Editorial

Valuable Valuation

Readers will recall that the last issue of The Management Accountant focused on corporate strategy. One of the foremost requirements of formulating a corporate strategy is to estimate the value of one's organization. Business valuation is a process and a set of procedures used to estimate the economic value of an owner's interest in a business. Valuation is used by financial market participants to determine the price they are willing to pay or receive to consummate a sale of a business. In addition to estimating the selling price of a business, the same valuation tools are often used by business appraisers to resolve disputes related to estate and gift taxation, allocate business purchase price among business assets, establish a formula for estimating the value of partners' ownership interest for buy-sell agreements, and many other business and legal purposes.

The most common benefits of an annual business valuation policy include: Accountability and Performance (an annual business valuation enables the shareholders to see the value that is being consistently created or destroyed by the management of the firm), Estate Planning Purposes (many shareholders have on-going estate planning strategies aimed at protecting wealth for heirs), Buy-sell situations (for those firms that do not have buy-sell agreements in place, annual business valuations are a good way of avoiding disputes that may arise when a shareholder seeks to sell his shares to the other shareholders), Facilitate Banking (the ability of a firm to borrow based on the value of the goodwill or the value of the company's shares may expand the universe of value-creating investment options available) and Expands the Investment Options (for closely held firms which suffer from a lack of liquidity).

The most common approaches to valuate a business are: asset approach (establishment of fair market value, replacement value or liquidation value of the assets and liabilities), market approach (future maintainable earnings valuation- capitalisation rate, discount rate and discounted cash flow methods) and market appoach (relative valuation compared to company & comparable transactions).

Understanding how to value a business and give an accurate business appraisal is a difficult and time consuming process. Setting a price for a business that is too high can result in the business not being sold for a long period of time; sometimes not at all. If the business owner eventually adjusts the price to how the market is responding, the deal will often be tainted with the view that something is wrong with the business or that the owner is desperate. Setting a price for a business that is too low can often result in the business owner not realizing the full benefit of their investment, ultimately losing out on the true business value. Determining the cost of valuing a business is dependent on the size and complexity of the business being evaluated, as well as any fundamental factors that may affect the business value: Business Cash Flow, Industry Sector, Competition, Buyer Market, Employee Skill Level, Customer Base, Owner Involvement, Revenue, Age of Business, Availability of Vendor Financing and Profitability Trend.

The articles covered in the current issue are aimed to equip readers with facts and issues on business valuation.