence step is simple and public: look up the licence, identify the qualifier and classification, and ask who else on staff could qualify. The contractor licence lookup protocol covers the mechanics of resolving licences to legal entities. The same pattern (a licence or registration held through a named individual) recurs in other regulated sectors; the statute, not the sector label, decides.

What public data cannot tell you

Public records can surface the legal and visible dimensions of dependence. They cannot see:

- **Customer relationships.** Who the top accounts call, and whether they would stay.
- **Pricing authority.** Whether staff can quote and discount without the owner.
- **Undocumented processes.** Estimating rules, supplier arrangements, informal credit terms.
- **The owner's intentions.** Public data cannot tell you whether an owner wants to sell, stay, or step back gradually.

The population context matters too. Among families that owned businesses in the Federal Reserve's 2022 Survey of Consumer Finances, "78 percent employed fewer than five people, and 52 percent owned nonemployer firms" (Federal Reserve Bulletin, October 2023). Most privately held businesses are too small to have a management layer at all. Owner dependence is the default state of the population buyers screen; the question is whether a given target has moved beyond it.

Pricing dependence without inventing a discount

Rules of thumb such as "owner-dependent businesses sell at a lower multiple" circulate widely, but no public source verified for this article measures that effect for small private companies. Rather than applying an unsupported haircut, translate dependence into explicit cash-flow and structure assumptions that can be argued about line by line:

Dependence finding	Where it belongs in the model	Example adjustment (illustrative)
Owner performs a full-time role	Normalized EBITDA	Add a market salary for a replacement manager, sourced from a compensation survey or recruiter quote
Top accounts deal only with the owner	Revenue forecast	Model attrition scenarios by named account, not a blanket percentage
Owner is the licence qualifier	Transition budget and timeline	Cost and lead time to hire or designate a qualifier inside the statutory window
Undocumented processes	Transition budget	Owner consulting days plus documentation work
Second tier at flight risk	Retention costs	Retention bonuses for named employees

Each line is visible to the seller and can be negotiated: the owner who disagrees that a manager is needed can be asked to demonstrate it during the transition period, which links the price argument to the structure in the next section. This keeps the valuation discussion on evidence rather than on a multiple nobody can source.

Transition structures

Owner dependence is usually not a reason to walk away. It is a reason to structure the deal so the owner's incentives and presence overlap with the buyer's first period of ownership. The common tools:

Structure	How it addresses dependence	Watch for
Rollover equity	Owner keeps a stake, so shares in the outcome	Governance rights; exit alignment
Earn-out	Part of price depends on post-closing results	Disputes over how results were measured; owner may lack control post-close
Seller note	Deferred payment; buyer may be able to set off claims	Subordination to senior lenders
Consulting or employment agreement	Owner's time is contracted for a defined period	Scope, hours, compensation, termination
Training and transition period	Specific knowledge transfer milestones	Vague obligations ("reasonable assistance") are hard to enforce
Licence-qualifier arrangement	Owner remains qualifier until a replacement qualifies	Statutory requirements on hours and employment status

Lender rules. Where an acquisition is financed with an SBA-guaranteed loan, lender requirements on the seller's continuing role are set by the SBA's Standard Operating Procedure. SBA lists SOP 50 10 "Version 8.1 with Technical Updates" as effective October 1, 2026, replacing Version 8 (June 1, 2025) (SBA SOP 50 10 document page). Appendix 15 of that SOP states that "the seller in a Business Expansion or Initial Acquisition change of ownership transaction may not remain as an officer, director, stockholder, or employee of the business"; if a transition is needed, the business may contract with the seller as a consultant "for a period not

to exceed 24 months (in aggregate, including any extensions)." A seller may stay on as an owner or employee in an Owner Buyout (Partial Change) or an ESOP or cooperative purchase (SOP 50 10 8.1, Appendix 15). For an owner-dependent target, that 24-month consulting cap is the outer limit of any transition plan in an SBA-financed full acquisition; confirm the structure with the lender before agreeing a seller role in an LOI.

