

Maximising Value when Buying a Business

By Jeff Robson and Bill Scanlan, published August 2011



Figuring out the Value Puzzle

Good financial modelling can be very useful in determining the real value of a business and enabling potential buyers to make informed proposals. In this article I identify five critical points of consideration in the buying process and for each I explain how a financial model can help address them.

Business longevity

It will usually take years to generate returns from a business purchase so a key point to consider is business longevity.

One of the best things you can do to get a sense of longevity is to aim to purchase a business with a track record.

Using historical data, a financial model can generate numerous forward projections depending on the inputs used. This can allow the user to gain a good insight into how the business will look under a range of future scenarios.

What are the risks?

Identifying business risks is the first step toward mitigating them.

By documenting and analysing reported numbers, a financial model enables users to identify aberrant outcomes. Then it is a matter of determining why such aberrant outcomes exist and assessing how the business would look in their absence.

Risk analyses can also provide a potential buyer with insight into the consequences of serious downturns in business conditions.

Identifying and valuing intellectual property

Much of the value in a business comes in the form of intellectual property but intellectual property can be extremely difficult to identify and value. Using a financial model is one of the best ways to ensure that intellectual property is properly identified.

Once identified, a potential business purchaser needs to consider whether the intellectual property is transferable and whether it is capable of being sustained. If intellectual property cannot be sustained then a financial model can be used to determine the effects on the business.

Identifying value to the new owner

A financial model is a very useful tool for identifying when a purchaser can expect to receive returns as well as the size of these returns and how they are generated. Such information enables potential business buyers to make an informed decision about whether they have the resources required to sustain the business while returns are not being generated. Insufficient cash flow is one of the primary reasons for business failure after purchase.

Identifying business weaknesses

A financial model is able to highlight business weaknesses. Such weaknesses are opportunities for a new owner. The implementation of small changes to avert identified weaknesses can result in drastic improvements. Common examples include the identification of an ability to dramatically reduce business expenses or working capital requirements.

Conclusions

Thorough preparation is critical to ensuring the best possible chance of a positive outcome from the purchase of a business. Business purchases that fail ultimately do so for a relatively narrow range of reasons that are nearly always related to an inaccurate valuation. Thorough due diligence, including detailed financial modelling, needs to be undertaken to ensure accurate valuation of a business.

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