

KNOW AND GROW THE VALUE OF YOUR BUSINESS

An Owner's Guide to Retiring Rich

Treat Your
Company Like an
Investment

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Introduction

About the time I completed my 1,000th business valuation, I started to notice two disturbing trends with my clients. The first was a major disconnect between the actual business value and the owner's perception of that value. The second trend was that in most situations, the business owner's largest financial asset was the company, but they did not view it as an actual asset or investment. My clients were spending a considerable amount of time and money with their investment advisor growing their stock and bond portfolios, while putting no effort into knowing and growing the value of their largest asset—their business.

About the same time, I read some articles by Chris Mercer, the CEO of Mercer Capital, discussing the concept that business owners should treat their companies like an investment. His writings crystallized my ideas about this topic, and his influence on my thoughts can be seen in Chapter 2 of this book.

Once I noticed these trends, I started to recognize the major consequences that the business owners were having in not treating their business like an investment. I was convinced that if business owners simply changed their mindset and started to treat their business like an investment, they would have a greater sense of purpose and become wealthier. This discovery started my journey of preaching to all business owners that they need to treat their business as an investment. I am grateful for the opportunity to share my passion for the investment mindset in this book.

This book is written in an easy-to-read format with many real-life situations¹ so that you will be able to understand how your business is valued, be aware of ways to grow that value, and know the options available to exit your business. My ideas are intended to be understandable, straightforward, and direct. This book is not written for the professionals who serve the business owner but it is written directly to you—the business owner.

¹To protect the privacy of my clients, I have blended companies and situations into composites that provide you with the realities of the situation without specific details of any engagement.

I have four simple goals for you:

- To encourage you to have an investment mindset toward your business.
- To help you fully understand the valuation process and the key components in determining the value of your business.
- To provide strategies to help you increase the value of your business and develop a plan of action to grow that value.
- To let you know all your options to exit your business and be able to select the strategy that best fits your situation.

If you can simply walk away from this book with a different view of your business and see it as your most important financial investment, then reading this book was well worth your time. If, after reading the book, you fully understand the valuation process, know how to increase the value of your business, and understand how to select your exit strategy, then this book will be a home run for you.

I cannot guarantee that reading this book will double or triple the value of your business in five years. The business world is complex, and you obviously don't have total control of your destiny. You can take all the advice in this book and still not have things turn out the way you want. However, when you gain knowledge and take action, your chance of being successful increases.

The book is divided into three different parts. Here is a summary of each of these parts:

PART I: Treating Your Company like an Investment (Chapters 1 and 2)

In this section, I will explain why your business is every bit of an investment as stocks, bonds, and mutual funds, and how cultivating an investment mindset about your business is the key to increasing value and building wealth.

I will also show you the consequences of not knowing the actual value of your business and why it is so difficult for you, the owner, to step back from your business and treat it as an investment.

You will also learn what steps to take in order to treat your business like an investment and the importance of each of these steps.

PART II: Knowing and Growing Your Business Value (Chapters 3–6)

After reading these chapters, you should have a solid understanding of how your business is valued and the strategies you can implement to increase its value.

I will explain the difference between enterprise value, equity value, and the net proceeds that you will receive after selling your business. In addition, I will explain all the processes and procedures that a professional goes through to determine the value of your business.

Once you understand the valuation process, I will discuss the three key areas to increase your business value and then present to you a detailed example so that you can see how small changes in your operations can result in big changes in value.

Lastly, I will take you through the process of selling from the time you decide to place your business on the market to the closing of the deal. My perspective on this comes from both successful and unsuccessful deals.

PART III: Getting Out Alive: Planning Your Exit (Chapters 7–10)

In the third part of the book, I will discuss in detail the various exit strategies and how to make a decision that is best for you. I will also explain why the entire process of choosing your exit strategy and determining your ultimate succession plan is so difficult. I will stress the importance of prioritizing this process well before your desired time to leave the business.

I present many actual scenarios to assist you in determining your best exit strategy and describe the process you need to follow to make this important decision. You need to understand all of the available options and perform an analysis to determine which exit strategy best matches your personal goals. Finally, I will show you how to develop a plan of action to make sure you are able to exit on your terms.

