



## Using Valuations to Understand and Manage Your Business

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For many family business owners their business is their single largest investment. Even when that's the case, many family business owners don't know the value of their business, nor do they realize the benefit of having the value determined by a Chartered Business Valuator (CBV). Worse yet, some may consider hiring a CBV to determine the value an unnecessary expense. But what many fail to realize is that a business valuation is one of the best ways of learning about what drives value in your business.

### Understanding What Drives Value in Your Business

Because of the nature of the analysis carried out in the process of conducting a business valuation, a valuation report can provide lots of valuable information about what drives value in your business. For example, a valuation report may include information and insights in the following areas:

- **Maintainable earnings/trends** – In the description of the valuation calculation the valuator will often describe the recent trends in

revenues, as well as earnings/cash flow of the business, usually over a five year period. Such information can show whether earnings are trending upward or downward, or whether earnings are volatile; clearly, the directional trend has an impact on value. Also, understanding the reasons for these variations (for example, new markets entered, new technology, the addition of salespersons, etc.) can help you identify factors that may further influence value and may help you reverse unfavourable trends.

- **Qualitative factors that impact on earnings multiples** – When a valuator determines an earnings multiple (sometimes also referred to as a discount rate or capitalization rate), various factors are considered that relate to the quality of the earnings of the business. For example, customer or supplier dependence, the impact of new or expected competition, the state of the industry, restrictions in the

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supply of raw materials, management experience, the condition of capital assets, etc., are all factors that can increase or decrease the value of a business because they can affect the chances of the business being able to maintain its historical level of earnings or its ability to meet forecasted results. Such qualitative factors are often not apparent to the owner who's busy with the day-to-day duties of running the business.

The valuator can help the business owner understand how some of these factors may be viewed by a prospective lender, or how a purchaser or investor might perceive the risks and value. As well, the valuation may reveal some internal factors the business owner could be better managing to increase the business' value.

- **Market conditions/rates of return** – Certain types of valuation reports include commentary concerning business risk factors, industry, and economic factors that affect your business. The valuator's comments can highlight for you trends in the industry or economy that may include external factors affecting the value of the business.
- **Market transactions and comparable companies** – Depending on the nature and purpose of the report, it may include information about market transactions and comparable companies, potential acquisition targets, or potential purchasers of your business. Such information would clearly be of interest as you engage in strategic planning.

## Some common situations calling for a business valuation

- **Valuation for Income Tax Purposes** – There are a number of tax planning reasons for having your family business valued, for example, where you're conducting a corporate reorganization or amalgamation, where you're doing estate planning, capital gains measurement, etc.
- **Financial Reporting** – If there's goodwill on the business' balance sheet, under the accounting rules you may be required to determine the fair value of your business to establish whether the goodwill has been impaired.
- **Mergers & Acquisitions** – If you've been approached by a prospective buyer of your business, or if you want a sense of the price your business might reasonably fetch should you decide to put it up for sale.
- **Shareholder Additions or Departures** – If you're thinking of adding a new shareholder or partner to your business, or if one of the existing shareholders wants to leave the business.
- **Succession and Business Transition** – If you're planning on transferring the business to the next generation or to the management team.
- **Divorce** – If one of the shareholders is getting divorced, the value of that person's interest in the business will be relevant to the division of property.
- **Litigation** – If the company is involved in any kind of legal dispute, such as a loss of business claim, a patent infringement matter, a partner or shareholder dispute, a breach of contract, or a personal injury lawsuit.

- **Reconciliation of previous values** – If your business was previously valued, a valuator can do a reconciliation of prior valuations. This may help pinpoint factors that may have led to an increase or decrease in the value of the business.

## What Type of Valuation Report Do You Need?

Recognizing that there are many different reasons a business might be valued, business valuers have developed different kinds of reports that are tailored to how the report is to be used. There are three types of valuation reports:

- Comprehensive,
- Estimate, and
- Calculation.

They differ in terms of the amount of analysis and document review done by the valuator, the amount of disclosure in the report, and the fees incurred to prepare them. So, when considering having a valuation performed you should discuss with your CBV how you plan to use the report. Based on this information, your business valuator will tell you what type of report will best serve your needs.

