Business valuation: What's it worth?

There is no one-size-fits-all process to value a business. **Interviewed by Kristen Hampshire**

Whether you are planning an exit or simply want to motivate employees to drive profit, a business valuation is a key tool that will help you implement a strategic plan to meet short- and long-term goals. Simply put, a valuation is an independent appraisal of what a business is worth in the marketplace. Though a valuation ultimately gives you a number — a worth for your business — the process of reaching this value is more art than science. There is no single value for any business. It depends on the acquiring party, circumstances in the market and the dynamics of the business.

This is why relying on an industry "rule of thumb" is no way to approach a business valuation. "Every business is unique, and that individuality can increase or decrease a company's value relative to others in the same industry," says Joel Guth, an advisor with Citi Family Office in Columbus, Ohio.

Smart Business spoke with Guth about why valuations should be tailored to individual companies and their goals.

Joel Guth
Advisor, Citi Family Office
Smith Barney

Why are business valuations not only an important tool for selling a business but also for exit planning and carrying out other strategic goals?

There are numerous reasons why you may need to find out the worth of your business. The first is obvious: an acquisition or transfer of ownership. Not only do you need to know how much the business is worth before selling it, but also acquiring parties will expect documented proof that the asking price is fair. Besides selling the business, you may decide to get a valuation annually and tie your company's worth to an employee incentive plan. Finally, a valuation is a critical tool in exit planning to show you where you are now, so you can plan where the business needs to be before you exit.

Explain why a company's worth may range drastically based on the reason for the valuation.

You must be very specific on why you want a valuation because an appraiser could provide a range of values depending on what you are trying to accomplish. For example, if a family member wishes to acquire the business, you want the lowest possible value to help mitigate some of the tax burden associated with the transfer. However, you want the highest value possible when selling to a third party so you can maximize gains. On the other hand, if the valuation is tied to an incentive program, you want to know the true market value of the company so employees will understand what the company is worth today and what they need to do to increase that value. There is no single value for a business, and you want to tailor the valuation to the audience and circumstances.

Who should conduct a business valuation?

A certified appraiser who is familiar with your industry should conduct the business valuation. If you are selling your company to a third party, partner with an appraiser who has experience in the dynamic M&A market. An appraiser who is not familiar with your industry may not be knowledgeable in current market prices. With any appraiser, communication is critical to receiving a valuation that suits your goals and can be used as an effective business tool. A valuation based on selling your business to a third party should not double as a valuation to show employees the worth of your company as it pertains to their bonus checks. They may wonder why the bonus isn't bigger!

When and how often should an owner get a business valuation?

A valuation is a critical prerequisite to exit planning, so you should count on getting a valuation at least three to five years before you plan to sell or pass on the business. But again, the 'when' question is dependent on why you need the valuation. When exit planning, a valuation should be tied with a needs analysis. Decide how much capital is needed from the business to live comfortably after you exit. This will determine who you sell to, what type of valuation is necessary and, if your business isn't ripe for the exit, how much work needs to go into getting financials in shape before you exit and meet your goals. Valuation is far more than putting a price tag on a business. An accurate, customized worth of your business is a great benchmarking tool and motivator to employees. Most of all, a realistic picture of your business today can help you better plan what's next.

Citi Family Office is a business of Citigroup Inc., and it provides clients with access to a broad array of bank and non-bank products and services through various subsidiaries of Citigroup, Inc.

Citi Family Office is not registered as a broker-dealer or as an investment advisor. Brokerage services and/or investment advice are available to Citi Family Office clients through Citigroup Global Markets Inc., member SIPC. All references to Citi Family Office Financials Professionals refer to employees of Citibank. N.A. or Citigroup Global Markets Inc. Some of these employees are registered representatives of Smith Barney, a division of Citigroup Global Markets Inc., that have qualified to service Citi Family Office clients.

Citigroup Global Markets Inc. and Citibank, N.A. are affiliated companies under the common control of Citigroup Inc.

JOEL GUTH is an advisor with Citi Family Office in Columbus, Ohio, which is a firm that caters to clients whose net worth is at least $25 million. Reach him at joel.j.guth@citigroup.com.