PART IV: Appendices

The appendices will provide you with a further understanding of the valuation process and the practical tools needed for those who are either selling their business or passing it down to the next generation.

This book was not written to make you a valuation expert and some of you may want to know more about valuation theory and standards. This is why I've included the IRS Revenue Ruling 59-60 and an excerpt of the AICPA business valuation standards. 59-60 is one of the most concise and practical writings on valuation theory. If you need to have a valuation prepared for IRS purposes, the AICPA excerpt will provide you with the IRS guidelines for business valuations and a comprehensive glossary of terms. Both of these items will assist you when you read a valuation report prepared for your company.

If you are going to sell your business in the next few years, the sample due diligence request will be of great benefit to you. This will give you a heads-up of what a potential buyer may request and will also act as a checklist to make sure you have the proper documentation and items that you will need for a buyer. On the other hand, if your goal is to transfer your business to the next generation, the sample family business creed will provide you with some ideas of what philosophy and rules you may want to set for family members who will be working in the business.

Final Words

Thank you for picking up this book. I hope after reading it you will look at your business differently and that you will see it as your most important financial investment. Finally, I hope you are able to retire rich and have many healthy years to enjoy the fruits of your labor.

PART

I

Treating Your Company Like an Investment

Country Club Lifestyle

Do You Know Your Value?

A sophisticated businesswoman in her sixties called me late one summer afternoon. “Mr. McDaniel, I would like you to value my company in order to complete a transaction with my nephew.” We spoke further and arranged a meeting for the following week. When I arrived at her company, I noticed how nice the furnishings were. It had the appearance of a very successful company. She provided me a tour and explained how the company started, her role in the business, and other relevant facts that were needed to prepare a business valuation. She explained to me that she was selling the business to her nephew, who worked in the company. He was in his late twenties and had been in the business for about six years.

I had seen numerous engagements like this one—a client wanting to use an independent valuator to set the price between related parties. It is required by the Internal Revenue Service (IRS),¹ and it often saves some bad blood between relatives down the road.

However, I was very surprised to find out that this engagement was different. When I asked her if my services and valuation report would be used to set the purchase price, she replied, “Oh no, the price is set. We just need a valuation report in order for my nephew to obtain a bank loan.” I asked, “What is the price?” She said, “\$2.5 million.” I continued, “How did you determine that

¹Transactions between related parties need to be at “fair market value,” or they may be considered a gift by the IRS and thus taxable.

price?” Without hesitation, she said, “This is the amount I need to support my country club lifestyle. I belong to an exclusive country club and if I obtained \$2.5 million, I will be able to maintain my membership at this club and live the lifestyle I want.” I was stunned by her answer. At that point in my career, I had been involved in more than 1,000 valuation engagements and never had a client provide an answer like that.

I proceeded with the engagement and determined that the company was worth significantly less than her expectations. It was my opinion that the company was valued at about one-third of her expectations—only \$800,000. Besides the \$50,000 salary that the nephew received from the company, he had no other financial resources and no bank would provide him with an \$800,000 loan, let alone a \$2.5 million loan.

How could this very smart businesswoman be so wrong? Why did she wait until she was in her sixties to find this out? Unfortunately, to maintain her country club lifestyle, she would have to continue working or find a fool who would grossly overpay at \$2.5 million.

Her compensation from her business was \$250,000, enough to provide her with the lifestyle she wanted. There was only one catch. She had to go to the office each day and work hard to make sure that her customers were happy, the employees were doing their jobs, and the bills were paid. If she would have sold her business at the true fair market value, she would have received close to \$600,000 after paying taxes and transaction fees. Like most business owners, her business interest was about 75% of her net worth. With her spending habits, the proceeds from the sale of her business would provide her with the lifestyle she wanted for only a few years.

While no one had ever told me they arrived at a price based on the country club lifestyle they desired to have, the details here are commonplace. Business owners guess at what their business is worth (their most important asset), and they typically guess wrong. Unfortunately, their guesswork leads to undesirable consequences.

■ **Note** The wealth of most business owners is tied up in the business, but the great majority have no idea what it is worth.

