What is my business worth?

What a business is worth is relative to your individual business, the market, current economic climate and what potential buyers are willing to pay. However, there are some common questions to consider when thinking about the worth of your business, including:

- What are the sales?
- What is the profit?
- What are the growth trends?
- What is driving new sales and is that sustainable?
- What channels do new customers come from and what is the breakdown of each channel?
- What is your market position?
- How reliant is the business on the owner?
- What systems and processes are in place to run the business?

The amount a buyer is willing to pay for your business will all come down to two things, return-on-investment (ROI) and relative risk. The lower the risk, the higher the price and vice-versa. With that being said, what really makes your business worth more is mitigating the risk of the business failing in the future by having the following characteristics associated with your business:

- Predictable key drivers of new sales
- Stable or growing customers from diversified sources
- Established suppliers of inventory with backup suppliers in place
- High percentage of repeat sales
- Clean legal history
- Brand with no trademark, copyright or legal concerns
- Documented systems and processes
- Growth potential

Working out the value of your business is important when selling your business as it can help you decide on the selling price. Here are some suggested steps to help you through the process.

1. Up-to-date business information

To accurately value your business, you will need a range of business information including finances and assets (e.g. financial statements); legal information (e.g. registration papers); business profile, procedures and plans (e.g. sales information, business plans); and staff, supplier and customer information.

Buyers may ask if they can value your business independently, so it's a good idea to have your business documents organised and up to date.

2. Ask a professional

A professional such as your accountant, a business advisor or a business brokers can help you analyse your finances, find trends within your industry's market, and help you work out a value for your business. They can also help you calculate the goodwill value of your business and estimate your business' future profit.

While it comes at a cost, using a professional can be advantageous as they may have clients who would be interested in buying your business, eliminating the need for you to spend time and money on advertising.

3. Choose a valuation method

There are a range of methods available to you to help you value your business and a combination of them may be used to assist you in setting your desired sale value. Keep in mind that you may also need to negotiate the method of valuation with a potential buyer.

Below are some common methods of working out the value of a business and if you decide to work with a professional as mentioned above, they can guide you through which method is best for your business and explain any industry specific methods relevant to your business.

- Look at current marketplace value and your industry
  - How you value your business can depend heavily on the industry you're in, and the current marketplace value of similar businesses within that industry.
  - Industries usually come up with their own rules and formulas to value a business, so it's a good idea to conduct research to gain a good understanding of your industry before you sell your business.

- Use the return on investment method to calculate value
  - The return on investment (ROI) method uses your business' net profit to work out the value of your business.
  - ROI = (net annual profit/ selling price) x 100
  - For example, you have a selling price of $2,000 000 in mind but want to test your ROI based on that price. You calculate that your business' net profit was $250 000 for the past year.
  - To work out the ROI, you use the formula:
  - ROI = (250,000/2,000,000) x 100

- In this case, your ROI is 12.5%.
- If you have an ROI in mind, you can use it to calculate the price for your business:
- Selling price = (net annual profit / ROI) x 100
- For example, if you were looking for a ROI of at least 50% for the sale of your business, and your business' net profit for the past year was $1,000 000, you can work out the minimum selling price you should set.
- Selling price = (1,000,000/50) x 100
- In this case, to achieve a ROI of at least 50%, you'll need to sell your business for at least $2,000,000.

- Use your business' assets to calculate value
    - When calculating your business' asset value, it's important to include both tangible and intangible assets of your business. Tangible assets are physical things you can touch such as tools, equipment, and property. Intangible assets are things that can't be touched but are still valuable such as intellectual property, brands and business goodwill.
    - After you've calculated the total asset value of your business, you can then use this value as an indication for how much you would like to sell your business for.
    - As assessing your business' assets value can be a complicated process, it's a good idea to talk to your business advisor or accountant for help.

What is business goodwill?

