

Wiley Finance Series



Equity Value Enhancement

*A Tool to Leverage Human and Financial
Capital While Managing Risk*

A breakthrough strategy to amplify intangible assets and transform equity value—
the role of midmarket governance, relationships, risks, and knowledge



CARL L. SHEELER

WILEY

In our holding company and in two of the single family offices I help run, the blueprints of value machines themselves are worth millions of dollars, and can be leveraged in many different industries or asset classes. While most books on the industry focus on statistics or outdated stressing of fee-only models, no other publication dives into the structures that drive value creation for ultra-wealthy families like this text does. In fact when you first start reading the book you will realize it speaks to professionals who are operating on another level in the space. I have hired Carl to speak at our most private and exclusive events for single family offices and \$100M+ families and if you read this book you will see exactly why and be glad you spent the time doing so.

Richard C. Wilson is the bestselling author of *The Single Family Office: Creating, Operating, and Managing Investments of a Single Family Office*,
Wilson Holding Company, Key Biscayne FL

Carl's book brings a refreshing twist to the valuation discipline. While most equity valuation literature out there focuses on technical and methodological aspects, Carl thinks outside of the box and delves into unique concepts and tools, namely, Governance, Relationships, Risks, and Knowledge (GRRK) and risk Identification, Measurement, Management, and Mitigation (IMMM) that lead to Equity Value Enhancement (EVE). This book is especially useful for valuation professionals who desire to be more than just routine commodity service providers and have a greater calling to become pro-active participants of a holistic advisory team integral to helping companies produce results, reduce operational risk, and leverage on and maximize valuable intangible assets.

Angela Sadang, MBA, ASA, CFA, Director, Financial Advisory Services,
Marks Paneth LLP

Carl is a very introspective individual. He approaches family businesses and public companies with a holistic approach; not just a single focus. Having grown up in a family owned business in manufacturing and working with many family businesses, I know firsthand that Carl understands the dynamics inherent in certain family businesses, and that provides true value. Carl has a talent for sizing up a business for its value, challenges, and governance. Having worked with him, he is someone I would love to work with again for his impressive and consistent ability to create value and help businesses grow.

James M. Hill, Chairman of the Private Equity Practice Group, and
former Managing Partner, Benesch, Friedlander, Coplan & Aronoff LLP,
Cleveland, OH

This wonderful book shines a light on a universal but widely unrecognized truth: value is only created in the networks of relationships, conversations and commitments between people. The failure to look beyond the numbers to cultural and systemic factors goes a long way to explain the dismal record of value destruction in mergers and acquisitions across the globe. Carl's book is

essential reading for executives, advisors and investors seeking sustainable value creation strategies.

Paul Sweeney, Managing Director, Berkeley Research Group (UK) Ltd,
Berkeley Research Group (UK) Ltd, London UK

While advisors provide advice to their clients, Dr. Carl Sheeler, based on 2 decades of experience and research, targets the advisors so that they can better assist their clients. As a professional appraiser, I fully agree with Carl that GRRK is so important to see what's driving operational performance. I am sure appraisers and other advisors will be able to become trusted advisors and provide the advice that clients need to enhance the value of their businesses after reading this book.

Chengjun Wang, Phd, FRICS, ASA, FCPV, FCPA, Vice-Chairman, Senior
Partner, Zhonghe Appraisal Co., Ltd., Beijing PRC

Dr. Sheeler's Equity Value Enhancement should be a wakeup call for business owners, large corporations and the people who provide a wide range of services to these firms. Sheeler sheds light on the tangible and intangible drivers of business value. His perspective is valuable for both business owners and their advisors. His approach to explaining the many ways business value is misunderstood and miscalculated is insightful and important. He does an exemplary job of establishing a foundation of understanding about the tangible and intangible drivers of business value and then providing the "how-to" approach to accessing and optimizing the benefits of a strong advisory team. The book also clearly articulates the sources of value creation for advisors. For a diverse range of service providers, he trumpets the criticality of differentiating themselves by going beyond their technical expertise to offer valuable perspective and advice, founded on understanding, that can help owners enhance business value. Equity Value Enhancement offers vital insight and offers an indispensable learning tool for all business leaders and the professionals who service them.

Carol E. Robbins, Executive Business Driver & Digitally Savvy Brand
Builder

This isn't just another book to stick on the shelf - it is a tool to be utilized. Carl has taken complex concepts and transformed them into accessible, actionable recommendations. What Carl refers to as "technical myopia" costs business owner clients vast amounts of money each year, but it doesn't have to be that way. With the largest transition of generational wealth well under way, Carl's approach to Equity Value Enhancement is a must read for advisors and business owner's alike.

Allie Harding, Partner at Orange Kiwi, LLC & PlanforTransition.com

With Carl's book, you find that a basic feature of modern enterprises is the need to create effective intangible assets through unique approaches. As a

professor, I gleaned from this that a business school should help its students identify the intangibles that are not disclosed by a balance sheet. This book opens a new window and shows the reader how to judge the value of a business with innovative thoughts and methods that transcend the typical limitations of valuation analysis.

