How much is your business worth?

A guide for clients

BWM, Castle Chambers, 43 Castle Street, Liverpool, L2 9SH
www.bwm.co.uk 0151 236 1494

Four main methods for valuing a business.

Whether you're making exit plans or you want to give confidence to investors, knowing the value of your business is a vital step.

From the inside, it might be hard to say what that value is. You've put long hours of hard work into building your business from the ground up, but what does that mean to a buyer or investor in monetary terms?

As a starting point, it's important to work out what it is you're actually selling. Is it the business's name, and the reputation that comes with it? Is it the lease on the premises – and is this currently owned by you or by your company?

The kind of business you run, the sector it's in, the assets it holds and the people who work there could all make a difference to its overall value.

Setting all of this information out from the start will help you to reach an accurate valuation, and to communicate it clearly to potential buyers.

Benefits of valuing a business

We've already mentioned a couple of the main reasons you might want to value a business – as part of your exit strategy, or to help you raise investment.

When it comes to selling your business, valuing it can also help you to determine the right time to sell, to negotiate the best possible deal, or to move negotiations along quickly.

It can also be useful to know when you're planning your retirement, and thinking about your financial future and that of your family.

Research by Which? suggests most households spend around £27,000 a year in retirement, but to fund a more luxurious lifestyle – including long-haul trips and a new car every five years – you'll need something closer to £42,000 a year.

Depending on your financial and lifestyle goals, you might want to find out whether selling your business could provide that income throughout your retirement.

Alternatively, valuing a business can help you and your team to focus on areas for improvement, and grow your business. You may choose to conduct an annual valuation to give you an up-to-date picture of the stage your business is at.

And if you're offering employees the option to buy or sell shares in your company, it can help you to set a fair price.

Things to consider

There are several factors that might come into play when determining your business's value, and some of these are included in the valuation methods we'll describe in more detail later.

Structure: Can the business function effectively without you? If you find it needs your constant attention to remain profitable, you may need to look at ways of streamlining, automating or delegating work.

Circumstances: If you're under pressure to sell quickly – for instance, because you need to pay off creditors or you want to retire due to ill-health – the price may be lower than if you have time to achieve a better deal.

Financial record: Detailed, accurate records that show a sustained history of strong financial performance will work in your favour when your business is being valued.

Reputation and customers: Is your business well-known within your field, and do people have a positive impression of the quality of your product or service? Similarly, do you have a solid base of returning customers who trust your brand? How profitable are they?

Staff: The skills and experience of your staff can often be a major part of your business's value. A loyal team of people who work well together may mean a higher value – but remember to consider how much of that depends on your leadership.

Intellectual property: What's the value of any trademarks, copyrights or patents that your business owns? Do you have secret recipes, for example, or innovative designs for your products?

Product or service: A high-quality product or service can mean a higher-value business. This should take into account how niche your product is, and how it compares to competitors.

Age of the business: Businesses in their early stages may have a lot of potential, but they'll often make losses. More established businesses tend to be profit-making and face fewer risks.

Business valuation methods

Once you've gathered together all of the relevant information about your business, it's time to get into the technical details of calculating its value.

There are four main methods for this, which we've set out below.

The most appropriate valuation method for you will largely depend on the type of business you operate: the sector it's in, the size of the business, how long it's been running, and so on.

Most people will use a combination of two or more methods to reach a final figure for their business's value.

Valuing assets

This method looks at the value of the assets owned by your business, takes away any liabilities, and bases the overall value on that figure.

This makes the most sense if you have a stable business with a lot of tangible assets – things that have measurable value, and usually a physical form, such as equipment, machinery, furniture, land, and so on. Property and manufacturing businesses tend to be good examples.

Intangible assets, such as the skills and experience of your workforce, or intellectual property like patents, copyrights and trademarks, tend to be much harder to value. Businesses that rely more on these assets than tangible ones will generally need to use an alternative method.

Discounted cashflow

The discounted cashflow method uses forecasts over several years to work out what a business's future cashflow is worth today.

The business's value is worked out at a discounted rate, to take into account potential risks and the decreasing value of money over time.

This method is one of the most complex ways to value a business, and it relies on several assumptions about long-term conditions. It's often used for stable, mature businesses that have relatively predictable cashflow.

Entry cost valuation

This method is most commonly used for new businesses. It's a way of working out a business's value by estimating how much it would cost to launch a similar startup.

It should take into account the cost of everything from raising finance, buying assets and developing products, to employing and training staff, or building a customer base.

It can also factor in any savings you could make, such as adopting more advanced technology, using cheaper materials, or basing the business in a less expensive area.

Multiples approach

Also referred to as the 'price to earnings ratio', this method uses a ratio based on the value of other similar businesses.

This tends to suit more established, larger businesses that have had stable growth and sustained periods of positive earnings.

A 'multiple' is usually a ratio that's calculated by dividing an asset's market or estimated value by a similar metric on another company's financial statement.

This approach can also be used by buyers or investors who want to work out a fair price to pay for a company.

Get in touch to talk about valuing your business.

FOR GENERAL INFORMATION ONLY

Please note that this guide is not intended to give specific technical advice and it should not be construed as doing so. It is designed to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.

About Us

Professional, Personal, Affordable.
We are one of the leading, independent chartered accountancy practices in Liverpool. At BWM we provide a wide range of accountancy and business support services to organisations and individuals throughout the

North West of England and beyond. Our experienced and skilled partners and their teams are ready to support you with high quality, individual yet affordable services however complex your personal or business needs.

For more details of how we can help you transform your organisation, please visit www.bwm.co.uk or call us on 0151 236 1494