## What's in a Valuation Report?

The nature of the information – and the amount of detail – included in a business valuation depends, in part, on the type of valuation report. But, regardless of the report formalities, most

valuation reports contain lots of information that can offer all sorts of insights into your family business.

You can generally expect the following information to be included in a valuation report:

- A description of the business being valued, including an explanation of exactly what is being valued (shares or specific assets).
- A definition of value – the purpose for the valuation tends to dictate the definition of value that is applied. For example, a valuation prepared for a family law matter might be based on “fair value”, while a valuation for tax purposes might be based on “fair market value”.
- A description of the industry the business is in, and the economic conditions in that

industry. (Note, however, that this type of information is not strictly required in a Calculation Report, so if such information is of interest, be sure to discuss with the valuator whether an Estimate or Comprehensive report might be more appropriate.)

- A description of the valuation calculation, which can include information relating to maintainable earnings, projected future cash flows, market conditions and rates of return, market transactions, comparable company data, the tangible asset backing of the company, and qualitative factors in the selection of a discount/capitalization rate. Of course, the nature and extent of explanation will depend on the type of report and the approach used.

- And finally, the report will set out the valuator’s final conclusion as to the value of the business.

## Conclusion

Having your family business professionally valued will provide you with valuable information about your net worth and with practical insights into the value drivers of your business. Your CBV can tailor the level of detail provided in the valuation report to suit your specific needs, so be sure to discuss your expectations with him or her.

## Layoffs are emotional – even more so in family-owned businesses

### *Tidbit*

**All successful businesses require skilled, qualified, performing employees. Don't jeopardize your family business by keeping family members on board who are underperformers. Offer them equity in the business and ask them to find other work.**

The simple fact is that from time-to-time most businesses will face having to lay employees off. Because family-owned businesses are often distinguished by their family-like relationships with employees (even non-family employees), layoffs are even harder in this context. Even when the survival of the business may be at stake, owners of family businesses find making the decision to lay off staff difficult and the actual act of breaking the news to staff often unnerving.

### **The Need for Communication and Honesty**

If you find yourself in the position of having to let employees go, there are

things family-business owners can do that can lessen the blow to both parties. Communication and honesty are the keys: communication before and after the fact.

Communication before the fact has to do with avoiding surprises and letting staff know the financial picture and the possibility that there could be job cuts or layoffs. Though employees can often sense that there's financial trouble, rumor and speculation can be counter-productive.

Being up front with folks early on might even yield unintended benefits, like suggestions from employees that may result in savings that may prevent the need for job cuts. Furthermore,

openness regarding the situation may help foster buy-in and understanding, which will be important in terms of those you let go. But, buy-in is even more important with regard to those who remain, as it's likely that their jobs will change and they may well have to take on additional tasks.

Keeping lines of communication open and fostering a good relationship after you've let someone go is important for many reasons. First and foremost is the fact that there may come a time when you're in a position to rehire them, so staying in touch is a good idea. As well, those laid off might still be customers of yours, or may still be in a position to influence other customers.

As noted, the other key is honesty. Though you may be naturally optimistic, take care to guard against giving laid-off employees unrealistic expectations about the chance of rehiring them within a certain time frame or at all. Though letting them go may be

difficult for them, misleading them – intentionally or unintentionally – may be more detrimental, as they may not try as hard to find other work.

### Be Strategic in Your Decision

Determining who to lay off or let go is also a delicate matter. In non-family business situations, choices are often made either based simply on seniority or cost. But in family-owned businesses other factors may be weighed in the decision-making. For example, you might want to consider whether certain employees might be financially better able to weather a layoff (especially if you anticipate the layoff being temporary), or perhaps certain employees might have skills that would make them attractive to other employers and therefore more likely to find another job fairly quickly or easily.

Family business owners must also consider the business knowledge and experience that might be

walking out the door if certain people are let go. Of course, you should also consult an employment lawyer to make sure you understand any legal obligations you may have to those you let go.

Depending on your financial situation, you may consider offering affected workers a bit of financial assistance. Other things you can do to try to lessen the blow include offering a reference, helping them find new jobs, providing information about social assistance and job retraining programs they may qualify for, and even just offering compassion as they search for a new position. Always try to remember that how you behave when you let staff go can also have a big impact on your reputation as a potential employer in the future.

