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Business Future Key to Sale

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The true value of a company lies in the potential buyer's plans for it

A business owner who is contemplating the sale of their business will naturally think about who might buy it. In fact, the more important question is, why would someone buy it?

When a company is being sold, a business owner needs to put themselves in the mind of the potential buyer. One thing we always emphasize to clients is that the true value of a business lies in the future as seen by the buyer.

A person who is interested in purchasing a business isn't buying the company for its history, nor for its current status, but for future potential - the potential to bring the buyer a healthy return on investment.

A potential buyer looks at a business to see what they can do with their combination of money, resources, motivation and management skills. Once they estimate how profitable they believe it could be under their tutelage, then they can determine what they think the business is worth.

Appreciating that the value of a business lies in the future as seen by the buyer can be a difficult concept for business owners to embrace. They're full of knowledge about their company's background and important milestones and may have a hard time accepting that the future return on investment is the foremost question on the potential buyers mind.

That's why, when business intermediaries who are specifically trained in facilitating the sale of a business, a great deal of effort is put into determining what the business's future is likely to be. An intermediary working on behalf of the seller will look at both broad economic trends and the specific marketplace for the company, including a detailed review of current and potential competition. The relevant history and performance of the business is then recast to provide a reasonable estimation of the future, thus determining the value of the company from the seller's perspective.

Meanwhile, the potential buyer estimates their return on investment by looking at such things as the cost of borrowing money, the degree of risk involved in the transaction, their need for income and liquidity and the future expectations of profit.

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If, for instance, sales are down, profits have dropped, there's a lot of competition in the market and large capital expenditures are needed in the business, this combination of factors will likely result in a lower purchase price being presented.

The type of business it is also affects how a company's value is estimated.

For instance, purchasing an insurance agency is considered a lower risk investment due to the fact that most insurance policies renew yearly.

However a construction firm is a higher risk because its activity depends on being the successful bidder in contracts, the business is only as successful as its most recent contract.

When a business is sold, the seller's goal and buyer's goal are naturally opposite. The seller wants the highest purchase price and the buyer wants the highest return on investment possible – and a lower purchase price means less risk to the buyer in achieving a strong return on their investment. These two, very different perspectives set up a process that is inherently confrontational. Again, this is where the role of a business intermediary can help, as a third party that is not personally involved. A business intermediary will assist with all negotiations between the buyer and seller and continuously work on moving the process forward so that both parties are happy. The process is similar to using a real estate agent to sell your house, a lawyer to manage a law suit, an accountant to handle an income tax reassessment. Putting specialists between two "opposing" sides can help make the transaction a smooth one and will ensure that the necessary regulatory issues are appropriately managed.

The bottom line is, while past and present performance are certainly important, it's the buyer's perception of the future that carries the most weight.

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