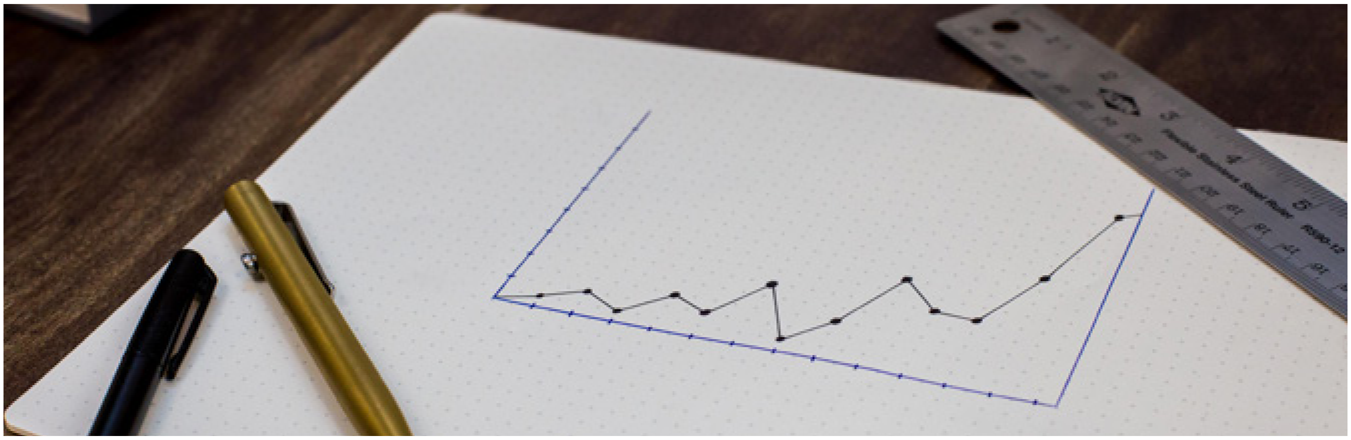

Business owners have an opportunity to increase the value of their business with focused effort in key areas. DLA Companies has identified some of the primary factors that have a leveraged impact on business value. With intentional planning and management, these factors can be improved, resulting in an increase in enterprise value.

1. Recurring vs. Non-recurring Income

The source and type of income for a business can be categorized as non-recurring or recurring. Examples of non-recurring income models are companies that trade project-level goods or services for a proposed fee or cost. In a manufacturing company, a non-recurring model would be referred to as a "job shop". Each project is bid or estimated as a standalone job. A very successful company with a non-recurring income model has developed the ability to efficiently estimate and deliver on customer needs on a repetitive basis. While this model can be proven sustainable over time, the assurance of future income is uncertain, since it is dependent on the ability to gain opportunities, estimate, and deliver in a consistent manner. This is assuming no unforeseen changes to customer needs or the ability to deliver.

The predictable quantifiable nature of recurring income drives enterprise value.

While the future is never guaranteed, a recurring income model provides some assurances. In contrast to a non-recurring income model, recurring income models provide goods or services on a contractual basis, to a customer base that has agreed to pay over time for a series of deliveries from the company. Recurring income relationships are considered more "sticky" and tend to be more attractive to buyers. A blend of non-recurring and recurring income streams can help smooth out the income levels and provide some degree of certainty for potential buyers. Recurring income streams are considered a value driver. A business model dependent on non-recurring income is not typically considered as valuable – and a discount factor is often applied.

2. Customer Concentration

In the lifecycle of a growing business, it is not unusual for a few key customers to account for a high proportion of the income. While the growth of valued accounts is usually very good for the cashflow, consideration should be given to the balance of income generated compared to the customer base. A diversified customer base is usually more valuable to a buyer. As history shows, change can occur in the marketplace very quickly and without much warning. When marketplace dynamics change, the impact is often more negatively felt in some sectors than others, depending on the market adjustment. If a considerable portion of the company income is being generated by a specific customer, how change affects that customer's buying patterns can have a big impact on the business. These unpredictable shifts in market conditions can also affect industry groups.

Your company customer list should be monitored periodically, to track the percentage of gross sales generated by customer. Additionally, customers should be segmented by industry group, to assess the percentage of business generated by industry sector. Efforts should be applied to diversifying the customer base, to manage the concentration of income. If one customer makes up more than thirty-five percent of your income, a customer diversification strategy should be implemented, to build other customer sales if possible. The same assessment is applicable to industry concentration. If one industry is impacted by a changein the economic climate that reduces demand, such as international trade tariffs, the business could be at risk. A diversified customer base is considered a value driver, while high customer or industry concentration can be a discount factor.

A diversified customer base minimizes buyer risk, increasing enterprise value.

