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Part I: What do Potential Buyers Really Want from Your Business?

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Time and again, I've been approached by business owners selling their company who are frustrated by the lack of interest from serious buyers. My first question to them is whether they've pursued a certified valuation that will provide an objective analysis of their company's true worth.

I start there because more often than not, business owners overvalue the worth of their company. A savvy buyer can quickly sniff out when the asking price is more than the true value and walk away, leaving the seller frustrated and angry.

There are also many other issues that can impede a sale. It's important for sellers to take the time to understand what a buyer really wants in a company prior to establishing a price point. Along with asking an independent, certified valuator analyst (CVA) to determine the market value, owners who want to sell should consider these issues:

1. Profits

If your company isn't making at least 15 percent annual EBITDA (earnings before interest, taxes, depreciation and amortization) then potential buyers might ask themselves how they can afford to buy your company. After all, how can new owners justify the purchase if they won't be making a profit after accounting for their market rate salary, debt service and capital investment? If your EBITDA is below 15 percent you are likely looking at reduced sales price.

When I've explained to business owners whose EBIDTA is below that 15 percent threshold that it might be causing potential buyers to walk away, I sometimes hear the response: *"But the potential for higher profits is there…"*

My answer: That might be true, but an interested buyer likely won't ante up for "potential." The buyer doesn't want to pay more for a company that hasn't shown a profit through past earnings even if the seller and buyer agree the potential is there.

Another rationalization I have heard repeatedly: *"I have business expenses the new owner won't have."*

My answer: You need to disclose all non-recurring items you expensed to the business. The buyer will need to examine these expenses and confirm they can be eliminated from the EBITDA calculation. Some examples we've run across in our years as consultants: rent of facilities from a related party above the normal market rate; one-time professional fees; expenses related to a mother-in-law on the payroll; a condo in Florida; a family trip to Europe every year that coincides with a trade show; and a business owner paying himself a salary twice the industry average. Elimination of these expenses considered outside normal operating costs of a typical business will increase EBITDA and the selling price, but they must be disclosed, discussed and accepted by the buyer.

2. Proprietary product or intellectual property
Market research shows 80 percent of potential buyers want a product. They want something tangible, branded, and patent-protected. Products, after all, are a platform for differentiated growth. Buyers are also on the lookout for intellectual property (defined as technical or manufacturing processes unique to the marketplace). Business owners know when they have intellectual property that matters because they're the only (or one of the very few) suppliers of a service, product, component or assembly.

Keep in mind: When considering the value of your company's intellectual property, consider that intellectual property is hard to put a price on without something tangible — like a patent. Without some sort of tangible ownership of intellectual property, the competition could conceivably catch up tomorrow, which makes purchasing your business a big risk for a buyer to take.

3. Diversified customer base
Buyers want a diversified customer base. If one or two customers represent 60 percent or more of your business, buyers are taking a huge risk. After all, they could buy today and lose half the business tomorrow if one customer walks away.

While there's no magic number to what percentage of business a single customer should account for, the rule of thumb is 10 percent to 20 percent. There are exceptions: For instance, we frequently see buyers strategically target a business for purchase simply because they want to take ownership of that business's customer list. By buying a business already embedded in a streamlined supply chain, they can gain instant access to a customer they've coveted.

Profits, a proprietary product or intellectual property, and a diversified customer base will go a long way to gaining the interest of potential buyers. But those issues certainly aren't the only factors a potential buyer will take into account when deciding whether to make an offer on your business. I'll explore other important factors in a second article published in the next newsletter.