Haisu Wang, Professor and Director of Research Center of Business Value, Zhongnan University of Economics and Law, Wuhan PRC

Dr. Sheeler's book succeeds in impressing upon the appraisal and advisory community that risk identification and measurement need not be a commodity. The real opportunity lies in establishing a strategy and culture where owners and advisors align their activities to leverage their knowledge and relationships. The book's focus is on the necessity for the often overlooked risk management and mitigation roles. This separates the dabblers from the industry professionals and allows for more lucrative engagements while making a real difference for the owner and investors in both liquidity and legacy.

John K. Paglia, Ph.D., CFA, CPA, Associate Dean & Associate Professor of Finance, Pepperdine University Graziadio School of Business and Management, Los Angeles CA

Carl Sheeler moves past the limiting aspects of valuation analysis by creating the Governance, Relationships, Risks and Knowledge framework. GRRK gives advisors tools that leverage governance into culture, relationships into advisory boards, risks into opportunities, and knowledge into insight. Applying GRRK methods to valuations provides insights and opportunities that advisors should share with clients to grow their businesses, expand their influence within their markets, and grow professional networks that can be new sources of revenue. The business services industry is moving away from hourly rates towards value pricing. Consultants should use this book and elevate service offerings to become deeply trusted advisors who bill on their value and not on their time.

Vito Colombo, Principal, Trügli Consulting, Middle Village NY

Carl Sheeler's work is a fine contribution to the field of applied and practical economics, which at a certain basic level is to understand human behavior. It succeeds because he simply makes sense. This is no easy task, and it is no minor contribution. Sheeler's work is important to advisors and clients alike, as it reminds us to focus on adding value and managing risk in pursuit of excellence by focusing on the relationships and practices that increase the probability of desired and desirable outcomes. This is a book worth keeping off the shelf and on the nearby table to use as a practical guide and reminder of sustained best practices.

Richard Levine, Esq. and Adjunct Prof., Colorado School of Mines, Law and Economics, Evergreen CO

Most business owners believe their value comes from what appears on their financial statements – sales, gross profit, EBITDA or net income. However, all acquirers buy the future, not the past, and the future is always driven by intangibles. In Equity Value Enhancement, Carl Sheeler creates a compelling argument for why and how business owners should use A-level advisors to identify and leverage their intangibles to maximize the value of their time, effort and investment.

Timothy G. Malott, Partner, Shoreline Partners, LLC, President/CEO,
ShP Securities, LLC

Equity Value Enhancement is a must for any business school, private equity firm or investment banking firm worth its salt. Carl takes an esoteric subject, equity valuation, and makes it come alive, in all its facets—well beyond ‘the transaction’, and carves a path for those who would endeavor to become better at being strategic value architects. His lessons on understanding the differences between value, price, worth and risk are intellectually thought-provoking, motivating, engaging, full of wisdom and fact-based. Frankly, I wish I’d had his book in hand three years ago. An excellent and well-organized read that you’ll take to the bank

Lara Abrams, Managing Member, Lara Abrams Communications, LLC

Exceptional! I wish I had this information when setting up our generational investing plans. What Carl addresses goes beyond practical advice to encompass contrarian viewpoints that every advisor and family member should consider. Attention to focusing on the cost-benefit analysis of the provider-client relationship as a key metric is a valuable consideration too often ignored by those who select a provider based simply on a friend’s recommendation. Reading this brought me to the realization that the way to analyze provider-client relationship is not simply by what is offered, but by the value of the provider as a knowledge base on how to preserve and grow equity, from someone with skin in the game, from the very beginning of the provider selection process throughout the length of the relationship.

Bill Townsend, Founder, Best Selling Author, Interminds, Pasadena CA

Over an almost 40 year career I have been an investment banker, an advisor to private equity firm management teams, a company director and an owner of small businesses. Mr. Sheeler’s book expertly describes the way to optimize the effectiveness of professionals in each of these rolls (and several more!). I wish I could have read it 40 years ago. I could have avoided lots of on-the-job learning!

Kevin K. Albert, Managing Director, Pantheon Ventures, New York NY

Equity Value Enhancement

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CARL L. SHEELER

WILEY

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There are six heart-felt dedications: to my family, my extended military family, business owners/executives, trusted advisors, my team, and my editor.

My family: *My precious wife, Sara, is the right-brain Shaman who keeps my left brain centered. She's an artist and a blessing. We're not Ozzie & Harriet. We both have been remarried and have five kids between us. There's that love-hate continuum that undoubtedly is exacerbated by work-life imbalance. They mean the world to us both.*

My extended military family: *Both Sara and I served in the USMC and will always have a special kinship to those who have served and their families. A good portion of the net proceeds of this book will ensure that their sacrifice and they are not forgotten.*

Business owners/executives: *The business media and our elected officials often give little notice to these unsung heroes. They may not be Fortune 500 companies, but they brave the odds and are the backbone of the U.S. economy by mastering the management of concentrated risk. Every advantage should be afforded to these companies and their success. This book is for you. You understand values are more than numbers.*