3. Defined Processes

Each business has a unique process or way they do business. As the business grows, it is not unusual for the processes to be taken for granted and the training function to be done informally. A process flow with a clear explanation of each step in the process, especially key functional areas, is an important way to communicate a sustainable business process and demonstrate an awareness of the operations. This process should be defined in an operating manual, reviewed periodically, and updated as needed. Process definition and review is an effective way to identify areas for improvement. Defined processes are considered a value driver while lack of process documentation often is considered a weakness and discounts value.

4. Sustainable Management Team

At some point in the evolution of a business, the business owner realizes they cannot do everything themselves. As a team is developed, business owners should work to empower managers to make decisions within an acceptable framework, but with autonomy. A business that revolves around the owner is generally considered high risk and difficult to transition. Customer relationships should be managed through a sales or customer service team rather than the owner. A leadership team should be groomed to make decisions and to be accountable for results. Ideally, the leadership team will include a CFO, operations manager, and sales manager who report to a president. When possible, design the organizational structure to avoid dependency on a single individual. Non-compete and non-solicitation agreements should be considered as a basic employment document for all senior level executives who are considered key persons.

Businesses in which the president reports to an absentee owner or CEO are generally considered more valuable than companies with weak leadership teams and high dependency on the owner. In the event that an absentee owner or CEO arrangement is unrealistic, the discount factor may be overcome with the owner agreeing to stay in an active role to assist in the transition for a period of time after the closing of the transaction. The challenges associated with moving the business owner to employee status under an operating agreement should be carefully considered in the planning process. While many business owners can easily adjust to the new role as needed, some spirited entrepreneurs may consider the role overly restrictive.

5. Written Contracts in Place

The importance of written contracts to memorialize the agreements with vendors, employees, and customers is often overlooked. While the business may operate with a handshake-type culture and it historically worked fine, a new buyer will most likely not share the same level of trust and confidence that things will work out. Buyers are much more comfortable with written agreements in place to clearly document the nature of the relationship, pricing and compensation, deliverable expectations, and remedies for noncompliance.
Employment agreements with key personnel that include non-compete and non-solicitation language are preferred when possible. Vendor and supplier agreements that outline the pricing and terms help provide a degree of confidence that the pricing structure and supply chain is stable. Customer contracts that specify the order commitments, delivery standards, and pricing, help to validate the customer relationship and support sustainable revenue assumptions.

6. Customer Relationship Management System

A Customer Relationship Management (CRM) system is an important discipline to embrace. CRM systems can be as simple as Google Contacts, and as comprehensive as Sales Force. As technology continues to advance, user friendly, cloud-based CRM systems will continue to mature and become more affordable. The investment in a CRM system should pay multiples in revenue through customer retention, cross-selling opportunities, improved customer service, and enterprise value (active customer base and online records management).

Customer information is very valuable when used effectively. In addition to the traditional "rolodex-like" contact information, an effective CRM allows users to access things like order volume history, trends for products and services ordered, and profit margins. Active CRM systems are used to communicate regularly with the customer base, marketing goods and services, and soliciting input through dynamic interaction. While these suggestions may sound overwhelming at first glance, technical advances have made these type of customer interaction and data management goals possible through intuitive solutions that are relatively easy to implement. The historical data of customer activity will be considered a valuable asset to buyers, and can increase the value of your business.

7. Estimating Process

There is usually a point in the sales cycle of every organization that a price must be generated for a proposed good or service. This process is typically referred to as the estimating process. It can also be referred to as the proposal or pricing. The process by which the estimate is developed can arguably be considered one of the most

Internal processes reinforce operational stability and consistency, providing a scalable framework to support growth.

crucial steps in the value chain of any business. An estimate is based on a set of assumptions or inputs. The validity of these inputs will usually have a significant impact on the profit (or loss) of a project, product run, or other engagement. If your business is enjoying strong profit margins, it is most likely due in part to a good estimating process.

It is not unusual for the estimating process to be conducted by a seasoned professional with industry or operational knowledge, and possibly the use of a spreadsheet to help with the math. As the use of technology in the workplace continues to evolve, some are slow to embrace change. Defining the estimating process down to a component level will help systemize steps that can create more accuracy and efficiency in the estimating process. Cost models should be dynamically linked to actual job cost performance, or a unit costing schedule should be refreshed periodically to ensure estimates reflect updated actual cost. There are a number of proprietary job estimating software solutions in the market. Some of the industry-specific ones may be worth exploring. Industry associations can be a good source for referral feedback on systems being used by other companies in similar industries. Work to eliminate single points of failure by cross-training estimators and encouraging electronic data sharing. When hiring estimators, consider getting a noncompete agreement in place. Costing information can be the "special sauce" in competitive industries. Buyers are usually more comfortable knowing the special sauce in your business is not at risk of walking out the door.

These seven areas are a good place to start when determining the value of your business.

Download our other documents to read more about creating an exit plan and the people you need on your team. We want your experience to be smooth and successful.