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## Knowing Business Value is a Very Good Place to Start

People don't want to spend money on things they don't need. So why would you need an estimate of your company's value if 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.

However, many owners look to the value of their businesses as the chief source of liquidity for their post-exit lives. Owners intend to leave as soon as is feasible rather than when they are completely burned-out. Therefore, most owners need to know the value of their companies now so they can be smart about creating greater business value as quickly as possible.

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

### **1. An estimate of value establishes the starting line and distance to the finish.**

An estimate of value tells owners where their unique race to their exits begins. The owner's job, whether the company is worth \$500,000 or \$50 million, is to fill the gap

between today's value (the starting line) and the value he or she needs upon exiting (the finish line). Based on today's value, an owner's race to the finish line may be shorter, longer, or perhaps much longer than expected. Once owners know how far they and their businesses need to travel, they can begin to create timelines and implement actions to foster growth in business value.

## **2. An estimate of value tests owners' Exit Objectives.**

An estimate of value helps owners determine whether their Exit Objectives are achievable. Let's assume that an owner, Kate, decides that her finish line (i.e., financial objective) is to receive \$7 million (after taxes) from the transfer of her business interest. Kate wants to complete her race in three years (timing objective). An estimate of value will tell her whether the distance between today's value and the finish line is too great to reach in three years. If the growth rate is unrealistic for Kate's business, she must either extend her timeline or lower her financial expectations.

## **3. An estimate of value provides important tax information.**

An estimate of value gives owners a basis on which to analyze the tax consequences of Exit Path alternatives. Once an owner chooses a path, the value estimate provides a basis for the owner's tax-minimization efforts. Taxes can take a significant chunk out of a business' sale price; therefore, the value of the company (i.e., what a buyer pays for it) usually must exceed the amount of money owners need to fund their post-exit lives. The size of that excess depends on how owners and their Exit Planning Advisors design their exits. Exit Planning, in turn, begins with knowing the company's starting value and the distance to the finish line.

## **4. An estimate of value gives owners a litmus test.**

Knowing how much value they need to create to meet their objectives helps owners determine where they need to concentrate their time and efforts. Instead of growing value arbitrarily, dedication to a goal may enable owners to exit sooner than owners who do little or no planning, with the same amount of after-tax cash. Pursuing Exit Plan success always begins with a starting value.

## **5. An estimate of value provides an objective basis for incentive plans.**

As owners design incentive plans for key employees (e.g., stock-purchase, stock-bonus, and nonqualified deferred-compensation plans) to motivate them to increase the value of the company (so owners can work toward a successful exit), they must base these plans on an objective estimate of value. Owners and their employees need a current value (or starting line) on which they can rely confidently.

## **The Estimate of Value Is Not a Full-Blown Valuation!**

We know you are thinking, "How much is this going to cost me?" However, we're suggesting that you only need an estimate of value to establish a benchmark; you do not

need the opinion of value, which might precede your transfer of ownership years from now. An estimate of value typically costs about half as much as a standard valuation opinion and is the basis for the later, complete valuation. However, it 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, all owners recognize that they will leave their businesses someday. While you might not yet have a vision for the second half of your life, you must understand that exiting your company is likely to be the largest financial transaction of your life. Does it make sense to go into that transaction and 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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