The Three Business Value Drivers of Wealth Post GFC

Issue 19 – 4 June 2010

Whilst many Business Owners recognise that their Business is their major Asset very few Business Owners extract maximum wealth from their Business.

However by considering the three core Business Value Drivers of Return, Risk and Readiness Business Owners can systematically plan to extract wealth from their Business on Sale or Succession.

What follows is an overview of the three Business Value Drivers of Wealth Post GFC.

First R – Return

A first step towards maximising wealth from a business is to examine ways of improving maintainable profits.

For e.g. there may be new equipment which would allow the business to introduce a new product range or improve profit margins on existing products.

Furthermore the cost structure of the business should be reviewed for waste.

Most small businesses do not devote the resources to focus on the efficiency of their systems and processes and yet businesses may harbour up to 20% to 30% of waste in their operating costs.

Waste includes:

- waste of time
- inappropriate use of staff, e.g. senior people doing unskilled work
- inefficient flow of product and paper
- waste of product, e.g. rework, off cuts

Cost has a direct impact in profit. A waste review may identify savings that will be immediately reflected in increased profit.

It is also important to consider how profits are presented.

A business valuation will make adjustments to profitability for expenditure which is abnormal or is a particularly attribute to the current owner. However there may be less obvious impacts on profits that a potential purchaser might not identify. By planning ahead for the sale, the vendor can make sure that the final years' profits are not affected by such items.

Second R – Risk

The second steps towards maximising wealth is to recognise the risks associated with any particular business and take steps to mitigate risk. On the next page is an overview of a general business matrix that may help to assess business risks.

Factors Decreasing Risk Wide Moat	Factors Increasing Risk Narrow Moat
1. Strong customer relationships at all levels	1. Weak customer relationships and frequent turnover
2. Proprietary products or services	2. Lack of proprietary products or services
3. No single customer accounts for more that 5% of revenues or profits	3. A single customer accounts for over 15% of revenues or profits
4. Strong management team (important mainly to financial buyers)	4. A weak management team. Principal dependant business
5. Excellent employee turnover and relations	5. Poor employee turnover and relations
6. Consistent revenue and earnings trends	6. Inconsistent revenue and earnings trends
7. Plant and equipment in good repair	7. Plant or equipment has been neglected and requires significant repairs
8. Intellectual property assets, which are legally protected	8. Lack of legally protected intellectual property assets

Third R – Readiness

The third major impediment to Business Owners receiving full value from either income or capital value of the business is the readiness of the Business to be sold or in turn gifted to a family member or members.

Deal killers and Impediments in respect to the maximisation of value in the event of a sale of a third party or a family member include:

- Liabilities – either employment or environmentally related;
- Litigation or pending litigation;
- Taxation penalties or compliance problems;
- Product Warranty obligations or litigation; and
- Long term debt obligation.

Some of the above deal killers or other impediments may require years to resolve. Nevertheless in many instances many Business Owners mistakenly believe they can just put up their hands and sell the Business with little effort. This may be true but it comes with a cost.

The cost being

- Failure to achieve maximum price;
- Escalating accounting or legal fees to “urgently” rectify problems (if possible under extremely tight deadlines); and

- Failure to receive total consideration upfront with a possible earnout where total payments may not be paid for some time, if at all or at a reduced amount.

To avoid deal killer impediments the following may be needed:

- Ensure audited accounts and tax returns are available before the sale process commences;
- Ensure the sale entity is tax and litigation problem free;

Make the assets transferable by removing long term debts;

- Simplify Business structures; and
- Remove any Vendor tax impediments to sell the Business.

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