OUTSIDE IN MANAGEMENT

Making Businesses Work Better

8 DRIVERS of Company Value

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8 Drivers of Company Value

Overview

We discovered that there are these eight key drivers that drive up the value of a company. The Value Builder assessment gives you a score for each of those eight drivers. This paper gives you the detail behind each driver and shows you how to get your own score.

Financial Performance

Your history of producing revenue and profit combined with the professionalism of your record keeping.

Growth Potential

Your likelihood to grow your business in the future and at what rate.

Switzerland Structure

How dependent your business is on any one employee, customer or supplier.

Valuation See Saw

Whether your business is a cash drain or a cash tap.

Recurring Revenue

The proportion and quality of automatic, annuity-based revenue you collect each month.

Monopoly Control

How well differentiated your business is from competitors in your industry.

Customer Satisfaction

The likelihood that your customers will re-purchase and also refer you.

Hub & Spoke

How your business would perform if you were unexpectedly unable to work for a period of three months.

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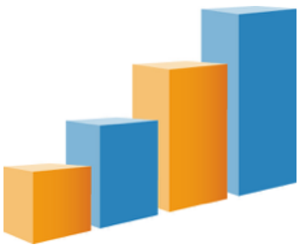
Value Driver 1: Financial Performance



The first driver is an easy one. It's easy to understand but it's actually very difficult to deliver: your financial performance. Essentially this Value Driver is made up your top line revenue and your bottom line profit.

The interesting thing about financial performance is that there is a second hidden element to it. It's not only what those numbers are but the quality of the reporting of those numbers.

To drive up your score, not only focus on your top line and your bottom line but also consider investing in an audit or some way to make sure that those numbers are as defendable as you can.

Because a buyer is going to come in and say, “great you've got these numbers but how defendable are they?” The buyer will come in and really scrutinise these numbers.

You should have a clear chart of accounts, consistent dependable accounting policies and robust feeder systems into your accounting system.

Investing in an audit, and/or regularly performing audits is one simple way to improve your Value Builder Score as it relates to Financial Performance.

Value Driver 2: Growth Potential

The second driver is your company's growth potential. The owner of the company, when they think about their business, they want it valued based on what they've done in the past. We're proud of what we've done in the past, that's normal. For example, the fact you won an Association Award or that you've got a 20 year business or that you're recognized for your reliability – whatever it is that you think you've done in the past.

But the hard truth of it is, that when a buyer comes in, they're not buying the past. They're not buying what you've done. They're really only buying one thing and that is: they are buying your future stream of profits – what this business is going to do in the future?

For you it's the end of the game. It's the finishing line. For them it's the start. It's a different frame of mind for them. They ask: What can this business do in the future?

So, to drive up your score on growth potential you have to make the case and focus on what is the future potential of this business. Can it operate in a different market? Let's say you've been successful in market A. Is it possible to scale to market B, C and D?

Could you cross-sell additional products and services to your existing customer base? Are there ways that this could work in different cultural markets for example?

The answer to those questions is going to drive up your growth potential. If you're not selling the business yet then you can exploit that growth potential for income now.

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Value Driver 3: The Switzerland Structure

This structure gets its name from the country of Switzerland. If you know anything about the history of Switzerland it's pretty amazing. They've taken this obsession with being independent.

They didn't join either of the two world wars. They didn't send troops to Iraq. They didn't even join the United Nations, if you believe this, before a referendum for the entire country to decide whether to join or not – they ultimately did.

It shows that as a country they're obsessed with this independence and not being overly dependent on any one faction or regime so to speak. That's essential for building a sellable company: that independence of any one constituency and the three most important groups you've got to make sure you are independent of are:

1. **Customers**. So you can't have an overly concentrated customer set. You've got to have good diversification among your customers.
2. **Employees**. To be overly reliant on any one employee.
3. **Suppliers**: This one is sometimes not as intuitive as the others. You can't be overly dependent on any one supplier either.

