



What Does Your Business Value Tell You?

No one wants to spend money on something they don't need. So why do you need an estimate of your company's value when you don't expect to leave for several or many years?

You may not — if you fall into one of two groups:

- Owners who are sure that their business exits are more than 10 years away.
- Owners who are certain that the value of their companies is miniscule compared to what they will need upon sale or transfer.

Many owners, however, look to the value of their businesses as the chief source of liquidity for their post-exit lives. We intend to leave as soon as it is feasible rather than when we are completely burned out. Therefore, most of us need to know the value of our companies now *so we can be smart about creating greater business value in as short a time as possible.*

Knowing the value of your business today is critical whether you plan to leave your business tomorrow, or in five years because:

- 1. An estimate of value establishes your starting line and distance to the finish.**
An estimate of value tells you where your unique race to your exit begins. Your job, whether your company is worth \$500,000 or \$50M, is to fill the gap between today's value (the starting line) and the value you need when you exit (the finish line). Based on today's value, your race to the finish may be shorter, longer, or perhaps much longer, than you expect. Once you know how far you and your business need to travel, you can begin to create timelines and implement actions to foster growth in business value.
- 2. An estimate of value tests your exit objectives.**
An estimate of value helps you to determine if your exit objectives are achievable. Let's assume that you decide that your finish line (financial objective) is to receive \$7,000,000 (after taxes) from the transfer of your business interest. You also want to complete your race in three years (timing objective). An estimate of value will tell you if the distance between today's value and the finish line is too great to reach in three years. If a growth rate is unrealistic for your business, you must either extend your time line or lower your financial expectations.
- 3. An estimate of value provides important tax information.**
First, an estimate of value gives you a basis for analyzing the tax consequences of Exit Path alternatives. Once you choose your path, the value estimate provides a basis for your tax-minimization efforts. Taxes can take a significant chunk out of a business sale price so the value of your company (what a buyer pays for it) must usually exceed the amount of money you need to fund your post-exit life. The size of that excess depends on how you and your advisors design your exit, and exit design in turn begins with knowing starting value and the distance to your finish line.
- 4. An estimate of value gives owners a litmus test.**
When owners know how much value they need to create to meet their objectives, it helps them determine where they need to concentrate their time and effort. Instead of growing value for the heck of it, dedication to a goal may enable owners to exit sooner with the same amount of after-tax cash than owners who do little or no planning. Pursuing exit plan success all begins with a starting value.
- 5. An estimate of value provides an objective basis for incentive plans.**
As you design incentive plans for key employees (such as Stock Purchase, Stock Bonus and Non-Qualified Deferred Compensation Plans) to motivate them to increase the value of your company (so you can work towards a successful exit) you must base these plans on an *objective* estimate of value. You and your employees need a current value (or starting line) that you all can confidently rely on.

This is Not a Full-Blown Valuation!

We know you are thinking, “How much is this going to cost me?” But we’re only suggesting that you need an *estimate of value* to establish a benchmark, not the *opinion of value* which may precede your transfer of ownership, years from now.

Estimate of Value

An estimate of value typically:

- Costs about half as much as a standard valuation opinion,
- Is the basis for the (later and) complete valuation, but
- Lacks the supporting information contained in a written opinion of value, and
- Is used for planning only. It cannot be relied upon for tax or other purposes.

Failure to Value

On some level, we all recognize that we will leave our businesses someday. While you may not yet have a vision for the second half of your life, you do understand that the exit from your company is likely to be the largest financial transaction of your life. Does it make sense to go into that transaction and into the second part of your life without an objective understanding of your company’s value?

An estimate of value can save precious time as you build value and pursue the exit of your dreams.

If you would like more information about the role of business valuation in Exit Planning, please contact us.

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