

THE SALEABILITY TEST

The Entrepreneur's Guide

Understanding Transferable Value



NORTHERN INVESTMENT
ALLIANCE GROUP LIMITED

**BRIDGING
THE VALUE
GAP**

PERCEPTION



VS.

REALITY

DID YOU KNOW?

Of business owners...

98% are not adequately prepared for the due diligence phase.

97% do not know the sales process.

86% are creating value that may not be transferable.

80% of their average net worth is tied up in their business.

75% have no exit plan.

71% do not have adequate tax planning.

60% have no contingency for death, illness or injury.

Only 10% of businesses are saleable.

Only 20% of businesses will sell.

Only 5% will sell for around what the owner expected.

HOW DO YOU BEAT THE ODDS?

Through the journey of acquisitions and helping businesses get ready for sale, investors/ buyers and our advisors often find that, **99% of the time, there is a financial value gap, a transferable value gap or a deal structure gap – and sometimes there is a combination of all three.**

- ▶ An owner believes their business is worth a £1m but buyers thinks it is worth £200k.
- ▶ An owner believes their business is attractive to everyone but buyers can't see past how reliant the business is on the owner.
- ▶ An owner believes someone will hand them a large cheque on completion but buyers cannot get funding.

There is over 4m small & medium sized businesses in the UK so it is a buyer's market and the odds of selling are not great.

- ▶ You need to stand out from the crowd.
- ▶ You need to make your business more valuable to a buyer.
- ▶ You need to reduce the risk within your business.
- ▶ You need to bridge the gap.

HOW DO YOU BEAT THE ODDS?

There are three key areas that every owner of a small or medium size business needs to be aware of:

1. How to value their business
2. Understand what transferable value is
3. Know what deal structure they need to use

Take some action:

1. Build a team around you who understands business exit planning and finances
2. Understand where you and your business are now
3. Have clear vision for your future
4. Bridge the gap

Sellers Focus on

PRICE

Buyers Focus on

VALUE

TRANSFERABLE VALUE = SALEABILITY

Here, we are going to focus on just one of the three key areas – TRANSFERABLE VALUE:

This is almost always forgotten when valuing a business. It is transferable value that makes your business saleable and attractive to a buyer.

What is transferable value?

Transferable value is what a business is worth to a buyer without its previous owner; it is determined by how well the business runs without that owner. Transferable value is what you could call 'goodwill' or 'intangible assets' and should not be confused with profit, which is what is used to calculate a financial valuation.

How do we create transferable value?

We start by taking the Saleability Test

THE SALEABILITY TEST

Buyers understand that, when buying a business, there is always an element of risk and they use strategies to reduce these risks as much as possible. But there comes a point where the scales tip, where sometimes the dependencies are too great or the risks are too high and we are not able to proceed.

This is not only frustrating from a buyer's point of view but it is equally frustrating for the seller, especially if they need to sell their business quickly or they need to achieve a certain amount from the sale.

The funny thing is, we have a buyer on one hand and the seller on the other. One wants to buy and one wants to sell. It should be a match made in heaven - you have demand and you have supply but they just keep missing each other so the odds of them connecting is extremely small. But it really doesn't need to be that way.

By the end of this workshop, you will have enough information to increase that chance of connecting to a buyer when the time comes.

THE SALEABILITY TEST

The Saleability Test consists of 15 VALUE DRIVERS split into five sections:

- ▶ Reputation ◀
- ▶ Realistic Future Potential ◀
- ▶ Regular Maintenance ◀
- ▶ Record of Performance ◀
- ▶ Risk ◀

Each Value Driver is scored out of 10.

Each value factor has a statement to which you will award a score of 1-10 according to your level of agreement with the statement, with 10 being the highest, where you are in total agreement, and one being the lowest, where you strongly disagree.

We are going to work through the typical process most investors or buyers will use when evaluating a business in order to determine its valuation and whether or not it is a viable proposition. At the end of the process, you will have a total score out of 150.

