

Making Everything Easier!™

Business Valuation

FOR
DUMMIES®

Learn to:

- Accurately determine the value of a business
- Understand financial statements
- Estimate the cost of capital
- Evaluate assets and income

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Business Valuation For Dummies®

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**by Lisa Holton and Jim
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Introduction

No two businesses are exactly alike — even those that are part of a national chain with exactly the same sign on every door. Each business or outlet of a business has its own complexities that determine whether it's worth a little . . . or a lot.

That's why business valuation is actually a pretty complex affair for someone who's never taken a finance class. If you go online or into a bookstore looking for books on business valuation, you're likely to find volumes that are written more for people who've already been exposed to business finance, accounting, or management training. If you're considering buying a business or have operated one for years without a lot of that training, we're pretty sure that a complicated textbook isn't what you need.

We think that valuation should be the first thing you think about before you make a move into or out of any business. Consider this book to be a starting point for a bright, well-informed future in buying or selling a business, because the dream of owning or selling a business should always begin with dedication to understanding the true value of what you're buying. If we can give you an understanding of the basics of business valuation and of the tools and expertise you require to get the right valuation for the job, we'll have accomplished our purpose.

About This Book

This book is very cautious because we think it should be.

We'll state this upfront: This book will not make you qualified to handle most business valuation tasks by yourself. Nor will you have a complete background in business accounting or business law when you get to the last page. The purpose of *Business Valuation For Dummies* is to give you an overview of all the critical skills, issues, and methods involved in small-business valuation without taking you through all the detailed theories and number crunching necessary to the process. Other, more-advanced resources are out there to show you those processes when you're ready. But by the time you're done with this book, you'll know which basic processes, resources, experts, and tools you need so you can put together the fairest and most affordable valuation solution for the business in question.

We tell you what various professionals do in the valuation process, but we don't tell you that you can do their job. We also tell you the many steps you can follow to educate yourself about valuation in general and your target business in particular, as well as how to make the right decisions to get an accurate valuation of a business. For instance, you can consult resources, free or nearly free of charge, to build a baseline of the business you're considering and then move on to the basics of valuing that kind of company. We tell you about those resources in this book, discussing rule-of-thumb valuation and other resources you can consult early in the process to start building knowledge. We encourage you to do this basic research before you even think about buying or selling a company. (And yes, even if you've owned a business for decades, you need to do this research before you sell!)

If we've done our job, this book will give you a thorough summary of all the steps in effective valuation and show you how to plan and execute that process. We give only two detailed examples of valuation in this book: one for the sale of a business and the other for a purchase. This way, you get a close-up look at how an isolated example works, which we think makes a lot more sense than attempting to generalize for every possible situation, which might mislead you.

This book adopts a holistic approach that involves expertise not only for business valuation but also for your personal and family finances. Why? The decision to buy or sell a business is a major life step; it's not just about the business. Ownership is tied to one's personal finances and family goals, and business valuation needs to tie into all those things. Even if you have a small business and a small family, getting advice tailored specifically to your circumstances is usually smart.

Last thing: Because one of the authors of this book is a valuation professional, you may say, "Oh, that's why they keep saying to use an expert." Keep in mind that we don't say which experts you need to use; you have a choice. But anyone who wants to be in business needs to know that tax, valuation, legal, and finance issues are interconnected, and you need people with excellent skills helping you manage these subjects if you don't have the expertise yourself.

Conventions Used in This Book

When this book was printed, some Web addresses — which appear in monospace — may have needed to break across two lines of text. If that happened, rest assured that we haven't put in any extra characters (such as hyphens) to indicate the break. When you use one of these Web addresses, just type exactly what you see in this book, pretending that the line break doesn't exist.

We use *italics* to highlight new terms, and we follow them up with easy-to-understand definitions.

What You're Not to Read

If you want to lighten your reading load or just simplify your understanding of the concepts, take a pass on any text preceded by the Technical Stuff icon. Also, although we encourage you to check the chapters that have a significant amount of formulas and math in them (which we haven't overdone, by the way), you may want to take a break on those or just save them for last. Finally, you can skip the sidebars — gray boxes containing related but nonessential text — if you want to get straight to the good stuff.

Foolish Assumptions

This book is designed for two kinds of people: those who are thinking about buying a business and those who are considering selling one. We consider this book to be optimal for people who want to go into business for themselves for the first time, because it addresses the critical knowledge that all good businesspeople have: the

ability to maximize value at all times. Yet if you're planning to sell a business, we provide a planning outline to allow you to maximize the value of your business before the for-sale sign goes out front.

Here are a few assumptions we make about you, the reader, whether you want to buy or sell:

You're probably looking at a company of less (sometimes significantly less) than \$5 million in annual revenues. This book focuses mainly on the purchase and sale of private companies — that is, companies that don't trade daily on a major exchange.

You have some experience with the business world. However, we don't assume that you have a background in finance or valuation, which are frankly two different and very complex disciplines.

More than anything, we assume that you don't want to be taken to the cleaners on your first foray into business or your last decision with the business you own. Perhaps you've watched other people go into business, and you just know that they don't have any idea what their business is truly worth; they've negotiated up or down with a seller, but they haven't fully kicked the tires. That move isn't the kind you want to make. You realize you need industry, financial, and operational knowledge to make the best decision.

How This Book Is Organized

Like all other *For Dummies* books, this book is divided into parts, and each part is divided into chapters. What follows is a summary of what you can see in each part of the book.

Part I: What Business Valuation Means

We start by telling you what business valuation is and why we think it's the first thing you should understand about being in business. We talk about why valuation is such a challenge, and we give you the basic accounting approaches that experts take to uncover value — or the lack of it — in an organization. Last, we talk about the greatest valuation challenge today: how experts evaluate what intellectual property means to an organization.

Part II: Getting Familiar with Valuation Tools, Principles, and Resources

This part is where we spend the most time talking about paperwork, process, and expertise. We talk about what a valuation report looks like and what various professionals do in the valuation process; we offer a primer on financial statements and how they're used in the valuation process. We also offer an important chapter that talks about rule-of-thumb valuation information — where it can help and where it can mislead.

Part III: If You're Selling a Business . . .

People sell businesses for lots of reasons. They're sick of running the business, for example; or they've made the business a rousing success that's ripe for a nice price from a new owner; or they're ready to retire or to pass on what they've built to the next generation. The reasons can vary, but one thing is clear: Planning for the sale of a business is something that you don't do just a few months in advance. The planning takes years and is best thought of as part of a founder's overall estate strategy. If you build a business, you want to get the best value for it in a way that allows you to enjoy the full rewards of what you created.

So if you're trying to figure out what to do with a family-owned company, this part is for you. Family businesses supply an incredible amount of drama in the valuation process. This part also introduces a detailed case study on the sale of a fictional business.

Part IV: If You're Buying a Business . . .

Knowing about basic valuation issues is the key to making a deal. Buyers have to do their own planning for a transaction because they may be going into business for the first time or buying another company in a series of companies to complement existing business interests. And of course, buyers have their own succession and estate-planning issues to deal with. In this part, we discuss valuation issues for the buyer and feature another