

SOLUTIONS FOR GROWING BUSINESSES

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PROVE YOUR WORTH

By Mark Henricks

While the wealth of the stock market exploded during the 1990s, the wealth of entrepreneurs fizzled. As the decade dawned, small firms held just over 59 percent of the \$5.7 trillion in total value of U.S. businesses, according to a study by the SBA. By 2000, that share had fallen to 42 percent as soaring stock valuations more than doubled big public valuations during the decade.

A lot has changed since then, and one of the changes is a switch in the relative performance of small and big companies. The \$11 trillion in big-company value seen in 2000 had slumped 25 percent to \$8.3 trillion by the middle of 2002, the latest period for which figures are available. Meanwhile, small-company value had fallen just 4 percent, to \$4.1 trillion. What happened? "Big companies have been hurt by the stock market. Most small companies are not public. That's why the small-business share rose the last couple of years," says Kathryn Kobe, chief economist at Joel Popkin and Co., the Washington, DC, research firm that conducted the SBA study.

If you're thinking this means investing in your own company is smarter than investing in the stock market, you're

**FORGET THE STOCK MARKET. THE BEST WAY TO
BUILD WEALTH IS TO INVEST IN YOUR OWN
COMPANY. AND NOW'S THE TIME TO SHOW THE
WORLD WHAT YOUR BUSINESS IS MADE OF.**



TALENT SCOUT: Worthy employees aren't hard to find for Nate McKelvey.

right. Not only have small-company values held up better than the stock market, but right now, formerly scarce and costly items such as labor, facilities and equipment are plentiful and cheap. As a result, entrepreneurs like Dave Ratner, owner of Dave's Soda & Pet City, a pet-supply retailer in Agawam, Massachusetts, are finding that investing in their companies has the allure once restricted to Internet IPOs. Says Ratner, 51, "now's the time [entrepreneurs] can really build value in the company."

After more than a decade in which other forms of investment stole the limelight, business owners are only beginning to wake up to the hidden value in their own enterprises, adds Ray Manganelli, managing director at New York City management consulting firm Strategic Decisions Group. In his book,

Solving the Corporate Value Enigma (Amacom), Manganelli says the average business creates only 60 percent of the value it is capable of creating.

Is that all bad? Not necessarily. That means entrepreneurs may be able to increase the value of their companies by 40 percent simply by paying more attention to it. "It's a tremendous prize," Manganelli says. "And that prize can be the difference between profit and loss, between surviving and folding."

WHY BUILD WEALTH?

Dean Dinas, senior economist and director of the Center for Economic and Industry Research for the National Association of Certified Valuation Analysts (NACVA), a trade group for valuation professionals, estimates only about 5 percent of small businesses have had a formal valuation done by a qualified professional. One reason is entrepreneurs are too busy running their companies to be concerned about the value of those companies. Also, some don't think they need to build or measure the value of their companies unless they plan to sell.

There are, however, dozens of reasons to know and increase your company's value, none of which have anything to do with selling it. Before you set up a buy-and-sell agreement with a partner, decide how much life insurance to buy as part of an estate plan, create an employee stock ownership plan, or apply for an SBA loan, you must have a documented value for your business, Dinas says.

Many entrepreneurs rely on balance sheets, income statements or a gut feeling to estimate their companies' true value. But balance sheets and other financial statements used in the daily operation of a business are only the beginning when it comes to valuing a business. Intangibles such as customer relationships and human resources don't show up on balance sheets but are essential to accurate valuations.

VALUE 101

The price the company might sell for

on the open market is the basic value benchmark. This can be determined by examining recent sales of comparable businesses. But no two businesses are the same, and selling prices vary according to what the buyer is looking for. Ratner had his business formally valued in anticipation of an expected bid by a large pet supplies retailer to buy it. The value came in at what he expected and at what the bigger firm typically paid for acquisitions—about five times annual earnings. The prospective buyer didn't offer a bid on the company after all, because Ratner's low-cost, out-of-the-way areas didn't match the bigger company's practice of locating in high-cost, high-traffic spots.

Expected future cash flow is the most common basic benchmark for



HEALTHY CHOICE? A robust company doesn't mean it's a more valuable one, as Rory Cutaia found out.

setting value. So, typically, you build value by increasing the amount of profit your business can be expected to generate in the future. That's how Robert LoCascio saved LivePerson Inc. from losing its listing on NASDAQ. LoCascio, 34, founded the live-chat customer service company and took it public in 2000. Despite never earning profits, shares in the company traded as high as \$8 before the Internet bubble burst. Then they fell as low as 7 cents, and delisting loomed.

LoCascio made LivePerson profitable by acquiring an Israeli competitor that owned technology, which drastically cut his costs. "Our original cost of goods was about \$600,000 a month," LoCascio says. "When we acquired the company from Israel, their cost of goods was \$60,000 a month." A year later, shares in the 100-person New York City company were trading at 30 cents each, and early this year, they topped \$1—a 14-fold increase in value despite poor market conditions.

WHAT'S IT TO YOU?