THE 15 VALUE DRIVERS

REPUTATION

- 1 Your Digital Footprint
- 2 Your References

REALISTIC FUTURE POTENTIAL

- 3 Market Potential
- 4 Growth Forecast

REGULAR MAINTENANCE

- 5 Finances
- 6 Housekeeping

RECORD OF PERFORMANCE

- 7 Proven Management Team
- 8 Consistent Sales Growth
- 9 Consistent Profit Growth
- 10 Cash Flow Drivers

RISK

- 11 Staff Dependency / Engagement
- 12 Product / Service Dependency
- 13 Supplier Dependency
- 14 Customer Dependency
- 15 Owner Dependency

THE 15 VALUE DRIVERS - SCORE

<60	The business is not saleable in its current state. A serious amount of work will be required to get the business exit-ready
60 - 100	The business will need a lot of work before it can be put on the market. Start implementing measures now that will make it attractive to a buyer in the next few years.
100 - 130	The business will still require some work to ensure you achieve the right valuation. Look for ways to enhance value and reduce risk for a buyer.
>130	The business is doing great; you are creating a saleable business. You should now be seeing and reaping the rewards of an exit-ready business. Keep on top of all 15 drivers to ensure the business remains attractive for a buyer.

By taking this test, you will be able to see which areas of your business are not yet transferable to a buyer. By being aware of these areas, you can then formulate a plan to strengthen those parts in order to extract as much value as you can. This will not only make your business ready for sale but will also be attractive to a buyer and make you stand out from the crowd when the times comes to sell.

1. Your Digital Footprint

What position are you trying to occupy within the market? Are your products or services clearly defined and are these communicated in all your marketing, sales strategy and brand story?

Buyers will look at this as part of their initial investigation when looking to acquire a business.

- a. **Website:** Is your website 'customer-centric' or 'owner-centric'? Does it focus on the features and benefits of what you do or does it focus on what is in it for your customers?
- b. **What is your story:** Buyers want to know: Who are you? What problems are you trying to solve for your customers? Remember, customers are only interested in how you can make their life better, safer or more efficient. What outcomes do your customers achieve by working with you? Do you know your customers' needs and are you able to satisfy those needs?
- c. **Giving Value:** What value are you providing to your customers? How many touch points are you creating so your customers can get to know, like and trust you?

Both investors and customers will look at these areas to decide whether they should do business with you. Ensure you have a clear customer journey which shows who you are but more importantly, what you are not.

2. Your References

Do you constantly seek feedback from your customers, staff and suppliers? Are these prominently displayed?

If you randomly picked 10 customers and asked them what they thought about your business, what do you think they would say? How would you feel if a potential buyer did that right now?

It is worth considering the following:

- ▶ Do you know what your clients, staff, suppliers are saying about you?
- ▶ Have you got an online review process? If you do, what do they say? If there have been any problems in the past, have they been dealt with and resolved quickly?
- ▶ Are you communicating with your customers, staff and suppliers on a regular basis?

Doing so will bring the following benefits:

- » It allows you to find out what your customers, staff and suppliers think about you and your business.
- » It gives you a chance to become aware of any problems that people are experiencing, allowing you to resolve them quickly.
- » It is another touch point where you can contact your customers, also giving you an opportunity to share with them all the other products or services you offer. Chances are, many of them do not know everything that you do.
- » By showing feedback forms and reviews to a potential buyer, you will instil a lot of confidence in your business, not to mention saving a buyer from having to conduct this themselves during the due diligence phase.

3. Market Potential - In the next 3-5 years

Buyers are looking for growth and predictability.

Are you operating in a high growth sector or is it in decline? How are you responding to changes within your industry?

If you constantly look to innovate and find gaps within your sector and embrace the inevitable changes, you will be best placed to evolve and change, resulting in you dictating your future, rather than being changed by it.

- ▶ Look for opportunities to find your ideal customers.
- ▶ Be sensitive to what your audience need and look for ways to fulfil that need.
- ▶ Include your employees – they are very often a good source of ideas and insight.
- ▶ Find strategic partnerships and combine resources and customer bases to expand and create more value to what you can offer.

There is also another angle here for exiting your business:

By looking ahead and noting the trends and market conditions, you should be able to plan the timing of your exit. Being able to see 3 – 5 years ahead is key for exit planning.

4. Growth Forecast

How accurate are your forecasts? What are you basing the next 3-5 years forecast on? How have you performed in the past against your forecast? Do you even have a forecast?

The key here is to work on your forecasts to get them as accurate as possible. The more you measure, the more accurate you will be but this takes time.

What an acquirer will want to see is a history of you hitting those forecast or as close to those forecast as possible.

If there happens to be a year or two where the turnover and profitability has been affected, then buyers will want to see at least two to three years, where performance matches forecast. This is all about showing trends and increasing buyers' confidence.

