What's It Worth?
Business Valuations, Mergers, Acquisitions, and Consulting
NEWSLETTER ARTICLE ARCHIVE

What Is My Return On Investment?

This question "What is My Return On Investment?" is many times overlooked – by the individual buyer who is looking to purchase a job; also by the synergistic buyer that has over estimated the "synergies" of the add-on purchase. On the public open market, operating companies can expect to achieve reasonable returns for their shareholders, while in smaller businesses, shareholders look for a lifestyle and job as much or more than a return on their investment.

Various studies suggest that both Main Street buyers and Middle Market buyers look for a pre-tax return in the range of 30%. Manufacturing companies will be in the lower range and service companies in the higher end of the range. To see where your Company or Target Acquisition Company stands the first step is to develop the profit/dividend that is available to the owner of a Company. This can be tricky and the following adjustments may need to be made to Net Profit:

- Tax reduction tactics – discretionary expenses;
- Cash accounting vs. accrual accounting;
- One-time expenses booked in the accounting year and
- Depreciation expense adjusted to the true economic life expense of fixed assets
- One owner's reasonable market rate salary adjustments

Discretionary adjustments address how the shareholders apply expenses to the Subject Company due to personal or tax driven reasons. In the United States, the typical goal of a closely held company is to make profits. Sometimes with smaller companies, the goal is to make just enough profits to provide a job for the majority owner. However, when it comes to paying federal income and state income taxes, the company's objective is to pay as little as possible and keep the profits for the stockholders. This scenario creates needed adjustments to remove tax-reporting strategies. Other discretionary adjustments are driven by personal issues of the shareholders, such as paying a family member more salary than justified by the fair market rate.

Once the typical annual profit has been determined, you have to determine the total investment into the Company. Pratt Stat's defines Market Value of Invested Capital (MVIC) as the total consideration paid which includes any cash, notes and/or securities that were used as a form of payment plus any interest-bearing liabilities assumed by the owner. MVIC would also include the non-compete value and the assumption of interest-bearing liabilities if the Company were purchased and excludes (1) the real estate value and (2) any earn outs (because they have not yet been earned, and they may not be earned) and (3) the employment/consulting agreement values.

By dividing your profit by your investment/MVIC you will find your true ROI. The bottom line is this: if your Company is at its peak health, the ROI will typically be in the 30% range and the salary you draw from the Company for the work your perform will be at the current fair market rate for a typical employee performing the same tasks.

For help in determining your ROI, please feel free to give Capital Endeavors, Inc. a call.

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