Based on my two decades of working with business owners, the following are some consequences that I have seen from a wrong guess of the true value of their business:

- Unable to retire at the lifestyle they expect
- Working more years than they had hoped

- Choosing the wrong time to sell their business
- Timing the transfer of stock to their children poorly
- Selecting the wrong exit strategy
- Not exiting the business on their own terms

What if the client had known that her business was only worth \$800,000 when she was 55 instead of 63? She could have implemented strategies to increase the value of her business and then lived the lifestyle she wanted. Alternatively, she could have changed her lifestyle to fit the actual proceeds she would receive when she sold her business. But now, it was going to be very difficult for her to remedy the situation at age 63.

Definitions

In this book, business valuation, succession planning, exit strategies, and the concept of treating your business like an investment will be extensively discussed. The terms succession planning and exit planning are commonly used and each business writer employs different definitions. Most use succession planning and exit planning interchangeably. However, I will not be using the term exit planning. Instead, I will use the terms *exit strategies*, *succession planning*, and the *investment mindset*. It is important that you understand how each of these terms are used throughout this book.

Exit Strategies

Exit strategies are the options that business owners have when they leave the business. The strategy that is chosen could have huge implications down the road.

There are only a few exit strategies for owners to choose from. Each will provide the owners with a different level of proceeds when they leave and will require different planning and timing to implement. The major exit strategies include the following:

1. Liquidate the business.
2. Retain ownership and have others operate the business.
3. Gift the business to your children or employees.
4. Sell the business to your children or employees.
5. Sell the business to an outside investor.

We will have detailed discussions about the advantages and disadvantages of each of these strategies, how to choose the best exit strategy for your situation, and how to implement the tips and ideas offered throughout this book.

■ **Note** There are really only five exit strategies for a business owner. The sooner you know which one you'd like to pursue, the smarter you can work to maximize the value of your business.

Keep in mind that you will exit your business whether you choose an exit strategy or not. Just this past week, a friend of mine who owned a CPA firm died unexpectedly. He had no exit strategy, and I have been talking with his brother about the options available to the family. Given the circumstances, the firm will either be liquidated or sold at a diminished value. It is unfortunate that a plan was not in place before his death; his heirs would have been far better off.

Succession Planning

One measure of great business leaders is the extent to which the business thrives once they leave their position. Succession planning is the process of preparing to hand over control of your business. There is no succession plan needed if your strategy is to liquidate the business when you stop working. But if you would like the business to continue after you are gone, then succession planning is both extremely important and extremely difficult.

Succession planning takes much more effort than establishing an exit strategy. A well thought-out succession plan will take years to develop and will include the following:

- An analysis of the various exit strategies
- Retirement planning
- Estate planning
- Personal and corporate tax planning
- A determination of the value of the business
- Insurance needs analysis
- Selection and training of future business leaders
- Contingency plans
- Timeline to implement the plan

Succession planning also requires the business owner to confront personal issues that are not pleasant to deal with, such as these: Do my kids have what it takes to be successful? Can I give up control and not interfere? Will I find fulfillment and purpose in my life away from the business? Will the business survive when I am gone? Can I face my own mortality and develop an effective estate plan?

Due to the complex and sensitive issues that must be faced, succession planning is a difficult process for many business owners. Unfortunately, most decide to delay the process until they are forced to deal with it and end up with less than optimal results.

There is a statistic that is quoted often in books and articles about family businesses. It states that only 30% of family businesses make it to the second generation, and less than 10% make it to the third. This is accurate but misleading. The truth of the matter is that most business owners do not want to pass the business on to the next generation. Some business owners start a business out of a passion for a product or service while others out of necessity due to a job loss or underemployment. A few begin a business in order to retire rich and sell at a large profit.

According to the United States Census Bureau, in 2008 there were 5.93 million existing business entities in the United States.² Of these business entities, 89.3% had fewer than 20 employees. These are typically small service companies whose owners have no intention of passing the business down to their children. So don't let this often cited and misleading statistic discourage you from accomplishing your desired succession plan.

