

# topical tips

Issue 21 Summer 2002 Making your business valuable

## Making your business valuable

The recent economic slowdown has knocked the wind out of many companies' sails. But owners will still want to realise their investment in the business at some point. Now is a good time to sit back and take stock of where the business is and what needs to be done to optimise its value in the future.

What makes a business attractive to a prospective buyer is also fundamental to long term success as an independently owned company. The two are far from mutually exclusive. So planning to maximise the value of the business is a sensible move whatever your intentions.

### What buyers look for

Potential buyers will look at acquisitions for a whole range of reasons, including:

- increasing volume;
- geographical expansion;
- diversification;
- additional skills;
- acquiring profile;
- management expertise.

One of the major influences on the price buyers pay will be a function of their confidence in the underlying profits they are acquiring.

What gives them that confidence? It will result from demonstrable evidence of certain inherent qualities within the business that attract high calibre staff and create more business from new and existing clients and

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customers. This in turn indicates continued future growth. Demonstrable evidence can be broken down into:

- management in depth;
- well spread, quality client/customer base;
- client/customer loyalty;
- a high quality profile for the business or its products;
- historic growth indicative of future growth;
- innovation in products and services.

Other factors buyers consider will be:

- strategic fit;
- size and profitability;
- sector;
- territory.

You may not be able to influence some of these, but if selling is a genuine goal then there is a lot you can plan for and control.

## People

One of the main routes to acquiring a reputation as a “quality” organisation is in the people you hire. Staff excellence will lead to more imaginative and more effective customer service and product offers. This in turn will lead to an enhanced reputation among your target market.

The skills being employed by the business should be in keeping with the size and nature of the organisation as a whole. Finding a way to attract and keep the right people is of prime importance. Buyers will look cautiously at companies where the up and coming management team has not been tied-in with long term incentives.

## Clients/customers

In addition to high calibre staff, a buyer will also need to see a diversified, quality client/customer base. One without over-dependence

on any one or two. Ideally, any one client/customer should not account for more than 20% of income. Whilst making sound commercial sense in sheltering the business from client gains and losses, it also demonstrates an effective business development or sales team.

Once a client or customer has been won, the aim is obviously to work with them for a meaningful period of time. Client/customer loyalty is an important yardstick and will certainly be measured in years rather than months. The depth of relationship is also important in a service business. The more client contacts, and the higher in the organisation they are, the better.

## Systems

Well run and appropriate systems which ensure client/customer satisfaction and produce quality are also important. If a buyer is going to have to spend money sorting out the infrastructure it will probably come off the purchase price.

## Cost control

**“Turnover is vanity, profit is sanity.”**

Boosting income levels is obviously one side of the coin, but must be translated into increased bottom line profits. This means ensuring that costs do not grow faster than the actual business generated. The most difficult, and expensive, area is usually staff costs. It is easy to become lax on salaries and staffing levels in the context of rapidly expanding business, and it is these costs that will eat large chunks of operating profit in a service business.

Equally important is to retain quality control over the client base. New business should be accurately assessed for profitability and credit worthiness, and not just taken on to generate growth for growth's sake. Effective job

profitability monitoring and sensible client acceptance criteria should be in place. Setting minimum fee levels, and sticking to them, is a good discipline. Obviously, exceptions can be made where there are marketing or strategic reasons to take the business on.

Cash is even more important than profit. Cash is the oil which makes the business machine go round.

Effective credit control and cash management should be in place. High interest, high loans and overdrafts will often eat into profits. Additionally, a buyer may deduct excess borrowing from the value of the business.

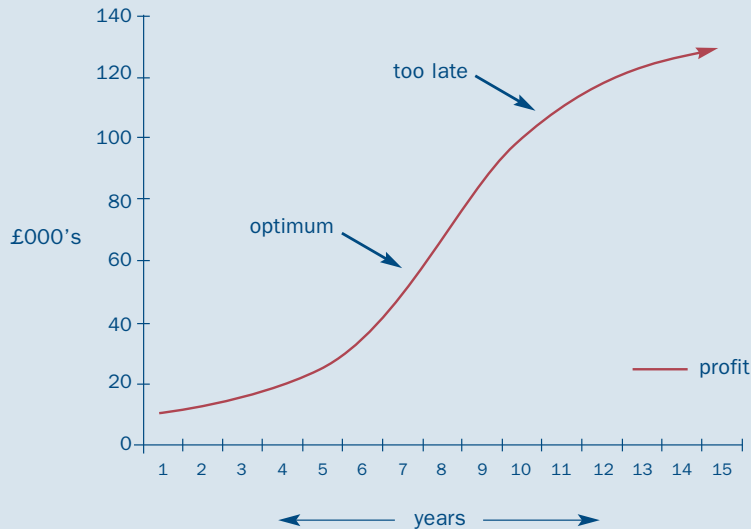
## Business finance

Polish that profit curve. A buyer wants to see past profit growth as an indication of future growth. Embarking on new ventures is risky and should therefore be planned carefully. Attractive as business diversification sometimes seems, it is never worth standing to lose more on a new venture than any projected profit growth on the company's core business units. New ventures should aim to be profitable within a reasonably short time-frame – say eighteen months.

## Financing new developments

Generally if a sale is imminent it is advisable for new ventures to be funded out of cash flow from trading operations and/or asset sales. If the company does not have sufficient cash, then it should be asking some serious questions as to whether this new development would help or hinder the business in the long run. Ideally, borrowings should be a lot less than shareholders' funds (share capital and retained profits) and kept as short term as possible. Long and onerous leases will be potentially off-putting, eg on equipment or premises.

## Polishing the profit curve



### Owners' perks

It always helps to demonstrate an interest in maximising profits. Attractive as the prospect of company-owned villas or yachts may seem, these assets imply that directors have lost interest in driving the business forward.

Prior to sale, one would be well advised to "clean up" the balance sheet, and ensure the company gives an impression of being totally results focussed.

### Good housekeeping

Keep your administration tidy. Make sure:

- employee contracts are sound and in place;
- appropriate client terms are in place, where possible;
- you are not exposed to extra tax on freelancers;
- your leases are in the right names and relate to assets you have;
- any intellectual property is adequately protected.

When we carry out due diligence looking at the financial and commercial position of target companies these are some of the soft targets. Other common areas for concern include lack of appropriate or regular management information, inappropriate accounting policies, undeclared tax on employee benefits, and not having the share ownership and other statutory records up-to-date.

The messier it is, the less confidence a buyer will have and the easier it is to talk down the price.

### Profile

Profile helps enormously in attracting good talent and the right clients/customers. Everyone wants to work with the pack leader. It is also a selling point to a potential buyer and should not be under-rated.

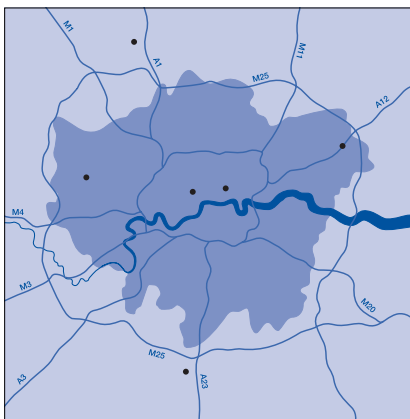
### Conclusion

Whatever the plans for the future, following these basic ideas will help provide your business with the strength and flexibility to give you choice: either for borrowing to make your own acquisitions or for finding the best exit route.

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