

# How Much is Your Business Actually Worth?

Most business owners have no idea how much their business is actually worth.

To make matters worse, when it's time to sell, they often come up with a figure that essentially comes out of nowhere — it's just the amount of money they want.

And that's just not how selling a business works.

In reality, it's the market that dictates what a business is worth; however, there are some generally accepted methods of calculating the potential value of your business and determining what the market is likely to pay.

## Business Valuation Methods

Some common methods of determining the value of your business include the asset approach, the income approach, and the market approach.

### The Asset Approach

What will it cost to create another business like this one that will produce the same economic benefits for its owners?

### The Income Approach

Buyers ask this question: If I invest time, money, and effort into business ownership, what economic benefits will it provide me, and when?

### The Market Approach

Compares the business to other businesses that are similar.

Of these three approaches, the market approach is most common.

## How the Market Approach Works

Calculating the value of your business using the market approach uses the following formula:

Value = Earnings x Multiple

Earnings are predicted by looking at the performance of the business over several years.

The multiple is based on some things you can't control, like your industry, the economy, and capital markets.

Other influences include the amount of cash the buyer has and the terms of the agreement.

## Earnings

There are two perspectives on earnings — taxable earnings and earnings used for calculating business value.

Accounting systems are tax-oriented, and they focus on deductions. There's a significant advantage to running your expenses through your business to lower your taxable earnings.

Some deductions include:

- Bonuses to shareholders
- Inflated salaries
- Cars
- Phones
- Vacations

When looking at earnings for calculating the value of the business, we want the highest number possible, showing how profitable the business is. You have to adjust for expenses that the prospective buyer will not consider legitimate, like the above.

These are called add-backs. You can add them back into the earnings of the business and increase the value to a buyer.

## EBITDA

EBITDA is the basis for earnings when calculating the market value of your business.

EBITDA (Net Income) can be calculated like this:

+Interest Expense

-Interest Income

+Taxes Expenses

+Depreciation Expense

+Amortization Expense

This gives us a clear picture of a company's value as it helps us maximize earnings when trying to calculate the market value of the business.

## The Multiple

Your multiple is what you multiply your earnings by to get your market value. There are a few things that can drive this beyond those already mentioned"

- Differentiated market position — if you have a monopoly or a cornered market, your business is worth much more than average
- Lots of runway — there's lots of potential market share available, giving buyers the potential to grow the business
- Recurring revenue — recurring revenue helps buyers feel assured that the business will still be there once you leave
- Financials — size, profitability, and bookkeeping all play a role here
- The “You” Factor — if the business depends on you to thrive, it's worth less because once you leave, it might fall apart

Maximizing your earnings and your multiple are the keys to determining how much your business is actually worth.

## Learn How to Put Your Business in the Best Position to Sell

*Get a Grip on the Value of Your Business* is a course designed for business owners who are thinking about selling or exiting their business in the next 3-5 years.

Over a 6-week period, you'll progress through a series of short modules that will teach you, step by step, how to prepare your business for your eventual exit.

Ready to build your business' value?

Sign up for Get a Grip today