



## Reduce Risk to Enhance Value

How much control does an owner have over the value of his or her business? As always, it depends on the business. Value is based on a combination of marketability and risk factors. Traditional wisdom dictates that more risk equals less value.

Business valuers consider a number of standard financial and business risks for each company. Think about your specific company — are there steps you can take to reduce risk in these areas?

### **Financial Risks**

This category refers to the debt associated with the company as well as other financing issues. The less debt, the more cash flow available. More cash flow means less risk.

In assessing financial risk, the business valuation professional will compare the company to its peers in terms of leverage, liquidity and turnover ratios. Is debt causing increased exposure? Is inventory too high? Are fixed assets performing?

Two obvious ways to enhance value are to increase the income stream and reduce debt. Consider receivables, inventory and equipment. There may be some easy fixes.

### **Business Risks**

When it comes to business risks, the business valuation expert will consider those that might influence a buyer's

interests in the future performance of the company. The following list, developed by Practitioners Publishing Company in *PPC's Guide to Business Valuations*, provides a good overview of business risk characteristics:

*Stability of historical earnings:* The stability of historical earnings is probably the most important factor the business valuator — and potential buyers — will consider. The less stable the earnings, the more risk involved in the company.

*Business and industry growth prospects:* Most buyers are interested in future growth, so it's important to look at any forecasts available for the company and its industry, as well as history, background and trends.

*Type of business:* Businesses that are easy to launch and don't require a lot of capital are generally less valuable than those that require specialized licensing and lots of investment.

*Quality of location and facilities:* Everyone knows the "location, location, location" mantra of retail businesses. But even for non-retail businesses, potential buyers might be turned off by questionable neighborhoods or poor facility maintenance.

*Stability and skills of employees:* Staff can make or break a business. Companies with well-trained employees and low turnover rates are generally more attractive than others.

*Competition:* Competition can have a negative or positive effect on a business. The business valuator will consider whether the company's specific competitive situation is a plus or a minus.

*Diversification of products, services and markets:* Generally, the more diversified, the better, because diversification means less risk.

*Desirability and marketability:* What are buyers willing to pay? Are there many prospective buyers or just a few?

*Management depth:* If the business' success is tied to its owner, it's obviously less valuable than a business that can thrive with new management. Another consideration is business structure. Does the entity provide for the transition

of management to others in the company?

*Availability of capital and/or terms of sale:* Even the best deal won't go through if a buyer can't get financing — which can be difficult to obtain for small businesses.

Depending on the specific company and its industry, certain business and financial risk factors will have more impact than others. The better you understand how these risk factors affect your business, the better you can reduce risk and enhance value.

*Interested in enhancing the value of your company? Our valuation professionals can help you assess the risk factors relevant to your business.*