



A SECRET WAY TO FORECAST THE FUTURE PROFITABILITY OF A BUSINESS IN DETERMINING VALUE

GOOD INVESTORS LOOK TO CASH FLOW TO DETERMINE THE OPENING BID WHEN A COMPANY COMES UP FOR SALE. TO SUBSTANTIATE VALUE ONE SHOULD:

- ESTABLISH THE HISTORICAL CASH FLOW OVER THE PAST 5-10 YEARS
- PROJECT THAT CASH FLOW INTO THE FUTURE, TAKING INTO CONSIDERATION ITS PEAKS AND VALLEYS
- DISCOUNT THE PROJECTED CASH FLOW TO PRESENT DAY DOLLARS, AND
- CHECK THE KEY PERFORMANCE INDICATORS

KPIs: A Gauge for Future Growth

KPIs are the specific, measurable, achievable, realistic and time limited indicators.

KPIs drive performance forward in anticipation of meeting strategic goals. Determining which KPIs should be used changes drastically from business to business – no two businesses are the same.

Financial Indicators

Financial Key Performance Indicators (KPIs) are output metrics such as Return on Investment (ROI), Gross Operating Surplus, EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) or the EVA (Economic Value Added):

- Revenue increases
- Production costs
- Margin changes
- Profitability over time

Be forewarned, financial indicators are limited because they lack interpretive quality, meaning they have little potential to forecast future profitability.

Internal Process and Learning Indicators

Internal KPIs measure how efficiently the firm turned its raw material into finished products. Measuring average production costs and time allow companies to monitor setup costs, locate bottlenecks and reduce redundancies.

Learning indicators focus on capturing what production activities must be done differently tomorrow to remain competitive:

- Alignment: How well do all parts of the business align with the company's mission and strategy?
- Sources of supply along with changes over the years
- Technological changes
- Total quality management and lean manufacturing techniques
- Product and client service innovations
- Employee turnover
- Customer service improvements, employee training and development

Customer Relationship Indicators

Customer relationship indicators track the relationship between the firm and its customers. And, when the relationship is unhealthy, potential growth is jeopardized and potential buyers run the other way.

- Trust: What is the company's level of transparency and accountability?
- Engagement: How well does the company engage its clients?
- Reputation: How favourable is the company's reputation?
- Satisfaction: How satisfied are customers?
- Customer turnover: How well customers themselves are performing

Alignment

KPIs need to align directly with the strategic objectives to be a valid and reliable measure.

- How well do all parts of the business align with the company's mission and strategy?

When objectives are not met, one must revisit the strategy to verify that it still fits the marketplace. Are the KPIs aligned with the objective, the objectives with the goals, and the goals with the strategy?

Because a KPI is a measurable value that demonstrates how effectively a company has achieved its business objectives.

High-level KPIs focus on the overall performance of the business (financial).

Low-level KPIs focus on organizational processes such as sales, marketing, human resources, and on goes the list (i.e., customer service, internal processes and learning) and the list goes on.

While a business evaluation is a point-in-time absolute measure of a company's value in the eyes of the buyer, KPIs change in response to shifting political, environmental, socio-cultural and technological (PEST) changes.

KPIs reveal how well the company's owner reads the markets, beats the competition and implements compensating strategies to enhance productivity, lower operating costs and increase profits of the company.

Selecting KPIs is a strategic process. It varies from business to business and relies on studying the market, setting goals, identifying business objectives and selecting the key performance indicators.

These indicators when monitored over time tell how efficiently and effectively the owner's strategy addressed market threats and capitalizes on opportunities.

When the owner's strategy is spot on, prospective buyers can confidently rationalize that the company used a strategic process. A process that utilized research to design strategic goals that were monitored by KPIs resulting in the efficient and effective use of resources to maximize profits. This is the best vantage point for a prospective buyer to visualize the company's growth potential.

When it comes to selling a business it's the intermediary's responsibility to evaluate the business and determine its future. Investors interested in purchasing a business are not buying it for its current status, the attraction is future growth.

THE BOTTOM LINE

When it comes to selling a business, Doug Robbins emphasizes that it is the intermediary's responsibility to evaluate the business and determine its future.

While a business evaluation puts a dollar figure on a company's current worth, KPIs are the gauges for future growth.

In reviewing a series of KPIs on a client with a patented product we concluded their KPI on distribution was low. We sold the business to a US firm, whose distribution KPI was far superior, at a price higher than traditional valuation models indicated.



About the Author

Caterina Valentino, PhD

Caterina is a contract instructor at the Ted Rogers School of Management at Ryerson University and the Faculty of Health Studies, Athabasca University. She teaches in the areas of leadership, management and diversity. She has held various senior leadership positions in the health care industry. She can be reached at caterina.l.valentino@gmail.com

Resources used:

Robbins, Doug. *Sell Your Business: 100 Tales from the Trenches by a Master Intermediary*

IT Performance Improvement: How to Manage Performance Kaplan and Norton's Balanced Scorecard
<http://ittoday.info/ITPerformanceImprovement/Articles/2014-03Lehmann.html>

Piloter.org Executive Dashboard The Four Perspectives of the Balanced Scorecard by Alain Fernandez
<https://www.executive-dashboard.org/balanced-scorecard/balanced-scorecard-perspectives.htm>

[Difference between Measurement and Evaluation | Difference Between](http://www.differencebetween.net/language/difference-between-measurement-and-evaluation/#ixzz5ISJC500) <http://www.differencebetween.net/language/difference-between-measurement-and-evaluation/#ixzz5ISJC500>

[Difference between measurement and Evaluation](http://www.differencebetween.net/language/difference-between-measurement-and-evaluation/)
<http://www.differencebetween.net/language/difference-between-measurement-and-evaluation/>

Stacey Barr What's the difference between evaluation and performance measure?
<https://www.staceybarr.com/measure-up/whats-the-difference-between-evaluation-and-performance-measurement/>



RBX

Robbinex Inc.
8 Christie Street, Grimsby, ON L3M 4H4
1-888-ROBBINEX (762-2463)
www.robbinex.com

