

Bridging the Asking and Offered Price Gap

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A business rarely sells at the asking price, even when sellers arm themselves with a professionally performed valuation. In general, the economic value of a business is reflective by its worth in an open and competitive market. However, other forces are in play and understanding the rationale and perceptions that influence price and value determination by buyers and sellers may help a deal reach fruition.

While sellers tend to take the optimistic “Pie-in-the-sky” premise, the buyer’s approach is more practical and cautionary:

What determines the seller’s value?

- Similar businesses produce similar utilities
- Long-term efficiencies may be maintained or increased after transfer of ownership
- Value is independent of economic and product life cycles
- An exchange-value exists and FF&E help determine value
- Companies within an industry command a uniform and homogeneous value
- State, completeness, and accuracy of financial statements
- Existence of off-books revenues
- Seller’s motivation
- Lenient recasting of financial statements
- Seller’s sentiment influenced by greed
- Expectations based on future personal financial needs

What determines the buyer’s price?

- Supply and demand market forces negates comparability
- Long-term efficiencies are unknown. A Pay Back analysis is more appropriate than a discounted cash flow analysis
- Price is directly related to adequate debt service and an expected reasonable compensation (Benefit to Owner) to the buyer
- Business assets may be utilized differently. FF&E has little or no value
- Perceived value (listed price) is always higher than actual price since the seller inflates value to allow for negotiation
- Restrictive recasting of financial information
- Buyer’s sentiment influenced by fear
- Post-acquisition operational and financial results are expected to decline in the first year due to learning-curve pressures and unfaithful customers, leading to greatly reduced financial projections and acquisition price

In addition, factors such as relative bargaining positions and skills of either party will influence the final price.

Some gaps may be bridged by explanations and reckoning. Benefits to Owner, which is a key element for both approaches, is a good example for differences reduction through logic and rationale. Another example is a well-prepared and supportive due diligence package that may help reduce emotional arguments and uncertainties. Supporting material acts as a great “confidence builder” between the parties. Supportive information and techniques may include:

- A comprehensive informational memorandum that portrays all aspects of the business including history, industry’s current state and outlook, operations, management, marketing, customer base, and financial projections
- Tax returns that reflect the true activity of the business
- Pre-qualify the business for financing
- Seller agreement to hold a note
- Attract many buyers to create a sense of competition for the business

Pre-qualifying a business in effect establishes an independent, third party valuation for the business. The loan to value ratio used by the financial institution determines a value by default, which may support the value perceived by the seller. The seller's agreement to hold a note provides a sort of "warranty" and also indicates a level of confidence in the business's strength, while reducing the buyer's required equity investment.

In summary, understanding the fundamental factors that influence a seller's determination of value and a buyer's market determination of price will help bridge the gaps between the two. Information is a key element in a typical deal as it provides a countermeasure to market forces and relative bargaining positions. Partial, incomplete or lack of information tend to shift attitudes from rational to emotional, thereby adversely influencing the buyer's perception of intrinsic value and weakens the seller's bargaining position.