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White Paper: Master Ten Value Drivers to Sell Your Business at the Highest Price

Takeaway: Evaluate your company through the eyes of a buyer. Master these ten value drivers and sell at the higher range of the multiples normally associated with your industry.

Business Value -- What Drives It?
A valuation is not about determining what a company is worth in the current owner's hands, it is about the company's transferable value. The purpose of this article is to help you evaluate your company through the eyes of a buyer. From that perspective we will ask you to focus on ten value drivers. Each driver is a characteristic of a business that either reduces the risk associated with owning the business or enhances the prospect that the business will grow significantly in the future. Simply put, the better your performance in these areas, the greater the selling price of your business. The likely result is that you will sell at the higher range of the multiples normally associated with your industry.

- **Value Driver #1: Stable and Predictable Cash Flow**
  Think of revenue and the bottom line cash flow of your business as the first introduction to a buyer. Revenue and cash flow is the number one attraction. A business with an established pattern of growth will bring a premium price when it is sold. The value associated with acquiring the available cash flow is directly related to risk. The lower the risk of losing that cash flow in a transfer of ownership, the higher the price will be to acquire it. If recurring revenues comprise a material portion of a company's overall revenues, the recurring revenue stream can be valued at a higher level than the non-recurring revenues. Examples of recurring revenues are maintenance contracts, monthly support agreements, annual license agreements, warranties, subscriptions, or other revenue streams that are contractual and repeating in nature. Buyers are willing to pay the highest amount when their perception is that cash flow is predictable and will increase into the future.

- **Value Driver #2: Reliable Financial Information**
  Reliable financial records are not only a critical element of business management but also support the claim that a company is consistently profitable. In the purchase of a business, the buyer will perform some level of financial due diligence. If the buyer is not comfortable when reviewing the company's past financial performance, there is no deal, or at best a reduced value for the company.

  If a buyer faces a seller of a business who asserts that the company has been making $1 million per year for the past three years and is projected to make at least that much in the future, the seller will be required to prove it. If the seller then produces past financial statements that are incorrect, insupportable, or incomplete, the buyer would most likely be gone.

  The lack of financial integrity is one of the most common hurdles encountered during the sale process.

- **Value Driver #3: Customer Diversity**
  A broad customer base in which no single client accounts for more than five to ten percent of total sales helps to insulate a company from the loss of any single customer. It reduces the risk of serious cash flow issues if one or more customers do not stay under new ownership.

- **Value Driver #4: Human Capital / Quality of Workforce**
  Keep your talent, they are your business. Buyers look for situations where management and / or key employees want to stay for the long term. The quality of the workforce, including experience, expertise and depth of knowledge, is also considered.

  An in-place team that can provide continuity and assist in the growth of the business under new ownership is a valuable asset. If a company's success is reliant on capable, well-trained employees - not the owner - it means the business will not be negatively impacted under new ownership. This reduction of risk will pay off with increased purchase price.

- **Value Driver #5: Growth Potential**
  When an owner can describe realistic opportunities for growth that specifically illustrate the reasons why cash flow and the business itself will grow after it is acquired, a higher value can be achieved. A documented growth plan demonstrates the viability of the company's future and may identify opportunities that a buyer had not considered.

  Some areas to consider in developing a growth plan:

  · Is your business in a growth industry?
  · Are there additional markets that a new owner should pursue?
  · What additional products could be delivered to existing customers?
  · Where are the best profit margins realized and can they be expanded?
  · Can your technology be licensed?
  · Will demand for your product or service increase as population grows?
  · How will enhanced marketing campaigns and sales efforts affect growth?
  · Are there opportunities to grow through acquisition?
  · Can growth be achieved by expanding territory or manufacturing capacity?

- **Value Driver #6: Operating Systems and Procedures**
  The establishment and documentation of standard business procedures and systems demonstrate that the business can be maintained profitably after the sale. Business systems include the computerized and manual procedures used in the business to generate its revenue and control expenses, as well as the methods used to track how customers are identified and how products or services are delivered.

  The following are examples of business systems that enhance business value.

  · Personnel recruitment, training and retention
  · Human resource management (an employee manual)
  · New customer identification, solicitation, and acquisition
  · Product or service development and improvement
  · Inventory and fixed asset control
  · Product or service quality control

- · Customer, vendor and employee communication
- · Selection and maintenance of vendor relationships
- · Business performance reports for management

- **Value Driver #7: Facility and Equipment Condition**
  The business facilities and equipment should be well maintained to realize maximum value. A buyer will not pay a premium, and may very well discount an offer, for a disorganized warehouse, office or other building. Seeing disorganized or poorly maintained facilities and equipment may cause the buyer to perceive that other aspects or the business may be similarly disorganized (employee records, financial records, compliance records, etc.).

  Owners should ensure that facilities and equipment are organized and maintained in peak condition before beginning the sale process. Buyers will appreciate that their investment will not include major repairs and that all equipment and inventory will be easy to locate and identify. Lastly, are the facilities large enough and machinery sufficient to accommodate some level of modest sales growth? A buyer does not want to have to look for additional space or immediately invest in new equipment shortly after closing.

- **Value Driver #8: Goodwill**
  This value driver involves stability and consistency. Name recognition, customer awareness, history, ongoing operations, and reputation are all part of business goodwill and influence value. Even if the company does not have many hard assets, relationships are key. The fact that customers have been with the company for a period of time does matter. Brand recognition, service or product reliability, and high customer satisfaction are distinguishing factors that add value. This driver of goodwill should not be overlooked in a valuation because it is helps mitigate perceived risk.

- **Value Driver #9: Barriers to Competitive Entry**
  Features that give a business an advantage over its competitors, strengthen its strategic position, or that can be leveraged for future gain boost value and lessen perceived risk. Buyers will pay a premium for a niche that has barriers to competitive entry.

One way to describe this Barrier Value Driver is to use Warren Buffet's term, "Business Moat." Buffet compares a castle's moat to the protection that a business needs to encroaching competitors. For instance, the wider the moat, the more easily a castle could be defended. A narrow moat did not offer much protection and allowed the castle to be breached. To Buffett, the castle is the business and the moat is the barrier that protects the business' competitive edge.

The following are example barriers that widen the moat and hinder competitors from breaching the company's castle.

· Copyrights
· Trademarks
· Patents
· Trade Secrets
· Developed Processes
· Proprietary Designs
· Proprietary Know-How
· Brand or Trade Names
· Engineering Drawings
· Customized Software Programs
· Step-by-Step Training Systems
· Customized or Proprietary Databases
· Published Articles or Industry Press
· Hard-to-get licenses, zoning, permits, or regulatory approvals
· Contracts with difficult-to-penetrate entities (government, for example)

- **Value Driver #10: Product Diversity**
  A narrow product set increases risk and drives down value. Diversity of revenue sources lowers the inherent risk of the business. Therefore, businesses with a healthy product mix, good gross profit diversification, or with products or services sold into multiple industries, receive a higher perceived value from prospective buyers.

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