MAKE IT PERSONAL:

How an Owner's Mindset Impacts Value

MassMutual | The ValueBuilder System™

FOREWORD

We widely accept that determining the value of a business is a scientific process. Most people think that determining the value of a business involves an in-depth look at the books, sizing up the market, and many other types of quantitative analysis. It is also common to evaluate the management team, their skills, and their track record.

The most overlooked aspects of determining business value are often the owner and their intentions, specifically, the number of owners, the reasons for exit, and the steps taken to prepare the business for exit. Based on our analysis of 1,511 business owners who completed the Value Builder PREScore™ questionnaire, the owner's personal reason for exit and the actions they have personally taken to exit play a significant role in the value of their business.

When comparing two similar businesses in the same geography and industry and of a similar size, if each owner has different reasons for exiting, they will likely have drastically different business values. Other factors that can impact the value of the business include the owner's steps to prepare for exit and the proportion of shares owned. When added up, these factors can **predict up to 53% of** the difference in the value of two seemingly similar businesses.

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PART ONE:
OWNER’S REASONS FOR EXIT

One hundred percent of business owners exit their businesses—either by design or by default. We can bucket these reasons into four categories that play a role in the value of the business.

1. VALUE ENHANCERS: PERSONAL MOTIVATORS

When the owner is personally motivated to move on to a new project or chapter of their lives, the value of the business is higher. One might conclude that this category of owners views the business as an asset and has made the commitment to grow that asset to its highest value possible so they can eventually harvest the wealth created within it to accomplish other life goals.

The exit reasons include:

"Looking to diversify my wealth."

"I want to cash out."

"I have a new business I want to start."

"I'd like to get involved in philanthropy."

2. VALUE DETRACTORS: PERSONAL CRISIS

It appears that when the owner is experiencing a personal crisis, they negatively impact the value of the business. The owner may be operating ineffectively because they have stayed too long in the leadership role, haven't identified an appropriate successor, or are focused on trying to survive rather than growing the business. In fact, only one-third of business owners have identified a successor, and of those who have, one in five aren't aware they are the chosen successor.[1]

The exit reasons include:

"I'm burned out."

"I have health issues."

"I am stressed and time-starved."

"I have a family crisis."

1. MassMutual Business Owner Perspectives Study, 2022

3. VALUE NEUTRAL: PERSONALLY AND PROFESSIONALLY PEAKED

It appears that when the owner feels they have peaked both personally and professionally, their reasons for exit do not impact the value of the business.

The exit reasons include:

"I'm just bored."

"I want to spend time on a hobby."

"I want to travel."

"I want to focus on my health."

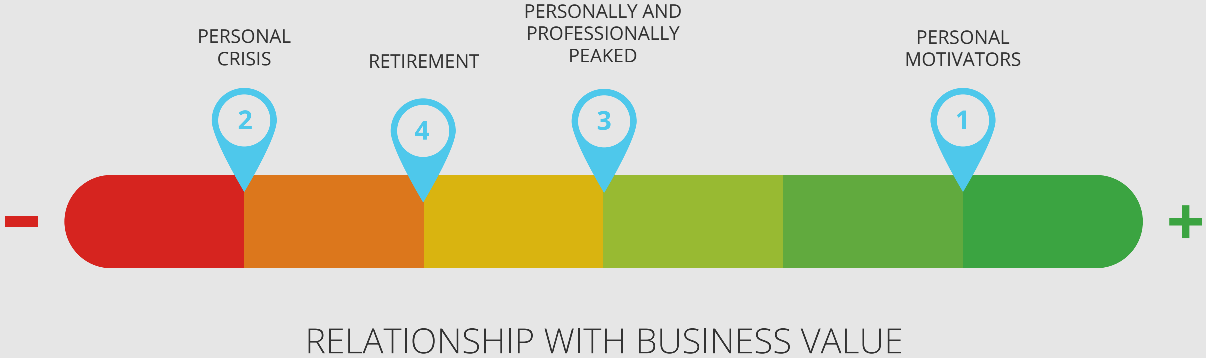
4. IT COULD GO EITHER WAY: RETIREMENT

When retirement is the reason for exit, this response negatively impacts the business's value slightly but less than an owner's personal crisis does. Of course, the reason for retirement will play a large role in the impact on business value. For example, an owner may choose to retire because they have lost control of the business and want it to be someone else's problem. Alternatively, an owner may choose to retire, identify a qualified successor, and be ready to step down as the key decision maker. In these two examples, the former will see the negative effects on value more so than the latter. The reality is that only 17% of business owners have set a timeline for their retirement and exit from the business.[1]

1. MassMutual Business Owner Perspectives Study, 2022

PART ONE:
IN SUMMARY

Of the four reasons to exit, it appears that Personal Motivators will have the most positive impact on business value. In contrast, a Personal Crisis will have the most negative effect. If the exit reason is Personally and Professionally Peaked, our research suggests there is no impact on business value. Lastly, owners who exit due to retirement will have a slightly negative impact on business value.



