Valuing a Business under Current Economic Conditions

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Valuation of a business is more of an art form than it is a science. Unless a business is "asset intensive", the pricing of a business in a valuation is typically based upon the sales and the earnings of that business. There are, however, other factors that enter into the process of valuing a business. Three factors that I break down when valuing a business are:

1. Future economic expectations – this has to do with the economic outlook of the country, of that area of the country, that particular industry as well as other industries that may have an impact on the industry of the business.

2. Location – many times the location can make or break a business, depending again on the business itself. If customers need to be able to access the business, is it located in an accessible area with adequate parking if needed? Is the area properly zoned for the business? Is it in a deteriorating neighborhood/town?

3. Goodwill – How strong is the industry? How much of a market share in the industry does the business have? How long has the business been around? Is it a business that has a good reputation? How do they market for business? Is their marketing successful? Do they have customer loyalty?

With the current economic conditions, I am more driven to try and get as much information about the company and its history than I ever was. Has the business sustained economic downfalls in the past? How are its reserves for the future?

Business valuators that say it is more important now to average several years' worth of data instead of taking one year. This is true, and will help to establish a more meaningful price base. I try and look at least five years backward and four years forward.

Finally, there are many questions on the appropriate marketability discount to use. Recently, I heard Dr. Ashok Abbot from West Virginia University's College of Business and Economics speak. He indicated that marketability discounts up to 45% should not be uncommon with today's economic conditions. Although I agree that marketability discounts generally will increase due to the economic times, I believe that each business carries with it its own story. It is unique in every way. Therefore, the valuation of that business, including the marketability discount, should reflect that.

So, what should we look for in the future of business sales? Because the sale of a business is market-driven, the price will always end up being what someone will pay for it. Credit has tightened and in some instances has become non-existent, so that limits the prospective buyers to those who have the credit worthiness to obtain financing. As a result, we will probably be seeing more seller-financing options in the future. We will see higher discounting and lower values. It is a great opportunity to pass a business from one generation to the next. It is also a good opportunity to get better rates of return than you can elsewhere for your seller financing. For a buyer, this timing is full of opportunity to begin a business at a discounted price.

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For a free one hour conference on valuing your business or valuing a business you are thinking of purchasing please call and mention that you saw this article. I would be happy to discuss with you how any of these factors impact the value of your particular business. Roben Hunter, Hunter Advisors, PLLC, 952-844-2507 rhunter@hunteradvisorspllc.com.