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THE SMOKE AND MIRRORS OF BUSINESS EVALUATIONS

MANY BUSINESS OWNERS ARE LEFT QUESTIONING WHY, AFTER YEARS OF HARD WORK, THE VALUE OF THEIR BUSINESS IS HIDDEN BEHIND THE SMOKE AND MIRRORS OF GENERALLY ACCEPTED ACCOUNTING TERMS (GAAP) SUCH AS CASH FLOW AND GOODWILL.

*Doug Robbins has always said, since he started Robbinex in 1974, "**The true value of a business lies in the future profitability of that business, as seen by the buyer".** The intermediaries function is to illustrate and support that future to prospective purchasers.*

The secret to this smoke and mirror problem is Robert Kaplan and David Norton's balanced scorecard. It's a way to account for those nonfinancial assets a company builds up over time. It's a tool that predicts future financial performance rather than simply report what's already happened. And it's future performance that's the underpinning of a high business evaluation. It goes like this…

A business valuation is based on a company's ability to generate *future* cash flow. And, goodwill is an intangible asset that's only recorded at the time of sale. In spite of profitable income statements, managing intermediaries must see key performance indicators (KPIs) that capture future growth potential if a business is to be assessed with a high evaluation.

John Carvalho, President & Founder, Stone Oak Capital Inc. (Alberta) in his article 5 Tall Tales Entrepreneurs Tell to Bolster Business Value (2018), believes if owners can produce cold hard performance measures to three questions, then they are able to assess how much goodwill their businesses are accruing.

Voilà, that's the balanced scorecard approach. It marries goodwill with future cash flow.

Carvalho Questions	Balanced Scorecard Key Performance Indicators 2.0 (1992)
Can you demonstrate customer satisfaction based on customer surveys or statistics on attrition?	Customer/Stakeholder Perspective
Can you show sales performance indicators that prove your projected revenues are achievable?	Organizational Capacity Internal Processes
Can you measure brand value with a documented margin advantage over your competitors?	Financial Perspective

The Balanced Scorecard 2.0

Kaplan and Norton's four-perspective balanced scorecard is a navigation tool. It guides entrepreneurs to select financial and non-financial indicators from robust management information systems that result in sustainable increased profits, and customer satisfaction. It allows business owners to adjust production in real time and assumes a forward-looking outlook.

Customer/Stakeholder Perspective: How do the customers see you?

Assesses performance from the point of view of the customer. Key performance indicators:

- Value for money
- Competitive pricing
- Hassle-free relationship
- Value-added services that complement the customer's product

Internal Process: What must the company excel at?

Views performance through the lenses of production quality and efficiency, including:

- Estimation time on task
- Number of worker touches per job

- Data entry inefficiencies
- Reduce human and production errors

Organizational capacity: What must be done better tomorrow?

Views capacity from the point of view of improvements, including:

- Continuous improvements, total quality management. LEAN techniques
- Product and client service innovations
- Customer service improvements
- Employee training and development
- Employee salary, benefits and recognition

Financial: Is the company solvent?

Often renamed stewardship or other more appropriate names in the public sector, views financial performance based on:

- Return on capital
- Cash flow
- Per-job profitability
- Performance reliability

Balanced Scorecard 4.0 – adding the fifth dimension

But in today's digital driven Fourth Industrial Revolution, the speed of innovation evolves exponentially. The breadth and depth of these changes require that KPIs predict the nimbleness of a business to accept and integrate technology and automation into its production processes.

Deloitte's 2017 report, *The Fourth Revolution is Now: Are you ready?* proposes that at the epicentre of this storm is production. That implies there is a fourth question that has to be added to Carvalho's three questions plus a new perspective to the balanced scorecard.

Fourth Question	Balanced Scorecard
Can you measure the leaders' responses to rapid digital advancements?	Operations: How astute are leaders in switching to new digital advancements?

Operations: How do leaders address Fourth Revolution pressures?

Looks at the operation from these additional perspectives:

- Number of channels of information and influence
- Redesigning processes for automation – re-deployment of staff
- Number of seamless alliances and partnerships that complement the values chain
- Investment in lean technologies for reinvestment tomorrow

THE BOTTOM LINE
When the inevitable time comes for transitioning a business to a different ownership arrangement, and it will come, having key performance indicators that accurately capture the value of the business's tangible and intangible assets provides the managing intermediaries with the information they need to provide a realistic estimation of the selling price range, value enhancement opportunities, alternatives to selling, along with the ideal tax structure of the sales transaction. And, forward-looking KPIs give the intermediary the confidence to market a business through a future lens of where the business is headed rather than a rear-view mirror look of where the business has been.

About the Author

Caterina Valentino, PhD

Caterina is a contract instructor at the Ted Rogers School of Management at Ryerson University and the Faculty of Health Studies, Athabasca University. She teaches in the areas of leadership, management and diversity. She has held various senior leadership positions in the health care industry. She can be reached at caterina.l.valentino@gmail.com