

Determine the Value of Your Business

Whether you run an independent brokerage or direct a team of agents, your business has a value. Here are some principles of valuing a business.

The value of business, like the value of anything else, is based upon the high price at which it will sell on the open market with a willing and knowledgeable buyer and seller. Several elements make up the value of a business.

Tangible Assets and Property

The tangible net worth of a business is derived from the combined value of the fixtures, furniture and equipment. Basically, it includes any tangible asset in the business function.

To determine the tangible net worth of your business make a list of tangible assets. These might include desks, chairs, computers and other electronic equipment, and an automobile. The more detailed the list, the better. Include the type, model, year made, manufacturer, cost and condition of each item. Taking photos of these tangible assets is also a good idea.

The tangible net worth is based on market value and not the depreciated value in relation to income tax or what the assets cost new. Many REALTORS® overvalue their tangible assets based on what they paid for them. Many items that make up the bulk of an agent's tangible assets lose value quickly. This is especially true of cars and computer equipment.

When a business owner also owns the land and building, they must be treated as one unit and the business is a completely separate unit. To determine the net profit, the business must be charged the fair market rent for occupancy of the land and building.

Annual Inventory Investment

A service business makes a profit by providing a service, such as a TV repair shop or a real estate office. The customer pays for a service performed. There is very little, if any, inventory.

For agents and brokers, however, the listings serve as a type of inventory. They have value and could be sold to another agent or broker.

Alternative Investment

Business buyers always have the option of investing their money in something other than the subject business. Appraisers who use a business develop a comparable investment rate of return.

Appraisers then add an annual yield from alternative investments of the tangible net worth, the yield from an alternative investment of the annual inventory and the normal annual managerial salary to

determine what the owner of the business could earn by working as a manager of a comparable business and investing the value of the assets. This gives a yardstick for rating the business against alternative investments.

Rating the Business Risk

When referring to business opportunities, we refer to the desired return as a "strength of profit multiplier." An investor invests money based upon a desired return. That return is based on the amount of risk in the investment. The greater the risk, the greater the desired return. Most investors expect a return of at least 20 percent or higher from the most profitable and secure business.

Appraisers divide businesses into six categories and assign a strength of profit multiplier to each. Each of these categories is analyzed based on the strengths and weaknesses of the business and given a rating between one and five. Here is an example of how each category is rated:

Income Stream--This consists of the depth and strength of the cash flow.

Competitive Edge--If a business is making a profit, competition is on the way. When analyzing the competitive edge, if the business is highly competitive and requires little capital or training to enter, a one or two rating is appropriate.

Demand--When analyzing demand, two factors must be addressed: future market conditions and the ability of a business to adapt to these conditions.

Image and Market Visibility--Two of the greatest assets a business can possess are a positive image and market visibility. When analyzing this, appraisers are concerned only with the amount of established repeat clientele and market visibility the business has created.

Growth and Expansion--There are only three directions a business's growth can travel: decline, remain steady or increase. Growth and expansion do not mean an increase in profit, they only mean an increase in production and distribution sites. If a profit is not being realized because of this growth and expansion, then the business must be responsible for the lack of profit and these factors must be addressed.

Quality of Lease--The success of a business will often depend on its ability to find, obtain and retain a desired location. For this reason, the quality of the lease has a direct effect on the continued success of the business.

Once all this information is gathered, the estimated value of the business can be determined. By understanding these principles and definitions, you should have a better sense of what your business is worth.

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