OPTIMIZING THE VALUE OF YOUR BUSINESS: WHAT ARE THE VALUE DRIVERS?

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It's generally accepted by those who specialize in the art and science of business management that anyone who is responsible for the stewardship of a business enterprise should have three primary management objectives: 1) to achieve a desired level of growth; 2) to attain an acceptable level of financial performance; and 3) to create equity value. Let's talk about the third of these, which is the objective of maximizing the value of your business.

Sooner or later every business owner is faced with the decision of whether or not to sell his or her company. In fact, the business brokerage industry estimates that about 20% of all small businesses are for sale at any given time. So it would seem only prudent for a business owner to manage his business in such a manner as to maximize its value over time. In order to do this, the owner should have an understanding of the basic concepts that drive the value of a business, regardless of its size or industry, in the eyes of a prospective acquirer.

Although qualified business appraisers, as well as astute buyers, often utilize a great deal of research and complex valuation methods to arrive at the fair market value of a business, the two fundamental, underlying concepts that drive the perception of value are straightforward and rely on common sense. So what are these concepts and how can you utilize your understanding of them to maximize the value of your business?

First of all, we need to identify them. They are 1) cash flow, specifically, the estimate of future cash flows that the business can reasonably be expected to generate for a new owner; and 2) the buyer's perception of risk, or his level of confidence that he will actually receive those cash flows if he buys the business.

The cash flow value driver is a function of both revenues and cost controls. Its affect on value is derived from the current owner's ability to maintain stable or growing revenues while, at the same time, controlling costs. Doing so over time creates a history of profits to the current owner that will be taken into consideration in developing reasonable estimates of potential future profits that will benefit a new owner.

With regard to the risk driver, we all know buyers are risk averse. So while we work toward establishing that the business can generate a certain level of revenues and profits, our concurrent goal should be to minimize a prospective buyers perception of risk with regard to his investment, in which case he will be more likely to pay a higher price for the business. Essentially, this consists of being able to provide compelling evidence to a prospective buyer, ideally in the form of historical financial performance, that he will actually receive those projected cash flows if he acquires your business.

So let's sum it up: stable or growing revenues and cash flow over the most recent three years or so are not only verifiable proof of your business's ability to generate a certain level of revenues and profits but also are indicators that those revenues and profits will continue. That's a good combination.

The manner in which one manages the day-to-day operations of a business can also affect value through its influence on risk. Customer or supplier concentrations tend to increase the perception of risk, whereas contractual sales and a history of return customers, for example, reduce that impression. Also, value may be increased by reducing the business's dependence on the current owner to generate cash flows. A buyer wants to know that the company can continue to be successful without your presence. Here, then, is a summary of the basic drivers that create value:

- Continuous and stable revenue growth over time
- A history of controlled costs and predictable cash flows
- A stable workforce and management depth
- A diverse customer and supplier base

Managing your company's financial performance in such a way as to establish a history of stability and growth provides a reasonable basis for the assumption that the prosperity of your business can be transferred to a new owner. This, coupled with sound operations and management depth, can help maximize the value of your business.

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