So, customers, employees, suppliers, you've got to be independent of those three. From a buyer's perspective, if they see that you're overly dependent on any one of those constituencies, they're going to discount the business because it's just too risky for them.

To improve your score, you've got to make sure that you have good diversification in your customers, make sure you're not overly reliant on any one employee and you get diversification in your suppliers as well.

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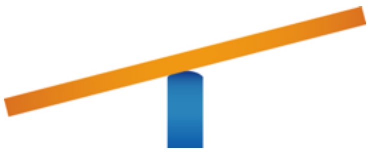
Value Driver 4: The Valuation See Saw



Remember when you were a kid you'd go to the playground and you play on a see saw? The light kid is on and then the heavier kid gets on and the light kid goes up?

The same relationship exists between the way cash moves through your company and its value.

Essentially when a buyer comes and buys your business they've actually got to write two cheques. They write a cheque to you the owner, that’s obvious.

But they have to write a second cheque. A lot of people don't really think about a second. It is to fund your company’s working capital. That's the money your business needs to operate the day you hand over the keys to the buyer. The problem is that the buyer has to write those two cheques out of the same chequebook.

The more cash your company needs to run, the more cash the company needs to operate, the less a potential buyer is going to be willing to buy your business.

The way to improve your score on the valuation see saw is to make sure that your business is generating cash.

If you collect debtors collect them faster. If you can, extend your creditors a little bit more. Make sure you're getting to the point where you're generating more cash as a business. And that's going to improve your score on the see saw. It will also make life easier before you are ready to sell.

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Value Driver 5: Recurring Revenue

When a buyer comes in to buy your business they want to understand how this business going to continue when you, the owner, leaves. The more reoccurring revenue you have the more valuable it's going to be.

There are really six different forms of recurring revenue and buyers view each of the forms a little bit differently. Here are the six forms of recurring revenue. I'll start from the lowest value one and end with the most valuable one in the eyes of an acquirer.

1. **Consumables:** The first of the six forms of recurring revenue is simply consumables. If you are a coffee drinker, you probably drink coffee daily, or even several times a day. You most likely also have a routine where you buy your coffee, and do this over and over.
2. **Sunk Money Consumables:** One step up the ladder is sunk money consumables. You've seen these Nespresso coffee makers where you've got the machine and then you buy the little capsules. That's called a sunk money subscription because you've sunk money in the machine. You're way more likely to buy the capsules from the same company.
3. **Term Subscription.** Next step up the ladder is subscription revenue. If you've ever subscribed to a magazine you know about that. There's a start date and an end date to your subscription and the editors know that you're a subscriber for either a year or two years into the future.

Value Driver 5: Recurring Revenue

4. **Sunk Money Subscriptions:** One step up the ladder is sunk money subscriptions where you sink money into a platform and then you buy information or something on a subscription basis. A good example of that would be the Bloomberg terminal. Wall Street traders have the hardware, the physical computer, that sits on their desk that's called the Bloomberg terminal. They also buy the information on a subscription basis. So it's kind of mashing together two of these concepts, not only sunk money consumables but also buying on a subscription.
5. **Auto Renewal:** Auto Renewal is the next rung up the ladder where instead of having a start and a stop to a subscription, it's in perpetuity. For example, when you store documents with a documents storage company like Iron Mountain that's in perpetuity. Iron Mountain keeps the documents until you say you want them to send them back or shred them. They just keep billing you on a continuing basis. That's what we call “evergreen subscription.”
6. **Contract Revenue:** The most valuable form of reoccurring revenue is contract revenue, where a customer is contractually obligated to buy from you in the future. That of course is the most rock-solid form of reoccurring revenue.

To improve your score on this Value Driver, what you want to do is to try to walk up this hierarchy of recurring revenues. Think of it as a ladder and you are trying to move up the rungs on the ladder. If you've got subscription revenue today think if you could turn that into auto renewal subscription. Or, if you've got evergreen subscriptions could you make those contracts?

Once you have climbed up as high as you can now you want to focus on the proportion of recurring revenue. The ideal would be 100 percent. Very few businesses get there but the higher proportion of recurring revenue and higher up the ladder you go the more valuable your company is going to be.

