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The Impact of Value Drivers on Sale Price

Business experts may mention "Value Drivers" as if everyone knows what they are, how they work, and where their impact will be greatest. It can be difficult or frustrating to know that building business value is a frequent topic of discussion, but *actually building value* is sometimes easier said than done.

It may be the case that one business has buyers lined up willing to pay top dollar while another sits on the market for months or even years. What do buyers look for in a prospective business acquisition?

There are many opinions about which attributes or characteristics buyers seek, but here's what we have observed: The characteristics buyers seek must exist before the sale process even begins, and it is your job as the owner to create value within your business prior to the sale. We call characteristics that impact value "Value Drivers."

Look At Your Business Through A Buyer's Eyes

To grasp the importance of Value Drivers when preparing to sell a business, owners must put themselves in the buyer's shoes. Consider the following case study, which illustrates how a buyer might approach the search for effective Value Drivers.

The Alpha Company has earnings before interest, taxes, depreciation, and amortization (EBITDA) of \$2 million, an owner who runs the business, and systems and processes that

create growth. The Alpha Company does not have a true management team in place, and the owner generates a majority of its sales. The owner is the locus of the company, holding both the CEO and CFO positions. With such overwhelming responsibilities, the owner is burning-out quickly.

By comparison, the Beta Company has EBITDA of \$2 million and a solid management team that runs the business, systems, and processes. The management team creates efficiencies within the business, and the owner vacations for six weeks a year.

If you were a buyer comparing these two companies, which factors would you consider more likely to lead to a successful acquisition? How much more would you pay for a business with a strong management team (one of the most important Value Drivers)? Would you be interested in buying a business whose management team (i.e., the owner) walks out when you walk in?

Experts in getting businesses sold understand that companies that lack strong Value Drivers also lack a strong pool of buyers. The buyers that do come to the table do not arrive with pockets full of cash.

The Most Common Value Drivers

Consider the following important Value Drivers common to all industries.

- **A Stable and Motivated Management Team:** If owners can wait a year to sell their businesses, they should consider an incentive compensation system that is either cash or stock based and rewards key employees based on how the company performs (usually measured by increases in pre-tax income). Sophisticated buyers know that with a solid management team in place, prospects are good for continued business success. Without a strong management team, it may be difficult to sell the business to a third party or transfer it to an insider.
- **Operating Systems That Improve Cash Flow Sustainability:** Operating systems include the computerized and manual procedures used in the business to generate its revenue and control expenses (i.e., create cash flow), as well as the methods used to track how customers are identified and how products or services are delivered. The establishment and documentation of standard business procedures and systems demonstrate to a buyer that the business can be maintained profitably after the sale.
- **A Solid, Diversified Customer Base:** Buyers typically look for a customer base in which no single client accounts for more than 10% of total sales. A diversified customer base helps insulate a company from the loss of any single customer. If the majority of an owner's customer base is made up of only one or two good customers, the owner should consider reinvesting profits into additional capacity that will make developing a broader customer base possible.
- **A Realistic Growth Strategy:** Buyers tend to pay premium prices for companies with realistic strategies for growth. Even if an owner expects to retire tomorrow, it

makes sense to have a written plan describing future growth and how that growth will be achieved based on industry dynamics; increased demand for the company's products; new product lines; market plans; growth through acquisition; and expansion through augmenting territory, product lines, and manufacturing capacity. This properly communicated, detailed growth plan helps attract buyers.

- **Effective Financial Controls:** Financial controls are not only critical elements of business management but also safeguards for a company's assets. Effective financial controls support the claim that a company is consistently profitable. The best way for owners to document that their companies have effective financial controls and that their historical financial statements are correct is through a certified audit or a verified financial statement from an established CPA firm.
- **Stable and Improving Cash Flow:** Ultimately, all Value Drivers contribute to stable and predictable cash flow. It is important that the company's cash flow remains substantial and continues to grow, especially in the year or so preceding the sale of the business. Owners can begin increasing cash flow today by focusing on ways to operate their businesses more efficiently by increasing productivity and decreasing costs.

You can install these Value Drivers and better position your company to secure a premium price upon your exit with the help of a trained Exit Planning Advisor.

If you have any questions about increasing the value of your business prior to your exit, please contact us to discuss your particular situation. We can help you identify and strengthen the current Value Drivers in your business, install additional Value Drivers, and create a road map to meet your overall Exit Objectives. We also have resources that explain Value Drivers in more detail and can help you apply these concepts to your business.

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