So, start building accuracy into your forecasts.

5. Finances

This is all about providing a buyer with quality financial information. It is very rare for any small or medium sized business to provide anything other than typical Profit & Loss and Balance Sheets Statements. Cash flow statements and forecasts are uncommon so, even if you are able to provide this, you will stand out from the crowd.

The costs of employing a Financial Director makes it impossible for a small or medium sized company to even consider. However, with the huge leap in cloud computing and digital accounting, it is very reasonable and affordable to expect every business to have access to a Virtual Finance Director. The quality of financial information that you will have at your finger tips will enable you to run your business properly.

A few points to consider:

- ▶ How often do you produce management accounts? Monthly? Quarterly? Annually?
- ▶ Do you receive detailed reports as to how your business is performing?
- ▶ Do you have someone acting as your virtual finance director? If not, then these are the things you should be looking at.

Having control over your finances will add a wealth of credibility to your business and will help you to stand out from the crowd.

6. Housekeeping

It is crucial to have legal documents, contracts, leases, agreements, shareholder agreements, IP, trademarks, etc. organised and up-to-date. It is good practice to have these in place at all times, even if you never sell.

Having this area ready will reduce the risk for both you and the investor and will ultimately put you in a very strong negotiation position, should you decide to sell.

As this is very often a forgotten area, acquirers tend to be all over this, so it is best to be prepared.

It will be worth while to periodically carry out an IT, accounting, legal and HR audit to make sure nothing is missing and everything is current and accounted for. These audits will start to form the basis of the due diligence phase.

7. Proven Management Team

At the end of the day, investors and buyers are not looking to buy a job. It doesn't matter how nice a job it is, they are not looking for a job. They are looking for a business where they are not involved in the day-to-day running of the company.

For those businesses that have a management team in place, do they have a proven track record for at least the last 2-3 years? If not, it may impact the value of your business.

It takes good leadership and culture within the business to build a team. It is about harnessing the collective power of a group rather than seeking individual super-stars.

You can start implementing this by investing in your employees. Create an onboarding process, ongoing training and progression within each department and CDP for those looking to improve themselves.

8. Consistent Revenue Growth

Are you showing consistent revenue growth? Are you showing consistent growth at more than 20% per year? Which products or services provide a reliable income stream?

For the investor, this is all about reducing risk and increasing confidence. In order to achieve consistent sales growth and reliable income streams, you need to address both saleability and the sales process. Many focus on one but not the other.

What is scalability?

Scalability is the control of all business functions and ensuring there is alignment with the company's goals and objectives, whilst creating procedures and systems to ensure predictable forecasting in a sustainable way.

What is a sales process?

A sales process is where you know everything about your customers and your customers know everything about you and what you have to offer. It is the entire operation from initial conversations to post-sale support and marketing.

So, scalability gives you the growth and the sales process gives you the consistency.

Here are five ways you can create consistency in your income:

- ▶ Create a subscriptions service, such as maintenance contracts.
- ▶ Offer future upgrades.
- ▶ Incentivise customers to take out 3-year contracts rather than annual contracts.
- ▶ Look to offer 12 month support for services/products you provide.
- ▶ Lock customers in to long term contracts by freezing prices.

9. Consistent Profit Growth

Now profits control value.

The more profit the business makes, the higher the value of that business.

Now when it comes to valuing an SME business, you would do well to get a multiple above 3 or 4 times EBITDA. If you hit these types of multiples, then you have everything in place: a management team, consistent growth, reduced risk, financial control, etc. If any of those elements are missing, the multiple will drop.

In the same way as with a proven management team and revenue growth, you will want to see consistent growth in profits.

It is also about understanding where you are in relation to other companies in your sector. By taking your percentage profit and comparing your figure to other companies in your sector, including the big boys, you will find out how you are performing in comparison. By knowing where you stand, you can gauge how attractive or unattractive your business may be to a buyer. If you are showing consistently higher profit margins than the average in your sector, that would be something worth shouting about to a potential buyer.

You can get these figure from websites like www.plimsoll.uk or www.redflagalert.com

10. Cash Flow Drivers

Unlike profit that dictates value, cash flow dictates both value and terms.

There are six drivers that control cash flow and you need to ensure they are all operating as efficiently as possible.

