Advice and thought leadership for entrepreneurs

What Impacts Business Value?

The value of a business is the price at which willing buyers and sellers consummate a transaction. For a successful transaction to take place, the following needs to occur:

- The buyer's return exceeds their cost of capital
- The transaction is financed with debt and equity
- The business is able to service the acquisition debt
- The seller needs to achieve their price

Privately held businesses can have multiple values depending on the context in which the business is valued and the buyer's objectives. Expectations of growth, cost savings, and other variables will differ from buyer to buyer. This explains in part why data on closed transactions shows a wide range of multiples for businesses of similar size in the same industry.

There are many variables that impact the value of the business besides the level of EBITDA. Other factors impacting valuation include:

- Company specific risk
- Amount of working capital to fund growth
- Capital expenditure requirements

As previously mentioned, a buyer of the business will typically finance a business acquisition with both debt and equity. Longer debt amortization increases what a buyer can pay for the business. Small Business Administration (SBA) loans allow for longer term amortizations than conventional bank loans.

Additionally, the price a buyer is willing to pay for a company is negatively impacted if the seller is not willing to provide some level of seller financing (which can range from 10% to 50% of the transaction price). Seller financing is permitted with SBA transactions but must be fully subordinated to the SBA loan if it is part of the required equity. Otherwise, as long as cash flow is adequate, seller note payments are allowed. Company value can also be negatively impacted if working capital is not financeable through a line of credit. SBA loans can include a working capital allowance.

Whether you intend to sell a business or buy a business, there are critical factors in determining value. Understanding those variables, as well as determining the best financing structure of a business transaction, is critical to a favorable outcome. Working with the right advisors and bankers for guidance through this process will lead to a better executed transaction.

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