Business Capability and Business Flexibility – how are they related?

August 2019

One method of project and business valuations involves calculating the net present value of a stream of future cash flow estimates. This generates a project or business valuation. Providing this value is higher than the realisable value of the net assets in today's money, the business is likely to be a going concern. The **business valuation** is essentially a measure of **business capability** i.e. an expectation of what the business can or will achieve in the future, in a foreseeable timeframe.

How are the future cash flow estimates arrived at? Essentially, business valuation or capability is a function of two things – **business reputation** and **organisational flexibility** (options held). These are in turn influenced by verifiable business strengths and commercially sensitive business strategy.

Business reputation is a combination of **net assets[1], training and experience** – experience being the historical stream of market tests, for the human (and increasingly the machine) resources of the firm and the knowledge gained from those tests. NB: Other words for the combination of training & experience are talent or ability. An example is that business reputation increases when the volume and/or intensity of the tests increase.

Meanwhile, organisational flexibility is a combination of both **business flexibility** (options held and managed by the firm) and the **personal flexibility** of its stakeholders (non executive directors, managers, staff, customers, suppliers and funders). Business flexibility includes resource access, resource opportunity, incentives and assigned roles. NB: Roles (job descriptions) can be made more flexible using devices like multi-skilling, matrix management, flexible working and workload outsourcing.

In summary **business capability** or valuation is a function of **net assets + talent + flexibility**.

One interesting insight about this equation is that the variables are in order of most to least likely to be matched by industry competitors and eventually commoditised.

It also follows that for sectors that are highly reliant on the levels of personal flexibility amongst staff e.g. the creative industries, private detective agencies, architecture studios, or business consulting firms, creating a business valuation is problematic, because valuing personal flexibility is itself problematic, relative to valuing net assets and talent. And problematic to value, compared to valuing business flexibility also.

Probably some of the goodwill on acquisition of a creative industry business, or consulting firm, relates to business flexibility and the remainder to personal flexibility. Likewise, for firms not needing personal flexibility, goodwill relates to acquired business flexibility only.

Lastly, for firms wanting to grow, they may have two choices – grow organically. Or grow by merger & acquisition. To make an informed decision on this, they need to value the sum of flexibility (personal and business) for both scenarios. However, until such firms better understand *the subjects* of business and personal flexibility, such evaluations will remain sub-optimal.

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[1] An example is free cash reserves on the balance sheet.