Five Times When Knowing Worth of Business is Key

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CHARLES STUBBS

Five times when knowing worth of business is key

IN THE LIFE of every business, there are times when knowing what your business is worth is essential.

Some events you can plan for, such as your retirement. Other events, like needing a line of credit, can come up unexpectedly. Knowing the value of your business is essential to getting the most out of your years of investment.

By anticipating events when a business valuation is necessary or advantageous, you can take steps to maximize your business's value and position yourself for the best financial result.

Financing growth

Your banker or investors are going to want proof of the value of your business in order to finance its growth. If you are looking to add a building or expand production or even purchase or lease new equipment, the lender is going to need to know how much your business is worth.

Other growth strategies are more complicated. They require not only a valuation of your business but may require other in-depth research as well. If you are going to start merger or acquisition talks or issue an initial public offering of stock as part of a growth strategy, a business valuation will be an important part of the process.

With a growth strategy using debt financing, there is really no way to prepare for your business valuation, other than running your business efficiently and having your financial statements reflect optimal results. You will contract out for the valuation when your lender says it is needed.

In this situation, there is less value in having the work done earlier because a business valuation is time-sensitive and could be considered outdated if you start it too soon. Keep in mind, your lender may want to approve the valuator as well.

Lenders have different things that

[tips]

1 | An efficient method to leverage the cost is to perform a traditional business valuation once to establish a baseline.

2 | In subsequent years, the board approves an "agreed value" that all buyers and sellers live with for the coming year.

3 | If you are planning your retirement, you should generally develop your exit strategy by age 50 or 55, even if you plan on working until you're 80.

4 | You don't want to find out that the business you thought was worth $40 million is only worth $25 million.

they look for in a business valuation. Banks will look at your collateral — your accounts receivable, inventory, equipment and real estate. A non-traditional lender will want to know what your cash flow is now and what can be expected in the future.

Strategic planning

Long-term planning is essential in every business. Part of that planning is knowing the value of your business and deciding what you need it to be worth in the future. Business valuations are commonly performed for buy-sell agreements, when you bring on a partner or as part of your exit strategy.

If you have a board of directors or governors, they will generally want the information a good valuation provides at a minimal cost. An efficient method to leverage the cost is to perform a traditional business valuation once to establish a baseline. In subsequent years, the board votes and approves an "agreed value" that all buyers and sellers live with for the coming year.

Many will also require business valuations on a set timetable — every five years, for instance. Of course, if an agreement on the value of the business cannot be reached or if there is a triggering event such as the death of a principal, you may need to initiate a business valuation at that time as well, pursuant to a buy-sell agreement, corporate by-laws or the partnership agreement.

Exit strategy

There are times when every business owner contemplates leaving the business. And there are many ways of exiting, but for any of them, you will need to know what your business is worth.

In order to successfully transition out of your business, you need time to formulate a strategy. Are you going to sell to key employees? Sell to your children? Find an outside buyer to take over? Sell to an employee stock ownership plan?

The time to think about exiting your business is three to five years before your target date. Many business owners find that it takes that long to deal with the emotions of leaving their businesses. Without this emotional separation it can be difficult to rationally evaluate exit options and formulate the best strategy.

If you are planning your retirement, you should generally develop your exit strategy by age 50 or 55, even if you plan on working until you're 80. You don't want to find out that the business you thought was worth $40 million is only worth $25 million. And if that is the case, you will need to have time to make the necessary changes to increase the value of your business or to rearrange your retirement options.

As you plan for retirement, knowing the true value of your business can help you better plan and ensure that you have the type of income and lifestyle you want during retirement.

Tax planning

If you are considering transitioning your business to a family member via a Family Limited Partnership or Family LLC, you will need to have a valuation done for the gift tax return. It is vitally important that you get a complete valuation done and it is done correctly.

If the information disclosed with the gift tax return doesn't meet the IRS test for "adequate disclosure," then the three-year statute of limitations doesn't begin and the IRS will have until your death to question the value of the gift.

Protection in legal disputes

In every life, there are times when personal disputes come up. When you own a business, sometimes there is even more vulnerability. You may need a business valuation for pre-nuptial agreements, divorce proceedings or dissident shareholder proceedings.

Generally, in these instances, you will need to disclose many private aspects of your business. Sometimes you will find that each party has contracted for their own valuation. However, you may be able to negotiate working with one business valuator to come up with a fair value, and reduce fees for all concerned.

In business, fluctuations that affect business value are inevitable. However, by creating a balance in your company where operational and financial activities are in line with expectations, you will be better able to manage these events for optimal results.

Knowing the true value of your business at important junctures can put you in the best position to plan for the inevitable ups and downs and make the most of your years of investment.

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>
> — Chris Shorba, KDV

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