

## HOW MUCH IS MY BUSINESS WORTH?

An Article by  
William A. Taylor  
(One of The Business Lawyers)

What (how much) is my business worth? Every entrepreneur wonders.

In a small, closely-held business, that question is similar to questioning how many angels can fit on the head of a pin; there is no definite answer. However, the question is valid because an answer is required: in a divorce proceeding, in the sale of all or part of the business, for lenders or investors, for buy-sell agreements.

To keep down your anxiety, the answer to the question at the top of the page is – the result of an educated guess. That’s right, a guess. Just the same as a doctor making a diagnosis that s/he hopes will solve your problem, a business appraiser will make a determination of value that s/he hopes will be respected by both sides.

Certified Appraiser \$20,000 is not too much to expect to pay to a certified valuation expert (aka business appraiser). Such a person (make sure s/he looks older than age 21) will have one or more of the following initials after his/her name: chartered business valuator (CBV), certified business appraiser (CBA), CPA/accreditation in business valuations (CPA/ABV) or accredited senior appraiser (ASA).

Business Value “Fair market value” (FMV) is not the only value of a business but it is the only “true” value of a business – and determination of that value doesn’t require an appraiser. FMV is determined by an actual sale (of either the business or of its shareholder’s stock). FMV requires a willing buyer and a willing seller, both approaching the sale transaction without passion (i.e., both critically analyzing the deal and willing to pull out if the facts dictate), and both of whom have knowledge of all of the relevant facts.

Aside from fair market value, there is also “fair value” (often used in divorce settlements for closely-held companies that have no public market). Fair value is a guess of a business’ economic value or investment value.

There is also “liquidation value” where no value is given to goodwill – for obvious reasons in a liquidation; the business won’t be continuing. In liquidation value, the sum of the parts of a business (its assets) is the value of the business – determined by use of either a forced liquidation assumption (quick sale) or an orderly liquidation assumption (a sale over a period of time to fetch the best price).

Liquidation value is the opposite of “going concern value,” where the business is evaluated as an operating business.

And then there is “book value,” which has problems because it is historical – it relies on the cost of assets, which costs are then aggressively depreciated down to zero on the books. That’s a problem when you are using the books to justify a value.

Valuation Adjustments In the real world, arriving at a valuation is not enough; the numbers will need to be massaged, i.e., adjusted up or down for certain reasons. If partners are in a buy-sell transaction, a premium adjustment will be added to the business value for a partner having ownership of 51% or more of a business. That is called a control premium.

When a partner owns only 49% or less of a business, the opposite adjustment occurs - and is called a “lack of control discount” or a “minority interest discount.” A business may also be subject to a “key person discount” where the loss of a key person would severely reduce the income of a business.

Income vs Assets An appraiser will choose an approach which will either be an income approach (relying primarily on the income statement) or an asset approach (relying primarily on the balance sheet). Using the asset approach, an appraiser can select to calculate value from “adjusted net assets” or the “net book value.” This approach has its problems, however.

Intangible Assets Many times, the intangible assets of a business do not show on the company’s books – as though they do not exist. However, in this information age economy, intangible assets constitute some of the more valuable assets of a business. They commonly are: a) goodwill (the fact that the telephone will ring with new and repeat business – in spite of no additional marketing), b) patents / trademarks / trade names / copyrights, and c) customer lists / non-compete covenants / software codes / relationships. Putting a value to intangible assets is an art (translated: a guess).

Income The income approach to valuation (as opposed to the asset approach) is an attempt to convert a cash flow number into an equity number (i.e., convert an income statement number into a balance sheet number). One method of using income is to capitalize (i.e., guess at a multiplier to use against) a business’ earnings and revenues. A service industry company that has few assets would be a company to value by use of its income, as would a company where the going concern value is greater than its liquidation value.

Another method of using income is to capitalize a business’ discretionary earnings, money that is used for the lifestyles of the owner-operators of small businesses. Again, that multiplier (the cap rate) is an educated guess.

Conclusion Just like a doctor’s diagnosis is respected because s/he loaded up on specific knowledge and techniques before making an educated guess about your symptoms, a business appraiser’s opinion of value is given respect because s/he did exactly the same thing as the doctor. It’s as close as society can get, short of putting every company on the stock market – and even there (like the tech bubble that burst ten years ago) the market is guessing.

**ABOUT THE AUTHOR:** William A. Taylor, attorney at law, is the managing partner of Taylor & Goins LLP, which does business as “*THE BUSINESS LAWYERS.*” He can be reached at (510) 893-9465 or [www.thebusinesslawyers.com](http://www.thebusinesslawyers.com)