

Using Business Value as a Benchmark

The ultimate indicator of how well a company and its management are performing is how much the company is worth. Any performance measurement or benchmarking system should include fair market value as one of its primary metrics. With public companies, it's easy to monitor this metric by tracking share prices and market capitalizations on public stock exchanges. It's not that simple for private companies, but just as important.



Management's ability to add value can be measured in two ways:

1. An internal perspective, which compares whether the company is worth more now than it was in the past.
2. An external view, which compares the company's value to other companies or industry composites.

Performance should be measured using both perspectives. The internal growth in value can be measured based on percentage and dollar amount increases. External performance can be measured by selecting a valuation multiple from a comparable company (or industry composites) and comparing it to the same multiple from your company. For example, a common valuation multiple for private companies is market capitalization (value) divided by EBITDA (earnings before interest, taxes, depreciation and amortization).

Problems

There are some practical problems with using business value as a benchmark for small companies. For example:

- The opinion of an objective business valuation professional is the preferable way to document the fair market value of a private business, but it is expensive. Getting one on a regular basis may be costly.
- "Quick and dirty" valuation methods, such as industry rules of thumb or standard formulas, don't consider factors specific to your company. They also tend to be ambiguous and may not be based on current market data. Relying solely on these quick and dirty methods can lead to erroneous conclusions.
- Because the fair market value of other comparable private companies is typically not available, you may end up comparing your company with a large public company that is not very similar.

Solutions

To control the cost of a professional business valuation, consider requesting something less than a full-scope valuation. Calculations of value cost less than formal "value conclusions," because they may be limited in scope and usually aren't accompanied by a formal written appraisal.

Annual updates can also usually be obtained for less than the cost of a formal first-time valuation. Another option is to get a valuation every three to five years. In between formal valuations, you may be able to apply historical pricing multiples -- such as price-to-EBITDA -- to your current EBITDA to estimate value for internal purposes, if market conditions, performance and risk factors have remained fairly consistent.

When relying on a past valuation -- even for internal purposes -- it's important to first discuss its limitations with the valuation professional who prepared it. For example, a valuation that estimates the fair market value of a 1 percent interest on a minority, nonmarketable basis may need to be adjusted to provide a meaningful benchmark of the company's entire value on a controlling basis. Or changes in market conditions or the company's financial performance may render a previous valuation invalid.

Bottom Line

The fair market value of your company provides insight into its risks and returns. But measuring value can be complicated for private businesses. Although rules of thumb and other forms of do-it-yourself appraisals may seem like an easy way to save money, they can be misleading. Contact Gryphon Valuation Consultants at (702) 870-8258 if you would like to discuss the most cost-effective and reliable approach to staying atop this important benchmark.

Gryphon Valuation Consultants is a full-service professional business appraisal firm offering a broad range of valuation and litigation consulting services. If we can serve your valuation needs, or if you have a question about our services, please contact us at 702-870-8258 or visit us on the web at www.BizVals.com. Gryphon is an independent member of the [American Business Appraisers National Network](#).

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