Like IP, business goodwill is an asset that is much harder to value. A seller will most likely value business goodwill much more highly than a potential buyer simply because that buyer has not experienced the benefits which that good will has brought to the business. Furthermore, business goodwill does not have a determined market price and it can include any of the following:

- customer loyalty and relations
- brand recognition
- staff performance
- customer lists
- reputation of your business
- business operation procedures.

It is recommended to use a professional such as your business advisor or accountant to accurately calculate the value of business goodwill because it can be a complicated process. Different methods will give different results and combining methods can give you an indication of the price range you would like to set for your business goodwill, and ultimately the value is what the marketplace or buyer is willing to pay.

Consider depreciation of assets

Depreciation is the loss of value for your assets over time and if you use your business assets to calculate value, remember to take depreciation into account. Talk to your accountant for more information about how to work out depreciation of your business assets.

4. Go back to the beginning

A good benchmark for valuing your business is the consider the cost of creating it from scratch. This is the estimated cost to build a similar business in your industry from the ground up within the current market. To calculate the cost, you'll need to include all costs related to starting from scratch, including the costs of:

- buying stock
- buying equipment and tools
- getting licenses and permits
- recruiting, training and employing staff
- developing products
- marketing and promotion
- buying or leasing premises
- setting up an online presence etc.

5. Future earnings

If you can show, through up-to-date and accurate financial statements, that your business is likely to be profitable in the future, you can demand a higher sell price for your business.

This helps give a prospective buyer an idea of the future profits that they may expect from your business in the future.

To estimate the future profit of your business, start by examining any trends in your business finances from recent years. It may help to also investigate the trends of similar businesses in your industry to see how your business compares and how the market is travelling as a whole. You can then use this information during negotiations of the final sale price of your business.

Who are the potential buyers of my business?

A maximum sale price of your business will only come if your business is at its maximum value to a buyer. This means firstly considering what is the optimum time of sale to the most likely buyers, before thinking about when is the best time for you to sell your business.

Researching prospective buyers prior to making a deal will allow you to identify buyers who are most likely to offer the best value as well as help you make your business as attractive as possible.

There are two basic types of buyers, financial and strategic. Financial buyers look for businesses they can buy to then subsequently sell. Many look for niche companies with strong managers who want to remain with the company after the closing. They may acquire only a percentage of the business. Their objective is to take the business to the next level and sell for maximum value. This 'gradual exit', with a further share of new value realised at sale time, is an attractive option for many sellers.

Strategic buyers can be either private or public companies and typically operate in allied industries and acquire because of expected operational benefits or strategic advantages when the two companies come together. This is also known as a 'trade sale'. Strategic buyers will acquire 100% of the business.

Selling to either type of buyer means the seller will have to stay on for a 'transition period'. An unwillingness to do this will result in sacrificing value, as the buyer discounts the added risk of an abrupt departure and the value that goes with that.

Other buyer groups include management, family and maybe even friends. You should be aware that selling to someone within your company's management, family or friends may leave you sacrificing price for the preservation of your legacy and culture. This is where your priorities will have a direct effect on the value of your business. Think carefully about this and to what extent you are willing to sacrifice sale price.

A Trade Sale

A potential trade purchaser will have specific reasons for targeting your company for acquisition and understanding their motivation is important in determining what price you are willing to sell the business for. Most of the reasons behind a trade sale will be related to leadership brand positioning, such as:

- Market Share /Entry - objective may be to increase market share or establishing a presence for existing products in new markets
- Vertical Integration - motivation may be to secure sources of supply or distribution outlets for the purchaser's goods or services.
- Diversification - objective may be to broaden product range or enter new markets.
- Strengthening – aim is to acquire specific resources such as management team, production capabilities, distribution channels.

The key criteria which any potential purchaser will consider include:

- Turnover
- Profitability
- Employee Numbers
- Ownership
- Location
- Main Products or services
- Customer base
- Suppliers
- Distribution arrangements