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The Business Value Manager

FOCUS ON YOUR FUTURE Critical Challenges Every Private Company Owner Must Address

Advice for business owners, investors and service providers on how to build value and wealth through investment in closely held companies.

Executive Summary—Page 2



Readers of the *Business Value Manager* typically own a private company, manage one or advise those owners and managers. This issue of our newsletter addresses critical challenges that private company ownership creates, and emphasizes both the need to proactively address these issues and the risks of failure to do so.

◆ Harvesting Your Wealth
The following are suggestions about each.

Building Your Wealth
You are considering an investment. Wouldn't you naturally investigate the cost, the expected return and the estimated risk? After all, these factors determine your return on investment.

As private company owners (and your authors

Private Company Ownership	
The Rush	The Reality
<ul style="list-style-type: none"> • I'm my own boss and set my company's strategy • My company is the best way to build long-term wealth • My family can work in the company with me • When I've had enough, I can sell out • I can retire early with no financial worries 	<ul style="list-style-type: none"> • Customers and competitors create constant strategic challenges • Concentrates owner's wealth and prevents portfolio diversification • Family disputes are the rule, not the exception • Private companies are hard to sell so cashing out is a special challenge • Most businesses start at little or no value and end at little or no value

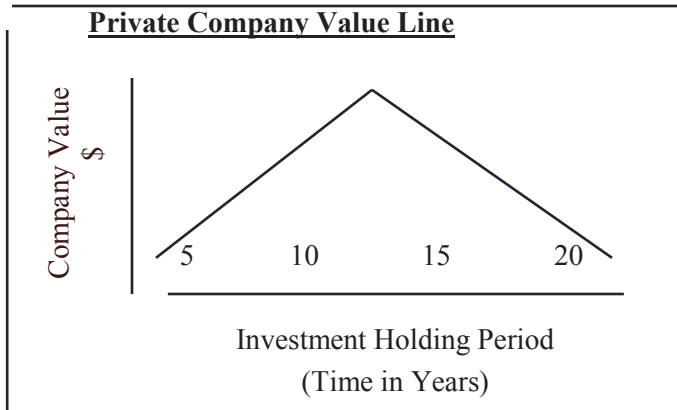
are), we all live the entrepreneurial dream. To avoid the relatively high likelihood of unfulfilled dreams, owners must have a formal program that includes plans for:

- ◆ Building Your Wealth
- ◆ Protecting Your Wealth

Now consider your private company as an investment. (It may be your largest.) Do you know its value today, which is your current investment cost? Do you know the
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real cash return it generates for you or how risky it is? Most private company owners and executives do not. Even more importantly, they don't know what factors most drive their company's value or what risks most threaten it.



As the graph above displays, most private companies begin at little or no value, and unfortunately, most end there. Is your company's value increasing, has it reached its peak, or is it declining? Do you know why? Do you have a strategic plan to maximize your long-term value?

Building private company value begins with a clear understanding of what your company is worth and its competitive position. Armed with the knowledge of both your value and your strategic advantages and disadvantages relative to your competition, you can prepare a strategic plan to beat that competition. *The key first step is to know your value, what drives it, and what threatens it.* Call our office to learn how to implement valuation-based strategic planning.

EXECUTIVE SUMMARY

Most private company owners fail to recognize that their business is an investment—often their largest—and they must carefully plan to build, protect and harvest their private company wealth.

This issue of the *Business Value Manager* presents essential steps to build, protect and harvest wealth from a private company. It also offers answers to two questions business owners continually ask about their business ownership:

When should I get out?
How do I get out?

Protecting Your Wealth

What has made your company successful? A good brand or reputation, the best technology or processes, excellent service, or efficiency and controlling costs? For most companies, it is some combination of these and other factors.

More importantly, particularly for the long-term, success can usually be traced to *people*. Strong companies are led by a broad and deep team of management talent.

In private companies, the founder builds the company on his or her (or their) core skills. Sustainable growth, however, requires added depth. Increases in customers, products, markets, employees, technology and regulatory compliance make more management talent a must.

While management development and succession is easy theoretically, for private company owners, it is often difficult to implement. The entrepreneur's drive and urge to control that built the company are often the same characteristics that impede success in building a management team, delegating authority and implementing a succession process.

Transferring stock to children is *ownership*, not *management* succession. The latter requires the recipient to have knowledge and experience, while the former does not. For your company to achieve sustainable growth—and value—it must have commensurate leadership. Is your company threatened by lack of a management succession plan? Call our office to explore how we can help you to implement management succession planning steps.

Harvesting Your Wealth

When should I get out? How do I get out? Many owners chronically ask these questions. Before we suggest answers, here are two other points to consider first.

- ◆ Investment theory routinely stresses the need for risk management, portfolio diversification and liquidity, particularly as investors near retirement. If you are over 50 and your private company is a major asset in your portfolio, you absolutely should be including it in your long-term investment strategy. This means allowing at least

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three years—and maybe five— to position this investment to sell it at the right time for the right price and terms.

- ◆ Private company owners frequently cannot or will not address ownership transition. In place of this planning, they allow external events to dictate their decision. Most commonly, these events are one or more of the “Three Ds”, divorce, disability (of either the owner or the company), or death. Due to lack of a transition plan, are you and your company (and your family) ripe for the devastation that results from ownership transition by the “Three Ds?” Do not allow failure to plan for your ownership transition to threaten your future.

**Ownership Transition Planning
by the “Three Ds”**

Cause	→	Potential Effect on Business
<p>Divorce Disability Death</p>		<p>Disaster</p>
<p style="text-align: center;">Lesson: Don’t let this default-based planning destroy your financial future.</p>		

And now, how and when to get out. The key is planning—broad-based planning, which includes the following:

- ◆ Identify and prioritize your personal goals
 - Do you want to continue working in the company, retire or something in between?
 - What future life and activities do you want for yourself and for your family and what time do you need for this?
- ◆ Quantify your financial resources, needs and goals
 - Do you have enough to provide for your security and lifestyle?
 - Are your tax and legal affairs and retirement and estate plans organized and updated with properly executed documents?
 - Do you have adequate insurance protection?
- ◆ Recognize the major reasons to get out and identify

which applies to you. The primary reasons are:

- Achieve value maximization through a sale.
- Avoid declining value due to deteriorating competitive circumstances.
- Achieve needed resources for the company including management, capital, technology or sales and distribution capability.
- Owner personally wants to get out to retire, due to burn-out, to achieve liquidity and portfolio diversification or a combination of the above.

Explore your circumstances, needs and goals to determine your best time to get out.

- ◆ Recognize the most common ways to get out, which include the following:
 - Sale to an inside party, which is most commonly achieved through a Management Buyout (MBO) or creation of an Employee Stock Ownership Plan (ESOP).
 - Sale to an outside party, which is most typically to a financial buyer who only brings capital to the deal, or a strategic buyer, who can create synergies and often will pay a higher price.
 - Gift or estate related transfer to an individual or a trust.

The key for owners is to understand the advantages and disadvantages of each of these options to determine the best choice for you. Engaging a team of experienced advisors greatly increases your chances for success in this process. Call our office to learn how to begin execution of this process.

Conclusion

Research on private companies reveals that many owners fail to successfully build, protect and harvest their private company wealth. The most common reason is poor planning or lack of planning, with the results being unmet personal and financial goals. To achieve your goals you must confront your future.

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“Is Your Company Building Wealth—12 Value Metrics”

“Is Your Shareholder Agreement a Timebomb?”

“Transfer Wealth at Discounted Values”

“SPECIAL REPORT: Sarbanes Oxley”

“Protecting Your Private Company Wealth from the Government”

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