

Ask SCORE

I've operated a successful locksmith business for many years. Recently I've been approached by a young man interested in purchasing half the business, with an eye to eventually taking over the entire business when I'm ready to retire in about five years. How do I determine the value of my business?

At first glance, this may sound like a difficult question to answer. But it's an important one if you're considering taking on a partner, issuing stock or selling the enterprise. If you're in the market to buy an existing small business, you want to know exactly what you're paying for, and how that value was determined.

There may be other situations where establishing the value of a business may be important. You may be considering spinning off part of your current business, or dealing with a dispute or litigation. Business value also figures in divorce proceedings and other cases where the value of one's assets is factor.

An accurate, up-to-date financial statement is only the first step in setting the value of a business. One must thoroughly analyze the past several years of business operations, and make an informed projection about the future—how will that industry and economy unfold, and how will the company compete.

Most people look to the Fair Market Value of a business, defined by the Internal Revenue Service as “the price at which the property would change hands between a willing buyer and willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts.”

However, there are several ways to determine a fair and equitable price for the sale of the business. Among them:

- **Capitalized Earning Approach.** This is the return on the investment expected by an investor.
- **Excess Earning Method.** Similar to the Capitalized Earning, except that return on assets is split from other earnings.
- **Cash Flow Method.** A method usually used when attempting to determine how much of a loan the cash flow of the business will support.
- **Tangible Assets (Balance Sheet) Method.** This method values the business by the tangible assets.
- **Value of Specific Intangible Assets Method.** This method is based upon the buyer's desire to purchase an intangible asset versus creating it. It also considers the value of the business's goodwill.

Unsure which one to use? That's why professional assistance is especially valuable when dealing with business valuation issues. The National Association of Certified Valuation Analysts (www.nacva.com) offers a free directory to help you find a business valuation expert who specializes in your particular situation.

This column is brought to you by the Merrimack Valley Chapter of SCORE, with nearly 70 current and former business executives available to provide free, confidential, one-on-one business mentoring and training workshops for area businesses. Call 603-666-7561 or visit merrimackvalley.score.org for information on mentoring, upcoming workshops and volunteer opportunities. SCORE is a national, non-profit organization and a resource partner of the U. S. Small Business Administration.

