DO YOU KNOW THE VALUE OF YOUR FAMILY BUSINESS?
Robert Powell, FBA Accredited Adviser

It's not uncommon for a family-owned business to go about the day to day operations with little or no regard to the value of the business, let alone what could be done to improve that value. This can typically arise when the current owners plan to pass ownership to the next generation of the family; that is, no external sale is being contemplated. Even where the owners are open-minded about the possibility of selling to a third party, they are usually under-prepared when such offers come along.

A number of the issues that family businesses commonly struggle with can have a negative impact on value; for example, lack of proper systems, documentation or robust financial reporting.

Another relevant aspect is that directors of family businesses have a legal duty to act responsibly and protect the company's assets, which would include a duty to ensure that the value of a business is not allowed to dissipate due to the director's inaction.

How is value arrived at?

While there are many different valuation methodologies available, for profitable businesses with a reasonable track record, the capitalisation of maintainable earnings is a commonly used methodology. This is a 3-step process involving:

1. Calculation of a $ amount of future maintainable earnings (FME);
2. Identifying an appropriate capitalisation rate, ie a multiple; and
3. These two factors are multiplied to obtain the $ value of the business.

In the case of family businesses, some common deficiencies tend to crop up which can suppress the multiple and therefore, suppress value. Factors which influence the multiple can be classified into 4 broad categories:

1. Products & distribution – eg. does the business have time-tested products? Is the business reliant on one or two major customers or suppliers?
2. Management – is there an effective Board of Directors? Does the Board and management team include non-family members where appropriate?
3. Market position – how much of the market does the business control, and what is the scope to increase? Can a separate (saleable) value be attributed to existing brands?
4. Systems –Are the financial statements audited? Are all relevant systems properly documented and regularly reviewed and updated?

What should family businesses do to improve business value?

The two areas which family businesses tend to struggle with most are management and systems. A 2009 survey conducted by Family Business Australia found that over two-thirds of family-owned businesses do not have a formal board of directors; only 4% of family-owned businesses have a non-family director; and only 3% of family-owned businesses have a non-family CEO. In relation to planning, the survey reported that 66% of family-owned businesses do not have a business recovery plan. These are the areas which family business owners would be well advised to invest their initial efforts to improving, in order to have the most immediate positive impact on value.

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