Trusted advisors: *Business owners, heed my praise and admonition. These are top-flight folks whose knowledge and relationships far exceed what they're paid. There are concierge advisors who don't define themselves by their professional titles. Instead they leverage their knowledge and relationships to the advantage of their business clients and fellow advisors with whom they collaborate. They are connectors. They invest the time and resources to develop deep relationships, not solely more transactions. This is why I see myself as a steward, a chief-of-staff, and a "strategic value architect." Trusted advisors who embrace the "it takes a village" notion of collaboration, I dedicate this book to you.*

Kelly, Rafiq and Boxy: *I would not know which day it is, when and who to call, and where to go without your steady reminders. You are my magic ecosystem that frees up invaluable time and the best human capital I have*

had the privilege of knowing. May abundance befall you and yours. God bless.

Adrienne Moch: I've been at this for three decades and I am not always able to string the right words to my thoughts to ensure the best balance of communication and intent. If you love purple and Chicago and somebody who edits like no tomorrow, contact Adrienne.

It is not the critic that counts; not the man who points out how a strong man stumbles, or when the doer of deeds could have done them better. The credit belongs to the man who is actually in the arena, whose face is marred by dust and sweat and blood; who strives valiantly; who errs, who comes short again and again, because there is no effort without error and shortcoming; but who does actually strive to do the deeds; who knows great enthusiasms, the great devotions; who spends himself in a worthy cause; who at the best knows in the end the triumph of his achievement, and who at the worst, if he fails, at least fails while daring bravely, so that his place shall never be with those cold and timid souls who neither know victory or defeat.

—Theodore Roosevelt

On April 23, 1910, Theodore Roosevelt, the 26th President of the United States of America, gave this compelling speech in Paris, France. Its wisdom is as applicable today as then.

Contents

Foreword	xv
Preface	xix
Acknowledgments	xxxi
About the Author	xxxiii
Author's Vision and Challenge	xxxvii
CHAPTER 1	
Value ABCs	1
Capital and Risk	4
Understanding Assets	5
Plugging the Gap	7
Notes	8
CHAPTER 2	
Focus on Trusted Advisors	9
The Path to Being the Best	16
Question Yourself	18
Taking It to the Next Level	19
Notes	22
CHAPTER 3	
Focus on Business Owners	23
The Role of Advisors	27
The Cost of Bad Advice	28
The Value of Leveraged Knowledge	29
Engaging the Best	31
Practical Vetting Suggestions	32
Size and Scope Considerations	33
Setting Expectations	34
Note	44

CHAPTER 4	
Risk in the Eye of the Beholder	45
Inexperienced Business Appraiser Lenses	47
CPA Lenses	48
Attorney Lenses	51
Investment Banker/Business Broker/Business Intermediary Lenses	52
Commercial Banker Lenses	54
Insurance Professional Lenses	55
Wealth Manager/Financial Advisor/ Fiduciary/Trust Officer Lenses	55
Research on Risk and Returns	59
Economist Lenses	60
MBA/PhD/CFA Lenses	61
Owner/Family Lenses	63
Family Business Advisor Lenses	70
Staff/Vendor Lenses	71
Client Lenses	75
Notes	80
CHAPTER 5	
The Role of Governance	81
Governance	83
Focus on Culture	84
About Boards, Governance, and Strategy	85
Healthy Board Governance and Strategy Creates Value	87
Strategy and Equity Value	90
Family Harmony and Legacy as a Governance Driver	93
Board Strategic Direction and Accountability	94
Board Structure and Member Traits	95
Governance and Risk Management	97
Qualitative Value Measures	98
Taking Control	99
The Secret Sauce	101
Governance Measurements	104
Governance Takeaways	106
Notes	106
CHAPTER 6	
The Role of Relationships	107
Client Relationships	112
Advisor Relationships	114
Commercial Bankers	116

Investment Bankers	116
Insurance Agents	118
Wealth Advisors	120
Board of Directors	121
The Bottom Line on “Free” Advisors	122
Accountants	122
Attorneys	126
Fractional CFO	127
Family Relationships	128
Shareholder Relationships	129
Vendor Relationships	129
Community/Legislative/Philanthropic Relationships	130
CHAPTER 7	
The Role of Risk: Financial- and Legal-Oriented Risk	131
Commonly Missed Risks	137
Final Thoughts	172
Notes	174
CHAPTER 8	
The Role of Risk: Operational-Related Risks	175
CHAPTER 9	
The Role of Knowledge	241
A Matter of Culture	244
Healthy Knowledge	247
Be Transparent	248
Encourage Two-Way Communication	249
Knowledge and Human Capital	249
Knowledge Measures	252
Notes	253
CHAPTER 10	
Valuation versus Value Creation (GRRK)	255
Software and Rules of Thumb	258
A Personal Aside	260
Collaboration, Cohesion, and Transformation	261
Notes	262
CHAPTER 11	
Putting It All Together—Four Vignettes	263
Vignette One: What the 2009 Financial Crisis Can Teach Us (It’s about Relationships)	265

Vignette Two: The Trees-and-Forest Syndrome	272
Vignette Three: The Path Not Taken	275
Vignette Four: Putting It All Together (Strategy, Human Capital and Finance)	284
Recommended Reading	313
Index	317

Foreword

I have known Carl for 20+ years from the first time he walked me not only to the door of his office, but to the elevator to the lobby and out to my car. I knew this was somebody with whom I would do business. He walks the talk. We've been referring top clients and advisors back and forth ever since.