Do you know what your debtor days, creditor days and stock days are? Do you know what the standard is for your business?

Like with the first three areas in this section, are you showing consistent growth in your cash flow? Are you keeping a record of how your cash flow moves? Do you have a cash flow forecast for the next 12 months?

Understanding your business from a cash flow perspective is key to improving your economic performance. It is the relationship between sales and overheads. Between income-generating assets and cost-saving assets. Ensuring all assets are working as efficiently as possible will increase the overall efficiency of the business, allowing you to start driving your business much faster.

There is a free Cash Flow Simulator available to you. It determines what your cash position will be in the next 12 months then you can see which drivers you need to change to improve your bank balance.

www.businessoptics.co.uk/cash-simulator

11. Staff Dependency/Engagement

In the UK, we have an average staff engagement of just 45%.

The reason people go to work is not necessarily for money. Although it can be a big driver, don't make the assumption that this is the only reason why your staff come into work everyday.

Here are the top 4 reasons why people go to work:

Work-life Balance: Employees want their employers to support them in creating a work-life balance, whatever that may mean for them. This has been more apparent since the pandemic.

Independence: People want the freedom to carry out their jobs but within clearly defined parameters. Problems arise when people are either micro-managed with well-defined parameters or are free to do whatever they want but have no parameters in which to operate.

Growth: People want to improve; they want to get better at what they do. The question is, are you investing in your staff? Do you provide internal training courses or external CPD? Are you pushing those individuals to greater things?

Purpose: This has a lot to do with leadership. Have you communicated how the purpose and the goal of the business is linked with each staff member's individual role within the company? It is about linking everyone's individual efforts towards the company's common goals and purpose.

BUT: It can also go the other way. A business can either be too reliant upon certain employees and force them to shoulder most of the workload or they have employees with critical knowledge of how a process or procedure works which isn't shared with others in the company. If these people were to leave, it would either create a workload hole or a knowledge gap in the business.

12. Product and Service Dependency

As buyers are becoming more sophisticated and educated in the acquisition process, they will be looking at your business and asking themselves “What will this look like in two- or three-years’ time?” To put it simply, buyers do not want to buy a problem.

There are essentially two parts that a buyer will take into consideration when looking at your product or service portfolio.

1. They look at which products or services contribute to the total revenue. They want to know which products or services make up your revenue profile and how much each are contributing to the bottom line.

Investors want to see this clearly measured in terms of a percentage of sales and a percentage of gross margin. This allows an investor to quickly identify which products or services contribute most to the turnover and which offer the highest margins.

This may reveal certain products or services to be as a potential risk, should the demand for that product or service change. This is not only useful to the investor but also to you.

This allows you to constantly evaluate which products or services to keep, replace, remove or improve.

2. Buyers look at potential industry or technology change.
(Are you able to adapt quickly?)

The ability to adapt to an unpredictable sector is something investors will look at favourably. Having a product or service development plan will not only ensure you stay ahead of the curve but also that you appeal to number of potential investors.

Consequently, companies who fail to plan or adapt will leave themselves open to market forces, rendering them vulnerable.

So, are you constantly developing your offering, creating new products and services, establishing new routes to market?

continued over...

Products and Service Dependency continued...

Consider the following:

- ▶ Do you know which are your top five products / services? If not, that would be useful to know.
- ▶ Using the popular phrase from 2020, is your business able to 'pivot' and adapt to market changes?
- ▶ Are you looking at moving into new sectors or new markets?
- ▶ Or are you relaying on old sectors, old jobs or legacy products?

13. Supplier Dependency

Supplier diversification is equally important when assessing and valuing a business. Investors do not want a single point of failure within the supply chain. This is obviously industry and sector dependant but, for the majority of businesses, no single supplier should account for more than 10% of your total spend. This too will make your business vulnerable should that supplier cease trading, change product ranges or increase prices.

This could even include a competitor acquiring that supplier and then either refusing to supply you or increase prices to the point that it is no longer feasible to use that supplier.

To reduce this risk, and at the same time add value to your business, as the owner, you will need to prove that you have one or two other suppliers that you use, or could use. This will ensure continuation of product or service quality for the future.

14. Customer Dependency

When you examine your customer list, which customers are contributing the most to your overall turnover?

The aim is to develop as many A-grade customers as you can, but the key is to never have a customer contributing more than 10% of your annual turnover. Again, this is industry and sector dependant but, for the majority of businesses, if a customer is responsible for more than 10% of your revenue, this could leave your business vulnerable, should that client leave or stop trading.

