Determining the Value of a Business for Sale (*Entrepreneur Magazine* – July 27, 2003)

I'm often asked this question: "If I'm thinking about buying an existing company, how do I counter the seller's 'official' asking price?" And this business finance question also shows up from the seller's side of the deal as well, when I'm asked: "If I'm trying to sell my firm, how do I effectively counter the buyer's offer?" Looking at the big picture, these two questions actually relate to the same fundamental concern.

First, let's take the position of the seller. It's fairly normal to expect that the seller of a business is responsible for getting the process started by listing an asking price for the business. The seller has all the insider information about the company's cash flows, assets, employees, contracts, legal affairs, financial structure, partnerships and other alliances. The seller has the most complete perspective on the true numbers that comprise the firm's valuation. In starting the process, the seller essentially says, "Attention interested parties: We believe the firm is worth this much, and we have provided solid, tangible evidence and rationale to support that figure." The biggest concern of the seller's valuation deals with disclosure.

There are four ways to view this. The value seems well-documented, offers good rationale and is presented with a solid disclosure to support that figure. The second is the other extreme, that the value comes across as poorly documented, with highly questionable and suspect underlying rationale, and is presented with minimal (if any) disclosure to the prospective buyers. The other views are less cut and dry for the buyer to approach. The value could be accompanied by several documents and a well-honed story to support the premise for the asking price, but when it comes to very specific, footnoted disclosure, the seller does not give away the details necessary for the buyer to weigh the pricing. The fourth way involves what appears to be a lot of disclosure, but the methodology and rationale on using all this disclosure are inappropriately applied and the valuation doesn't quite make sense.

The second position, that of the buyer, is similar to the seller's in that a value must be determined and then held to, even in the face of the other party disagreeing with that number. But while the seller has the insider information on the true numbers and detailed descriptions of the company's operations, the buyer is left to work with limited or speculative information only and must rely almost exclusively on his or her own due diligence in making the offer price to the seller. Many deals are assumed to begin with the buyer at a distinct disadvantage because of the lack of symmetry in the amount and credibility of the information available in assessing the value of the company.

Finally, they both want to know how the negotiation process should proceed given all the back-and-forth of asking prices and counter offers. The key here is that the seller usually tries to drive the negotiation process based upon the insider perspective brought to the table. For example, the seller can always say, "I know this piece of information is such and such, because I've been running the firm for the past several years, so regardless of what the industry averages are, this is the correct measure for this particular area." What usually happens is that the buyer must shore up the offering price by assembling a large arsenal of public information on other similar firms in that same market and industry. This data helps build a basic context for what a typical business (like the one under negotiations) sells for.

While the buyer insists that the deal be based on industry averages or "comparable" firms, the seller tries to sway that argument in favor of the unique nature and content of this particular deal. In the end, the best and truest value of a company is the one that both sides can agree to. So be prepared for plenty of back-and-forth, and always ask for new disclosures at each round. Every successive volley in the bid-ask process must open up new information to support the latest proposed adjustment in the pricing of the company.

If the back-and-forth can settle at a value where both parties feel comfortable, some of the negative concessions of these details can be resolved to some degree in the terms of executing that value for the deal. If the two sides cannot narrow the bid-ask spread sufficiently to close a deal (and this happens often), then it's best to walk away and move on to the next best potential deal, rather than hang on and try to make something happen where clearly there is no deal to be done.