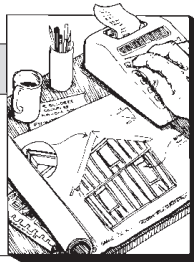


Setting the Value of Your Business

by Tom Duncan



There are plenty of good reasons to know the value of your business. Even if you're not planning to sell your company, it's wise to plan for succession long before the actual need arises.

If you work with partners, you may want to sell your share or buy another partner's share. If you're preparing to retire, it's a good idea to track your company's value so you can sell when business is good and you're likely to get the best price. In some cases you might want to sell your business and get into some other line of work or start another business. Or you might decide to buy a business some day. Knowing how to evaluate its worth might save you from paying too much.

Sometimes determining your company's worth is just plain interesting. You may have no intentions of buying or selling but just want an idea of how much equity you've built up over the years. But be forewarned: Most people think their business is worth more than it is. Don't be surprised if your company's value is only a fraction of its sales. Most construction or remodeling firms are worth the value of their assets, plus a premium for goodwill when earnings are sufficiently high.

Getting Help

I learned the ins and outs of setting a company's value when I bought my father's kitchen and bath business about a year ago. He started E.H. Duncan as a bathroom remodeling firm in 1956 and later expanded into kitchens. We added a heating, air conditioning, and electric division in 1987. When he was ready to sell the business and retire, we were doing about \$1.35 million in annual sales.

It was important that we set the value of the business accurately and fairly. Business owners looking to sell may put a higher price tag on their company in hopes of having room to negotiate. But in our situation, the selling price determined my father's retirement income, the debt I would have to pay off, and the company's profit.

There are all sorts of methods for evaluating a company's worth. In some cases, you may be able to do it yourself by simply following one of the formulas that are available in various books and business magazines. But if you're looking to buy or sell, it's a good idea to get some help from financial advisers. You

may not relish the idea of paying their fees, but their help can pay for itself in the long run.

We called on our lawyer, a stock broker, and our accountant. Some business owners may want to work with their bankers and a financial planner instead of, or in addition to, other advisers. We found that working with a few different people gave us some perspective and helped us develop a fair cost.

Sometimes the people you're used to dealing with aren't knowledgeable about setting business values. We were fortunate that our accountant specializes in business buyouts, but not all accountants can provide the guidance you need. That means you may have to call around for help. There are a couple of things you need to look out for:

- Make sure that whoever you use has some experience. You don't want to find out after it's too late that the value you set was too low or too high.
- Keep your contacts confidential. When news gets out that you're looking to evaluate your business, everyone will assume your company's on the block. That can generate ill-will among employees, subcontractors, competitors, and clients.

If you are looking to sell your company but don't have a buyer in mind, business brokers will help you set a price and line up potential buyers. Again, be cautious about who you choose. A broker's commission can be hefty.

Where to Start

Our first step was to look in the Yellow Pages for a property appraiser. A good real estate agent may also be able to help.

Next, we set about listing our assets. These included our vehicles, cash on hand, inventory, showroom, and any real estate. Assets are then balanced against liabilities, including payables and receivables. Keep in mind that if your business is small or service-based (such as a remodeling firm), you may not have a lot of assets to record.

We tracked the values of these items over a four-month period and averaged them out. You may wish to track the values over a longer period, if you're prone to seasonal ups and downs. Most buyers will ask for three years of financial records.

Finally we developed a figure for goodwill, which basically told us

what the company's name and reputation were worth. This is a crucial number since many building businesses are valued almost solely on the owner's sales and craftsmanship abilities. Unless your earnings are significant, your company may not be worth much. As our accountant told us, goodwill is only as good as the previous owner. In most cases, earnings will decrease by about 25% when a new owner takes over.

Once we'd gathered all this information, it was time to work out the particulars of the deal. Finding ways to avoid taxes was our first priority, since the Internal Revenue Service can take up to one-third of the seller's profit. Here's where your accountant and your lawyer can save you money.

We also had to work out a system of payments that I could live with while providing my father with a good income. We decided to stretch the payments over 12 years. But there may not be this kind of flexibility when you're working with a buyer who's outside the family.

Dealing With Emotions

I learned that buying or selling a business is not just a financial matter. There are lots of emotions that go into the process as well, especially when you're working with your family.

After years of sacrifice and hard work, some business owners are so involved with their businesses that letting them go is like parting with a child. That business is part of the owner's identity. Selling it may make them feel as if they've been cast adrift. In some cases, the company's founders don't trust the new owner to run the business the way they think it should be run. Or, as in my father's case, some owners feel they are being pushed out, even though it was their decision to sell.

It's just as important to cope with these issues as it is to make sure the financial arrangements are straight. And be honest with your employees. If they find out that you're selling, they'll worry about what will happen to their jobs and this can affect morale and productivity. ■

Tom Duncan is president of E.H. Duncan, The Bath and Kitchen Center, in Poland, Ohio.

For More Information

Two practical guides to setting the value of your business are:

Putting a Price Tag on a Business by Thomas J. Martin, Thomar Publications, Inc., 1991.

When You Buy or Sell a Company by Paul B. Baron, Center for Business Information, Meriden, Conn., 1980.