

What Is Your Business Really Worth?

By

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Your business is worth a lot of money, right? After all, there is the value of all the furniture, fixtures and equipment, the sums you poured into leasehold improvements, and, of course, all that “sweat equity” that went into your business.

But hold on. The fact is, what really counts is cash flow—the true earnings of the business derived by subtracting cost of sales from gross income, and then further reducing that figure by the true expenses the business incurs.

Sad to say, but without cash flow, you can figure that your business is worth a very heavily discounted “asset value.” And “sweat equity” in this circumstance does not count. Asset value implies selling the used stuff for dimes on the dollar (an “orderly liquidation”) or for pennies on the dollar (a bankruptcy auction).

You can enhance the value of your business by doing what you set out to do when you started: maximize your sales, minimize your cost of goods sold and minimize your expenses. With respectable cash flow, you can figure very generally that your business will be worth a multiple of two to three times that cash flow figure.

However, the market value of a business is affected by risk and opportunity for the buyer of the business. The higher the risk, the lower the net earnings multiple that the buyer will be willing to offer. Conversely, if the business shows clear potential for increased future earnings, then a higher multiple might be justified.

A word on “potential,” please. If your business shows little or declining earnings, an attempt to price the business for sale based on the “potential” for earnings increases is a strategy that is likely to fail. The first question from the business buyer centers on the reason that, if there is so much “potential,” why has the current owner not realized it? A high asking price based on “potential” requires the buyer to assume the risk and uncertainty of developing that unproven potential.

Therefore, to maximize the value of your business, follow your business plan or, if necessary, cut your losses and revise it. In enhancing the value of your business, nothing succeeds like success!

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