Value transfers

How to utilize business valuations in succession planning and transferring ownership **Interviewed by Troy Sympson**

Approximately 90 percent of the businesses in the United States are family-owned. However, studies show that two-thirds of closely held businesses fail to survive into the second generation. Many owners spend a lifetime building their businesses, but several ignore the planning that is needed to transfer ownership. This failure to adequately plan for this transition is a leading contributor to the low survival rate.

"A business valuation is a key first step to help family businesses figure out what planning steps they should take to ensure the company survives under second generation leadership or continues operating via the sale to key management or a third-party buyer," says Mark R. Schaaf, a shareholder and the director of valuation services of Briggs & Veselka Co.

Smart Business spoke to Schaaf about business valuations and how they can help in succession planning and transferring ownership to the next generation.

Mark R. Schaaf
Shareholder
Director of valuation services
Briggs & Veselka Co.

What are the benefits of doing a valuation for helping in succession planning?

Going through a formal valuation process can be the cornerstone for determining what steps owners need to take to achieve their succession goals. It is good to get a valuation now to get that 'home plate' valuation to get an idea of what the business is worth to a third party.

Owners of small businesses cannot flip open the business section of their paper or look online to see the traded value of their company. An experienced valuation expert knows what questions to ask when analyzing a company to arrive at a fair market value of the business upon which sound succession or transition planning can be based. In addition, the best valuators understand the factors that create value. The valuation process can therefore frequently reveal such valuation drivers to the business owner in time to reposition the company for a higher sales price at some point in the future.

What other factors need to be considered?

Many times, the business owner has taken the annual profits each year and has become accustomed to a high level of cash flow annually. Selling the business means that this annual cash flow will go away, and then the big question becomes: 'What value is sufficient to allow for a comfortable retirement or exit from the business?'

A fair market valuation gives those answers — often leaving the owner to say: 'I can work X number of years more and get that same cash.' Thus, frequently it takes a major life event — health issues, family issues, etc. — to get owners to face the fact that time doesn't go on forever and the economic value of the company is not dependent on some never-ending cash flow to them. In fact, that ongoing cash flow is what third-party buyers or subsequent owners pay for in a purchase.

Those factors above show why it is important to get a grasp of the current value, as well as potential steps that might be taken to improve the valuation over time.

What about selling to key management?

Frequently, the value of the business is a direct result of the efforts of a few key employees' efforts. A valuation consultant can walk a business owner through the different 'standards of value' that may apply to a transfer. A fair market value would be based on the willing buyer/willing seller concept, and this value is often discounted for lack of marketability issues and other issues associated with the risk of ownership of the business. A fair value typically is a higher value and does not include such discounts. A valuation consultant can explain the differences in the two, what it means to the owner and the key employees, and help work out a value and a buyout plan that is executable and understandable to both sides.

How about transfer of ownership to family members?

Valuations can also help in transitioning the business within the family. A multiyear gifting plan can help accomplish this goal as well as selling to the second-generation family members or to trusts of the family to combine the goal of transferring the business along with achieving tax savings and implementing valuable estate-planning techniques.

What about selling to outsiders?

Among potential buyers for the business, independent third parties may present the highest multiples, but there is also the highest risk of failure and disclosure of confidential information. By planning ahead and using the guidance of an experienced professional, these risks can be minimized and key selling points emphasized. <<

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