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Realising The True Value Of Your Business

If you are planning to sell your business it's clearly an advantage to have an objective idea of what it is worth. Even though ultimately a business is worth what a buyer is willing to pay, it's easy for a seller to undervalue and lose out in the deal, or to unrealistically overvalue and miss out on attracting buyers.

Many companies are oddly reluctant to invest in getting an accurate valuation. Even among owners who had tried to sell their business at one stage, a survey reported by CFO.com found that only 12% of them had ever had a formal valuation done. This is surprising. Guessing the value to put on your biggest asset is really risking your future.

There are a number of different valuation methods and different methods may be appropriate for different types of business. For example, if you run a services business there's little point in evaluating it based on the value of its physical assets. Other methods consider intangibles, such as goodwill, that are difficult to put a figure on but which can represent a significant element of the value of some businesses. And value may also be in the eye of the beholder – it will actually be worth different amounts to different people depending on their reason for wanting a business.

A variety of factors are taken into account in ensuring that a valuation is accurate and useful. Primarily, the valuation needs to be in line with hard data, particularly your current and past financial position. Some valuation methods focus on financial data such as profit levels, asset value, cash flow and debt carried by the business. Other factors are not so cut-and-dried. The valuation might incorporate financial projections for the next three to five years. It might consider intangible assets, such as intellectual property like patents and trademarks, brand names and goodwill. You also need to consider the context. Your own company may be doing very well but its value will be diminished if it is part of an industry that is in serious difficulty or in decline overall.

There are over a dozen different valuation methods. The crudest methods operate by rule-of-thumb or 'multiples'. For example, landscape businesses are estimated to be worth 1 to 1.5 times their discretionary earnings plus the value of their capital assets. However, multiples only give a rough, industry wide ballpark figure for business value. They do not necessarily give the real value of a particular business. More accurate methods include the 'balance sheet' approach, which basically subtracts business liabilities from assets. The 'adjusted book value' method is similar but uses current market value rather than purchase price or depreciated value.

Retail and manufacturing businesses are generally assessed according to the value of their assets because they tend to store large amounts of value in their inventory or capital assets while service company valuation is based on the 'capitalisation of income valuation' method, which places a heavy emphasis on intangible assets. It's also possible to calculate the value of a private company by comparing it with an equivalent public company and making appropriate adjustments. Business value can also be estimated by anticipating cash flow over a three to five year period and adjusting that into current dollar terms.

A current valuation can be important at times other than sale. There are numerous business and legal situations that require a detailed valuation, among them: when considering a merger or acquisition; when seeking investment capital; when buying out a partner or implementing an employee stock ownership plan. A properly determined valuation inevitably enters into less pleasant activities such as shareholder disputes and divorce settlements also. Tax minimisation planning can involve business value, for example in developing estate plans and gift transfers.

A valuation can also indicate how your business compares to its direct competitors. If the value is below that of competitors it should be a prod to focus you on building more value into your business. This will improve your outlook in terms of succession and estate planning.

With this many potential situations requiring a business valuation it's important to have an up-to-date professional estimate of the real value of your business. To get a valid and commercially useful valuation you will need to work closely with a professional who has experience in the area. Your accountant already has a good understanding of your business and will be able to advise you on which valuation method will be best suited to your business circumstances.

Forming A Strategic Alliance

Looking for a smart way to grow your small business? A strategic alliance may be the answer. A strategic alliance is essentially an agreement, formal or informal, to combine efforts with another business. The project may range from leveraging better prices from suppliers by bulk buying to building a product together with each partner carrying out the part of the production process they are best set up for.

Just who might be a good candidate for a strategic alliance depends on what you want to achieve. Partnering with a key customer can cement the relationship and protect your custom with them. Partnering with a firm that already has a well established brand offers the opportunity to become better known by association. Even partnering with a competitor to achieve specific strategic goals can be beneficial. Apart from the bulk buying type deal, it could involve working with them to win contracts that may be too large for you to handle by yourself.

