

14 IMMUTABLE LAWS OF BUSINESS VALUE



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Businesses
Since
1989

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Based on over 20 years of
communication & business research

Introduction

In mid-February I found myself alone in the middle of the Yukon Range. It was after midnight and I stood looking at my frozen truck and freezing cold with soaking wet clothing. I had unexpectedly driven through a raging river. It happened on my way from Salt Lake City to Alaska. The river path was blocked by an ice dam that diverted it over the road. After scraping a quarter inch of ice off the windshield I continued on my journey. I traveled only a short distance and was faced with a similar situation and asked, what would be my next move?

Similar, business owners continually raise the question, "What should I do next?" After being involved in many business transactions and advising engagements since 1985 no single business has been like another, yet value principles and rules contained in this book have been my guide. What is your guide?

While advising client years ago, a professor from a well-known University overheard a conversation I was having and then asked, "Why don't you write a book?" I answered, "Instead of writing a book I wrote software with core value metrics so I could analyze business value and then apply principles and rules while measuring results." In answer to his question, this book is about building business value based on principles and rules that when broken business value lowers.

Now you will have a working framework for new initiatives or a business concern, not only typical cost reduction or productivity ways but using these principles and rules contained herein. Perhaps, previously you might have used or heard (different name) some of them but it's not the principles or rules that have changed—only dynamics of promotion or implementation of the principle has changed. And these rules are *by no means intended to be the only way business value could be achieved*, but they certainly provide a workable and measurable alternative that addresses elements of business value.

Finally, this book begins how to build business value based on principles and rules not a whim. Application of these principles and rules not only enable an Owner to achieve the "ideal business" model, but they also provide a workable and measurable way to address essential elements necessary to optimize business value.

Best of Luck,

David C. Whipple

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**Immutable Laws of
Business Value**

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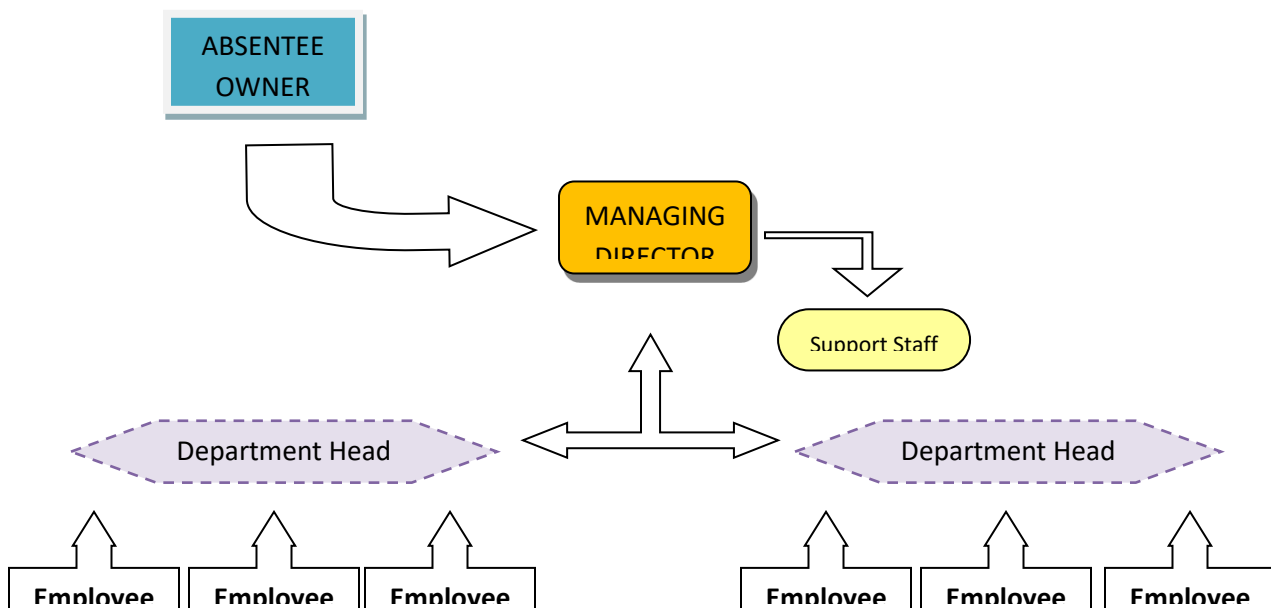
An “Ideal Business” Model

Every Entrepreneur must eventually position their company for either selling or closing the door. A business sells on the average of every 3-5 years, like a home sells about every 7 years or car 2.5 year (a good business). This requires the Owner (s) to sell their interest in the company and exit with their equity. Unfortunately they are either not positioned to realize full business value (diminishing their return on investment); or they are positioned and attract the interest of a possible Buyer but can't sell because the Buyer feels the Owner is too vital for success of the company. Or they want an investment not a job. Often times Business Owners are somewhere between these ever changing scenarios.

Unless an “ideal business” model is achieved maximum business value cannot be realized or the Owner does not have the option to step-out of the business realizing a good return on her or his investment. The most concrete foundation for positioning a company for sale is implementing methods and techniques necessary for an “ideal business” model. This model must comply with and be limited by the following three components in order to reach maximize business value.