Succession plans are effective when business owners have a strong desire for their legacy to continue and actively lead their families and organizations through this challenging process. The success rate for business owners that want the business to go to the next generation is much higher than the often quoted statistics. There is a great amount of satisfaction that comes from transferring what you have built to others and to helping them thrive.

■ **Note** Despite what you read, business owners who choose early on to leave the business to the next generation often succeed in passing along a valuable entity.

A key to accomplishing this goal is for the business owner to have an investment mindset.

The Investment Mindset

The majority of the net worth of most business owners is tied up in the value of their business. It is their most important investment, but it is rare that they view it this way. Among other reasons, the investment cannot be converted to cash easily, and it is difficult to value.

²United States Census Bureau, "Statistics of U.S. Businesses: 2008," www.census.gov/epcd/susb/latest/us/US--.HTM, retrieved on December 2012.

Business owners spend more time and money managing liquid assets (stocks, bonds, and mutual funds), which are easy to value and do not have the large potential for growth like their business does. They hire investment managers who assist them in managing their liquid investments and pay them a management fee based on a certain percentage of assets under management.

Typical business owners do not view their business as an “investment.” It is more of a “piggy bank,” “identity,” or “a job.” One of my goals in writing this book is to challenge the reader to have an investment mindset regarding the business.

An investment mindset is critical for business owners to accomplish their long-term succession goals and to increase the value of their business and their net worth. The investment mindset means that business owners will

- Know the true value of their business.
- Have the mindset to increase the value of their business.
- Implement actions to protect the value of their business.
- Know how to exit their business on their terms.
- Know the best timing to implement their exit strategy.

The next chapter will further explore why the investment mindset is important and how the business owner can obtain this mindset.

What Do You Want?

There are many books and consultants (including myself) that can provide you with effective tools to assist you in choosing the optimal exit strategy, create a robust succession plan, and provide you with advice on increasing the value of your business.

The problem I have with some of these books and advisors is that they never start with the most important question:

■ **What do you really want to happen?**

For example, do you want

- To ensure that the business continues under the same care and culture that you developed?
- To let your children or employees have the business even if it means that you don't get the true value of it in return?

- To sell the business for top dollar and never look back?
- To continue to dabble in the operations after you no longer own the business?
- To die at your desk and let your family liquidate the business?

There are different strategies and methods to assist you in accomplishing any of these goals. You can hire outside advisors, read books, and consult with family members. But at the end of the day, you are the only one who can answer the following question:

■ **How do you leave the business on your terms?**

Before starting down the path of setting your exit strategy and your succession plan, think long and hard about how you would like to exit your business.

Whatever path you choose, you need to know the true value of your largest investment (your business) and treat this investment like the important asset that it is. This rarely happens in the real world due to the consuming nature of being a business owner. Many times, it takes a major event to the business owner's personal life (divorce, heart attack, etc.) or to the business itself (poor results, death or birth of a product line, etc.) before there is any urgency to the process.

■ **Important** Don't let a major, unexpected event like an illness dictate your exit strategy. Have a plan in place so that you are prepared if disaster happens.

The Business Owner's Dilemma

Based on the 2,000 exit strategy/valuation engagements that I have been involved with, I believe that usually 60% to 80% of a business owner's net worth is tied up in the business. As a business owner, you cannot spend this wealth and probably do not have a plan to convert it to cash. In the back of your mind, you know that you should step back from the business and actively manage your most important investment. But it is not that easy.

You have risked it all, putting your house on the line, and working 80-hour weeks to make sure the business survives. Years later, you have created a valuable business. At this point, you may not be working 80 hours a week anymore

or living on a shoestring budget. But the day-to-day demands of the business are still there. Every day, you have to make sure of the following:

- Your customers are happy.
- Your employees are doing the right things.
- There is enough money in the bank to pay the bills.
- Taxes are paid.
- You have the right inventory levels.
- The receivables are being collected.
- No one is stealing from you.
- Your products maintain your high quality standards.
- You do not have Environmental Protection Agency (EPA) or workers' compensation issues.
- You can answer banker and auditor questions.
- You can cover for an employee who quits or is ill.
- You have time for your family.