The nature of many SMEs is that they are specialised in one area or another. That means your skills and knowledge will be most attractive as a strategic alliance partner to a business whose product or service you complement in some way. Relationships can be formed vertically (between supplier and manufacturer or between manufacturer and distributor) or horizontally (between similar firms in the same industry). They can operate at both the local and global level – forming an alliance is one way that SMEs can get started in overseas trade.

Whatever the nature of the alliance there are some rules for ensuring it works out to deliver the advantages you want from it.

Communication should be your foremost consideration. While it isn't necessary that each member of a strategic alliance have exactly the same objectives, each should still be committed to a common outcome. To make sure that you and your alliance partner share similar goals it is important to be honest from the outset. That is, be frank about what you hope to achieve from the alliance and what you can provide to make sure your partner's needs are met.

One of the most common mistakes is a failure to clearly lay out the details of the alliance from the beginning. The result of this failure can be significant – mismatched goals, insufficient commitment, and an inability to alter the alliance easily at a later stage. Especially important is defining where the alliance ends and competition begins.

When considering an alliance look for situations that will deliver strong benefits to both members. Only take part in an alliance when you think it will improve your business relationship with the other party overall, not just during the term of the arrangement. Alliances are only worthwhile if they represent a win/win situation for all parties involved.

For the SME entering into an alliance with a bigger firm there are other challenges. Try to establish connections with several of the company's members. This is important because, in a large firm, it is more likely that if one department is dealing with you others will be unaware of, or at least unfamiliar with, the alliance. It could destroy the value of the alliance to you if your key contact suddenly leaves or is moved to a different office.

Don't get too locked into an alliance. The benefits deriving from an alliance can decline over the longer period as each organisation develops along its own strategic pathway or outside factors alter the situation. One type of alliance may have suited your goals at an earlier stage of the business' development but have since lost relevance. Others may have proved to be too narrow and need to be widened to meet your continuing business needs.

Forming a strategic alliance is becoming a more and more common tactic for expanding the reach of an enterprise without committing to expensive internal expansions beyond its core business. For small businesses a strategic alliance may consist of no more than 'bartering' with customers, suppliers and even competitors. But the terms can go way beyond that and open up the possibility of allowing your business to share expertise, assets, expenses and risk with another business without necessarily incurring cash debt or trading away too much of your equity.

Perfecting Your Sales Presentation

Invariably in preparing for a sales presentation the question comes up - *“Just how am I going to convey to these clients that what I have to offer will suit their needs best?”* These tips will help you create a winning pitch.

Know your prospect

It is vital that you have a solid understanding of your potential client's business. You can use the Internet to do some background research on their company. Start with having a look at the company's own website, which should give you a good overview of the business, then follow up any sites that look like they might provide further insight – maybe they mention other firms they do business with and that you will be competing against. Then talk to the company, preferably to the person who will be primarily instrumental in deciding whether or not to go with your product. Tell them that you are calling for some information in preparation for the meeting – you want to make the meeting as meaningful as possible so as not to waste their time at all. You can ask them what they expect from the meeting and who will be attending.

Never assume that all prospects are the same and will be sold on your product in the exact same way. Some will be more interested in the technical aspects, others in the selling points or cost involved. Get to know as much about the prospect's likely area of interest and develop some marketing messages that tailor the presentation to those interests.

Avoid surprises

Find out how much time you will have for your presentation and in what sort of venue (e.g. office or a meeting room) it will take place. That's so you can get an idea of what equipment is likely to be available to run the presentation and what you will need to supply. If you're preparing a PowerPoint presentation for example, you will need a data projector. Does the room have one or do you need to bring one yourself?

Get the audience involved

Getting your audience involved will make your presentation a lot more interesting to participants. You can ask each participant for suggestions on what they would like you to cover and refer back to these individuals when addressing the issues related to their question. If it's feasible hand around samples of the product or present a hands-on demonstration to make it real.