### Conclusion

Letting staff go is one of the hardest things a business owner will ever face and it's often a last resort. The unpleasant task is never easy, but if you approach it with the same integrity you apply in running your family business, you'll get through it and – before you know it – your business will be growing and you'll be in a hiring mode again.

#### *Tidbit*

**Flexibility isn't just for yoga gurus. In a recent survey of 150 senior executives in the U.S., 71% of them said that they budget for "flexible staffing" – in other words, temporary employees. According to the study sponsor, a temp agency, the need for agility and the ability to respond to changing circumstances has led to the increased reliance by businesses on temporary employees.**

## Q&A – Staying in the Loop

**Q.** – My mother, father, and aunt started our family's business over 40 years ago. Growing up it was clear that everyone hoped me and my three siblings and cousins would join the business. In our 20s we all did but some of us have gone off to do other things and so we're not active in the day-to-day running of the family business. We all have an equity interest in the business (along with

the original three founders). Though we all care about the family business – and not just because of our financial stake in it – the business is growing and evolving fairly quickly and a few of us feel out of the proverbial loop. Any suggestions for what we can do to ensure the flow of information about the business among those of us who are less involved?

**A.** – First off, what you described is not particularly unusual, especially in family businesses where there are a number of family members with an equity interest in it but who are not active in running it. It sounds as though what may have worked in the past – for example, an informal sharing of information, perhaps at family gatherings, or maybe even family meetings specifically convened to discuss the family business’ financial situation – no longer seems sufficient. If that’s the case, then it’s probably time to recommend formalizing mechanisms for distributing information among family members.

The first step is deciding what family members should be on the “distribution list” (or in the loop, as you put it). Since it’s a family business, we recommend that you cast a fairly wide net, including, for example, spouses of equity owners and perhaps even members of the next generation who may someday become involved in the business. A good rule of thumb is to include any family member who may be impacted by what happens in the family business.

The next step is deciding what information to share and in what format. Information about sales may be relevant, but an Excel spreadsheet may not be the best way for all family members to make sense of the information. Be sure to consider other information (besides financial information) that may be of interest to some family members, for example, employment policies and salaries might be of interest, especially if non-active family members are considering whether to join the business. Information about the values and vision that drives business decisions should also be shared, as well as information about the business’ strategic plan.

The timing of dissemination of the information and the format for delivering it should also be decided on. For some families it may only be necessary to distribute information annually – but for others more frequent updates may be desirable. The best thing to do is establish a calendar for when information will become available – that way everyone knows what to expect and when to expect it. The way the information is distributed should also be addressed – it could be done by written report or in person at a family gathering. Written reports may be easier to disseminate, but they lack the personal touch. Also, if you decide to send the information electronically, be sure to consider security issues if the information is confidential in nature. In establishing your plan, it’s also a good idea to determine who will be responsible for getting the information out.

And finally, if you find yourself in the position of having to persuade others that such formalities are necessary, reassure them that your wanting more information is no reflection on how the business is running or on the current state of affairs and take comfort in the fact that instituting such procedures will help guard against tensions that may arise in the future and may actually bring the family closer together because everyone will feel informed and up-to-date.

### *Tidbit*

**Ensure your family business reaps the benefits of the talents of both male and female family members by taking steps to close the gender gap. Though Mom may have been an “informal” counselor to Dad (the proverbial power behind the throne), ensure daughters have recognized roles.**

## Happy Holidays? Not if family issues surface

Holidays often mean family gatherings. Unfortunately, when the family is in business together, the joy of the season can give way to stress and strife if there are problems or issues in the business.

The key to avoiding acrimony and tension during the holidays is to remember that family get togethers are not the time or place to raise business issues. Family gatherings are meant to bring people together and to provide an opportunity to relax and enjoy. And, if there are children around – the holidays are a time for creating happy memories for them. (If you need another way of thinking about the kids, consider this: if you’re hoping

they might someday take over the business, the last thing you want is give them the impression that when you’re in the family business it’s on your mind 24/7, 365 days a year.)

