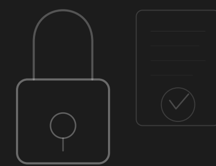
The Due Diligence: PE Readiness

THE 50 FACTOR — GROWTH FACTOR #46

Getting PE-Ready — Investor Readiness as an Operating Discipline



The Complete Implementation Guide

BY SCOTT SCULLY

Growth Factor #46: Getting PE-Ready — Investor Readiness as an Operating Discipline

The Complete Implementation Guide

This white paper is a companion to Chapter 46 of The 50 Factor by Scott Scully. The book tells the story. This guide gives you the framework to prepare your company for institutional investment — and to become a better company in the process, whether you ever take a dollar or not.

Why This Growth Factor Matters

Getting PE-ready makes your company better whether you ever take a dollar or not. The discipline of clean financials, documented operations, a real management team, and strong unit economics is the discipline of a well-run company. Every item on the PE readiness checklist is something you should do anyway — the prospect of an investor looking under the hood just accelerates the timeline.

Most founders think about PE readiness as an exit strategy. It's not. It's an operating strategy. The companies that pass due diligence are the companies that have clean books, documented processes, a management team that can run the company without the founder, and unit economics that prove the growth engine works. These are the same attributes that let a company scale from $25M to $50M without breaking — with or without institutional capital.

What PE Firms Actually Look For

Private equity firms evaluate five dimensions. Understanding them lets you build readiness as a byproduct of building excellence — not as a last-minute cleanup project.

1. Revenue Quality

PE firms want revenue that's recurring or contractual, not project-based. High retention (90%+, ideally 95%+). Diversified — no single client above 10-15% of total revenue. Predictable growth, not lumpy. If your revenue comes from annual contracts with 93% retention and no client exceeds 8% of total revenue, you have high-quality revenue. If it comes from one-time projects and your top 3 clients represent 30%+ of revenue, you have a concentration problem that will cost you at the negotiating table.

The fix takes 12-24 months: build the client diversification plan (Principle #8), install the retention systems (QBRs, Net Promoter tracking, expansion pipeline), and gradually shift the revenue mix toward contractual relationships.

2. Unit Economics

CAC, LTV, LTV-to-CAC ratio (Principle #31), gross margin, payback period. These numbers prove that the growth engine works efficiently — that you're not buying revenue at a loss. PE firms want to see LTV:CAC above 3:1, payback under 12 months, and gross margins above 50%. If your unit economics are strong, the investor knows that every dollar invested in growth will produce a predictable return.

3. Management Team

Can the company run without the founder? This is the Version 3 transition from Principle #45. PE firms evaluate the depth of the management team — not just whether the roles are filled, but whether the leaders in those roles can execute independently, make decisions without the CEO (Principle #21), and drive results on their own scorecards (Principle #6).

If the founder is still in every meeting, making every decision, and running every client relationship — the company is founder-dependent, which is the single biggest risk factor in PE due diligence. Founder dependency doesn't mean the deal doesn't happen — it means the valuation suffers, the terms tighten, and the earn-out gets longer.

4. Clean Financials

Audited or audit-ready. GAAP-compliant. Monthly close within 15 days. Revenue recognition that matches the accounting standards. No personal expenses running through the business. No informal side agreements with clients. No "I'll explain that number" items that require a 30-minute story.

Clean financials aren't about looking good — they're about being trustworthy. An investor who finds surprises during due diligence loses confidence fast. The deal doesn't die because of one messy line item — it dies because messy financials imply messy operations, and messy operations imply risk.

5. Documented Operations

Playbooks (Principles #11 and #13), scorecards (Principles #5 and #6), SOPs (Principle #25), quality systems (Principle #36), onboarding programs (Principle #39), and the business rhythm (Principle #40). PE firms call this "transferable institutional knowledge" — the proof that the company's operating system lives in documents and systems, not in people's heads.

Every principle in this book contributes to this dimension. The 50 Growth Factors, taken together, constitute the documented operating system that makes a company investable. If you've been implementing the Growth Factors as you read them, you're already building this dimension — you just didn't know it had a name.

The 12-Month PE Readiness Checklist

You don't need to decide whether to pursue PE to begin this work. Everything on this list makes your company better regardless.

Months 1-3: Financial Cleanup. Engage an audit firm (even if you're not doing a full audit yet — have them review your books and flag issues). Clean up accounting inconsistencies. Standardize revenue recognition. Close the books monthly within 15 days. Build the weekly financial snapshot (Principle #41).

Months 3-6: Build the Virtual Data Room. Organize every document an investor would request: 3 years of financial statements, client contracts, employee agreements, org chart, playbooks, scorecards, client retention data, pipeline reports, cap table, leases, vendor contracts, insurance policies, IP documentation. Having this organized before you need it saves 3-6 months of scramble during an actual process.

Months 6-9: Fill Executive Team Gaps. Assess your leadership team against the PE standard: can each leader run their function independently? Where are the gaps? If you don't have a CFO, hire one. If your VP of Sales is also your top salesperson, that's a gap — the buyer-player model doesn't scale. Build the team that can run the company without you (Principle #45).

Months 9-12: Engage an M&A Advisor. Understand the market. Get a preliminary valuation range. Learn what comparable companies have sold for. Decide whether to pursue a transaction or keep building. The advisor educates you on the process, the timeline, and the realistic range of outcomes — so you negotiate from knowledge, not ignorance.

Valuation Framework

B2B services companies typically trade at 5-8x EBITDA. The multiple varies based on several factors:

Premiums for: Recurring/contractual revenue (vs. project-based), high retention (95%+), strong growth rate (20%+), management independence from founder, scalable and documented operations, diversified client base, strong employer brand and talent pipeline.

