Creating Value to Get Top Dollar Upon Your Exit

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Did you ever wonder why 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? The characteristics buyers seek must exist before the sale process even begins. It is your job as the owner to create value within your business prior to the sale.

To get an idea of the importance of value drivers when preparing to sell your business, it is important to put on the buyer's shoes for a minute. For an example, let's look at a hypothetical case study that compares two similar companies with a different emphasis on value drivers.

The A Factor Company has cash flows of $1 million and has an owner who runs the business, systems and processes to create growth. The A Factor Company doesn't have a real management team in place and the majority of sales are generated by the owner. The owner is the center point of the company, holding both the CEO and CFO positions. With this level of responsibility, the owner is burning out quickly.

In comparison, The B Factor Company has cash flows of $1 million and has 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 the buyer who was looking at purchasing these two companies, which situation would provide a more attractive business opportunity to you? How much more would you pay for a business with value drivers in place such as a strong management team?

Investment bankers in the market have seen that without value drivers in place – such as a strong management team – sellers reduce their buyer market by more than three-quarters. With value drivers playing such an important role to the overall sale of a business, let's take a look at the following value drivers that are common to all industries.

A stable and motivated management team. If you don't plan to sell your business for at least a year, then you may want to establish an incentive compensation system, cash- or stock-based, that rewards key employees as the company performs (usually measured by increases in pretax income). Sophisticated buyers know that if a solid management team is in place, prospects are good for continued business success. If a strong management team doesn't exist, it may be very difficult to sell your business to a third party or transfer it to an insider.

Operating systems that improve sustainability of cash flows. 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 will typically be looking for a customer base in which no single client accounts for more than 10 percent of total sales. A diversified customer base helps insulate a company from the loss of any single company. If you find the majority of your customer base comprising of only one or two good customers, it is important to consider reinvesting your 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 having a realistic strategy for growth. Even if you expect 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, manufacturing capacity, etc. It is this detailed growth plan, properly communicated, that helps to attract buyers.

Effective financial controls. Financial controls are not only a critical element of business management, but they also safeguard a company's assets. Most importantly, however, effective financial controls support a claim that a company is consistently profitable. The best way to document that the company has effective financial controls and that its historical financial statements are correct is through a certified audit or perhaps a financial statement reviewed or compiled by an established CPA firm.

Stable and improving cash flow. Ultimately, all value drivers contribute to stable and predictable cash flow. It is important, especially in the year or so preceding the sale of the business, that cash flow be substantial and on an upswing. You can begin increasing cash flow today by simply focusing on ways to operate your business more efficiently by increasing productivity and decreasing costs.

By increasing your knowledge, by working with a trained Exit Planning Professional, and, most importantly, by thinking about what the business needs to become more valuable, you can put into place the elements necessary to drive the value of your business upward and position yourself to get a premium price for your business upon your exit.

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