Subtle Factors That Impact a Business' Value

by Ronald Hertenstein

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Business owners seldom sell too soon but often wait too long. Most businesses are not sold! They just fade or are given away. Examples of long established businesses simply closing their doors are legion. Many others are sold at less than fair value because of ill health, divorce, partner disputes, owner burnout or business slow down. Because of these adverse or distressful conditions, they do not command their greatest potential value and are often simply liquidated.

On the other hand, we all know or have heard of companies that have sold for fantastic prices with a substantial amount of cash paid at the closing table. The million or maybe multi-million dollar question is why? After much thought, and over a decade of experience gained in the sale of several hundred companies, the answer is both simple and complex.

The major factors threatening the value of a business are:

· The decision to sell or not to sell a viable company can be continually postponed. · The entrepreneurial nature of most business owners. · Conventional wisdom as to how and to whom a company should be sold is generally inappropriate. · There exists a misunderstanding of the factors that drive the value of a company. · The inability of business owners to position their company so as to obtain its highest value.

Sell or Not to Sell Perhaps the most important and most difficult decision a business owner ever has to make is the decision to sell. Unfortunately, most business owners agonize over the many variables involved in selling without ever making the decision to sell.

The result of the postponement usually is that the decision is made for them. Poor health, divorce, slumping sales, creditor demands, poor employee relations, lack of operating expansion capital are very often the symptoms of an owner who should have sold but failed to do so when the business was right for selling.

Nothing stays the same. Over time a business changes as does the owner. Eventually the demands and needs of the business are in conflict with your perspective and skills. Something has to give. Will it be your personal life and health or the business that suffers, or both? By failing to make the decision to sell the business owner allows it to be made for him.

Entrepreneurial Nature of Business Owners Unlike management of larger corporations who can draw upon many resources for support, information and operational advice, the management of the small private companies must wear all the hats themselves. Competition and the many financial drains facing smaller companies mandated that the owner do it himself whenever possible. The luxury of drawing upon outside resources is generally restricted to limited accounting and legal advice.

Most business owners have received unsolicited inquiries from potential buyers. It would seem logical therefore that attracting a buyer would not be that difficult. To the successful did-it-himselfer, selling the business doesn't appear to be that difficult, especially to the owner who has experience in successfully selling his product or service. Fortunately, the owner who makes those assumption is partially correct. Finding buyers is easy. In fact, everyone "has a buyer." Buyers hire firms to search for companies, network actively with lawyers, accountants, bankers, and others as they search for the right business. The typically aggressive buyer will look at scores of companies, make several offers and still be looking for a company. These buyers report to us that most sellers are unrealistic, don't know what their business is worth, often don't know how much they are making or losing and that getting adequate information on the business is difficult.

What really is happening: the businesses are not prepared for sale, are being exposed to the wrong buyers and are positioned as less than attractive opportunities. Selling a business should not be a do-it-yourself project.

Conventional Wisdom is Generally Inappropriate The public perception of how and whom to sell a company comes from several sources: newspapers, movies, television and hearsay. Unfortunately, these sources provide information that is either misleading, inappropriate or wrong, when applied to mid-size companies. These sources deal with public company happenings not those of private companies. There is a world of difference between the two. No one person owns a public company, shareholders do. Public company accounting methods are focused on maximizing profits in order to satisfy shareholders' demands and allowing management to maintain their jobs. Private company accounting methods focus on minimizing profits for the reduction of taxes.

Private company owners need not be concerned with hostile takeovers, junk bonds, P/E ratios or loss of a job because the company did not show a sizable profit in recent quarters. Most observers would agree that a major difference in protocol and culture exists between private and public companies. Because there is no public information available regarding the sales of private companies, many business owners and their advisors will apply public company protocol when attempting the sale of a private company. This methodology could generate the wrong buyer which creates unproductive negotiations, breach of confidentiality with employees and customers, and result in an asset value only sale. This method could also create the wrong price that is artificially high then loses the right buyer, keeps the business on the market too long creating a shop worn viewpoint, and attracts too much exposure of sale without tangible results.

What Drives the Company's Value Surprisingly, financial results are not the only factor in driving a company's value. The person or firm that recognizes the highest value is paid for entities that can demonstrate historical and future performance. Any buyer will be looking for a payback on their investment and this can only come from the perception of future profitability that is most likely to happen. Unfortunately, this step does not usually receive the attention required. The business owner or his advisors, although immersed in the business climate, are not familiar with the marketplace forces and the various types and categories of buyers that find this crucial.

Opportunity is an obvious factor that must be on everyone's list. Everyone seems to equate opportunity with potential but it is not true in the derivation of business value. Buyers will pay for opportunity but will not pay anything for potential. Buyers will not pay for what they will do with the business. They will pay for what opportunity has been proven to be and proven to continue.

Value is driven substantially by earnings. Since most private owners minimize earnings for taxation, the true value of the company lies within the recasted earnings into a meaningful cash flow for a potential buyer. In addition, the recast will need to be a demonstration of the future cash flow capabilities of the business.

Positioning the Company Positioning is similar to attitude in that proper positioning will produce positive results just as a positive attitude produces a richer and fuller life. Because it is virtually impossible to view oneself truly objectively, positioning should be left to a professional. To properly position a company for acquisition steps must be taken to objectively determine the company's strengths and weaknesses. Identify the firm's uniqueness and hidden values. Understand the subjective environment that surrounds the business. Research and gather data and information from outside sources to substantiate and verify opportunity. Quantify subjective data so as to give credibility to a projected future value. Weave the gathered information into a comprehensive profile of the company and the opportunity the firm represents.

A properly positioned firm sells for a premium price to a person or company able to enhance the operation. The owner receives an optimum price. The buyer acquires an exciting opportunity. Customers, employees and vendors continue their beneficial relationship with the firm.

Conclusion
Obtaining the best price for a business begins with the timely decision to sell. Doing it yourself should be limited to the decision to sell only. Thereafter, professional assistance should be obtained in order to maximize value, maintain confidentiality, and avoid costly mistakes.

Major corporations engage "pros" to enhance the value of their products in the marketplace. Professional athletes have their promoters, actors their agents, public companies their investment bankers. The unfortunate fact that most small to mid-size companies are sold for much less than they should indicates that the owners of these companies need professional assistance in their sales process.

About the Author:
Ronald Hertenstein is the founder and President of Anthony Wayne Business Exchange, Inc. (http://www.anthonywayne.com) established in 1987. He spent several years as a CPA with a major national firm and within his own company. His accounting background assists sellers and buyers in understanding the true cash flow of the business under consideration. He has been an entrepreneur for over fifteen years and knows the ups and downs of business ownership. He has assisted hundreds of people in buying and selling business of all sizes