THE SMALL BUSINESS CFO REPORT

Helping you create equity in your business

I. Valuing Your Business

In order to focus on building equity in your business, it is helpful to have a consistent and effective way to periodically measure the value of your business. Not only will this allow you to track your business equity, it can help you manage your business in such a way as to increase your business equity. There are many different ways to value a business, and certain industries have well defined methods. While having a professional appraisal done from time to time might be a good idea, what you really need to have is a solid benchmark for internal use that you and your management staff can easily understand and utilize. By doing a periodic self-valuation and incorporating it into your planning process, you can:

1. Build a better awareness of what creates value in your business.
2. Focus your planning and resources on the areas that increase business value.
3. Have a ballpark idea of what your business may be worth at any point in time.

II. The Valuation Rationale - Coming up With a Value Method

A professionally done appraisal of your business can be a very detailed and complex report encompassing a number of different valuation techniques. As previously stated, having this kind of valuation performed on your business from time to time can be a worthwhile thing and may be a good starting place in developing your in-house valuation method. However, for planning purposes, you need to come up with a method that you understand, and that is not too difficult or cumbersome to work with. Ideally, the valuation technique should summarize nicely onto one page, and represent the key value areas for your company.

Ultimately, value is added either through owning tangible or intangible assets, generating present profits, or creating a structure that promises future profits. A valuation method for a start-up would likely focus on the potential to generate future profits, whereas a mature business would likely focus more on the current bottom line. A company creating intellectual property would want to take into account the value of its intangible assets in the same way that a company which owned real estate would value its tangible assets. There are many good books and web sites on the subject of valuation, and by all means tap the expertise of outside people in setting up your in-house process. You should also become familiar with what the standard valuation methods are for businesses in your industry. Keep in mind, however, that the key is for you and your planning team to become familiar with whatever measures of value you choose, for you need to focus on those areas that add value to your company.

III. Making the Valuation Mean Something - Good Data

You can't come up with a useful value for your business if your data is corrupt. Thus, you need to have accurate books to get even a good approximation of value. If your books are not in good order, then this is the first place to start in creating value in your business! If your business has inventory, this is an area you especially need to pay attention to, and you must do a physical inventory count for your valuation. Also, most small businesses run some personal expenses of the owner through the books, so you may also need to adjust for this before doing your valuation (an even better idea is to stop the practice all together). In addition, it is important to get your books on an "apples to apples" basis. Sometimes a business will accelerate income or deductions for income tax or other purposes. In doing your valuation, you should adjust out any of these entries which aren't truly reflective of your business situation.

IV. Making the Valuation Mean Something - Managing to Create Value

Having an in-house valuation is handy, but using it as part of your planning and operations is where it can really pay dividends. Once you have gone through the process of designing your valuation, you will have a better idea of what adds value to your business. As a small business, you have limited resources to work with. You need to be more efficient than a larger operation. So why not focus your planning and resources on the areas that create value in your business? By looking at your valuation, you should be able to articulate three to five short and long-term goals to increase the value of your business. Based on those goals, you can put together strategies, action plans and measurements to use in your planning and management process. Updating your valuation then goes hand in hand with your planning process. And from a day to day management level, you can include the question "how will this impact the value of the company?" into your decision making process.

V. A Broader Definition of Value

In the world of large exchange traded companies, the value process is all about adding to shareholder value. In a small business, value can have a broader definition. Making money defines a for-profit business, but other things can hold value for the owners of a small enterprise. Having a flexible work schedule, building a certain type of business, charitable or environmental concerns, building a family business or a multitude of other considerations may add value for the owners. Whatever issues that are considered of value to the business owners should be added to the valuation process and treated just as the measure of monetary value. That means stating them, finding a way to measure them, and adding goals, strategies and action items that relate to them in the planning process.

VI. Summary

What gets measured, gets managed, gets done. If you want to build equity in your business, then you need to have a process to measure it, and you need to integrate it into your planning and management process. Having an outside appraisal is a good idea, but you need to have something you can work with in-house and most importantly, you need to understand and focus on the things that build value in your business. Once you set up an in-house valuation process, you need to make sure your accounting data is as accurate and consistent as possible. This in and of itself will increase the value of your business! You also need to incorporate your valuation into your planning and management, using it to set your goals, objectives and strategies, and considering the effect of all decisions on company value. Finally, value for a small business can mean more than just monetary value. The owners may have other things, both tangible and intangible, that add value to the business for them. These items should be considered and added to the valuation process.