DOES SIZE MATTER? (Part 2)

In our last newsletter (June 07) we referred to research on valuation of businesses by the USA writer/researcher Shannon Pratt in which he concluded that the size of a business had significant impact on key valuation measures.

We also stated that evidence from the Bizstats data base of NZ business sales confirmed this overseas research and we offered some reasons for the impact of size. (This newsletter is available on our web site www.bizstats.co.nz)

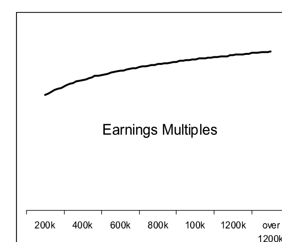
In this months article we show some of the empirical evidence from the Bizstats data base to demonstrate the effect that the size of a businesses **EBPIDT** (Earnings Before Proprietors-income Interest, Depreciation & Taxation) has on key valuation measures.

Here are 5 ways in which higher EBPIDT's may affect the valuation measures:

1. The Earnings Multiples tend to increase.

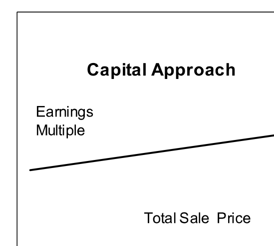
The earnings multiples tend to increase as the size of a business increases.

However, as the size of a business grows from an 'owner/operator' valuation basis and returns on investments in assets assume greater importance; the growth in the earnings multiple tends to level out,



2. The Capital Approach.

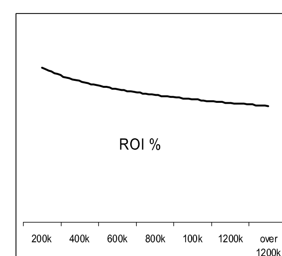
Businesses which sold for the highest prices, tended to have had the largest earnings multiples.



3. The ROI % tends to reduce.

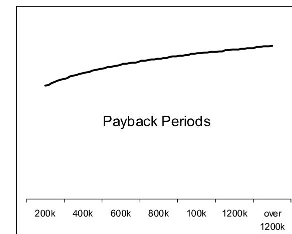
Consistent with the points made above, the ROI% of a business reduces with size and tends to level out to an 'investment' rate of return as the EBPDIT's of businesses increase.

At the top end, the largest businesses in our data base showed similar ROI%, regardless of business sector.



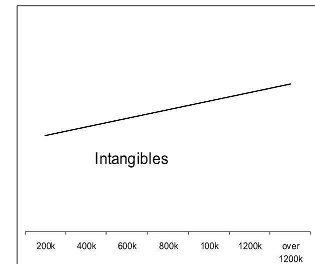
4. The Payback Period of a business tends to be longer.

With higher earnings multiples and lower ROI%, the payback period for larger business tends to be longer than for smaller businesses.



5. The Intangible Assets increase as a % of EBPIDT

The value of the Intangibles expressed as a % of EBPIDT show an upward trend as the size of EBPIDT increases. The data shows a lot of variation, but the overall trend is very specific.



The value of intangible assets is not independent from other assets. A business that is overcapitalised (plant/inventory) may have a lower intangible asset value as a result.

The above points are inter-related, but the data clearly demonstrates the different valuation features for large and small businesses.

Smaller businesses are more focused on earning a salary for the owner, and the investment in assets is less significant.

Larger businesses have higher investments in assets (tangible & intangible) and the need to earn a yield on those investments, may be as important as providing an owner/operator's salary.

Larger businesses also tend to have a different risk profile compared to smaller businesses. A larger business is more likely to have well documented systems and procedures, patents /brand names, contracts for supply and sales, an assembled and trained work force. It is less dependent on the skills of a single owner/operator. These and similar factors put larger businesses in a different risk category to smaller businesses, and are reflected in the key valuation ratios.

SIZE MATTERS in the valuation of SME's in New Zealand.

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