Focus your presentation on the prospect's needs

Don't waste their time or stretch their patience by taking up time talking about you. The presentation isn't about you, it's about the prospect and their needs, so the focus has to be on the benefits your product or service has for them. Talking too much about yourself could talk you out of a sale.

Close by creating an opening

Your presentation must end with a call to action of some sort. If appropriate ask for the sale then and there. Where the prospect is going to need a little time before they can come to a decision ask for an indication of how long that might be. In this circumstance a good closing might be to ask them for a follow-up meeting in a week to talk about the next step or to answer any questions that may have come up meanwhile.

Researching your prospect, getting organised and developing a close – all essential parts of delivering a winning presentation. But in the time between these and the actual presentation don't forget to practise. A couple of dry runs in front of someone on your team will identify any weaknesses in the storyline, provide you with ideas about how to get your points across and give you time to memorise the information so that the presentation goes off smoothly and professionally.

The Power Of Numbers: Solvency Ratios

This second article in our series on The Power Of Numbers deals with Solvency Ratios. There are a number of solvency ratios but they all have a common purpose – to measure business risk, specifically the risk attached to your ability to pay your debts in the absence of any cash flow. Investors are very interested in these ratios because they indicate the amount of debt your company can handle. By indicating the amount of investment equity you have in your company they tell whether it owns more than it owes.

Debt To Equity Ratio: the debt to equity ratio measures your net worth. If your debt to equity ratio is growing quickly it's an indication that you need to decrease your liabilities before taking on more debt.

Formula: total debt / owner's or stockholder's equity

Paying off debt or increasing the amount of earnings retained in the business (at least until after the balance sheet date) will improve the ratio. You might opt to defer paying some of your debts, cut back on inventory purchases or delay a major fixed asset purchase.

Debt To Assets Ratio: shows you the percentage of your assets that are being financed by your creditors, that is, financed through debt as opposed to by the business.

Formula: total debt / total assets

Generally it's considered sensible to finance less than 50% of your assets by debt. A higher ratio could mean a problem meeting repayments if cash flow slows. You can reduce this ratio by paying off debt or by increasing the value of your assets – could you have more value tied up in inventory than you estimated for instance?

Coverage Of Fixed Costs Ratio: shows how easily you can pay your fixed costs. Coverage of fixed costs is also sometimes called 'times fixed charges earned'.

Formula: (net income before taxes + fixed costs) / fixed costs

Fixed costs are costs that remain pretty much the same even when sales increase or decrease (such as rent on premises). If you cannot cover your fixed costs as they come due your business is in serious jeopardy so the higher the number the better. Many working capital loan agreements specify that you must maintain this ratio at a certain level as an assurance that you continue to have the wherewithal to make repayments.

Interest Coverage Ratio: represents how many times the net income generated by your business, without considering interest and taxes, covers the total interest charge on it. It is also referred to as 'number of times interest earned'.

Formula: net income before interest and taxes / interest expense

It is similar to the Coverage Of Fixed Costs ratio but narrower in focus – it relates to just the interest portion of your debt liability. It shows by how many times your interest obligations are covered by your earnings from operations. The higher the ratio, the better your ability to meet interest payments.

Debt and equity are two key elements of your financial statement and lenders or investors often use the relationship between them to evaluate their risk in providing funds. In general, the lower a company's reliance on debt to finance its assets, the less risky the company. By checking these ratios you can assess your level of debt overall and in relation to a number of specific obligations and decide whether it is at an appropriate level or if you are at risk and need to address the situation.

Regular Pieces

How To Make The Most Of Your Newsletter

Be sure to read each article with the mindset 'How could this apply to our business.' Thinking of it that way will guarantee that you get value. Better yet, take notes as you read and commit to having the ideas implemented by the time the next edition arrives. Also, make copies for each team member. To really make sure something positive happens, work with your business development specialist to talk your team through the ideas and how to set a schedule for getting them implemented. We're here to help you get started.

Memorable Quotation

In our factory, we make lipstick. In our advertising, we sell hope - Charles Revson

An Important Message

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