Philosopher and Nobel Prize winner Albert Camus stated, "Real generosity towards the future lies in giving all to the present." Never before have words jumped off pages of a valuation and equity value creation book and impacted me the way Carl's book has. I'm not surprised. Valuation usually presents itself as an academic exercise, but it is in fact a tool that can change people's lives, and it's about time somebody said so.

The greatest risk of any wealthy individual's life is that they never achieve some significant measure of fulfillment while on this planet—as Carl references from "success to significance."

While success for a few might be defined as the amount of money or assets they accumulate during their lifetime, for most it is the less calculable metrics of having the time to do good in their communities. It is the way posterity will remember their family's name or legacy. Carl's book bridges this gap from this holistic "ecosystem" perspective to that of the families' "constituents"—most often thought of as their advisors and clients but, as he illustrates, much, much more.

The greatest risk for any professional advisor (I am referring to accountants, attorneys, bankers, and financial advisors), assuming they serve wealthy entrepreneurial individuals, families, and Family Offices, is that they will only contribute to wealth preservation by offering common product and services. They will seldom make any measurable contribution to the more hard-to-measure attributes for their wealthy clients (and for that matter, for themselves). Carl's book offers an alternative narrative where all achieve an aligned vision and share in the success.

I am a certified public accountant and my business office is physically located within a multi-family office. Here, we primarily serve two ultra-wealthy families, originating from two brothers and their spouses. They had 6 children who in turn have had 19 children, making us a third-generation family.

While I am a CPA, I do not prepare income tax returns or financial statements, which are the two services most typically associated with being a CPA. I do indeed review income tax returns prepared by other CPAs on our families' behalf, and sometimes also work in other technical areas, such as income tax controversy representation and estate and gift tax planning and reviewing legal documents.

For the most part, I assist my families with matters that might be described as nontechnical, which are typically not associated with being a CPA. I have been serving these families for almost 25 years. I call what I do "family governance."

But as Carl points out, I leverage my knowledge and relationships. This translates into differentiation and a higher level of services, superior clients, and more revenue.

I have known Carl on a professional and personal basis. His grasp of families' governance issues—a charter, its strategy and execution, as well as its value measurement and management—is rarely matched. Family governance means I am available to Family Office employees and owners and members (patriarch, CEO, CFO, etc.), to family members who are not actively participating in the Family Office's operations, and to all of the professional advisors that serve the Family Office and all of its individual stakeholders.

Carl's and my main focus is to remain central to (*consigliere*) all of these associated relationships, so that an open and transparent platform exists. Our main goals here are:

1. Make sure that all of the work that we do is consistent with the families' value and mission statements and culture.
2. Provide all stakeholders (*constituents*) an easy-to-access resource to ask questions and discuss ideas. Help them find and leverage resources they want and, in essence, help in any way we can.
3. Save the valuable time of key personnel in the Family Office or family business who do not want to ask 10 different professional advisors the same question.
4. Look at all of the risks associated with the business decisions we make, with an "outside view" so that we do not have bad surprises.

Also, and not solely associated with my own Family Office services, we counsel CPAs, attorneys, bankers, insurers, and wealth advisors. My focus for wealth advisors is to help them to make the CPAs they interact with heroes to the CPAs' very best clients. This is a different business model than what most wealth advisors use: Most try to reach end-users (aka customers or clients) directly and not through CPAs.

And for CPAs and attorneys, we assist them in becoming the Most Trusted Business Advisor to their very best business and real estate owning clients. This, too, is a different business model than that used by most. Like many advisors, they have a lot of clients, most of which are not of an “A” variety but rather are of “B” and “C” variety, and they focus on doing large volumes of compliance/regulatory work. This is a model for mediocrity.

Carl led a countywide initiative during and after the financial crisis called Strategic Trusted Advisors Roundtable (STAR). STAR addressed these professional deficiencies that culminated in a higher level of connecting of professionals in order that they might provide a more integrated, holistic, and economically more efficient and effective model of doing good for business clients and fellow professionals.

It also succeeded in enhancing the depth and breadth of each member’s service offerings, resulting in higher billings and client caliber. It focuses on deeper relationships versus solely technical knowledge and transactions. I remain a board member and cross the bridge to bring broader perspectives than those limited to business alone.

When I present in public, which I do frequently, many CPAs, attorneys, and wealth advisors tell me that they would like to work with Family Offices. I like to point out, in response, that Family Offices exist, at least in part, because the traditional service models used by CPAs, attorneys, and wealth advisors rarely offer enough value to wealthy families and individuals. Thus, as Carl knows, inadequate value is one reason wealthy families create their own Family Office by taking these functions in-house.

