Where Transferable Value Comes From

One of the most important elements of a successful business transition is transferable value. No matter what an owner sees for the future of the business, transferable value can be the common denominator that makes all goals more achievable.

What is Transferable Value

Transferable value, for a closely-held business, is most simply what a business is worth to someone else without its original owner. Transferable value should not be confused with profit. Just because your company brings in millions of dollars of profit each year, does not necessarily mean it has transferable value. True transferable value in a business is determined not by how well you run the business, but by how well the business runs without you.

Business owners aren't always aware that transferable value is more than a formula involving multiples of earnings or some calculation of discounted future cash flows. To get a more accurate representation of the current state of your company's transferable value, you can start by asking yourself a few questions:

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- If you permanently leave your business today, would it continue with minimal disruption to its cash flow?
- Who will be responsible for running the business without you—and with minimal disruption to cash flow?

Value Drivers

One way to start to build transferable value is to evaluate your value drivers. Installing and enhancing value drivers can help create a company that can be transferred to someone else (whether that's the next generation of family members or an outside third-party buyer)—without the owner—with minimal disruption to its cash flow. Some examples of value drivers that you may need to focus on are:

1. Next-Level Management
2. Operating Systems Demonstrated to Increase the Sustainability of Cash Flows
3. Diversified Customer Base
4. Proven Growth Strategy
5. Recurring Revenue That Is Sustainable and Resistant to Commoditization
6. Good and Improving Cash Flow
7. Demonstrated Scalability
8. Competitive Advantage
9. Financial Foresight and Controls

One might measure the effectiveness of value drivers in two ways:

1. Their positive contribution to cash flow.
2. Their ability to continue to contribute to cash flow under new ownership.

A company with strong value drivers might demand (and receive) a higher multiple on the same amount of EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) than a company with weak or non-existent value drivers.

Build Transferable Value with Your Management Team

Building a management team that you can confidently leave your company with can be challenging. You may want to create a loyal "next-level" management team that will not only maintain the value of your business but is just as motivated as you are to grow the business to new heights. Understanding where your company may have weaknesses is an important step in knowing the type of person you will need to attract to help fill the gaps. It's worth it to ask yourself whether you are focusing on attracting people with the skills sets the company needs to accomplish growth independently from the efforts and resources of the current owners. Establishing this highly qualified team long before you are thinking you'll transfer the can give them the time and space to prove their ability to perform.

Attracting the right team is the first step, retaining the team long after your departure is the real task. To hold onto these vital team members, they may require more money or some percent of ownership as a condition of employment. Creating an effective incentive plan that fits the needs of your team is the best way to ensure your management team stays in place and continues to increase business value after your departure.

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