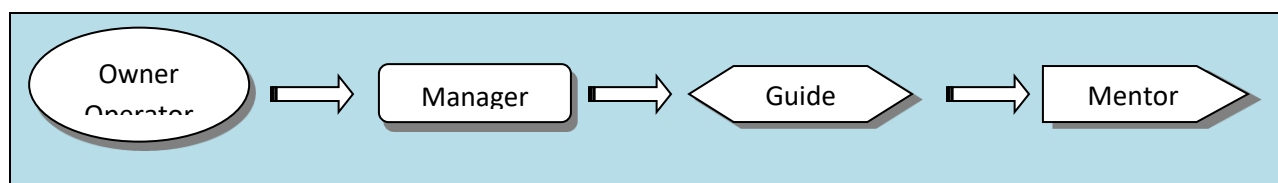
Component 1

The most essential attribute of an “ideal business” model is an owner free from business decisions. All management roles, responsibilities, tasks, and decisions of the Proprietor must be transferred to the managing director prior to achieving this model. The organizational chart below gives a human resource view of an “ideal business” model.



The “ideal business” model is the same for a traditional brick-and-mortar business or an Internet concern. Reaching a hands-free decision-making process means a Business Owner must find and groom a successor. Business Owner’s salaries range in \$100,000s and typically responsibilities involve many areas of the business. The new manager must be trained and able to successfully operate the business before stepping in. This must be proven with the proprietor having a limited role while making as few decisions if any while offsite.

Selection, training and handing reigns over to a successor are some often hard to accept and accomplish. For some companies this human reorganization involves revamping decision-making processes, matching personality traits, offering a compensation that will draw the necessary talent, implementing accountability measures, transferring information, changing roles and responsibilities and establishing essential functions. The chart below shows some of the main phases of this transition.

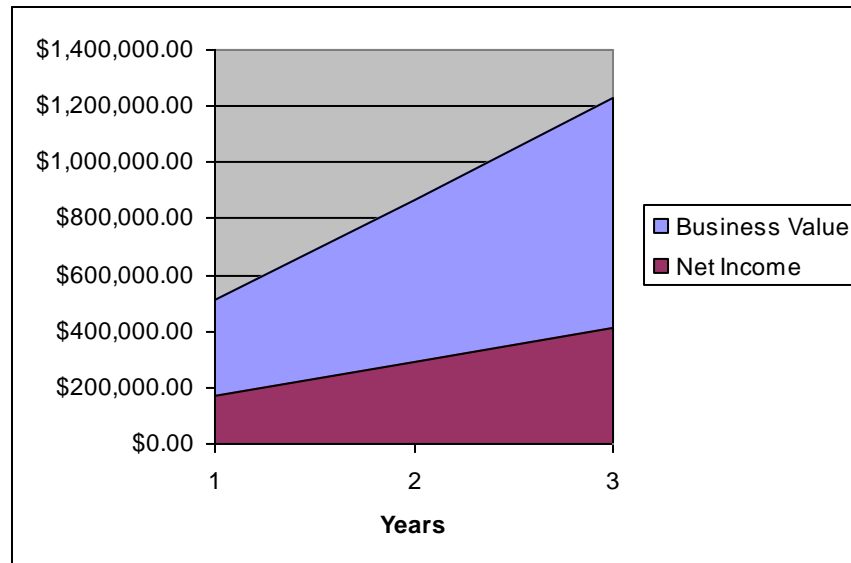


The successor selection process will not be an easy one. Many times the first choice does not work out. For this reason it is important to know that it is sometimes necessary to let go of a friend, move aside another manager, close down a position or make other highly sensitive changes. It will require sacrifices. It is highly recommended you get assistance from an outside party not associated with the business hierarchy or family traditions. This is one of the reasons for having a clear understanding of the purpose of the “ideal business” model and why it must be attained.

Component 2

The second attribute within the “ideal business” model is generating sufficient cash flow. This component is essential on several levels and the principal will be covered in greater detail in the next chapter. What is important to conceptualize at this time, is how it plays on the “ideal business” model in conjunction with the other two components. When a proprietor cashes in her or his earnings and places it in a retirement portfolio, a substantial time-frame shift for the

Owner occurs—sometimes saving as much as three times using a standard valuation method. See a representation of income to earnings in the chart below.



The chart above shows business net income (red) and business value using a multiple of 3 times EBITADA (blue) in a typical business. In the above scenario a normal business applied an earnings move with a customer base of 10,000 patrons. The formula for the move was based on increasing average purchase price and margin while lowering advertising budget. Each business is different requiring a unique earnings move based on principles and rules, along with other parameters to optimize business value required for “Time” in the next section. Make sure you have the numbers right.

Component 3

The third necessary component of an “ideal business” model is the business entity affording normal “TIME” to the owner along with the other components. Don’t forget the option of allotting “TIME” to sell the business for full asking price (this can sometimes take one to two years). And retirement time constraints. If business owners have sufficient cash (see Principle of Cash Flow) and a successor in place, they have time to do what they want, when they want. Business owners can only gain this freedom with an “ideal business” model. But remember, once acquired, freedom could be taken away with a poor decision.

In summary achievement of an “ideal business” model is when a business Owner is free from business decisions with sufficient cash flow while affording the owner “TIME.” These three components are required for maximizing business value and afford options. Savvy business buyers know and expect this type of absentee, owner-run business. They know there is not

enough cash flowing to fill the cracks of an owner operated business. Applying principles and rules found in this book will help you reach the “ideal business” model while maximizing business value and bringing retirement faster than other methods.

These are 14 out of 30 principles and laws of business value.

One principle or law could mean \$100,000s to your personal equity.

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