How To Evaluate The Worth Of An eCommerce Business

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December 27, 2016

So you may want to sell your eCommerce business…

Or maybe you want to buy one, and you don’t know how to tell what it’s worth.

Naturally, you wouldn’t want to sell your business for less than it’s worth. And you certainly don’t want to overpay for a business that is worth much less.

So how can you evaluate an eCommerce business to understand what it’s worth?

Digital Consultants know that every business has a fair value, which a seller and a buyer can use to negotiate a final deal. There are a number of valuation methodologies you can use to determine the fair value of a business.

Let’s take a look at what it takes to fairly evaluate an eCommerce business for its worth. Valuing a business takes careful calculations and access to vital information, and what we’re offering isn’t a direct how-to. However, knowing a few basic valuation methodologies can help point you in the right direction, and help you make an informed decision before buying or selling a business.

Ecommerce Business Valuation Methodologies

There are a few ways you can determine the value of an eCommerce business. Each uses different factors to determine worth, and some methodologies are better suited for certain situations than others. The type you choose will largely depend on the business in question.

Multiple of Seller Discretionary Earnings

You might evaluate a business's worth by looking at its historical earnings. Start by looking at the business's net profit for the past ten months, then multiply it by a given number (typically between 1.5 and 5, depending on the situation). The result is the company's valuation.

Let's look at an example: an online shoe store made $50,000 in net profit last year. Based on the factors at hand (for the sake of the example, we don't know those factors), this number will be multiplied by 2. Therefore, the business's worth is $100,000.

The multiplier is determined by a set of factors that the buyer, seller, and broker agree on. These factors can include scalability, the workforce required to run the business, and the company's past growth. When favorable factors are agreed on, the business's expected worth will be higher during the valuation.

Discounted Cash Flow Analysis

Discounted Cash Flow (DCF) Analysis isn't the primary way to evaluate the worth of an eCommerce business, but it is a useful analysis.

The DCF analysis aims to show what a company will be worth in the future. It's the estimated return on investment for purchasing the company, adjusted for time and inflation.

A DCF analysis is best suited for traditional businesses with a stable history. Online business sales fluctuate more widely than those of traditional businesses, which makes this analysis less suitable for eCommerce. However, it can offer a decent look into what a company will be worth in the future, whether or not the projections are as accurate as they might be for a traditional business.

Precedent Sales

One way to value a company is to look at the price of companies in similar markets, and what they're selling for by comparison.

This metric should never be used solely to determine a company's value, but it can offer some helpful insight into what it's worth. But before you can look at precedent sales by comparison, you need to know which companies are worth being compared to.

Identifying relevant precedent sales is reliant on a number of factors. These can include a company's size, years in business, yearly revenue, and so on. Similarly sized companies can be evaluated as relevant precedent sales.

Precedent sales are used as much to determine an online business's value, but to provide a reality check to both the buyer and the seller. Both parties may have an inappropriate number in mind for the company's value, and precedent sales can help both parties understand what a real expectation for value might be.

Understanding Valuation Factors

No matter what methodology you choose, there are certain valuation factors at play when you determine a company's value.

Customer Base & Market Outlook

A company with an active customer base and positive market outlook will be worth more than a company without active customers or a profitable niche.

An active customer base means the company has a plethora of repeat customers, and buyers come back to make repeat purchases regularly. When a company has an active customer base, this shows their products are of quality and buyers are interested in working with them over a period of time.

By comparison, what does it say when a company sells a product once and the customer never cares to come back? This will be the case for some shoppers, but if no one is returning, it may be a sign customers aren't happy with the products their getting.

Customer base factors can also include:

> - Size of a company's email list
> - Churn rate
> - Uniqueness of customer base
> - How quickly the customer base is growing
> - Number of competitors in the same market, and how they stack up
> - Costs of acquiring new customers for the company

Brand Recognition

It's more profitable for you to buy a recognizable eCommerce brand than one without a well-recognized brand identity. Identifiable brands tend to have larger customer bases and will prove more profitable to you as a result.

Branding is absolutely crucial to any eCommerce business otherwise, the only way to compete is by offering the lowest price on a product. However, good branding can mean a loyal and growing customer base, as well as an already-established presence on the web and social media.

Established brands may also rank more highly on Google because of their recognition. This is invaluable to you as a buyer because you're getting a head start on important organic exposure.

Store Traffic

Ecommerce stores rely on traffic. The more people visiting your store, the more likely you are to make sales.

Online businesses with high daily traffic are considered worth more than those with lower numbers. More traffic means more exposure, which again means more sales.

Because traffic comes from many different places, and spikes in traffic don't necessarily translate to spikes in sales, more traffic doesn't always mean your company is worth more. Ideally, you should have high paying traffic – those who come to your store and actually make a purchase.

Operating Costs & Financial History

Like any other type of business, eCommerce stores require some kind of overhead to keep their doors open. Before you buy a business, you need to know what it's going to cost to keep it running, and how profitable it will be for you once the overhead costs are met.

Some operational costs and factors to consider when valuing an eCommerce company include:

Scalability – How well can the business grow to meet market demand? Is there room for the business to expand into new markets?

Underlying cost structure – How will the underlying costs be transferred to the new owner? How can underlying costs be cut?

Product concentration – How much of the company's revenues are reliant on certain products? Do too many products make up for too few sales?

Supplier agreements – Will the business's suppliers stay with them after the company is sold? Are there any special agreements you should know about beforehand?

Final Thoughts

Evaluating the worth of a company doesn't come easy, however, it's a necessary step you must take before finalizing a sale. If you do it right, you can get a very accurate idea of what your company (or future company) is worth, and you can make sure you're getting a fair deal during the sale.

No two valuation factors are treated alike, and each has its own weight on the value of the company. If you want to be a successful buyer or seller, be smart about the valuation process and pay attention to all factors at hand.

Special thanks to our friends over at We Make Websites for their insights on this topic.