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Is your business your largest asset? How would you value it to sell?

- A market value comparison is critical for an optimal exit plan

Some common questions business owners have in planning succession include: Can your business be compared to other private companies? How do you know whether your company is undervalued or overvalued compared to your industry? An initial step in exit planning is to determine how your company compares in value to similar ones.

This analysis is commonly referred to as a Market Transaction Analysis. There are a number of databases that gather information on the sale of privately-held companies. Some databases focus on very small companies. Other databases gather information on small, medium and high privately-held companies.

Important comparisons should analyze the financial metrics that buyers are focused on, companies approximately the same size in revenue and in earnings. Many businesses can be classified by SIC (Standard Industry Classification) or NAICS (North American Industry Classification) codes.   Most businesses fall in a code and may not be perfectly aligned with the code. Though, the comparison usually is sufficient for value analysis. The more data compiled with similar codes make for a better quality comparison.

The sales transaction comparison involves a regression analysis to find how your business best fits with low, midrange, and high multiples of earnings and capitalization rates shown in the transaction data. The multiple in earnings is usually computed by dividing the actual business' selling prices by the companies' earnings as shown below.

In many analyses that our office has prepared, we use metrics like the company's EBT - Earnings Before Taxes, EBITDA - Earnings Before Interest, Taxes, Depreciation, and Amortization – and SDCF- Sellers Discretionary Cash Flow - which is EBITDA plus owner compensation. The multiples on the earnings metrics analyze and compute a weighted average to indicate an approximate value for the business. In many cases, we use five years of data; the weighted average is higher for the most recent history of the company.

The value comparison allows the owner to have in mind a reasonable range of his company's value in the negotiation process with buyers.

The analysis is first computed without discounts to the value. Typical discounts that are considered in the analysis include minority shareholder discounts and lack of marketability discounts.

The minority discount is an accepted valuation discount with certified business valuators and has been proven to show that minority shareholders wishing to liquidate, many times, do not have the influence or control to make major decisions in the company.

The discount for lack of marketability is an accepted discount by business valuators that reduces the value in the sale of privately-held companies. The discount is based on the size of the companies and transaction data that show the amount of value reduced in privately-held company sales compared to publicly traded companies. In other words, the lack of marketability to sell a privately-held company requires the seller to discount it in order to sell it in a reasonable time period

With each of the noted discounts, there have been many studies completed by noteworthy business valuation firms that confirm these discounts to the value.

Once the low, midrange, and high value ranges are computed, the minority interest and lack of marketability discounts provide a more accurate value range comparison with similar, actual companies sold.

A vital component for sales growth is Quality.

In order for sales growth to be sustainable, it is vital that a business's product and services be topnotch. Otherwise, sales efforts will be hampered or completely ineffective with customer complaints offsetting sales growth initiatives. Quality is essential to support your company's sales growth actions. Quality has been one of the most prominent features of modern business. Poor quality goods and services are increasingly unacceptable to a demanding marketplace; firms without a quality focus risk being rejected in favor of quality conscious competitors.

At minimum, meet the expectations of your customers

Working to achieve quality requires a total dedication on the part of everyone in the business. It's not just 'doing the best you can,' or turning out a product without flaws. It's about ensuring that every aspect of the business is up to best practice standards, from the way team members answer the telephone, to the after sales service the business provides.

Think about what happens when you purchase a product or service. You have expectations about such characteristics as its price, its dependability, its performance and its ease of use. Your perceptions of the quality of this product or service will be based on how well, or poorly, it meets your expectations. If it meets or exceeds them all you will conclude you have made a 'quality' purchase. If it disappoints you in any way you will perceive it as inferior to what you expected. If all your expectations are met you can be sure this didn't happen by accident. Quality is only achieved by good business management and requires a lot of time and effort to make it happen.

Quality Control and Q & A – you need both

There is the traditional approach to achieving quality, quality control, or 'QC,' as it came to be called, and is still valid and used by most businesses. This is essentially a process of inspecting and testing a firm's output and rejecting anything that's faulty. The biggest problem with quality control is that it only picks up flaws after a product has been made or a service has been delivered. This is expensive and doesn't really fix the cause of the problem with quality.

Quality assurance, or 'QA,' is a more cost effective approach. It involves designing and managing every step of the manufacturing and delivery processes in such a way that the possibility of quality flaws is minimized. Quality assurance begins right back at the stage of product design and continues from there. The product is designed to be problem free, along with the manufacturing process and the delivery system. Risks of quality troubles are minimized from the start, and the process receives ongoing attention to keep it that way.