This is a description of common structures, not legal or lending advice.

Reducing dependence before and after close

Frame each item as a diligence question with an observable answer, not as a promise that the risk will go away.

Before signing

- Who besides the owner has met the top ten customers in the last year? Ask for names, not assurances.
- Which decisions require the owner today? Get the list in writing.
- Is there a second-in-command, and what is their tenure and compensation? Will they stay, and on what terms?
- Who holds each licence, permit and certification, and who could replace them within the statutory window?
- Which supplier and customer contracts have change-of-control or key-person clauses?

In the purchase agreement and transition plan

- Named transition deliverables: customer introductions by account, documented pricing rules, process documentation by function.
- A defined consulting or employment term with hours, not just "reasonable cooperation".
- Retention arrangements for the second tier, sized and timed to the transition.
- For licensed businesses, a qualifier plan with a named replacement and a date.

After close

- Track customer retention by account against the pre-close list.
- Hold the owner to dated transition milestones, tied to any earn-out or note mechanics if the agreement allows.
- Re-run the public-signal scorecard at six and twelve months. If reviews still name only the founder and the licence still runs through them, the transition has not happened.

Using signals in screening and the research handoff

Signals are only useful if they are recorded so someone else can check them. For each signal, log:

Field	Example
Target legal entity	Harrow Valve Repair LLC (fictional)

Field	Example
Signal	Owner is licence qualifier
Value	Yes, responsible managing member, classification C-36 (fictional)
Source	State licence lookup page, URL
Retrieved	2026-10-28
Quote	Verbatim text from the page
Confidence	Confirmed, inferred or unresolved
Diligence question raised	Who else could qualify within 90 days of disassociation?

Carried into a research handoff evidence packet, these rows let the deal team start the first owner conversation with specific questions instead of generic ones. If the mandate is specifically about founder transitions, Docket's founder succession thesis sets out the hypothesis-level framing.

Docket's Scout agent records answers like these as typed values, each quoting a retained page, so the signal and its evidence travel together.

Sources

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Source links

Links cited in this article, in order of first appearance. Full addresses are provided for readers using extracted text.

1. https://www.bizbuysell.com/insight-report
2. https://researchprofiles.ku.dk/da/publications/do-ceos-matter-evidence-from-hospitalization-events
3. https://www.nber.org/papers/w12356
4. https://leginfo.legislature.ca.gov/faces/codes_displaySection.xhtml?lawCode=BPC&sectionNum=7068
5. https://leginfo.legislature.ca.gov/faces/codes_displaySection.xhtml?lawCode=BPC&sectionNum=7068.2
6. https://www.federalreserve.gov/publications/files/scf23.pdf
7. https://legacy.sba.gov/document/sop-50-10-lender-development-company-loan-programs
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Research against a defined mandate

A useful target list needs more than company names. Docket focuses on the questions that determine whether a company fits an investment mandate, including the evidence needed to support or qualify each answer. Our research approach makes the connection between screening criteria, source material and conclusions visible to the team reviewing the work.

Triage, Scout and Audit

Docket's three named research agents perform complementary tasks. Triage resolves company identity and screens fit. Scout collects sourced answers against the mandate. Audit checks retained evidence, addresses contradictions and leaves unsupported answers visibly unresolved. This structure helps reviewers distinguish established findings from missing information and questions requiring further investigation.

Evidence that supports investment-team judgment

Our research library covers market mapping, screening criteria, private-company data, succession and ownership, source evaluation and evidence standards. These resources explain the methods and limitations behind origination research. Findings support a team's judgment; they do not establish that a company is for sale or guarantee a transaction or investment outcome.

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Public examples are illustrative unless explicitly identified otherwise. Research preparation and authorized outreach are separate activities; confidential target lists and customer outcomes should never be inferred from an educational example.

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