The dilemma is that the demands of the daily business issues have to be dealt with, but you are not getting any younger. Time is marching on. The good news is that life is not boring, but the bad news is that the day-to-day focus keeps you from stepping back answering these important questions:

- What is my largest investment worth?
- How do I increase its value?
- How will I exit my business?

It is rare when I meet business owners with a well thought-out plan to exit their business on their own terms. This is due to two major obstacles that most business owners face. First, they work *in their business* rather than work *on their business*. Second, they focus on the *urgent* issues and not the *important* issues. Two best-selling business books have taken these obstacles head on.

Working in Your Business

The tyranny of working in the business day to day is one reason why the business owner is not proactive in managing the business like an investment.

In his best-selling business book, *The E-Myth*, Michael E. Gerber explains this phenomenon as he explores different entrepreneurial myths (HarperCollins, 1995). He states that most new businesses are started by technicians who

enjoy the day-to-day operations. They focus on working in their business rather than being strategic. They eventually fail because, as they grow, the business becomes more complicated and they are no longer able to effectively manage the business.

Gerber's focus is on getting business owners to "work on their business" instead of "working in their business" allows them a greater chance of succeeding. I agree with this premise and wish to expand his thoughts to not only operational issues, but to the big picture of how to exit your business on your terms.

You can only maximize the value of your business and implement a successful exit strategy by choosing to stop working in your business and start working on increasing the value of it.

■ **Note** Spend time working *on* your business as well as *in* it.

Important But Not Urgent

The 7 Habits of Highly Effective People, by Stephen R. Covey, has impacted the lives of millions (Free Press, 1989). My personal copy of this book is falling apart because I have referred to it so many times.

All of the seven habits are important to consider. But in order for you to exit your business on your terms, it is critical that you understand and embrace Habits 2 and 3.

Habit 2 is to *Begin with the End in Mind*. Covey encourages readers to examine their behavior in the context of what is really important to them. He goes into great depth about people being busy and efficient but not being effective because they fail to accomplish what is really important to them in life. He begins this chapter by having readers imagine that they are witnessing their own funeral and determining what they want others to say about their lives.

Habit 3 is to *Put First Things First*, and its chapter is subtitled, "Principles of Personal Management." The emphasis of this habit is to organize and execute around priorities determined in Habit 2. You cannot be effective with Habit 3 until you have defined what is really important to you. Without first determining what is important to you, Habit 3 has no power because you cannot separate what is important from what is not.

In the chapter on Habit 3, Covey introduces the time management matrix, which plots the concepts of urgency and importance into four quadrants.

These quadrants represent where you are spending your time. The following is my version of Covey's matrix tailored to the business owner:

	Urgent	Not Urgent
Important	I Pressing customer issues Production issues Key staff replacement Lawsuit	II Strategic planning Succession planning Value creation New opportunities
Not Important	III Some phone calls Most e-mails Some complaints Meetings with no impact	IV Internet surfing Expense reports Junk mail Office pools

Typical business owners spend most of their time in Quadrants I and III, the urgent categories. This is truer today than when Covey wrote his book in 1989. With the recent economic slump, we all must accomplish more with fewer resources. Also, when Covey wrote his book, e-mail and instant messaging were in their infancy. In today's world, there is now the expectation of instant answers from our e-mail culture. It is so difficult not to be driven by the concept of urgency.

No one is calling you up and demanding that you know and increase the value of your business. There isn't an urgent e-mail saying you must spend this Friday working on your exit strategies. You might get some nudges from your spouse or advisors on occasion, but it rarely rises to the urgency phase.

■ **Note** Time spent on important but not urgent things is time well spent and is where value is created.

The only time exit strategies, succession planning, and valuation issues reach the urgent level is when a crisis happens. The following are events that cause these issues to reach the urgent level:

- The death of the business owner
- A serious illness or accident
- The divorce of the business owner
- A child quits the business out of frustration

- Lawsuits between partners or family members
- Owner burnout and depression

Unfortunately, when succession planning becomes urgent, mistakes are made, value is diminished, and relationships can suffer damage. Concentrating on Quadrant II on a consistent basis is absolutely fundamental to achieving the right plan for you and your family.

How Will It End for You?

