TEN WAYS TO INCREASE THE VALUE OF YOUR BUSINESS

From Now Through the Exit

Mutual of Omaha
Protect Your Kingdom

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1. Create a Stable and Predictable Cash Flow

This may be more difficult than it sounds, but it is also probably the single most powerful factor that can increase the value of the business. The cash flow and revenue from the business is the first thing a buyer will want to know, and probably the most important as well. A strong and transferrable cash flow can overcome many other possible defects in a business. The value that a third-party buyer will pay to acquire a cash flow is directly related to the risk that cash flow carries. The lower the risk of losing that cash flow after transferring ownership, the higher the price a buyer will pay. If a company has recurring revenue (such as subscriptions, maintenance contracts or other contractual revenue streams), those revenues can be valued at a much higher level than non-recurring revenue. The more stable, predictable and transferrable the cash flow is, the greater the sale price vs. riskier revenue at the same level.

2. Create and Keep Reliable Financial Information

A buyer will do some level of due diligence, and if a seller makes financial claims that can't be proven, or produces unsupportable or incomplete financial information, the buyer will be gone or will offer a much lower purchase price. It is important to have full and complete financial records that clearly support verbal statements.

3. Create a Broad Client Base

If the business has a diverse group of clients in which no single client accounts for more than 10% of total sales, the business will be perceived as lower risk and therefore will command a better sale price.

4. Create Incentives to Keep Key Employees

To a large extent, employees are the business. A buyer will look for - and pay a premium for - a quality management team that will stay in place after the current owner's exit.

5. Create and Use Effective Operating Systems and Procedures

The right operating and business systems will not only make the buyer's due diligence easier, it will also make the buyer feel better about their ability to manage the business by keeping those systems in place. The systems should cover financial reporting and human resources issues, recruitment and training, performance reports, as well as client and vendor relations.

6. Create a Clean and Well-Organized Facility

While a lot of business owners are comfortable with a disorganized warehouse, stacks of paper or a few deferred repairs, buyers will feel better and pay more for a clean and well-organized facility. A buyer can more readily imagine themselves in such a facility rather than taking over a facility that is hard for everyone to navigate except the former owner. Buyers will appreciate that they won't need to face major repairs and that the equipment and inventory is easy to locate and identify. Also, it is advantageous for the facility to have capacity for some growth after the transfer of the business, so that money for additional space or new equipment won't be needed right after closing.

7. Create and Maintain Corporate Goodwill

Goodwill includes name recognition, customer awareness, history and reputation, and goodwill is a key value driver. Customer relationships are essential to business value, especially if the company does not have significant hard assets. Long-term customers, positive brand awareness and high customer satisfaction all translate to a higher price for the business.

8. Create Barriers to Competitive Entry

Warren Buffett often talks about a "business moat," comparing a business to a castle and the moat surrounding the castle to the protection a business has from competitors entering the market. To the extent a business has a wide "moat," or a strong barrier to competitive entry, the value of the business will increase. Examples of barriers to competitive entry are copyrights, patents, trademarks, trade secrets, brand names, difficult to obtain regulatory permits, contracts with government or other large (perhaps exclusive) purchasers.

9. Create a Diverse Range of Products and/or Services

Often risk will be lessened in a company by offering a diverse range of products and services rather than a single item. Of course, this must be viewed within the context of the finances and personnel capabilities of the company, and it is probably better to have one good service than three or four mediocre ones. All other things being equal, however, it is better to diversify the business risk by having several items that can be offered. This will make a buyer feel better about the continued viability of the company, even if one of the products should lose market share.

10. Create Identifiable and Transferrable Growth Potential

Most buyers see growth potential, or it is likely they would not be interested in buying. However, if the growth potential is all based on the buyer's future efforts, the buyer is not likely to offer to pay more for the chance to create that growth. On the other hand, if a seller can demonstrate built-in growth that will continue after their exit, a buyer is likely to offer more for the business. Keeping in mind that pursuing growth prior to exiting a business comes with some time and money risks that may diminish value, here are some areas for an owner to consider:

a. Is the business in a growth industry?

b. Are there additional products that can be delivered to existing customers?

c. Can you expand your best profit margin areas prior to your exit?

d. Given your exit schedule, can you create growth without increasing debt significantly?

Reminder: Your financial professional is here to help, make sure to schedule some time with them if any of the above may be of concern to you.

Business Valuation Points of Consideration

- The valuation is for the operating business and may not accurately reflect the separate value of business owned real estate.

- It's important to understand the relevant values:
  - Equity value is most appropriate as a starting point for a co-owner buyout or a transfer to a family member or other insider.
  - Asset sale value is closest to what a third-party buyer is likely to offer.

- A buy-sell agreement can protect a business from the unexpected.
  - If there are two or more owners (other than a married couple), a buy-sell agreement should be considered.
  - If a buy-sell agreement is currently in place, re-evaluate how it is funded and think about utilizing life insurance to pre-fund the agreement as it provides funds at the time they are needed.

- Protecting a business's most valuable asset.
  - Does the business have key person life insurance, so that there would be enough money to keep the business going if something happens to the owner(s) or another key employee?
  - Face amounts are generally up to 15 times compensation.

- Replacement insurance
  - Do the business owners have income replacement insurance?
  - If not, is the assumption that a family member can come in and run the business at the same level it currently performs?
  - Is that assumption realistic?

- Retirement plans
  - Is selling the business the primary retirement plan for the business owners?
  - Will the business sell for enough to provide retirement income for the rest of their lives? Are they sure?
  - If there is no retirement plan in the business, consider setting one up. Or supplement one through cash value life insurance, building tax advantaged cash outside of the business.

- Personal liability
  - If the business owner has personally guaranteed business loans or commercial leases, make sure there is insurance in place to cover that guarantee.

Why Mutual of Omaha

Over 50 years of Mutual of Omaha's Wild Kingdom taught us that the animal kingdom and the human kingdom have something in common … an instinct to protect what matters most. Through insurance and financial products, we help people protect their lives, protect their families, protect their kingdoms.

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