Value Driver 6: Monopoly Control

Monopoly control is another very important Value Driver. Monopoly Control means that you've got control over how you price your product. You're not being commoditised because you're unique and different in a marketplace.

You've heard Warren Buffett, the famous investor, talk about this idea of having a deep and wide moat around your business. He's referring to the idea that he invests in companies that have a differentiated marketing position.

A lot of investors look for companies that have a differentiated proposition because that gives you an ability to control your pricing. The more you control your pricing, the more margin you make. The more margin you make, the more you can invest in sales and marketing.

And this triggers a nice little domino effect that enables you to stay different in the marketplace. Again, the more different you are, the more control you have with your pricing.

So the way you can improve your score on the monopoly control is to scrutinise the way you're marketing your business through two lenses. A marketing strategy has to have two attributes, it's got to be meaningful to customers and has to be different.

So scrutinise all the messages you have in the marketplace. Look at your website, the side of your vans, however you communicate to your market and ask: “Does this make us different? And do customers care?”

Those are the two drivers that drive up your monopoly.

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Value Driver 7: Customer Satisfaction

Customer satisfaction is an obvious driver of business value. How satisfied your customers are is going to be important to a buyer.

Because again, when a buyer buys a company they're buying the future. So when you leave, ride off into the sunset, they're going to want to know how is this business going to be performing when you, the owner, is gone.

To drive up your score on this attribute you've got to really quantify, empirically, quantitatively, measure customer satisfaction.

Probably the most well-liked, well-respected, way to do that is something called a Net Promoter Score. You can Google it later, but essentially you're measuring and benchmarking your performance on the likelihood that your customers are going to recommend you.

The more you have that data the more you'll know for your own peace of mind that your customers are satisfied. But for an acquirer, they will also be able to see that your customers are satisfied and likely to repurchase from you, which will lower the potential risk for the acquirer.

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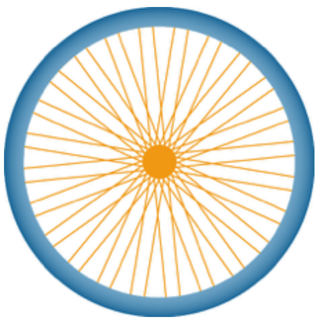
Value Driver 8: Hub and Spoke



The Hub and Spoke refers to how dependent your company is on you personally. Again, when the acquirer comes in to buy your business they will want to know how this thing is going to operate when you leave. The more dependent the company is on you personally, the lower you're going to score on Hub and Spoke.

The name comes from a conversation John Warrilow, the founder of the Value Builder System, had with a business owner over 20 years ago. The business owner was describing his role in the company: “I'm a hub in a hub and spoke model where all my employees come to me when they've got a question. My customers come to me when they need a quote. My suppliers come to me when they want me to buy something.” He was proud of that operating style saying that that's what makes his business efficient.

Well, it may be efficient but if you've ever flown through Heathrow Airport when there's a snowstorm and the hub breaks down and everything gets locked up – it's a disaster.

The same thing is true of a Hub and Spoke business owner. When everything is dependent on the Hub and Spoke owner or that Hub manager, then there's not much value left in the company.

The key here to improve your score on the Hub and Spoke is to make sure your business becomes less dependent on you personally. Start documenting processes and systems for all staff to follow. The ideal test is to take a holiday. When you return, find out where the business broke down and systemise it better. Keep doing this until you feel you can go away for three months with no worries.

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Now it's time to take the next step and get your Value Builder Score by visiting:

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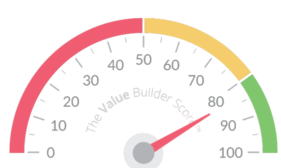
3 REASONS TO GET YOUR VALUE BUILDER SCORE

1. Make Your Company More Valuable Than Your Industry Peers
2. Discover Your Company's Hidden Assets
3. Spot Your Company's Silent Killers



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