Carl Sheeler is this country’s most forward-looking valuation and strategic advisory expert. I dubbed him a “strategic value architect”—a fitting moniker. He gives us a choice: “Do good work for your clients, by only focusing on what they want; or, make a significant contribution to improving your clients’ lives by helping them with what they truly need. The choice is ours.” Until then, and after, it is all GRRK™ to me!

Richard Muscio, CPA, is The Family Office Guy. He is best-selling author of *So, What’s Your Play? How Billie Jean, Bobby and Blindness Begat Tolerance*. Richard is a co-host of the “It’s Your Money and Your Life” radio show, voted Best Radio Series in San Diego by the San Diego Press Club for 2013 and 2014.

Preface

An investment banker introduced me to her attorney friend who had a client whose trust held shares in a 10-figure annual sales distributor. Most of the equity was derived from her mother's passing. Her mother's brother (her uncle) controlled both the company and her trust. Her uncle retained a national appraisal firm to substantiate an unusually low value both for estate tax purposes and to use the value to negotiate a buyout of her brother's and her shares. Both she and her brother, who had his own counsel, felt they were being slighted. They alleged their uncle was underreporting company performance and assets held. They alleged he had breached his fiduciary duty. They were worried about a drawn-out and costly confrontation with their uncle.

They just wanted what was bequeathed to them. This was a six-figure retention, which would balloon to a seven-figure engagement, which would allow me to acquire a dream ranch that offered equine therapy for both veterans and a retreat for business owners as well as well as solitude for my wife to do her art.

This book starts with this story because it sums up nicely how to distinguish between a "check-the-box" analyst who is evaluated by hourly rates and the expert who understands the premium placed upon wisdom and mastery that solves irretraceable problems. Think of Showtimes' Ray Donovan (Liev Schreiber) as a "fixer" of messes (without the gun).

Compare this with a recent communication with an attorney who had expressed on a listserv she felt the four-figure fee for an appraisal was too high after researching appraisal firms on the Internet. The rationale was the client would "know" the right amount because he would accept the buyer's offer. Why spend the money? Counsel was certain she understood fair market value.

I tried to dissuade her from her premise by using the following example: "If the seller was first offered \$100,000, but held out and received \$200,000, is this the value of the asset?" It may be what it is worth to the seller, but that is not necessarily the value of the asset. The buyer may have more experience and knows the asset is worth \$1,000,000. The buyer would have been willing to pay as much as \$800,000. So, the "price" differential of \$600,000 (\$800,000 - \$200,000) was money left on the table. And, if the seller had

found out? A flawed premise is a transaction between two parties establishes arm's-length value. The analyst is usually retained to identify value, assuming a reasonable exposure and marketing period with knowledge and access to capital under no duress. The notional investors are typically assumed to be a pool of transactions examining both the buy and sell motivations so intrinsic or synergistic value is isolated.

I used another example: "If legal services fees came to \$10,000 and the dispute was over property found to be worth \$10,000, would the client have overpaid for the services? Conversely, if the fee was \$10,000 and the benefit of the dispute was \$1,000,000, has the client underpaid?" The point is there is a difference between value, price, cost, and worth.

The examples illustrate that an hourly rate alone only meets the threshold of cost for services, where the value received may not be understood or appreciated by clients. They may commoditize services and will be resistant to fees if nothing above common knowledge is received. The advisor has a duty to articulate the value provided and not solely the price. Otherwise, the advisor is just as likely to minimize fees for services, making no distinction between good and great services.

The optics of the previous examples is understandable because professional services deliver human capital intangibles. What does good look like? This has long been the case for business valuation services. It is in large part why writing this book was important not only to my practice but to all professions and those who retain our knowledge and relationships.

The valuation community is still evolving. Some professionals and their entrepreneurial clients understand the merits of a well-crafted appraisal report with the associated intellectual rigor and research. I salute those who do and who are willing to pay a premium for quality work. This reinforces competence over commoditization.

For the reader who is an appraiser, she or he may be perfectly happy performing more routine work product. For the balance, I shall demonstrate there is more than simply identifying and measuring risk to benchmark business and equity values.

There is a greater calling to provide equity value enhancement (EVE). This is the premise of risk management and opportunity optimization, and the elevated ability to master disputes where risk is mitigated by both measuring the impact of risks existence and then to assist in their minimization or elimination. This is common in matters of alleged value impairment ("damages" and "discounts").

Our audience is the founders, families, boards, and C-suite of private mid-market through small-cap public companies, private equity, investors, and their trusted advisors. Our goal is to articulate how *governance, relationships, risks, and knowledge* (GRRK) allows the reader to become

a *strategic value architect* and a chief-of-staff who not only measures but can manage, facilitate, create, and maximize company intangible assets value through the leverage and alignment of human and financial capital. Only then is real value created above the assemblage of tangible assets.