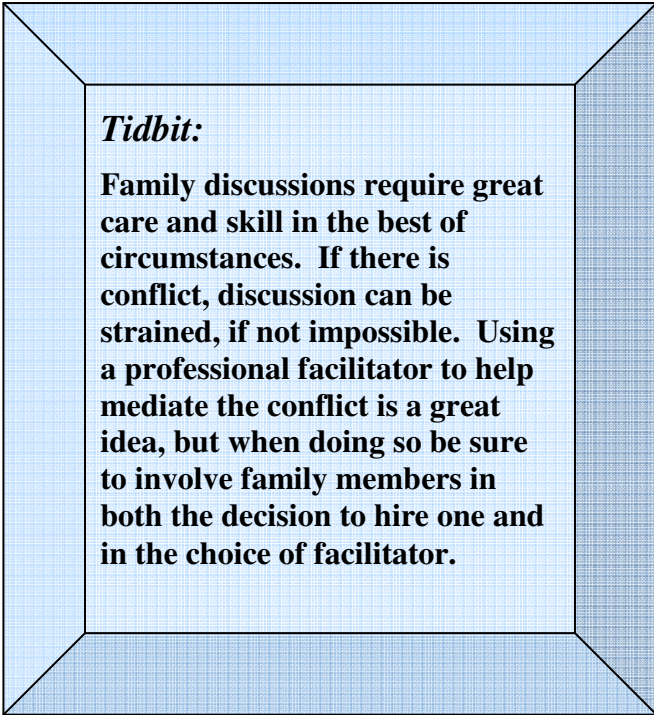
And, if someone raises a work-related matter during a gathering, don’t get defensive – but don’t ignore it either. Instead, temporarily deflect it by telling them you hear what they’re saying and suggest that you take it up again when you’re back in the office. Validating their concern and assuring them you understand that the issue is important to them might actually be a first step toward resolving this matter.

Of course, business troubles and issues aren't the only things that can put a damper on holiday family gatherings. Any time family members gather, old grudges and resentments of all sorts can surface. Unfortunately, not all holiday reminiscences recall happy memories – especially when some family members seem to take joy in recalling past blunders, foibles, and the mistakes of others.

If you find someone's singling out your behaviour or actions, try to take the high road. Don't respond to negative comments – after all, no matter what you might say in response, it's unlikely you'll change their mind and you'll only prolong their needling or unwanted attention. Just as holiday gatherings are not the time to work through business issues, they're not the time to work through old family issues.

And remember that avoiding acrimony at family gatherings is everyone's responsibility – including yours. Work hard to avoid hurting others' feelings. For example, curb sarcasm or the inclination to use put-downs. Better yet, why not take matters into your own hands and set a positive tone by finding something nice to say to each individual as you greet them. (At least a few of them are likely to reciprocate with kindness.)

Separating business matters from family matters is always a challenge for people who have a family business. But if the holidays mean something to people in your family – enough that they decide to gather together – then take care not to confuse the holiday dinner table with the boardroom table.



***Tidbit:***  
**Family discussions require great care and skill in the best of circumstances. If there is conflict, discussion can be strained, if not impossible. Using a professional facilitator to help mediate the conflict is a great idea, but when doing so be sure to involve family members in both the decision to hire one and in the choice of facilitator.**

### **Impediments to strategic planning in family-owned businesses**

Family business owners are often so engrossed in the daily running of the business that they don't focus on strategic planning. But attention to day-to-day matters isn't the only reason many family businesses don't engage in disciplined strategic planning. In "Strategic planning is vital for managing business risk," (Family Business Magazine, Summer 2007) author-consultant Mark Brenner points to four forces that often block strategy work in family-run businesses:

1. The force of complacency – basically the idea that so long as you continue doing what you've always done, you'll continue to be as successful as you've always been.
2. The force of inertia – this stems from the fear of moving out of one's comfort zone.
3. The force of over-control – the idea that the founder has taken the business to the level it's already at and so the founder knows what's best.
4. The force of conflict aversion – the idea that it's not right to challenge the views of family members who have hard-won battle scars, as well as past victories, related to the family business.

Though these forces can be seen as a natural outgrowth of past successes, family business owners should try hard to overcome them because the best way of meeting today's competitive business environment is by engaging in strategic planning.