Determining how you want to exit your business and establishing your succession plan are both important, but not urgent issues. Yet it is vital that the business owner be proactive with these important issues. In Part III, I will discuss how business owners can do this and answer these questions:

■ **What do you really want to happen?**

■ **How do you leave the business on your terms?**

In my practice, it is important for me to get a conversation going with my clients on these critical questions. That's how I help them along the way with their desired path—and how I will be helping you in this book.

Deciding on your legacy will be one of your biggest challenges. Success is very rewarding, and failure in this area can be costly.

Summary

It is critical that you actually know what your business is worth. Guessing at its value based on your personal needs will lead you down the wrong path.

It takes a great deal of planning and effort to exit your business on your own terms. You must step back from the day-to-day operations and the tyranny of the urgent and focus on creating value and planning for your exit of the business.

One way of doing this is to develop an investment mindset toward your business. With this mindset, you will have a much greater chance of leaving your business on your terms.

The Investment Mindset

The Key to Unlocking Value

How would you like to have \$23 million in the bank by investing only \$1,000 a month? It can be done.

The catch is that you have to invest monthly for 30 years and the annual return on your investments needs to be at least 20%. If you are able to get this type of investment returns, you do not need to be reading this book. In fact, you should write your own!

It is amazing how small changes in the rate of return that you earn on your investments have an effect on your future net worth. This same investment of \$1,000 a month for 30 years is only worth \$832,000 at a 5% annual rate of return and \$2,260,000 at a 10% annual rate of return. As you can see, the rate of return that you earn on your investments is a critical factor in building wealth.

The goal of all investors is simply to exit their investment with more wealth than they had when they made the original investment. This is true whether it is stocks, bonds, a savings account, or a business. The expectation of growth in their personal wealth is different for each type of investment. If you take on significant risk, for example, there is an expectation that you may earn a large return on the investment.

All investments have risk. This includes investments that are considered to be safe, such as United States Treasury Notes or certificates of deposit (CDs) at a strong bank. Investing in or starting a business is much more risky than these

safe investments. It is unlikely that you will lose any of your original investment in a CD. However, you can lose your original investment, and even your house, when you start or buy a business and it fails. Therefore, the expected annual return on an investment in a business should be significantly higher than the return from a CD.

Basic Investment Principles

Let's now look at basic investment principles and how they relate to the ownership interest you have in your business.

There are a plethora of investment philosophies and advisors in the marketplace. Investment advisors will tell you where to invest your money, assist you with your investment goals, and guess on where the markets are heading. If you asked 100 different advisors for investment advice, you would get 100 different answers.

However, there are some basic investment principles that are universal. Most investment advisors believe that investors should take the following steps:

- Know the value of their portfolios at all times.
- Have a plan to grow their investments.
- Protect their net worth through diversification and wise choices.
- Establish an exit strategy for their investments.
- Implement their exit strategy at the right time.

An easy summary of these basic investment principles is this—investors should know, grow, and not blow the value of their investments.

■ **Note** Investing 101: Know, grow, and don't blow your investments.

Investors will have different goals and strategies in the various stages of their lives. Each has different personal needs and risk tolerance levels. In addition, there are so many investment choices in the marketplace; therefore, no off-the-shelf cookie cutter plan will meet the needs of any one investor. For most, investing is too complicated or frightening to do on their own. This is why most investors hire an outside investment advisor.

Investment advisors get paid one of two ways. They either earn a commission from selling a product, or they charge an advisory fee. Some advisors receive payment both ways. An investment advisory fee is usually based on a small percentage (1% to 2%) of the total assets under their management. This

fee not only includes payment for their investment advice, but also includes reports on the value and earnings of your investments.

Paying a fee to an effective investment advisor can be a very wise choice. Remember how we started this chapter. A very small change in the annual return rate earned will have a large impact on the future value of your investments.

■ **Note** It is worth hiring an investment advisor if the advisor can achieve a higher return on your investments than you can on your own.

Is Your Business an Investment?

Absolutely!

You started your business with a monetary investment and a lot of hard work. The expectation is that you will earn a return on this investment. Your return will come through the distribution of profits or by having a very large salary. In addition, you hope to earn an additional return on your investment by selling your business for an amount higher than your original investment. Hopefully, a lot more!