Why GRRK? Successful businesses and entrepreneurial families often see their concentrated wealth as part of an ecosystem of family members, staff, client, vendor, and advisor “constituents.” They do more than consider revenues and profits. They focus on the family’s future expectations and harness a culture that goes beyond daily challenges. It’s when they are bogged down by the more familiar, yet less productive daily blocking and tackling, that they plateau and often seek to minimize advisory expenditures versus seeking to leverage the advisor’s time and talent investment. Protecting their asset becomes defensive versus embracing innovation and remaining on the offensive where reducing risk provides more time and resources to sense and seize opportunity for value growth.

Supersized, stellar growth occurs because these unique executives, founders/families, advisors, and involved constituents foster value creation by harnessing their collective *uncommon* knowledge and relationships (human capital). This is why those who harness the role of steward, chief-of-staff, and/or strategic value architect thrive, not just survive. Since value creation is dynamic, advisors who align with others are most likely to assist in achieving it.

Expressed differently, the wealthy often get richer not solely from hard work and competent concentrated risk management. They access unique opportunities often unknown to others. It affirms the notion of not only what *you* know, but whom you know and what *they* know. This is why “connectors” are much different than one-off isolated advisors

Steward-leaders have a culture and a strategy that assures success. Success is more than wealth. It is earned significance and respect. So, we have to assist in answering, “How are you getting from here to there?” We then identify resource gaps that may derail progress. If we assist in growth and transition, we have a seat at their table—one that is on the same side as the decision makers sit. We ask tough questions and find independent solutions and options. As important, we just don’t have a strategic plan. We have a plan that’s executed!

Knowledge and resource gaps occur. Sometimes there is a “bubble” or “silo” around and/or between each constituency. This serves to stifle innovation, growth, and profitability while failing to leverage opportunities or mitigate concentrated risk. This becomes evident when thinking is solely tactical and technical. Such thinking is often transactional and commoditized. It contributes to stagnation versus enduring proactive, strategic, and holistic planning that fosters growth.

As I wrote this book, there were significant market forces in play such as changes in capital availability and increased volatility of marketable securities that define in part how risk is measured. These factors do not impede twenty-first century innovations like the cloud or artificial intelligence, biotech, and other advances.

In each case, *risk* and its alter-ego *opportunity* are the cornerstones of how ideas and companies are valued. The difference is many wealthy families are pursuing direct investment with “patient” capital and vying with private equity groups for companies in which former may hold for decades, not just years. This is in part a reaction to the public company share price volatility that is less about company-specific risk and more on the speed and frequency of institutional trades.

To better understand the intellectual rigor to have enterprises and equities properly valued with risks identified that impact price multiples, we must have a certain degree of mastery of how value is created. This book goes to the heart of whether there is an over reliance on simply revenues and profits as well as financial ratios as current measures of company-specific risk. If so, we change the valuation industry discussion from measurement to active management roles needed by fellow advisors and business owners.

Who am I to ask and seek answers to such questions? I see myself less as a business valuation professional and more as a concierge and connector. The latter two allow me to be a strategic value architect and/or a chief-of-staff, as these attributes permit me to harness and align others’ knowledge and relationships. (I don’t need to be the smartest person in the room; I just need to know where she or he can be found.)

Before we delve into the issues that were the genesis for this book, here is a brief background of why I may be qualified to share my thoughts. During the past 25+ years, I’ve been engaged in valuing 1,200+ 7- to 10-figure public and private companies in myriad industries for clients ranging from professionals to private equity for what I refer to as the *6Ts*: tax, transfer, transaction, transition, transformation, and trouble (disruption) purposes.

I refer to these matters as either planned or unplanned events. Unplanned are disruptive. I have been a court/IRS-qualified expert on 170+ occasions for tax, partner, shareholder, and third-party disputes and damages matters. During this period, I have been asked to assist hundreds of advisors, family offices/businesses, ESOPs, private equity groups, UHNW investors and public and private businesses to measure, create, manage, and/or defend \$50+ billion in company values and counting.

After all this, I’m left with one humbling and overwhelming conclusion about business- and real estate-owning entrepreneurs as well as the trusted advisors who counsel them: We all don’t know what we don’t know. That

may initially seem a bit simplistic, but there's quite a bit of depth behind it—which is the reason for this book.

This book endeavors to address why ultra-high-net-worth (\$25+ million) entrepreneurs are able to continue to attain greater wealth through concentrated risk and why both private and public companies and their advisors who focus on more than financial statement measures may have better success. *After all how do you measure persistence?*

Spoiler alert! The UHNW have access to more and better uncommon knowledge. This knowledge truly is power. It is certainly true when it comes to valuation and, specifically, value creation.

SOME SOBERING REALITIES

From the fledging entrepreneur to the seasoned corner-office executive of a global company, growth decisions are made based on “build versus buy.” *Build* is organic growth, and *buy* is through merger and acquisition. It comes down to the risks and rewards of the time value of money.

No one chooses to start or acquire a business because they want to fail. Yet, the odds are stacked against even the most capable, regardless of which business path followed. Those who acquire must have adequate understanding of their capital needs (both human and financial) and their optimal utilization. Those who opt to go the angel investor/venture capital-backed route suffer a failure rate north of 90 percent. They often give up equity to their investors and set their sights on achieving hyper-growth as a result of their innovation.