Always try to spread the risk and avoid a single point of failure.

Consider the following:

- ▶ Do you know which are your top 10 customers?
- ▶ Do you know which are your bottom 10 customers?
- ▶ Are there customers contributing more than 10% of your annual turnover?
- ▶ Do you know how many customers you are gaining vs. losing each year? That again would that be useful to be aware of.

15. Owner Dependency

Owner dependency. This is a big one and potentially a real deal killer!

There is always an element of owner dependency but the question is:

- ▶ How great is that dependency?
- ▶ Are you aware of it and are you doing something about it?

Obviously, when you first start a business, it will naturally be heavily dependent upon the owner. That is absolutely fine but, as time moves on, as the business grows, the dependency upon the owner needs to reduce. That will be done through the owner building a team around them that can take on their knowledge and expertise.

Now, every owner has a choice to make. You can either stay as the expert and do the things you find easy and comfortable or you can choose to be your company's CEO a role that will require you to focus on three key areas within your business, namely:

1. Strategy
2. Finding and Nurturing Talent
3. Financials.

Those are really the only three things that you need to focus on. You can employ people around you to take care of the other day-to-day tasks. Crucially, if you decide that it is easier to remain the expert in the business, focusing on the daily tasks, staying within your comfort zone, it will have a dramatic impact on the saleability of your business.

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Owner Dependency continued...

How can you test where you are on the owner-dependency scale?

There are two tests you can do:

1. Take an inventory of your time over the next month. Log what you spend your time on by allocating tasks into four columns:

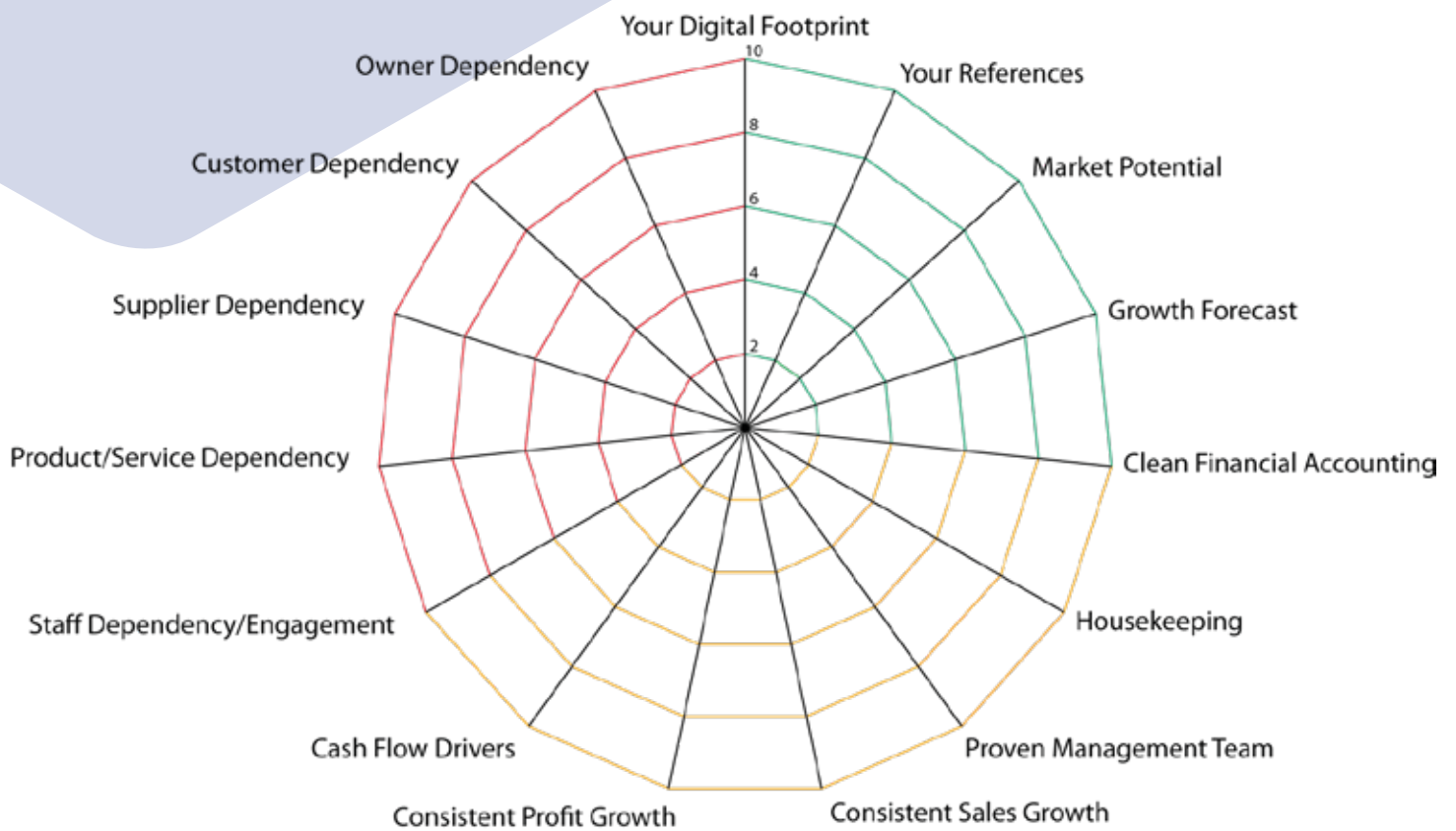
- » Strategy
- » Talent
- » Financials
- » Stuff