Some entrepreneurs have become extremely wealthy by investing in a business (e.g., Steve Jobs of Apple), while others have lost their entire investment and more. Putting money, blood, sweat, and tears into a business is as much of an investment as buying stocks or mutual funds. However, most business owners do not view their business as an investment. A 2007 survey by Laird Norton Wealth Management highlights this point.

Laird Norton Wealth Management is an investment advisory firm in Seattle, Washington. Every so often, the firm publishes a comprehensive study on the state of family businesses and how prepared business owners are for their future. The most recent national survey, “Family to Family: Laird Norton Tyee Family Business Survey 2007,”¹ was based on 788 responses from business owners across the United States. More than 85% of the businesses surveyed had revenues between \$5 million and \$30 million, and all of these businesses had been in existence for at least five years.

¹Laird Norton Tyee, “Family to Family: Laird Norton Tyee Family Business Survey 2007,” http://familybusinesssurvey.com/2007/pdfs/LNT_FamilyBusinessSurvey_2007.pdf, retrieved on December 2012.

The survey included the following observations about these family businesses:

- About 60% of the majority shareholders were 55 years or older and 30.1% of them were over the age of 65.
- Only 54% had a written strategic plan outlining the direction of their company.
- Of those surveyed, 71% had no succession plan in place.
- A total of 93% of the business owners had no income diversification and were totally reliant on the business to meet their lifestyle needs.

Also, based on my own personal observations and other family business surveys, it appears that most business owners do not have a formal valuation prepared periodically to determine the value of their business.

This information indicates that most business owners are nearing retirement age and are totally dependent on the business for most of their income needs. They have no plans on how to exit their business. They do not know what their most important asset is worth and have no plans to increase its value. In other words, they do not treat their business like an investment because of these reasons:

- They do not know the value of their business.
- They do not have the mindset to grow the business value.
- They are not diversified; therefore, they are exposed to the possibility of large losses in their net worth.
- They have made no plans on how and when to exit their business.

I started this chapter by asking if you would like to have \$23 million in 30 years. It's a silly question because of course you would. Your business is just like any other investment—small changes in the annual growth rate will have a large impact on your net worth over time. This table shows how the value of a business changes with different annual percentage increases in value:

Value today	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000
Annual percentage increase in value	5%	10%	20%
Value in 5 years (rounded)	\$ 1,276,000	\$ 1,611,000	\$ 2,488,000
Value in 10 years (rounded)	\$ 1,629,000	\$ 2,594,000	\$ 6,192,000

Your business is no different than your other investments. Small changes in the annual rate of return will have a large impact on the future value of the investment. The major difference between your business investment and your

other investments is that the business is a much larger part of your overall net worth. Growth in the value of your business will have a greater impact on your net worth than the growth in your other investments. Consider this example.

April owns a business, and she has a total net worth of \$5 million. Her net worth consists of the following assets:

- Value of the business: \$3 million
- Marketable securities: \$1 million
- Real estate and other assets: \$1 million

She reads the *Wall Street Journal* on a daily basis and has quarterly meetings with her investment advisor to discuss her marketable securities portfolio. Her goal is to earn a 7% annual return on her marketable securities over the next ten years and then retire. If she achieves her goal, the securities will be worth \$1.97 million. If there is no growth in the value of her business and other assets, her net worth would grow to \$5.97 million.

Now let's assume that she is also focused on growing the value of her business at the same 7% rate over the next ten years. If she achieves her goal, the business will be worth \$5.90 million. If both the business and marketable securities investments grow at 7% annually, her net worth would grow to be \$8.87 million in ten years.

By focusing on growing her business along with the value of her securities, April's net worth will be \$2.9 million higher ten years from now.

■ **Note** Your business is an investment. If you treat it as an investment, it will have a large impact on your future net worth.

Treating Your Business As an Investment

How can business owners treat their ownership in their business like the important investment that it is?

Let's go back and remember the basic investment fundamentals discussed earlier and apply these to a business interest. In order to treat your business like an investment, you must take the following steps:

- Know the true value of your business.
- Have the mindset to increase its value.
- Implement actions to protect the value of the business or diversify.