However, those who choose the bootstrapping or “family and friends” funding route face a slightly better but still dismal failure rate near 80 percent within two to five years. They retain their equity, believing their idea will blossom into a sustainable business.

Small businesses (\$5 million and lower revenues) have only a 25 percent chance of selling. Larger businesses that are acquired fail to achieve the synergies sought over 80 percent of the time, creating seller's and buyer's remorse. And, within three generations, many family businesses usually cease to exist or have been sold at least 85 percent of the time. Advisors are either part of the solution or observers to these preventable, sobering statistics.

Why do entrepreneurs still pursue the brass ring given these abysmal statistics? They're usually spurred on by the businesses that do succeed—something I call *selection bias* (ignoring the preponderance that fail). Or, they are either unaware of or oblivious to the high potential of failure—something I refer to as *Economic Darwinism*. They believe in themselves and their idea, ignoring all potential naysayers. Their demise is often failing to plan, which is a plan to fail.

What does this have to do with value creation? It should be obvious: Those who have achieved significant value are exceptional in the manner in which their investment is measured and managed. Those who overlook these critically important metrics and actions are more apt to fail.

IMPROVING THE ODDS

It truly does take a village (*ecosystem*) to build and maintain a successful enterprise, whether an operational business or a portfolio of income-producing real estate. The endgame for most is legacy and liquidity: that is, to sell or transfer part or all of their equity. Most investors in public companies buy and hold stock looking for capital appreciation (growth) and secondarily yield (income).

Ironically, most private company owners/executives do not know the market value of their companies, nor do their advisors. They have to think more like investors in their companies. Building value is an ongoing process of equity value enhancement, not simply managing sales and profits because they're easier to identify.

Savvy business owners will seek advisors who can best help them create value. Other owners will be complacent, accepting familiar over greater capability. Therefore, advisors have a critical responsibility to leverage governance, relationships, risk, and knowledge (GRRK) in client equity value enhancement (EVE). And business owners can foster success based on the advisors they select to counsel them.

As an example, it's important to seek professionals who are able to discern between economics, accounting, and finance backgrounds for a valuation expert. Each background differs, with financial expertise being more than merely generating or reporting numbers. These professionals must understand what produces results and reduces operational risk while elevating intangible value and what causes equity impairments. Arguably, the ideal valuation expert ought to possess a blend of strategy, operations, finance, and human behavior knowledge.

Further, there is a great difference between risks *to* an asset and risks *within* an asset. The prior is often tabled as asset-protection or preservation activity and the latter deals with risks inherent to the asset, its market, and its management.

These considerations would be inherent in any value creation plan. Focus on advisors who are proactive. (Most are reactive.) You may find it eye-opening to ask existing and potential advisors how they differentiate themselves. If you can swap their name or that of their firm with another

name, they may not be adequately differentiating the influence of their knowledge and relationships to serve clients.

The ultimate holistic advisory team is likely to focus on elements of governance, relationship, risk and knowledge management and maintenance as a way to create value by leveraging intangible assets. It's not simply a financial capital game. It's a human capital one, too. It's about seeing what's driving operational performance. *Values are more than numbers!*

These are things an accountant, attorney, wealth advisor, insurance professional, or banker individually may not know—and may be unlikely to ask—so that's why a diverse advisory team is optimal. The ultimate advisory team is one that helps a company play an “A” game versus one that benefits from a company client that is playing their “A” game—a symbiotic versus a parasitic relationship.

THE OPPORTUNITY IS THERE

Many privately-held businesses were started by Baby Boomers who were contemplating some exit in the mid-2000s. Then, from 2007 to 2012, we saw the Economic Darwinism: Businesses that underperformed were swept out of the market.

Those that survived picked up the remnants of competitors, as fiat capital (U.S. denominated dollars printed and electronically infused through treasury bond sales keeping the market moving through “Quantitative Easing”). Some thrived. These owners now find themselves looking beyond today's operational realities and starting to conceive a strategy that may include the sale of part or 100 percent of their equity.

The best-case scenario is a sale prepared for and at price/terms that makes the equity attractive to sell and able to produce the net proceeds an investor seeks. Rare, but it happens.

This is where my lament “they don't know what they don't know” is derived. Business owners can be blindsided by issues they or their advisors never saw coming like hyper-inflation from too much quantitative easing or an all-out regional war in the Middle East or the impact of oil or water shortages on their business. I have intentionally designed this book to demonstrate that no single perspective is adequate to create and sustain concentrated wealth.

While there are several underlying issues, the theme focuses on unmet critical needs in the professional advisory communities and in multi-generational entrepreneurial families. These knowledge and resource gaps often dilute rather than create value.

This is exacerbated by transactional, technical, and tactical thinking and language that compounds the disconnect between the advised and the well-meaning advisor. Most advisors favor preserving wealth through legal, tax, financial, and allocation strategies. They use terms like *optimize*. This is an example of doing things right versus doing the right things. Think of the absolutely perfectly dug hole in circumference and depth. Now, what if that perfect hole was unnecessary or in the wrong place?

