How much is the store really worth?

Have you ever looked at buying a store or selling the business and not known what is even meant by goodwill, let alone understand how a value for this goodwill is calculated?

To the ordinary person, goodwill generally means a business has a favourable reputation. Goodwill exists whenever a business is sold for a price in excess of the fair market value of the assets. An accountant or business valuer puts a dollar value on expected future earnings over and above required earnings.

In other words say a store makes $20,000 a year after the owner payed themselves an appropriate salary and provided for a realistic return on the money they have invested in the business. The reason they are generating this $20,000 could be because they get on so well with the farmers, they are in the right spot, their efficient, and their management is superior act. And all this comes under the umbrella - Goodwill.

OK. So how is goodwill calculated in $ terms? Let's look at five steps in turn, using on method: the super profit method:

Step 1

Determine the value of all the tangible assets eg cash, stock, cars, money owed (debtors), fixtures and fittings, Say that these come to $180,000.

Then find out what the business owes (liabilities). These include an overdraft, loans, and creditors. Let's say these come to $80,000.

Now

Assets - Liabilities = Owners Equity (or net tangible assets)

So: $180,000 - $80,000 = $100,000

Step 2

Let's take that $100,000 and estimate how much it could earn if you invested it elsewhere with roughly the same risk, taking a reasonable conservative return of seven % - that would be $7,000.

Step 3

Now give yourself a salary for running the business. Make it an amount you'd have to pay someone else to run the business, say $40,000.
Add step 2 and 3 together.
That equals $47,000.

Step 4

Determine the three previous years net profit and average it. For instance, let the average profit be $50,000.

Step 5

We can now calculate a value for good will.

Net profit last three yrs (average)	minus	salary to yourself plus what your money could earn elsewhere	=	Super Profit
$50,000	minus	$47,000	=	$3,000

How long can anyone buying the business expect these super profits to continue?

This is profit above what comparative business are making and is due to the goodwill of the business. The continuation depends on how risky the business is in the market place.

To work out what figure you can add to the business for goodwill, we'll have to use a risk or capitalisation factor to bring these super profits over the next three to five years back to a present day value - because that the value we want o know if we're buying or selling. Say the business your in has a capitalisation or risk factor of 25%. A business is not a risk free venture and so a component to cover this risk has been added to the safe return rate. Using what called the capitalisation method, we can find (at last!!) the expected value of goodwill for the business.

To calculate the goodwill using this method take the super profit ($3.000) and divide by 25% or 0.25. This gives you a goodwill amount of $12,000.

Valuing the assets of a business (including the goodwill component) is not an easy task. Goodwill adds considerable value to the business and it's worth seeking help from an account or business adviser if you're thinking of buying a business.

Ultimately, however, as I sure you're aware, a business is worth only what someone is willing to pay for it at the time of the sale.

COST. WHERE CAN YOU MAKE A SAVING IN YOUR STORE

Every year most owners and managers review the profit and loss statement provided by their accountants or head office and say with conviction "Profit would have been better if it wasn't for the costs." The cost of what? Obviously total costs are made up of smaller individual expense items and these items contribute to reducing the net profit we actually see at the end of the year.

Where does cost control start? With you, the owner/manager. It is up to you to keep your finger on the pulse of business costs as well as to provide both insight and example to staff on cost saving methods.   Cost control comes in many different sizes and shapes, from a few cents saved on turning off unnecessary lights to thousands of dollars saved by smart buying. Each contributes to the reduction of costs and hence a larger net profit at the end of the year. Costs are classified as direct variable costs, dependent on sales, such as cost of stock, freight and handling; and fixed or semi fixed costs not dependent on sales but still a cost such as rental, rates, wages, and salaries.

Cost control has the most dramatic effect on profit in the cost of stock. Too much stock causes increased costs in the capital outlay for stock, increased bank interest to cover the debt, extra insurance to cover the added value, extra staff to handle the added volume of merchandise and ultimately the added costs to cover the loss of product from damage and deterioration. How does one get to much stock? Generally it is due to an unclear plan of the purchases needed, and a little bit of good salesmanship by the reps. How

many times has the rep offered a deal that you just couldn't pass up, only to find the item still on the shelf, in abundant numbers six to nine months later? You may not be aware but there is an opportunity cost in investing in stock. If you are aiming for a 25% return on funds, invested in the operation, this equates to 25%/12 = 2% per month. The money invested in the stock could be used elsewhere in the operation. A crucial first step to cost control for stock, is to know how much stock you will need during the year and to plan your purchases. With this knowledge in hand you can then start looking for ways to reduce your costs. Costs of goods can be reduced in a number of ways, such as utilising discounts on bulk orders, discounts for early cash settlement, consolidation of orders for freight and handling. A routine as simple as weighing inbound and outbound freight to insure you're being charged the correct amounts or a system to ensure staff are correctly checking in stock can save thousands of dollars a year in product costs.

Very little can be done to reduce costs on the individual expense items such as rent, utilities, and rates. Sound judgements and common sense need to be mixed in equal portions to arrive at the correct strategies for reducing costs in most expense areas.

Obviously you can't switch off all the lights to save the $ in electricity costs without your customers thinking you're closed or out of business. The same holds true for telephone costs. Are there ways to decrease these costs through planning or training? Staff can be encouraged (or trained) to turn off the extra lights in the stock room and loo, or to restrict out bound calls to business, or to have a check list of items to cover during the call, so as to

decrease the amount of time spent on the phone. Staff costs generally seem to be the item that comes up most often as a way to cut expenses. If staff wages and salaries are of concern, you should be looking towards what these costs reflect, total staff numbers and the productivity of the staff. Do you have too many staff? Could the full time position be replaced with a part time casual or junior position? How productive are the staff with their time (your time)? Do you see groups of people chatting to each other, while customers or work waits? Is there a tendency for the 1/2 hour lunch to stretch to 45 minutes and the smoke break to get longer every day? Perhaps no more staff is needed, maybe the ones you have need to be more productive. The old adage "Time is money" comes into play here. Are you paying staff to play?

Other line item expenses can sometimes be reduced by putting to "tender" the fact that you are shopping for rates on such items as insurance, equipment leases, rents, even cleaning services. Costs need to be assessed on an individual basis for each item and a decision made on whether there is a way to reduce the expense by either staff or purchase decisions. If the staff is to be involved, they need to know the reasons behind the actions, so they can make this effort part of their motivation rather than having it be a directive from the boss.

Strategies to reduce cost should be an integral part of each re-sellers yearly plan and be reviewed on a monthly basis to see how well the plan is proceeding. If the strategies are not working, the question needs to be asked as to why, and a decision made on how to improve the situation. Given this

process you at least have forced yourself to be thinking about possible solutions. This is also an excellent time to call in the assistance of the staff to help with the problem. You might be surprised; they could have a solution to the problem that has eluded you for months.