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Factors Influencing a Company's Value

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Most business appraisers will agree that business valuation is a unique combination of art and science. Because there is not a universal formula that can generate the exact value of a company, deriving the accurate worth of any business requires the consideration of many factors.

Earnings

Ultimately, the value of your business is determined by what someone would pay for it in the marketplace. The buyer is looking to purchase a future income stream that will provide a desired return on his or her investment, which will justify the purchase price. As a result, most appraisers base their valuations upon multiples of earnings in which the historical and future earning patterns of an operating business become the biggest factor in determining value.

Risk Factors

If all factors were equal, earnings would be the sole determinant of a company's worth. However, every company has unique risks associated with its operation, and appraisers must weigh the company's future opportunities against the perceived business and economic risks. Elements of the business that increase risk will decrease value, and conversely, elements that decrease risk will increase value. Some risk factors that influence valuations are as follows:

1) Diversification

By diversifying the company's customers, suppliers, product lines and employee talent, a company reduces its risk in case of market turbulence.

2) Infrastructure

A solid infrastructure of people within the company helps decrease a buyer's risk, and therefore increases the business' value. Talented managers, trained employees and established operational systems help the company run like a well-oiled machine, meaning the company is more able to transfer seamlessly to a new owner.

3) Timing

The value and risk of a business depends on many time factors, both internal and external. Internally, a company has less risk if it displays a positive trend of historical financial performance. A healthy future earnings projection also decreases the company's risk. External factors, such as industry stability, market conditions and economic outlooks, all shape the company's future performance expectations.

4) Assets

In an asset intensive business, the conditions and efficiency of equipment affect the value of the business. Well-maintained equipment means buyers will not need to invest significant funds into upkeep and repairs. Likewise, the value of intellectual property or proprietary content will also increase a company's value.

5) Appearances

The way a company looks, both physically and on paper, affect the perception of value and risk to a buyer. The organization and efficiency of the working environment reflects upon the company and its overall management. Clean, organized financial statements will increase the confidence the buyer has in the company's actual performance.

6) Finance-ability

Most buyers will require a lender to finance a portion of the transaction. Whether through a traditional bank loan, a SBA loan, a private equity fund or from friends and family members, the amount financed will determine the amount the buyer can offer. It is important to remember that in all transactions, bankers will be scrutinizing the company's financial statements. Clearly document all transactions, outline any reconciliations and owner perks and write-off old inventory and receivables.

7) Terms and structure

Tax implications are a major factor in valuing a business because it greatly affects the cash flow of a company during the vital first years. Structuring the sale as an asset or a stock sale has conflicting benefits and consequences for the buyer and seller. In addition, the amount the owner is willing to have at stake after the transaction also reduces the buyer's uncertainty. A transaction with owner financing or earn-out will have a higher price than an all cash-transaction, but the owner must be willing to shoulder the risk associated with these types of structures.

Conclusion

There are many other factors appraisers consider when valuing a business. With so many variables to consider, the best way to ensure an accurate value is to meet with an accredited business appraiser.