Exceptional entrepreneurial families have overcome the odds associated with concentrated risk and wealth. Yet, most businesses started without a plan, or the plan is sell more and make a profit.

It stands to reason, they're as unlikely to have a plan when contemplating one of the 6T's. Meanwhile, right now the largest degree of wealth is transferring from the Baby Boomer generation, with the youngest reaching age 50 in 2014.

While families with modest wealth or revenues are not excluded from consideration, the book's focus is on what families have been able or wish to achieve by leveraging their trusted advisors' abilities to scale their company revenues and wealth to \$25 million or more.

Governance (issues of culture, codification, and control), relationships (family, business, staff, and advisory), risk (what operational, legal and financial factors are overlooked), and knowledge (internal, external, uncommon, IP, policy/procedure, and human capital) are integral.

The book's eleven chapters illustrates that the letters and concepts of GRRK are interconnected. In the aggregate, their influence dramatically changes pricing multiples and economic benefit, proving that value creation is dynamic.

In **Chapter 1**, we provide some basics about what value is, as a way to lay the groundwork for the information that follows.

In **Chapter 2**, we explore fundamental trusted advisor relationships overlaid with the notion of concentrated risk and the owners who possess these unique esoteric assets. We provide distinct win-win reasons to operate within a purposeful and collaborative framework of relationships and connections that offers unique value beyond technical know-how.

In **Chapter 3**, we speak to business owners, providing them food for thought to assess whether they are working *in* or *on* their concentrated risk (their business), and challenging them to leverage all the resources they have to understand and to build value.

In **Chapter 4**, we address the traditional ways various professionals measure risks through their lenses, beginning with a brief list that's common to their perspectives. This provides evidence of the benefit of involving multiple disciplines and their alignment to ensure the big picture can evolve.

In **Chapter 5**, we focus on the role of governance: what it is, the role culture plays, and a healthy approach to measure, manage, and maximize governance's influence on value.

In **Chapter 6**, we focus on the role of relationships, assessing the various stakeholders, why they are deeply important, and how they can evolve in healthy ways that can lead to value creation.

In **Chapter 7**, we define and discuss the role of legal and financial risks, which are more readily found due to the financial metrics: a “warm-up” for the following chapter. Please remember, the lower the risks, the higher the price multiple; and the higher the price multiple, the greater the value.

In **Chapter 8**, we identify many less easily measured operational risks that also influence human and financial capital.

In **Chapter 9**, we address the role of knowledge, reflecting on how this human capital intangible provides considerable power that can be leveraged when better understood and harnessed.

In **Chapter 10**, we focus on the business appraiser, providing insight into how the importance of this profession is often overlooked and giving tips on what to look for in a seasoned valuator.

In **Chapter 11**, we provide four vignettes to tie together many of the insights and concepts shared within this book.

There will always be those who want the knowledge nuggets from a 30,000-foot view. While we encourage reading this book cover to cover, that may just be my own wishful sentiment. While not all inclusive, here are some of the top take-aways to consider and apply.

Observations

- Book value is seldom a guide to business value. The latter is dynamic and uncertain.
- Businesses are all their assets—tangible and intangible. They both have life cycles.
- The assets hidden below the financial statements often drive equity value.
- Governance, relationships, and knowledge are assets, not line items. They impact risk.
- How a company tracks and measures its assets influences whether value will be created.
- The higher the ratio of sales to fixed assets, the greater the likely value of these assets.
- Value creation occurs when both tangible and intangible assets are well managed.
- Relationships, knowledge, innovation, and culture (governance/strategy) drive growth.

- Risk and opportunity decisions often differ between entrepreneurs and their advisors.
- Risk management must consider internal and external variables in the context of an ecosystem.
- The ecosystem includes constituents whose ideas, insights, and actions must have alignment to be impactful.
- Leadership is not administration. Leaders inspire uncommon knowledge and actions.
- To differentiate a business must be dynamic. It senses, seizes, transforms, and scales. This is achieved through leveraged human capital.
- Optimal levels of employee retention and decision making are indicators of higher values.
- Most businesses and advisors focus on revenues, profits, and taxes—not risk and innovation. One deals with yield and the other capital appreciation.
- Effective leaders integrate risk management and strategy resulting in value creation.
- Navigating risk well reduces obstacles, saves time, and increases opportunities—a huge differentiator.
- Tools and language can provide transparency and clarity. It’s what we all want.
- Value can be extracted from and/or offered to others beyond technical know-how.
- Value creation occurs with a strategy that is executed to rethink and recombine all assets.

Questions for Consideration

- What is the company’s free cash flow? Is revenue/profit more important than value?
- What is the company’s return on equity/assets/invested capital and what changes can have the greatest impact on value?
- How will strategy be communicated, executed, and governed to achieve scalability (growth)?
- What assets and measures are relied upon to weigh risk/opportunity and value?
- What is the articulated and aligned strategy of founders, families, and their advisors?
- What is the vision of the this ecosystem and its constituents?
- What are the resources needed to get from here to there? What are the gaps?
- How will differentiation and measurement be used to leverage assets?