How a Valuation Can Help You Manage Your Business

What is your business worth? It’s a good idea to find out, for at some point you may need to know the answer.

For example, assuming your manufacturing firm is probably your single most valuable asset, that knowledge becomes especially important in retirement planning. When the time arrives to step down, one of two things will happen: either you will pass the firm to your heirs or you will sell the business to someone, be it a partner, current management, or an external buyer. If the former, your estate planning team should recommend that you get an appraisal due to the estate tax implications. But if you are selling your manufacturing business to outsiders, it would prove most helpful to know what your business is worth before you put it on the market. This enables you to make some value-enhancing changes while time remains.

Keep in mind there are other circumstances that may necessitate a professional valuation, including acquisitions, shareholder disputes, divorce, insurance claims, and charitable contributions.

Like any business decision, valuation entails several logical elements: Where do you start? How does it work? What does it involve? Where do you go from there?

Hire a professional appraiser
Hiring a certified professional will ensure that your business is accurately appraised. Appraising a business is much more complicated than valuing residential real estate. Certified professionals have undergone extensive training in both tax and legal issues that impact how either the IRS or the courts may view your business. Several organizations certify business appraisers: the American Institute of Certified Public Accountants, American Society of Appraisers, Institute of Business Appraisers, and National Association of Certified Valuation Analysts.

Methods used to value a business
A professional valuation is usually performed using three different methods that are then weighted to derive a final value. These are the market method, the asset method, and the income method. Like any technique, each has pros and cons. The market method utilizes any available transaction data on businesses similar to yours. The difficulty here lies in finding a comparable business that has been sold. The asset method estimates the replacement cost of both tangible and intangible assets minus the liabilities. The challenge here is accurately valuing what the intangible assets (think goodwill, trademarks, patents, etc.) are worth. Finally, the income approach measures the discounted income of the business going forward.
In undertaking the task, an appraiser will consider many factors that may influence the value of your business down the road. “Valuing securities is, in essence, a prophesy as to the future,” as IRS Revenue Ruling 59-60 points out. Therefore, things like the state of the economy, the industry your business operates in, and the companies you compete with weigh heavily in preparing the valuation. The appraiser also will conduct a thorough financial review of your business and compare it to those of your peers.

**Applying it to your business decisions**

Once you have this information, you can make some decisions. If the business is worth plenty, you need not do anything—just sell it now. But, if the business is worth less than you hoped, what can be done to fix it? With a detailed valuation in hand, you have a strategic tool that can help identify weaknesses reducing your company’s worth. From there, you can start addressing operational issues to rectify the situation, such as improving processes, cutting costs, enhancing quality, or growing sales.

On the other hand, you can always take the “wing it” approach—that is, wait until you are ready to sell your business and hope for the best.

--Matt Haynes
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