Take a look at which columns are taking up your time. I suspect that the majority of the time will be filled with sorting out 'Stuff' rather than the three areas that a CEO should be focusing on.

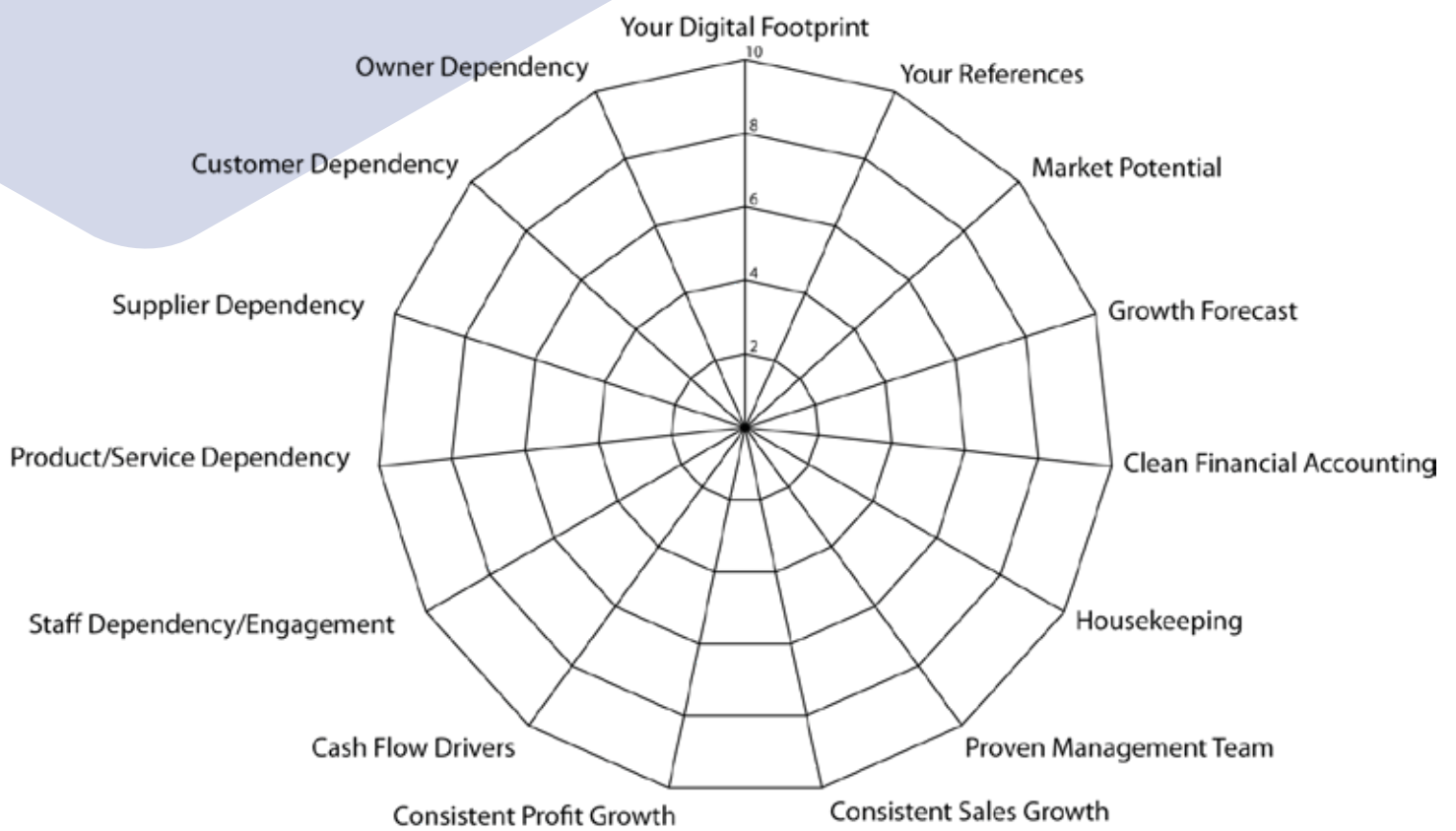
2. Take a 3-6month holiday. Leave your phone in the office and see what happens to your business. That could be a scary thought for some!