The seven steps to quality

Start by putting yourself in the position of your customers. What do they want? What are their expectations? Be objective so you can honestly say you know what you have to give them. Then take a long, hard look at your business. Look for everything that's wrong and make a personal commitment to fixing it. Now you're ready to base your management on these seven principles and give your business a true quality focus:

1. Share your personal commitment to quality with your customers, your suppliers and the members of your team.
2. Talk to your customers and ask what they think is important. Then be sure you give it to them.
3. Involve your team members. Ask them for their commitment and their suggestions on ways to improve the quality of your products and everything else you do.
4. Don't just correct mistakes; do whatever it takes to prevent them from happening.
5. Accept that quality will cost something and know that your customers will pay for it.
6. Make your service delivery systems better; there's always room for improvement.

Never stop looking for ways to be better at what you do.

Business growth is essential for success – How?

A business that stops growing is really shrinking or on the verge of topping out; knowing where and how to grow is often difficult to decide. Will it be cost effective to expand within your existing market; or are there better opportunities in entering a totally new market? Any move to expand your market needs a lot of thought and analysis before going ahead. Growth may be growing in actual physical size, growing financially with a business purchase, or purchasing the source of your products or services – your supply chain.

Grow where you are…or get moving

Carefully examine your present situation. Some businesses are overlooking the potential that's literally knocking on their doors simply because their facilities are inadequate to generate additional trade. If you're losing customers because your showroom is too small, you might be able to grow your business just by making it physically larger.

It might also be beneficial to move to a new location. Retail and service businesses are especially sensitive to changes in the composition of their customer base and traffic can gradually decline as population shifts occur. It will almost certainly cost more in rent for a location that gives you more passing trade, but it is often worth the extra expense.

Growing by the numbers

If you can replicate your business in another location without cannibalizing your present revenues, expansion through opening new outlets could be the way to go. Use your present income and expense figures as the basis for your calculations and see how it looks on paper. Be aware that expansion can lead to market saturation. There may be enough customers in an area to support three outlets but a new outlet would just take business from the other three without gaining a worthwhile overall share.

If you're confident your business model is a good one you might also consider franchising. Getting a new franchise underway can be expensive and take a lot of hard work, but it offers the potential of excellent returns from people you help into business. An interesting possibility for manufacturers with patents on their products or processes is to license other companies to use them in return for a royalty fee. Some manufacturers inject themselves into these arrangements by selling their licensees raw materials or management expertise as well. Just be sure you don't give away your rights to someone who's going to compete with you for customers.

Purchase the source of your products

A retailer or manufacturer often finds that the costs of goods and materials they purchase rises more quickly than the price at which they can sell their products. This means they have to either find alternative sources of supply or become their own supplier.

Fast food chains, for example, often find it cost effective to purchase and operate their own sources of fresh vegetables and meat products. This also gives them absolute control over the quality of their ingredients. This type of expansion is called 'vertical integration' and can often be the best kind of growth if you have the managerial talent to successfully operate the sources of supply you acquire.

When possible, get rid of the middleman

Every extra level in the distribution channel takes away some of your profitability. If your business buys or sells products through agents it may be possible to get rid of the middleman and do your own buying or selling. Manufacturers can open their own retail outlets if their products suit the model of direct selling. Another option is to market by telephone your products; this does away with wholesalers and retailers but does require a significant investment in a telemarketing setup.

However you decide to expand, consider the competition carefully. What will their response be to your expansion? Are you getting into markets now served by businesses with which you're unfamiliar and what are they likely to do to counteract your entry into their territory?

As much as possible, stay with what you know. Expanding can make good sense, and by using familiar products and processes you'll find it easier to perform the calculations required that will help you decide how to grow your business.

Regular Pieces

How To Make The Most Of Your Newsletter

Be sure to read each article with the mindset 'How could this apply to our business.' Thinking of it that way will guarantee that you get value. Better yet, take notes as you read and commit to having the ideas implemented by the time the next edition arrives. Also, make copies for each team member. To really make sure something positive happens, work with your business development specialist to talk your team through the ideas and how to set a schedule for getting them implemented. We're here to help you get started.

An Important Message

While every effort has been made to provide valuable, useful information in this publication, this firm and any related suppliers or associated companies accept no responsibility or any form of liability from reliance upon or use of its contents. Any suggestions should be considered carefully within your own particular circumstances, as they are intended as general information only.

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