Chapter 2 - Why valuing your business pre-sale matters

Speakers

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Transcript

Russell:
In chapter two, our industry and HSBC specialists take a more in depth look at the importance of understanding the value of your business. They discuss how this can help you to manage the information flow with potential buyers, how to handle unsolicited bids, as well as the sort of negotiation tactics that buyers may use to lower the price in a deal.

Andra:
So let's start chapter two by asking, why is it important for the seller to have a clear view of the value they expect to obtain from selling their business before going to market?

Paul:
It's really important for a seller to have a clear idea of what they're likely to achieve before they go to market. A sale exercise can consume a lot of resource, it can be an expensive exercise and it's certainly time-consuming. And on that basis, you don't want to be walking down that path if you know that the end result is unlikely to deliver what you need it to, or you thought it might.

Amar:
It's a bit like selling your house. You'll appoint an estate agent and you'll ask them what they think it's worth, but you probably won't take one at their word. You'll want to seek a second opinion. And there's a bit about looking at comparable houses until you have a view. And it's just like that. It's important for you to know what you think your business is worth before you go to market so you can benchmark the sorts of valuations you get. But I think the thing that's really important to note is, your business will be worth different valuations to different people. It could be really strategic - it could be your nearest competitor who's next door, who would be willing to pay a strategic premium. And knowing what some of those things are that could drive a different valuation is really important ahead of time so you can maximise those features during your sale process.

Paul:
So yes, get a very clear understanding of what you think that business might be worth before you start your exercise.

Russell:
Obtaining a valuation pre-sale provides a good benchmark to assess offers and manage your route to market. Setting your own expectations will impact how you influence those of your buyers. Now on that note, a business owner knows their business inside out as compared to the buyer who has a lot less information. So we ask our experts, can that information mismatch between the owner and the buyer lead to valuation gaps and what can be done to manage it?

Amar:
Bridging the information gap is the core part of the sale process, and often you need an advisor alongside you to help you do that. But usually it's focusing on what information a buyer needs at the start to build their investment case, i.e. understanding why they might want to buy your business, and then giving them the information to prove that. And then after that point, and you've set your valuation, giving them everything they need to finalise their due diligence. The way to think about it is when you are selling your house, you might write a brochure which has all the best features of the house or your business - to make people think - "I want to own that house or that business". And then they need to do a survey. Now you wouldn't put all the survey contents in your brochure because people don't need that, but you need to give it to them at the right time to make sure they're deliverable on the price they've put out in the first place.

Andra:
Now we move on to one of the most burning questions from business owners, and that's how to handle unsolicited bids. So how should a business owner react to receiving an unexpected bid?

Amar:
I think when receiving unsolicited bids, it's important to distinguish between opportunistic bids and strategic bids. Opportunistic bids are typically from people from the outside who may have admired your business and want to catch your attention. Often those valuations won't have enough information to be credible, but the interest could still be relevant. Alternatively, strategic bids are from people who already know your business, have a strategic reason to want to invest in or own your business, and have been thoughtful about what that business is worth to them. And so often their valuation may be more credible. The way to distinguish this is to read everything in the offer letter that's not the number - you know, how thoughtful have they been? Can they talk knowledgeably about your business and about the shareholders and what they might want to do? So reading around the number is really important to distinguish the credibility of a bid you may receive that's unsolicited.

Russell:
Agreeing a selling price is arguably the most difficult part of the sale, especially when buyers try to drive down the business's value. We asked what tactics might buyers use to lower the sale price and how should owners respond?

Amar:
I think the best thing a seller can do to protect value in their business is firstly, prepare - have a clear idea of what their selling messages are going to be in a sale process. And secondly, have the right data to support those selling messages. One of the biggest areas we see in value leakage is people not being able to support their selling messages with key pieces of data over a suitably long enough period of time.

Paul:
It's often the case that buyers will look to anything and everything to try and negotiate, renegotiate price as they move through a transaction. And there's certain things that you can do to stop that. Obviously, they'll be pointing to key things that have come out of due diligence, some current trading, or other areas that may relate to employment, tax, IP, or anything else. And the way to mitigate against this risk in particular is number one, to ensure there's some competitive tension and that the buyer gently knows that they're not the only person in the ring. And secondly, that you're not coming to the market at a point in time where you desperately need to sell because buyers will be able to sniff this.

Russell:
It's not a surprise to hear that some buyers are conditioned to try to lower your price, so it's good to hear experts' views on how to respond to this. Let's move on to the final question in this chapter, where we asked our experts, how should you respond if you get approached by different buyers with different ranges of values where the natural temptation is to go with the highest bidder?

Paul:
So it's often the case in the well-managed sale exercise that you will end up with a range of different offers for your business. Some will be higher, some will be lower, there'll be different terms, there'll be different chemistries. A whole range of things may be different between these offers. But if you said to me, what's the single most important thing to assess in advance of making a selection alongside pricing, it will be deliverability. It's the ability of that party to actually end up writing the cheque that they've promised and delivering it in a timely fashion. So deliverability is absolutely key.

Andra:
Listening to our experts, having a firm understanding of the value of your business before you get into a sale process is extremely helpful. Aside from managing your own expectations around what you might get in return for all your years of hard work, it sets the stage for negotiations and can help to speed up the sale process. Preparation is key - setting clear objectives, identifying your business's unique selling points and having the data to back them up, will strengthen your position, paving the way for a mutually agreeable outcome.

To listen to the other chapters in our 'How to Value your Business' episode, visit our **'Beyond Business Ownership'** series page on the HSBC Global Private Banking website.