This is easier said than done but awareness is the key. Start by taking stock of what is taking up most of your time and then delegate. Train up or employ people to take those tasks off your hands. Carve out time to focus on your company's strategy, talent acquisition and finance. Doing that will not only improve your life now but you will start to create a more saleable business for when the time comes to pass it on.

SCORE



SCORE



SUMMARY

By knowing what to focus on it will enable you to make those changes that will increase the value of your business and make it more saleable. I hope this saleability test has been useful to help you understand what buyers look for when acquiring a business. As always, if you would like any assistance in implementing any of the 15 value drivers please feel free to contact me: david@niagroup.co.uk

This test takes a very broad view of what makes a business saleable. I do appreciate that certain value drivers may or may not apply to various sectors and industries that you may be operating in. Please score yourself accordingly to what is applicable and pertinent to your sector or industry.

NEXT STEPS

To book a **FREE business valuation** based upon your cash flow:

Call:

Email:

Book:

To book a **FREE 30 minute consultation** based upon your results:

Call:

Email:

Book:

WOULD YOU BUY YOUR BUSINESS?

5 Categories / 15 Drivers

Score yourself between 1 – 10 for each driver: 10 being in total agreement with the statement.

SCORES

REPUTATION

1	Your Digital Footprint:	Your digital assets are customer centric, communicate what you can do for your customers and have a compelling and engaging story that speaks to your target audience.	
2	Your References:	You constantly seek feedback from your staff and suppliers and you ask every customer for a testimonial. Feedback is recorded in an orderly manner so that it can be reviewed and acted upon.	

REALISTIC FUTURE POTENTIAL

3	Market Potential:	Your company is in a high-growth sector, with a very strong position. You seek to create strategic partnerships to enhance your offering.	
4	Growth Forecast:	You have at least three years' data showing performance vs. targets / performance vs. budget, as well as a 3-5 year forecast, and these are as accurate as possible.	

REGULAR MAINTENANCE

5	Finances:	Your finance records are up-to-date. You seek professional help to look after your finances and identify any areas for development.	
6	House-keeping:	All your legal documents, contracts and leases are present and up-to-date.	

RECORD OF PERFORMANCE

7	Proven Management Team:	You have a management team with a proven track record. You have systems in place to provide professional and personal CPD to all employees.	
8	Consistent Sales Growth:	Your company has consistent growth of 20% or more. You have an understanding of scalability and of your sales process and these are in place within your business.	
9	Consistent Profit Growth:	Your company shows consistent growth and has a percentage margin in line with or above your industry's average.	
10	Cash Flow Drivers:	You understand the key drivers of cash flow and your cash flow is consistently growing. You could show a potential buyer right now that you have your cash flow under control.	

RISK

13	Supplier Dependency:	Your company has a range of suppliers to choose from and does not have any one supplier contributing more than 10% of your annual spend.	
14	Customer Dependency:	You know who your top 10 / bottom 10 customers are, you have no customers contributing more than 10% of your annual turnover and you know how many customers you are gaining or losing each year.	
15	Owner Dependency:	You delegate the day-to-day running of the company to your employees and spend the majority of your time working on the three key CEO areas. You are able to go on holiday for extended periods of time.	

TOTAL



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