Value vs. price: some thoughts on the gap between business buyers and sellers

There is a scene in an episode of *Breaking Bad* where Skylar White makes an unsolicited offer to buy a car wash. She has observed the car wash for days and figured it's worth $875,000. The owner's knee jerk counter offer is $10 million (later raised to $20 million when he hears who the real buyer is). While somewhat melodramatic the exchange illustrates two very different takes on business value.

On the one hand we have Skylar's calculated approach where she has figured out cash flow, applied an "industry standard" multiple and added real estate. On the other hand the owner's reaction is that he has worked 30 years to build the business (and $10 million probably seemed a good number for his retirement).

Sounds familiar?

To start with it is important to distinguish between "value" and "price" (which ideally should be close but often aren't). "Fair market value" (the best starting point for a negotiation) is a notional value in a "fair" market where all parties are equally informed, equally motivated and at arms' length. Price, on the other hand, is what the business ultimately sells for in the real world. Price is impacted by the negotiating abilities of the opposing parties and depends on how motivated each party is to do the deal. It is also impacted by how well informed the buyer is. While it may be true that value is ultimately determined by what the parties settle for, it is important to recognise that buyer's remorse is a feature of many business sales.

Value is best understood as the inverse relationship between Opportunity and Risk.

Opportunity is what gets most business owners up every day. It's the chance to sell more widgets, open new markets, improve cash flows, and so forth. It's invigorating and mostly positive. It's the "beef" of the business.

Risk is what keeps the owner awake at night over worries about competition, employees, product redundancy, new legislation, economic changes etc. It can be discouraging and to an outsider it can be opaque.

Opportunity is relatively easy to quantify, risk much less so. Herein lies one of the main reasons that owner managers place a higher value on their businesses than outsiders would. Most owners know how to manage the weaknesses and threats in their businesses. Their perception of the risks is thus lower than the perception of an outsider. The value, therefore, is higher in their eyes than in the eyes of the outsider notwithstanding that they may agree on the opportunities for the business.

So what can we learn from all this?

Buyers: Do your homework before you make an offer and, most importantly, develop a complete understanding of all the risks in the business you propose to buy. You need to negotiate with informed confidence.

Sellers: Help the buyer understand how you have managed the risks in the past. If you can do this you should be able to reduce the perceived risks in the business and justify your asking price more fully. Better still find a way to transition the business in a way that allows the buyer to get to know the risks with you by his/her side during an agreed transition period.

Paul Maarschalk CPA, CA, CBV is a Chartered Business Valuator based in Kelowna. He can be reached on 778-484-5572