Discounts for: Customer concentration (any client >10-15%), founder dependency, messy or unaudited financials, declining growth, thin management team, high employee turnover, undocumented operations.

A $5M EBITDA company with strong attributes might trade at 7-8x ($35-40M enterprise value). The same EBITDA with weak attributes might trade at 4-5x ($20-25M). The difference — $15-20M in value — is determined by the quality dimensions above. Every Growth Factor in this book contributes to moving your multiple toward the high end.

The Emotional Truth

The number on the term sheet is a market price. It is not a valuation of your worth as a person. It is not a judgment on the significance of what you've built. It is not a grade on your career.

Separating your identity from the valuation is the most important psychological work you'll do during a transaction. The founders who negotiate well — who evaluate terms clearly, push back on unfavorable structures, and walk away when the deal isn't right — are the ones who maintain that separation. The founders who equate the number with their self-worth make emotional decisions that cost them millions.

Work with your advisor, your attorney, and your advisory board to evaluate any offer on its merits — not on how it makes you feel.

Common Mistakes and How to Avoid Them

Mistake #1: Starting the cleanup 90 days before the process. You need 12 months minimum. Rushed cleanup produces surface-level fixes that due diligence exposes.

Mistake #2: Hiding problems. Investors will find them. Every hidden problem discovered during diligence costs you trust, valuation, and negotiating leverage. Disclose proactively and show the fix.

Mistake #3: Not filling the management gaps. A company with a great CEO and a thin team is a company that depends on one person. Fill the seats before the process, not during it.

Mistake #4: Confusing revenue with revenue quality. $30M in revenue from 3 clients is worth less than $20M in revenue from 200 clients with 95% retention. Quality matters more than quantity.

Mistake #5: Going in without an advisor. PE firms do this every day. You've done it zero times. The information asymmetry is massive. An M&A advisor closes that gap.

Quick-Start Checklist

- ✓ ☐ Start the financial cleanup this quarter — engage an audit firm for a review
- ✓ ☐ Close your books monthly within 15 days
- ✓ ☐ Build the weekly financial snapshot (Principle #41)
- ✓ ☐ Calculate and document your unit economics: CAC, LTV, LTV:CAC, payback, gross margin
- ✓ ☐ Assess client concentration — any client above 10%? Build the diversification plan
- ✓ ☐ Begin assembling the virtual data room (even a shared folder with organized documents)
- ✓ ☐ Assess your executive team: can each leader run independently? Where are the gaps?
- ✓ ☐ Fill 1-2 critical executive gaps in the next 6 months
- ✓ ☐ Have a preliminary conversation with an M&A advisor — learn the market
- ✓ ☐ Separate your identity from the valuation. This is a business transaction, not a personal judgment.

Implementation Tools

Ready-to-use templates for this Growth Factor

PDF **PE Readiness Self-Assessment**
Score yourself across all five dimensions

PDF **Virtual Data Room Checklist**
Every document an investor will request

XLSX **12-Month Readiness Timeline**
Columns: Line Item, This Month Actual, This Month Budget, Variance, YTD Actual, YTD Budget, +1 more

XLSX **Unit Economics Dashboard**
Columns: Function, Task, Hours/Week, Repetitive? (Y/N), AI Tool, Est. Time Saved, +2 more

PDF **Executive Team Gap Assessment**
Evaluate each leader against PE standards

This is Growth Factor #46 of 50. PE readiness is the culmination of every Growth Factor that came before it — clean financials (#41), strong management (#45), documented operations (#11, #13, #25), quality systems (#5, #36), and unit economics (#31). The investor isn't evaluating a pitch deck. They're evaluating an operating system. The 50 Growth Factors are that system.

Get the book: The 50 Factor by Scott Scully

Building Readiness Without Deciding Anything

The most common objection founders raise when PE readiness comes up is: "I'm not sure I want to sell." That objection misses the point entirely.

PE readiness isn't a decision to sell. It's a decision to operate at the level where selling becomes an option — an option you control, not one that controls you. The founder who has clean books, a strong team, documented operations, and healthy unit economics can choose to sell, choose to take on a minority investor, choose to recapitalize, or choose to keep building. They have options. The founder who doesn't have those things has one option: keep running.

Every item on the readiness checklist is something your company should have regardless of your capital strategy. A weekly financial snapshot makes you a better operator. A strong management team lets you scale. Documented operations prevent chaos. Clean books prevent surprises. Unit economics prevent unprofitable growth.

The PE lens just gives you urgency — because imagining a sophisticated investor examining every aspect of your business creates a clarity of standard that "we should probably clean this up someday" never does.

The Timeline That Most Founders Get Wrong

Most founders think they can get PE-ready in 90 days. They can't. Here's why:

Financial cleanup alone takes 3-6 months. Not because the math is hard — because the habits are hard. Moving from quarterly or annual accounting reviews to monthly closes within 15 days requires new processes, new discipline, and often a new CFO or upgraded controller. The financial systems that produce audit-ready books are not built in a weekend.

Management team gaps take 6-9 months to fill. Executive recruiting takes time: sourcing, interviewing, negotiating, onboarding, and then the new exec needs 90+ days to prove they can run their function independently. A VP hired in January isn't "proven" until at least June.

Client diversification takes 12-24 months. If your top 3 clients represent 30% of revenue today, reducing that to under 15% requires significant new client acquisition — which means the Growth Formula, the sales training engine, the hiring-ahead system, and the marketing-for-sales discipline all need to be running.

Start the work now. The readiness you build over the next 12 months will make your company worth millions more — whether you sell next year, in five years, or never.