Chapter **6**

Discounts

Nearing retirement, an owner of a tier-two supplier to the automobile industry wanted to sell her business. The tier-two supplier did around twenty-five million dollars in annual sales.

The company had a serious concentration issue: 1) one hundred percent of its sales were to the automobile industry, and 2) fifty percent of its sales were to one customer.

The company's business was concentrated to one industry, and one customer made up fifty percent of the sales.

The company was an attractive, nice business.

It was discussed with the owner that she had choices to make. One, she could sell the company and take a substantial valuation discount for a buyer's increased risk due to concentration. Two, she could sell the company on some type of contingency arrangement, probably tied to maintaining a certain level of sales to the major (fifty percent) customer. Or, three, diversify and reduce or eliminate the concentration risk, and later sell without either of the consequences of the first two options.

The owner still had the luxury of a number of years before her retirement. She chose to diversify, now sells to three different industries, and the major customer's sales are reduced to around twenty-five percent of the company's total sales, with the percentage dropping only due to higher company sales. If the owner now decides to sell her business, she will almost certainly be able to sell at a normal buyer risk valuation.

A buyer’s risk increases when buying a business with major customer or industry concentration, lack of control, lack of marketability, or key person dependency. Discounts compensate for the increased buyer risk. In practice, discount areas are ordinarily assessed and mitigated, like in the above case, versus applying a discount percentage.