

## Business Value and Pricing

By Michael Terry

When it comes time to sell and the decision has been made to do so, business owners generally ask, "How much do we sell it for?" At this point, a business appraiser or other advisor is often asked to help arrive at a price for the business for the purpose of sale. Here are some things to consider when it comes time to price your business.

Businesses are priced for a sale using a variety of methods. We will not address how to calculate value or use pricing models here, but will assume a valid, reproducible method was used. Value is the monetary worth of something based upon the relative quality as compared with other similar items or things. It is generally assumed that the worth will be in "cash terms" and is determined by many factors and considerations. Income or profit is often the primary value-driver. Determining an asking price is usually aligned with value, but please understand the actual sale price of anything can be much more complex and could involve many factors not considered in a valuation. Some of these factors include atypical seller and buyer motivations, special financing terms, urgency of sale, real estate considerations, local supply and local demand. It is generally known, that businesses are rarely sold for their full value. In fact, think of value as the amount the seller hopes to get and sale price is actually what was or is likely to be paid based upon all the factors present in the contemplated sale. Sellers hope they are the same and there should be some level of correlation, but again they are almost always different.

Value calculations usually establish a starting point or asking price and it is very important to arrive at a justifiable asking price for the business at the onset. When a professional is used, think of it as the appraiser's opinion of where the value/price should be placed in a range of acceptable values/prices appropriate to the business being reviewed. Also, understand that value is always an estimate with limited precision.

Valuations or pricing for a sale should generally, have some correlation or alignment with what the "market" says similar businesses sell for and if the value/asking price is not aligned with the market, then specific reasons should be given for the deviation. Remember, it is the buyers that typically define the market based upon their willingness to pay a given amount for the item of a particular quality. With enough sale transactions that are closely grouped around a defined parameter, a rule of thumb can be developed. Due to simplicity, sellers and buyers like "rule of thumb pricing" and an example of this is that Retail Sales Businesses, reportedly sell for 25%-40% of annual gross sales. In this example, statistics gathered by someone show that the retail business sale price to annual gross sales ratio is in a certain percentage range. From this, a sale's price range can be suggested for Retail Businesses by substitution for similar businesses based on their gross sales revenues. This assumes the businesses are truly comparable, but let's make that assumption and assume the value obtained from other pricing methodologies correlates with market comparisons. Under those assumptions, most would agree some validity could be established for the value or price. Now, this is very important, but be careful in trying to make correlations that are absolute. Some businesses just won't fit or the range is very wide. But let's continue under the assumption you have a "value/asking price" obtained by calculations that correlates with market data comparisons. Is that an appropriate price for the business? You would hope but, we recommend that you test the value/asking price even further.

In the real world, one very important question must also be answered, "Will the business cash flow sufficiently to allow the typical buyer to "service the anticipated debt and receive an appropriate salary?" No guaranteed answer can be given for this question, but *using historical data, current lending terms and assuming the income streams can be duplicated*, one could suggest that the value/asking price is appropriate, if the answer to the above question is yes.

**So, if your calculated value/asking price is in the general range of what similar businesses sell for and it cash flows sufficiently to service debt and give a reasonable buyer salary, you probably are where you need to be in terms of an asking price. There are few absolutes, but the outlined process provides a template that makes sense and can be justified.**