"INCREASING VALUE of a privately owned business"
By Greg DeFoor, CPA

Many business owners think that the main driver of the value of their business has to do with revenue and net income. These may not have any correlation to the enterprise value of the business.

Cash is king, but not the only factor that drives value. Three main variables that impact value are: cash flow, growth and risk. To increase value, a business owner needs to concentrate on increasing the cash flow, increasing the growth potential of the business and decreasing the risk of owning that particular business.

Even though there are several variations used in calculating different versions of cash flow, all small and mid-market buyers utilize some acceptable form of cash flow calculation to aid in determining what price they will pay for a business.

Financial statements should be recasts for cash flow monthly or at least quarterly. Owners don't have to know how to recast financial statements for cash flow; they can use an advisor to do that. What owners need to know is it is crucial to the value of their business to monitor cash flow on a regular basis.

I'd like to emphasize the value of keeping detailed books and records. Make notes and keep detailed records of any expenses might have been discretionary, excessive, unusual, unnecessary or due to special circumstances. Be proactive and think like a buyer instead of an owner: what would you want to know if you were buying this business one, two or three years in the future? Keeping detailed records of what can be legitimately added back to net income for cash flow purposes is extremely important. Take action to eliminate or reduce discretionary or unnecessary expenses. Every dollar increase in cash flow may result in a multiple of that dollar in increased value.

Growth is a very important factor in driving value. Is the business growing, mature or declining? If the industry is growing, what is the company doing to continue to grow and prevent competition from taking away market share? If the business is mature or in decline, what is management doing to add or improve products or features to maximize the revenue potential and profit margins of the business based on current conditions? Does the business need to be reengineered into a completely different product line or industry? The growth cycle of the business has a definite and measurable impact on the current and future value of the business. Even if the business is mature or experiencing a bit of a decline, the negative impact on value might be minimized if the owner can show that the change has been monitored and appropriate corrective action is being taken.

Decreasing risk is the final factor that drives value. If there is risk of the product line becoming obsolete, steps need to be taken to expand or add new products or services. The owner may need to hire and transition a professional manager or key executive that will be able to run the company's business if the owner becomes unable to perform or begins planning for the sale of the business. Are there environmental or legal concerns that need to be addressed and corrected before they affect value? Do you need to invest in training, research, marketing or product lines to reduce the risk of the business declining? Does the business need capital improvements, additional space or even relocation?

You can add instant value to your business by keeping better records of things you experience daily. It can be as simple as making notes in a spiral notebook by date of occurrence of items you consider discretionary, unnecessary or unusual. Documentation needs to be maintained in a separate and easily located file. You might not realize how some of these things impact value. Keeping detailed records may help you think of ways to improve your business. The most important thing to remember is to monitor, record and adjust value drivers constantly. The extra effort will be well worth it when the time comes to sell the business or pass it along to the next generation of ownership.

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