PART TWO:

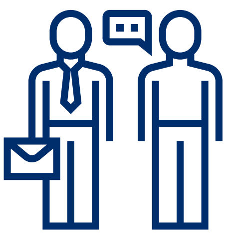
PREPARING FOR EXIT

The decision to exit is only the first step in a series of critical decisions an owner must make. How they prepare themselves and the business for exit also plays an important role in determining company value. We analyzed the following areas of an owner's preparation to exit: an owner's personal financial goals, involvement after exit, employees' well being, and ownership structure. How an owner approaches each of these four areas will have an impact on company value.

1. PERSONAL FINANCIAL GOALS

Owners should define a "minimum number," that is, the lowest number they will accept to exit the company with no future regrets. Owners who have thought about their minimum number build a business that is up to 5-6% more valuable, according to the PREScore™ analysis. Interestingly, the owner does not have to verify if their minimum number is accurate to have a more valuable business. The simple act of thinking about the number appears to help the owner prepare for the exit and to have a more valuable company.

2. INVOLVEMENT AFTER EXIT



The more an owner is willing to remain involved in the business after exit, the more valuable the company appears to be. An owner who is willing to accept any option beyond handing over the business and walking away will have a 4-5% more valuable business, according to the PREScore™ analysis. There seems to be a premium paid by the buyer for an owner to stay involved through the transition process. MassMutual research conducted has found that of those surveyed, half plan to stay involved and act as a mentor or consultant when they step down from the ownership position.[1]

3. EMPLOYEES' WELL BEING

Some business owners wonder how the new ownership team will treat their employees after they exit. Nearly 70% of business owners surveyed frequently think about ways to keep their key employees loyal to the business.[1] Some owners may plan how they will thank their employees, while others will take steps to negotiate with the buyer to look after their employees. Having a plan and thinking through employees' well being appears to lead to a 17-21% increase in business value, according to the PREScore™ analysis.

1. MassMutual Business Owner Perspectives Study, 2022

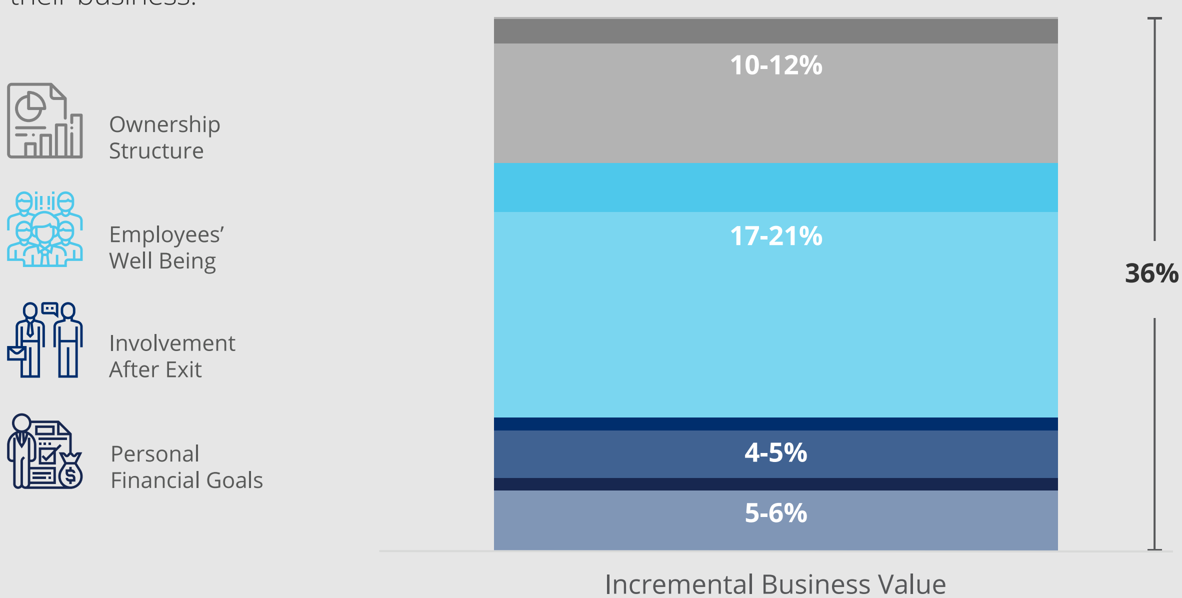
4. OWNERSHIP STRUCTURE

The fewer shares the majority owner holds, the more valuable the business is. Businesses with more than one owner appear to be 6% more valuable. The value of the company appears to be 10-12% higher when there is no shareholder that owns 50% or more of the business, according to the PREScore™ analysis. There could be many reasons for a higher value when there are multiple owners. One might conclude that business owners that control 100% of the company are accountable only to themselves, while multiple owners are accountable to one another. It could be that when more opinions are freely weighted and expressed, the better the business operates and potentially increase its value.

PART TWO:

IN SUMMARY

As business owners prepare for exit, how they approach these four areas can drastically impact business value. If all four areas are addressed effectively, and we add up all the potential incremental value increases each may provide, owners may realize a 36% increase in the value of their business.



