Business Accounting Network

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Going Beyond Accounting, Taking Business Forward

THIS MONTH'S FOCUS

How Saleable Is Your Business?

By Monique Sharland

" … there is ultimately only one reason to create a business of your own, and that is to sell it!" [Michael Gerber – The E-Myth]

Did you know that only 12% to 18% of smaller businesses ever sell in South Africa? The number one reason for this is that business owners become so caught up in the energies of getting their business off the ground, then, once it is established, they become lost in the world of being a technician, working **in** their business as though it were a job, and neglect to work **on** their business to successfully create and grow its value.

Consider this. What if you got ill and couldn't work for any period of time, can your business run without you whilst still earning you an income? Yet, the one thing entrepreneurs neglect to do when they start their business is to think ahead to the day they no longer can or want to run their business so that they can be prepared for the future.

Business Exit Options

So, what are the exit options for owners of smaller businesses?

- Work in your business until the day you die
- Semi-retire and let someone else run the business until you die
- Liquidate the assets of the business
- Just close the doors
- Sell the business

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It Is Important To Plan Your Business Exit Strategy Years In Advance

Ideally you should begin preparing your business for sale between 3 and 10 years before you put it on the market. Concentrate on increasing net profit and cash flows year after year and prepare your business in advance for the onslaught of a potential buyer's due diligence.

Business Valuation

The thing is this, most business owners think that their business is worth more than it actually is. All too often when a smaller business owner is asked what they think their business is worth, they might give a figure, say R5 million. When asked how they got to that figure, they might explain that "it the money I need to retire on".

From a buyer's perspective, they do not care how much money you need to get out. They are only interested in whether they can earn a good return on their investment and be paid well if they choose to work in the business.

In all truth, a business valuation should be done annually to measure whether management is effective in concentrating on the key value generators. Business valuations is a specialised field, so it would make sense to only use qualified and seasoned business valuators or brokers, such as BAN's alliance partner, to accurately value your business.

Improve Your Business's Value

If you are surprised to discover that the valuation process produces a lower-than-expected asking price for your business, the good news is that there are steps you can take to increase it prior to a sale. It is important to start immediately however, as you need to start planning years in advance to implement the kinds of changes that substantially improve the value of your company.

The area to focus on is ways of increasing your net profit equal to or better than your competitors so that you can attract multiple buyers or investors.

Here are some other important value drivers:

- The business should not be dependent on the owner's day-to-day involvement and relationships.
- Build strong, consistent cash flow.
- Ensure that you have at least 5 years of reliable financial records, consistent profits, positive cash flows generated from operations and low gearing.
- Create systems and document operational and service processes.
- Protect your intellectual property – ensure registered patents and/or trademarks are current.
- Build a top team of employees.
- Build a reliable and quality supplier base.
- Build a profitable and consistent customer base that resonates with your business.
- Carefully consider employee contracts and document job descriptions and company policies
- Make sure that equipment, machinery and other operating assets are well maintained.

The Buyer's Responsible Due Diligence

Few buyers will purchase a business without conducting an extensive due diligence, their responsible thing to do. A buyers offer is always contingent on the results of a due diligence process.

The purpose of the due diligence is:

- For the buyer to validate the information you've provided;
- That the buyer is reasonably comfortable;
- The buyer understands the risks in the business.

If your business does not have a long serving outsourced accountant and has a poor **accounting system** which produces meaningless financial information, it's a huge obstacle to a successful sale. Buyers are interested in businesses that create confidence. Inadequate financial records create uncertainty and doubt. Once scepticism and distrust arises in a buyer's mind, a successful sale transaction is highly unlikely.

Here is a small snippet of actual financial due diligence questions most buyers have asked:

- Provide copies of audited/independently reviewed/professionally prepared financial statements for the past 3 years.
- Provide copies of the monthly management accounts for the past 3 years.
- Provide the business's financial plan (also known as budgets or forecasts) for the next 3 years and management's reasons for supporting turnover, gross margins and net profit.
- Provide written description of the budget process.
- If any of the year-end management accounts do not agree to the audited/independently reviewed or professionally prepared annual financial statements, please provide reconciliation of all periods.
- Provide copies of the internal financial budgets projected by management for the last three years and actual performance compared with management's forecasts.
- If the budgets were not prepared in the same reporting format as the company's internally prepared management accounts, please provide reconciliations of all years presented.
- Provide sales by Rand and calendar month by top 10 customers, location and service categories for the past 3 years.
- Provide gross margins (R and %) for all cost of sale components by month.
- Provide components of employee costs by function per employee (salary, bonus, benefits, etc.) for the past 3 years.
- Capital expenditure breakdown for the past 3 years and projections for the following 2 years (including maintenance vs. growth expenditure)

Most sellers ultimately realise that they need to enlist the assistance of a good accountant to prepare the business for the financial due diligence onslaught by prospective buyers so that they may increase their chance of a sale and to retain their sanity through the whole process!

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