

Building value

***A benefit of the Business Improvement Process
and the Financial X-Ray***

“Let’s chat” series

*You are growing your
family business but are
you growing its value*



The main focus for most managers and owners of private businesses is on growing their bottom line. Unless they are preparing for a sale or transition, few are focused on building the value of their business. "A lot of owners think about maximising profits, repaying debt or growing their bank balance, but not about building lasting value in their businesses" - Stephen Beach, Partner

For privately owned businesses, the concept of value is different from other types of businesses. While the value of the business is ultimately what another person is prepared to pay to acquire that business, that value typically represents a large amount of the owner's personal wealth, in most cases this represents their life's work. The transition of the business' ownership often comprises the owner's retirement plan.

From this perspective it is important for the owner to maximise the value of their business to ensure that it provides them the lifestyle they want or that it sets up the next generation with a strong foundation to continue their work.

From the business' perspective, growing value can play an important role in enticing new investors, strategic joint ventures along the business' supply chain, as well as attracting and retaining key talent.

Without knowing the value of the business it is hard to ascertain what could be done to grow that value. That's because growing value begins with an accurate assessment and understanding of your business's current value and then setting a goal for what you want it to be within a certain time frame.

Unless they have gone through the experience of a business sale or purchase **transaction**, it is

unlikely a private business owner will have a good understanding of what the actual value of their business is. "A lot of private business owners and managers know how much they owe their lenders, and how much cash they have in the bank, but when asked, what is your business worth, unfortunately many people hesitate", says Michael Collins, Senior Manager.

Solid business fundamentals are critical to growing value. Building value is about having a solid business strategy supported by effective operations and motivated managers. "When there is need for improvement, most owners immediately think about sales and product performance" says Beach. "But they really need to consider the quality of their business processes and people". By linking the business strategy with effective performance, management capabilities and processes, it facilitates in growing the business' value.

At PwC we use our Business Improvement Process (BIP) to assist the owner or management team to build value. The purpose of the BIP is to get the business to focus on the big picture, while employing the necessary controls to manage ongoing business performance. The BIP consists of four stages - explore, change, grow and renew.

The starting point is to explore where the business is at now - its financial performance, financial

health and key activities. "Most business owners or managers will usually be supplied a monthly profit and loss, balance sheet and cashflow statement. However, these rarely provide enough information to know how the business is really performing", says Collins.

The Financial X-Ray takes the information from the monthly accounts and performs a high-level financial analysis focusing on margins, working capital, return on capital and free cash flow. Once the initial Financial X-Ray has been completed, a further analysis is performed based on the key activities of the business. This Activity Based Management (ABM) reporting is a powerful tool which breaks down sales, expenses and profit by unit of activity. This information is compared against previous periods and budgets to determine trends and then utilised to influence and guide future strategies for improved financial performance. "With the Financial X-Ray and ABM reporting, we make the invisible visible", says Collins.

Once the explore stage is completed the focus shifts to change, which is done through creating a strategy plan or strategy map. Maximising annual profits is obviously important, but for building business value you should set longer term strategic goals and objectives in order to create a plan for long term success. "It's rare that you see small and

medium sized business prepare a strategic business plan, but an owner should be able to speak to the primary components of a strategic plan. We help clients set strategic goals and develop plans to ensure goals are met”, says Beach.

Once the strategy is set the next step in the BIP is to focus on performance management – creating the link between the strategy and the setting of goals and objectives for both the short term and long term. “We work with the owner and management team to execute on their strategy as this is an area most businesses don’t spend enough time” says Collins. This growth is achieved by the improvement of key business processes in the 5 main functional areas of sales/marketing, people/HR, finance, operations and governance . The processes are typically broken down into two levels.

The first level is the overall summary and is used to understand, map and measure key business processes to improve operational and

financial performance. This provides the owner and manager a snap shot of overall process responsibility and actual performance against the target set.

The second level is a deeper dive into each process that sets out the activities that comprise each process and assigns individual responsibility for both performance and review of each activity. This provides not only the business owner and manager the understanding of how effectively the activities are being performed, but also the individual performing the tasks. This can empower the individual to suggest or make changes to the activity they perform. “When you empower your employees, you are creating long-term value,” says Beach.

Building value takes time, which is why the final step in the BIP is to renew. This moves the focus of the owner and manager back to the strategy to start the process again. In fact, it will likely take between two and five years to effect the strategic and operational changes necessary to

significantly enhance value so don’t leave until tomorrow what you need to start today.

For private businesses there has to be a clear distinction between business value, which includes goodwill, versus the personal value and goodwill associated with the owner. “The value of many businesses would decline sharply if you took out the owner, as they have the personal goodwill tied up in their long term business relationships and trusted expertise”, says Collins. Building value is about building an excellent management team that can carry on the continuity of key relationships if the owner wasn’t there.

If you are interested in learning more about how the BIP and Financial X-Ray can assist you in creating or building lasting value in your business contact us at PwC PNG to make an appointment with our Private Clients team.

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Contacts

For more information about how we can help you, visit our website at <http://www.pwc.com/pg/privateclients> or contact our Private Clients team.



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