TAKING ACTION

While a business owner may never know when a personal crisis will strike, they should always be ready to exit. Here are four suggestions that any business owner can consider today, regardless of when they are looking to exit, whether five, ten, or twenty years from now. You might want to take an annual day of reflection to consider the following:

1. CONSIDER YOUR NEXT CHAPTER

Take some time to figure out the next phase of your life. If yo may want some time to travel and relax before starting a new chapter, you may want to have a project always lined up. This can help remind you that the current business is only a chapter in your life and may ultimately help you increase the value of your business. Here are some questions to get you started:

- ***What will your professional life entail? Will it include starting another business, consulting, investing, retiring, or something else?***
- ***What will you do in your next chapter to give your life a sense of purpose?***
- ***What kind of lifestyle do you aspire to have?***
- ***What relationships will you invest more in?***
- ***What hobbies and interests will you indulge in?***

2. KNOW YOUR MINIMUM NUMBER

While you may not know the value of your business, you should consider having a minimum number. This is the minimum amount of money you would want to garner from selling the shares of your business to be able to look back on your exit without regret. Knowing this number alone can help you realize a more lucrative exit.

To get there, first determine your "income replacement value." hat's what you need the business to be worth to maintain your current standard of living in retirement. To do this:

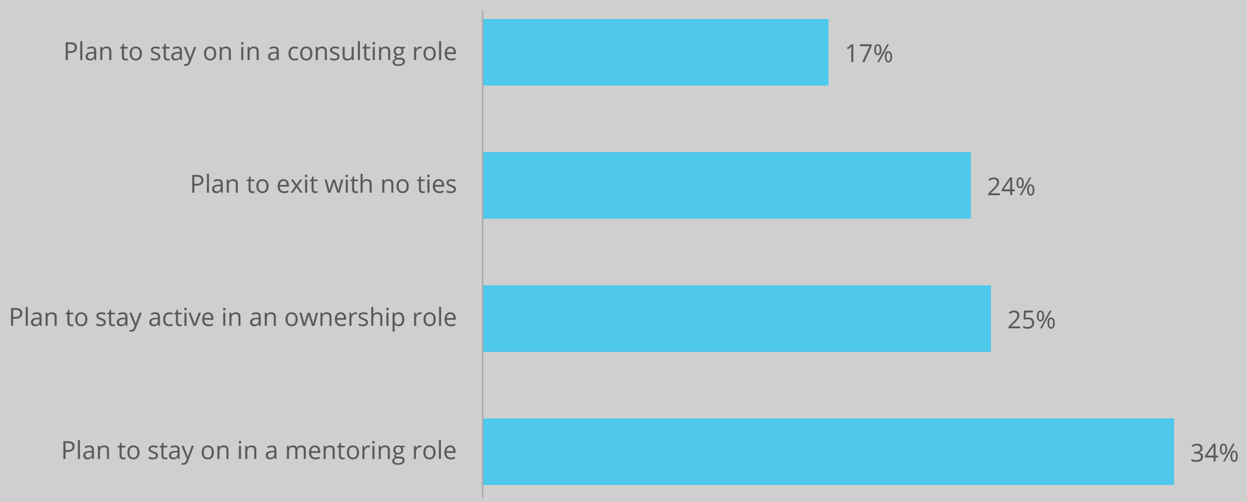
STEP 1: Determine the salary, bonuses, and benefits you receive from o run through the business annually.

STEP 2: Add the value of all those benefits up

STEP 3: Divide that number by a reasonable withdrawal rate (typically between 3-5%).

3. IMAGINE YOUR EXIT

Contemplate what possible roles you would be happy to continue working in within the business, in what capacity, and for how long. Below are some of the roles business owners decide to assume after exiting:



Source: MassMutual Business Owner Perspectives Study, 2022

- ***Are you willing to stay on as a consultant?***
- ***Will you assume a minority ownership role?***
- ***Do you prefer to stay on as an operator with a majority role?***

Answering these questions on an annual basis can help maximize the number of options to exit and the amount you garner. If you intend to receive income for your continued involvement, be sure that it is commensurate with the value you are bringing back into the business.

4. THINK ABOUT YOUR EMPLOYEES

Think of all the employees that have helped you make your business a success. Consider how you want the buyer to treat them. Here's an exercise to help you get started:

- » ***Make a list of all your key employees. Ask yourself: If you were to leave and start a new business, who would you take with you?***
- » ***Beside each name, check off if you want to include them in helping you get the business ready for exit.***
- » ***Determine how you want to thank that employee for helping you achieve your exit. It could be through employee stock options or a monetary amount.***
- » ***Decide how and when you will tell them about your decision to exit.***
- » ***Decide whether their future employment is necessary to include in your exit plan.***

Spending some time thinking about your exit, the next chapter of your life, your minimum number, and your company's succession plan can help you maximize the value of your business.

CONCLUSION

It's popular to think of business valuation as an exact science. However, an owner's readiness to exit appears to play a significant role in the overall value of their business. While an owner may not know when they might have to exit a business due to a personal crisis, being prepared to exit can pay off when it's time. To do this, an owner can start by considering life after the exit for both themselves and the business. Every owner wants to maximize their business value, and they must understand how their personal readiness can impact it.

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