CHAPTER 1

What Is My Business Worth?

> In theory, the value of a business or an interest in a business depends on the future benefits that will accrue to it . . .
>
> —Shannon Pratt, *Valuing a Business*, 4th Edition (New York: McGraw-Hill, 2000)

What is my business worth? This is the essential starting point for business valuation.

VALUE IS NOT PRICE

Price is what someone is willing to pay for the business. Price includes the quality of the sales process, negotiation, emotion, economic demand, timing, luck, and financing. Price for private businesses often includes terms with post-closing price adjustments based on continued business performance or adjustments due to failures of representations and warranties. These terms are hard to translate into useful data. There are no mechanisms to determine downstream what actually gets paid for earn-outs and seller notes.[1] There is no verifiable data on how often representations and warranties result in post-closing price adjustments. The importance of emotion in the sales process cannot be overstated. It takes tremendous energy to buy or sell a business. This is diametrically opposed to the valuation process.

VALUE IS . . .

Valuation consists of applying established analytical methods and preset assumptions to what is known or knowable about a company in order to estimate its value as of a specific date. These assumptions rarely resemble real-world sales situations. Value and valuations are useful for sale and exit planning discussions but they do not represent prices. In the same way, value is useful when there will not be an arm's length sale. Value is the best that can be done for situations such as adding or removing owners, divorce, litigation, and required compliance situations, for example bank loans, estate and gift taxes, Employee Stock Ownership Plans (ESOPS), fairness opinions, and the like.

Value and price are related but not the same. The only way to determine its price is to buy or sell a business.

Most of this book is about how to value a business. Chapter 13 addresses working with business owners to prepare them and the business with an exit strategy. The chapter concludes by explaining ways to sell small businesses in the market for a price profitably.

NOTE

1. Earn-outs are adjustments to the price based on results that occur after a sale closing. Seller notes are sometimes adjusted or not paid after closing. Each of these can be viewed as an adjustment to the price paid. There is no mechanism for these post-closing price adjustments to be reported to the transaction databases.