

What is Value?

by Tom Stocker



Value means different things to different business owners. If you ask an owner just starting up their business the answer may be revenue growth or available cash. Ask another who has gotten past the startup phase and it may be cash and/or profit, and ask a stockholder of a public company and it will probably be profit. They are all correct of course, but the real value in any non-public company isn't just growth, profit and cash. It is much more.

Value is not a here and now measure of how much cash the company has available or the profit it made last quarter. It is a long-term metric that is measurable and changeable. It is the most important measure of any company, private or public. It is a measure of sustainability and transferability. Ultimately it is how much your company can sell for on the open market. At any given time, what would someone be willing to pay for the enterprise as it exists today. You should be aware of this value whether or not you are planning to sell or transfer your business today, tomorrow or twenty years from now. Because it is so important to you, your strategies must start with how to increase this value.

For a private company, real value is sustainable and transferable profitability. For public companies, sustainable and transferable are given as the enterprise is generally transparent and value is reflected in real time through the enterprise's stock price. Private companies do not always see

value in this light but should consider and understand the implications of avoiding or ignoring these two key factors. The most valuable private companies generally conduct themselves in the same manner as public companies. They have a board of directors and/or a board of advisors, a clear succession plan, easily understood structure and documented processes. All of these things reduce risk and provide superior enterprise value.

Risk is an important factor to consider when you think about enterprise value. All valuation experts use a risk factor to determine a company's value. As the owner and/or CEO of your company, part of your job and obligation to your owners is to minimize risk as much as possible. Making sure your company has adequate business systems, processes and structure will go a long way toward minimizing internal risk. This is a topic in itself which I will address in a future blog.

At Boardroom Advisory Group we have two presentations we call "The Story of Value" and "Building an "A". In both cases we talk about the meaning of value for private companies and concentrate heavily on how important sustainability and transferability are to building a valuable company.

Sustainability is a very important concept for making a valuable company. Outside investors won't pay much for a company if they can't see or understand how an enterprise can continue to grow revenue and profitability. Likewise, they need to feel comfortable the business can survive without you the owner/CEO. If you are the

“octopus” (see my article “Are You an Octopus?”), haven’t done anything to groom a competent management team, all processes are in peoples’ heads or are “custom” for each transaction or action; you don’t have a transferable business and are at risk of not having a sustainable business. As a result, there is higher risk and thus a lower valuation than a similar business/competitor that does have these internal characteristics in place.

These concepts hold true regardless of where you are in your business lifecycle. The best time to be working on long-term value is all the time. Clearly the longer time horizon you have before you plan to exit your business the more value (and less risk) you can build. Having a lot of time (meaning multiple years) provides the flexibility to work on this in smaller bites. Regardless of your timeline, a sense of urgency should be in place to get it done as quickly as possible.

Think about what would happen to your business if something were to happen to you today to remove you from the business suddenly and permanently. Could it survive? Is there someone in place who could step in and provide the leadership to at least sustain the business? Is there someone who can provide the vision and leadership

needed to make the business thrive? Are there multiple people (children) who think they are that heir apparent, but you know only one of them is right and you haven’t talked to any or all of them? What if the “wrong” one emerges as that successor in the aftermath? If this is a family business, will this event tear apart your family? Clearly there are many alternatives and conclusions to this story. But from a business standpoint the ending is clear. The company will be worth less and may not survive because sustainability and transferability were not addressed.

It is clear to see how sustainability and transferability are important cornerstones to all businesses. With a public company sustainability and transferability is taken for granted. It is part of the stock price of all public companies. Private companies who can be considered “A” companies have also addressed these important tenets of control. But unfortunately, many private companies have not and could suffer when a transfer of control becomes necessary for whatever reason. And with the “retirement boom” of aging baby boomer owners currently underway, business transitions and pressure on business valuations are only going to increase. Start getting ready now.

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