ROBBINEX®
EXECU-BRIEF®
May 2021

Past Issues

Reduce Your Risk → Increase Your Value

By: Craig Nagel

When an owner begins to think about the next step for their business, thoughts quickly turn to considering the value of what they have built. Taking this to the next step and focusing on increasing the value of your business provides a wider scope of benefits to an owner than anticipated.

Exploring the idea of improving the value of your business can produce ideas in many different forms. All have the same goal: to reduce risk within the business. From the perspective of a business valuator (one of the many hats we wear at Robbinex®), reducing risk will improve the multiple applied in a valuation. In our language, this is represented by the inverse relationship between return on investment and earnings multiples.

At Robbinex®, our Company-Specific Risk Premium looks at eighteen different risk factors, split into two categories: Operations and Financial. Reviewing the side bar list of risk factors quickly leads one to realize that reducing risk in any of these areas may also improve profitability. Improved profitability plus a higher multiple will drive an increase in the valuation of your business.

Identifying and categorizing risks is a starting point towards successful risk reduction. Prioritizing where you are going to focus your mitigation efforts is made easier by ranking or measuring your areas of concern. Some areas of your business will be operating with an acceptable level of risk and not require further attention, while others will clearly identify themselves as areas of concern. The goal is to better prepare your Company to succeed through difficult situations. Risk will not be eliminated, but minimized.

Let us review a couple of examples that help drive home this point.

The 18 Factors of Risk

Operations:

1. Corporate History/Structure
2. Major Customers
3. Major Suppliers
4. Key Personnel and Employees
5. Major Competitors
6. Location/Facilities
7. Equipment/Vehicles
8. Product/Service Breakdown
9. Other Factors

Financial:

10. Quality of Information
11. Monthly Revenue
12. Net Working Capital
13. Accounts Receivable
14. Accounts Payable
15. Inventory
16. Profitability
17. Cash Flow
18. Expenses

An established business owner, with steady sales, sets an annual goal to achieve a 20% increase in monthly sales. When the owner evaluates their results the next year, they find the sales team has grown to include one more experienced team member, revenue is up more than forecast and profitability grew by more than sales.

A carefully implemented plan to increase sales reduced overall risk for the organization in at least three areas and their valuation will benefit by more than the annual impact.

A major appliance repair company proudly purchases all their service parts directly from the manufacturer, resulting in the business having only one established supplier. They feel strongly that their purchasing power results in better pricing, simpler processes, and the owner enjoys the annual reward trip. When the manufacturer exited the parts supply business, the Company was forced to begin purchasing from alternate suppliers.

One year later, the owner evaluates his supplier relationships and finds their purchases now come from three different suppliers and the benefits are plentiful: improved employee productivity due to more pickup locations, increased margins on part sales due to decreased costs, and improved cash flow due to faster warranty reimbursements from one of the new suppliers.

Each of these benefits also checks-off a reduced risk box for the perceived future value of the Company. A buyer is not interested in what the business did under the current ownership, they are more interested in what the business will do under new ownership. If the current ownership has reduced some of the risks before taking their business to market, that is less work for a new owner to do.

Risk mitigation changes need to deliver on the promise of less work for a new owner. Solving a labour shortage with temporary employees or deferring capital investments to improve cash flow can draw additional attention to an employee issue. Make sure changes implemented are done with the view that new ownership will accept the work as completed and will not need to spend additional time or capital to undo them. These changes also need to position a Company to prepare for and lessen the effects of potential threats. Ownership should never implement a change just for the sake of change.

Bottom Line

A business owner will never be disappointed by reducing risk in their Company. The measurement of success is an increased valuation. Adding risk mitigation to your mindset as a business owner goes hand-in-hand with increasing the value of your Company.

About the Author

Craig Nagel, Analyst – Robbinex Inc.
Craig joined Robbinex in 2020, bringing 25-years of corporate business experience. Holding a Masters of Business Administration (MBA) degree from York University, Craig uses a professional mix of experience and academic credentials to quickly evaluate new situations.

Craig can be reached by email at craig@robbinex.com

The Robbinex Mission

To assist clients who are considering transition to make

…the right decision at
…the right time for
…the right reasons™

by providing experience-based knowledge