Think you don't need to build the value of your company because you don't plan to sell? There are dozens of reasons for entrepreneurs to be concerned about the value of their companies. Following are some of the most commonly encountered:

- Adequacy of life insurance
- Allocation of acquisition price
- Bankruptcy and foreclosure
- Buy-and-sell agreements
- Calculating controlling interest
- Charitable contributions
- Divorce
- Employee stock ownership plan
- Estate and gift taxes
- Fairness opinions (opinions as to whether the consideration in a business transaction is fair from a financial point of view)
- Family limited partnerships
- Financing
- Franchises
- Gifting
- Incentive stock options
- IPOs
- Lease vs. buy decisions
- Leveraged buyouts
- Liquidation or reorganization
- Litigation support
- Mediation and arbitration
- Mergers
- Partner disputes
- Purchase of a business
- Sale of a business
- Split-ups and spinoffs
- Succession planning

Source: National Association of Certified Valuation Analysts

GIVING APPRAISE

You can also boost value by increasing sales or some derivative of revenues. Rory J. Cutaia's benchmark for valuing The Telx Group Inc. is revenues per square foot. The 34-person telecommunications company sells space in its New York City facility to large telecommunications companies and users who want to be able to connect easily and quickly to each other.

When the telecom market crashed, Cutaia, 47, was still able to increase revenues per square foot by finding ways to encourage his customers to do more business with each other. The techniques were as simple as hosting get-togethers for customers to meet each other and pitch their services, but it's worked well over the last two years. "Revenues have tripled, EBITDA quadrupled, and the company is much healthier," Cutaia says.

Unfortunately, healthier companies aren't always worth more. Because he's so deeply tied to the telecom industry, which has been in a steep and long-lasting decline, Cutaia figures his company may be worth less than it was two years ago. At the very least, he's not getting a good rate of return on the sales improvements he's making. "Our revenues have more than tripled over the past two years," he says, "yet our valuation has probably declined."

Cutaia is not the first entrepreneur to work to boost value only to see it stay the same or even decline. Ratner tried opening a new location he thought would appeal to another acquirer, but the new store didn't fit his operation, and he eventually had to close it.

Building value, notes Manganelli, is often counterintuitive. You may have to go against industry wisdom or sell off assets you would rather keep. Often, entrepreneurs find it's essential that they de-emphasize their own role in the business if they want to be seen as more valuable. Other times, they may need to terminate longtime employees and bring in replacements.

These days, it's important to be able to stand up to intense scrutiny when you do anything to increase value or place any value on your company. "Forensics and fraud [are] the hottest segments driving valuations," Dinas

Thousands of people from all walks of life are willing and, to varying degrees, qualified to place a value on your business and help you to increase it. These include business brokers, investment bankers, accountants, attorneys specializing in mergers and acquisitions, and even more than 4,000 professionally certified valuation analysts. Not all valuations are the same. Bankers, for instance, may look mainly at the price a company's assets would bring if broken up and sold.

Business valuers can be found in every city and town, and their services are available for prices as low as nothing—investment bankers will often perform a valuation, the cost of which is built into the commission they hope to receive in a sale or other disposition of the business. The most important thing to look for is experience and credentials that match the reason you are seeking a valuation, whether it's for estate or succession planning, pending litigation or some other reason. You can find a directory of accredited valuers at www.nacva.com, the Web site of the National Association of Certified Valuation Analysts.

says. Part of the reason is the spate of high-profile blowups like Enron, where billions of dollars of value disappeared as a result of questionable or fraudulent accounting. Another cause is the introduction of new accounting rules that require re-examination of valuations used in mergers and acquisitions.

BUILDING WEALTH NOW

The good news for entrepreneurs is that now is a fine time to invest in building the value of their companies. And it's not because other investment options are unappetizing at the moment. A few years ago, one of the biggest complaints of entrepreneurs

figure salaries. Those days are over." Now, instead of paying inflated salaries, McKelvey can employ his company's value to build value, as he did recently by acquiring a smaller company loaded with talented employees in exchange for minority ownership in CharterAuction.com. The move preserved cash, encouraged the new personnel to accept reasonable salaries, and locked in talented people by giving them ownership.

Other entrepreneurs say now is a prime time to purchase low-cost inventory, finance capital expenditures at low rates, or improve internal accounting and management systems to boost your company's visible value. "Buy inventory now; buy equipment now," urges Ratner. "You can get fantastic deals on them, and interest rates aren't going to be this low forever."

Building value doesn't have to cost much money, much equity or even much time. Manganelli says the most powerful value-building systems are based largely on attitude shifts. The first and most important step occurs when a company's leaders start paying attention to deploying strategy, assets, operations and measurements in a systematic fashion with the goal of increasing value. Still, he says, "It is hard to do because it requires action on a lot of different planes."

But building value can be done, and entrepreneurs are waking up to the fact that the best place to make a killing in investments is right in their own companies. The stock market may be spent, but entrepreneurial companies have yet to see much of their value appreciated. "If you look at the glass as half-empty, it's a loss of value," Manganelli says. "If you look at it half-full, it's value to be gained." ■

MARK HENRICKS is Entrepreneur's "Smart Moves" columnist.



BUY AND BUY: Now's the time to buy equipment and inventory, says Dave Ratner.

was that they couldn't hire enough good people to expand.

That's not a problem now, says Nate McKelvey, CEO of CharterAuction.com, an online booking service for private jets, with 17 employees. "It's a fantastic time to find talented people," says McKelvey, 33. "When I started in 1999, anyone [who had] computer experience could make six-

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