



## Professional Valuations Provide Businesses with More Than a Number

Are you selling your business, soliciting new investors, updating a buy-sell agreement, pursuing litigation or drafting an estate plan? An accurate business valuation prepared by a valuation professional is critical to the success of these and many other activities. Knowing some fundamentals about the process can help you understand your valuator's conclusions, what drives business value and where to invest resources. Here are some basic concepts you should know.

### Fair market and fair value

Although they sound similar, these two terms can have different meanings. *Fair market value* is the valuation standard used for tax, transaction and planning purposes. It represents the price at which a business or ownership interest would change hands between a hypothetical willing buyer and a hypothetical willing seller. It assumes that both parties are acting independently, have reasonable knowledge of the relevant facts and are under no pressure to complete the transaction.

*Fair value*, on the other hand, is a legal standard that generally depends on state law and court precedent. It's commonly used in shareholder disputes, divorce proceedings and certain litigation. Fair market value can serve as a starting point for an appraisal, but fair value generally requires adjustments to reach an equitable outcome. For example, when minority shareholders are forced out of a business through a merger, courts often rely on the fair value standard because those shareholders are neither hypothetical nor willing participants.

### Going concerns

Another essential concept is *going concern value*. This refers to the value of a business that's expected to continue operating into the foreseeable future.

A going concern is typically worth more than the sum of its individual assets because it includes valuable intangible assets. These might include an experienced workforce, established customer relationships, proprietary processes, operating systems, licenses and a proven ability to generate earnings. In today's economy, such intangible assets often account for a significant portion of a business's value.

### Premiums and discounts

Valuations aren't simply based on the numbers contained in a business's financial statements. Professional valuers also usually consider the ownership interests being appraised. For instance, a business may be more valuable because the owner can independently direct management decisions and influence the organization's future. This additional value is known as a *valuation premium* (in this case, for control reasons).

Conversely, a valuation professional may apply a *valuation discount* when circumstances reduce the appeal of an ownership interest. One of the most common examples is a discount for lack of marketability. This reflects the difficulty of quickly selling an interest in a privately held business. Depending on the facts, other discounts, such as those related to minority ownership, may also be considered when appropriate.

### Risks and opportunities

Even if you aren't facing litigation or don't plan to sell your business soon, consider obtaining a valuation. Professional valuations often review historical and projected financial performance, economic conditions, key-person risk, competitive position, and other qualitative and quantitative factors. Periodic valuations may alert you to potential threats and measure progress toward long-term goals.