Know How: Before the transaction, seller must start with business valuation

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As baby-boomer business owners approach their 60s, their thoughts often turn from an "achievement" mindset to one of "quality of life" values and concerns. It becomes a time of reflection — a time to sort out life's purpose and values, and to determine when enough is enough.

As business owners begin to think about this next chapter of their lives — one that will no longer be tied to the constant day-to-day demands and pressures of running a business — they look to their businesses and wonder about its "cash out" value and whether it will be enough.

What's key in this planning process is to determine the current value of the business, calculating the gap between the current value and the value they'll receive when they sell to support their desired retirement lifestyle, plus the specific improvements that would be needed to maximize the value that would meet their needs.

To ensure they get this right, valuation rules of thumb should be ignored, and a formal business evaluation should be conducted. This is the starting point to determine exactly where they're beginning, and to help identify the company's shortfalls that need to be corrected to build value.

When you map a plan, each area of improvement has an order of importance based on the value it brings to the business.

Here are 10 key attributes business buyers should look for:

- **Can this business operate independently of the owner?**
- **Does the business have a unique differentiator that sets it apart from all others in the industry?**
- **Is the business generating consistent sustainable profits?**
- **Is the customer base diversified and capable of further business development?**
- **Are the systems and processes considered first rate for the industry?**
- **Is the right team in place to grow the business?**
- **How strong is the management team?**
- **Are there proprietary assets that have future value?**
- **Does the business have contracts with key stakeholders: customers, suppliers, employees and other owners?**
- **Is there a business plan that demonstrates the business' potential?**

By matching up how the business stacks up against these questions, business owners can identify areas they can immediately begin to work on. The key in working on this list is their understanding of the business' value drivers.

The first driver is the history of the normalized earnings and cash flow the business has generated. Is it stable with consistent growth? For the most part, cash flow is what buyers are buying, unless an owner is fortunate enough to have a unique product or other offering. Often, a strategic buyer might only be interested in the business sales volume or the specific sales territory footprint.

The second driver is the earnings multiple. This is determined by the buyer's assessment of risk. Hence, the key is for the owner to work on things that reduce buyer risk. The lower the assessed risk, the higher the multiplier, which results in a higher business value.

As a business owner, how do you reduce this risk? Make sure your business has few, if any, dependencies, such as dependency on a single customer, supplier, employee or on you. A buyer's risk can also be lowered by referring to the 10 questions and having as many "built-ins" as you can, such as a strong management team to take over, a motivated and fully engaged team, strong culture, and lean and efficient processes and systems.

Monetizing the business' value to meet desired retirement lifestyle needs, after many years of hard work, is every business owner's hope and desire. Successfully charting the path to build the required value begins with obtaining a formal business valuation.

With so much on the line, business owners cannot afford to not get this first step right.

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