

What Would Your Business Sell For?

Determining Your Business Worth

Going through a process of business valuation is a requirement for [business brokers](#), sellers and buyers to determine the business worth. The key is to do things right from the very start and this means giving the idea of selling or buying a business a lot of thought and preparation with well-calculated assumptions designed to achieve positive results.

Every business is unique and there are no rules carved in stone to determine a business' worth. Some business sellers may assume that their business value depends entirely on strong business connections established through dedicated service to the customers they serve. Other business owner's may look back into their history and track record of high business income.

For business buyers, gauging a business worth is in part understanding the general economic trend and conditions that affects the competitive selling prices. How a business is being offered for sale also affects business valuation. A business buyer would think twice when presented with a fast sale in an auction situation verses a business offered for sale that is professionally presented with thorough and detailed offering memorandum designed to highlight the business strengths and the opportunities available to the would be buyer.

Simply put, the expected or assumed business selling price is what a business is worth. A well-thought of business selling plan by a professional business broker includes at least one of three basic methods in determining a business worth.

First method is looking into an overview of the assets and liabilities of the business in question and comparing it to a scenario of starting the same business from scratch. How much will it cost to start a new business of the same nature that can yield the same benefits as that of an established business for sale. The end result, which is the difference of this comparison, is the business intangible value.

The second method is reviewing the actual market place. Looking into the business comparable market value with businesses with the same products or services helps both business sellers and business buyers determine competitive selling prices and eventually satisfy their respective interests.

The third method is more popular with business buyers. It is looking into the history of the generated business income and applying the "what if" scenario. Here the practical reason for owning a profitable business is no doubt the end goal. Relative to this approach is taking risks as to what future benefits may be garnered. An experienced business broker uses two ways in using this method – capitalization and discounting.

The formula in capitalization is dividing the business' assumed earnings by capitalization rate. Assuming that the capitalization rate is twenty five percent, the business value is most likely four times the earnings per annum.

Discounting is done by projecting the generated income of the business over a defined time frame or holding period, and then determining the appropriate discount rate given the risks of getting the projected income over the specified period of time. The terminal value or final residual value (selling price) is then determined and the annual cash flows are discounted back to a final present value.

Both approaches serve their purpose for business valuation. The difference is in what income input to use. Whereas, capitalization utilizes one income measure, like the average earnings over a period of time, the discounting approach uses multiple income values over the years. Capitalization method is a good measure for businesses with a smooth sailing income yearly while discounting is best applied for businesses with variable income generation.

Measuring a business' worth using the income valuation yields different end results and is highly recommended by expert [business brokers](#) and business appraisers as the best method in determining a business worth. No two businesses are the same and the valuation method utilized should be chosen based on the attributes of each individual business.