



Do You Really Know How Much Your Business Is Worth? Why You Need a Business Valuation

During the 2012 Berkshire Hathaway annual meeting when discussing what business owners should know, the famed investor and entrepreneur Warren Buffett stated: “If business schools could offer just one course, it would not be on stock trading, the efficient market hypothesis or modern portfolio theory. Rather, B-schools should be encouraging students to learn the boring, but critically important, discipline of business valuation.”

You may have heard the term “fair market value.” Fair market value is often described as “the amount 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.” That comes directly from IRS Revenue Ruling 59-60, which is frequently cited as the authority that sets out what factors are considered in determining fair market value. Unfortunately, most business owners don’t know the true value of their company—whether it’s a C corporation, S corporation, partnership, limited liability company or sole proprietorship. Yet the business is most likely their most valuable asset.

Business valuation is the process to determine the economic value of a business or company. A detailed set of procedures is used to determine what a business is worth. However, getting a business valuation done right takes preparation, thought and expertise. Business owners often think that it is simply enough to value their company at a multiple of EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization), but that doesn’t take into consideration other factors, such as the type of industry, business and competitive risks, geography, cash flow, debt and more. Other valuation shortcuts or “rules of thumb” routinely fall short when looking at specific businesses.

It's always important for an owner to know the value of their business. Valuation comes into play for a variety of reasons, including these four common reasons:

1. **Business Succession Planning**
2. **Business Growth**
3. **Estate Planning**
4. **Pre- and Post-Nuptial Marital Agreements and Divorce**

1. Business Succession. This is probably the most important reason to have a business valuation done. Business owners should start thinking about their business succession plan as early as possible. Typically, the planning is in anticipation of retirement or a withdrawal from the business to do something else. But occasionally the planning is to address unanticipated reasons to withdraw from a business, such as death, disability, divorce, bankruptcy, disagreements with co-owners, and other unanticipated events.

But what's the value that they're planning for? If the goal is to sell the business to fund retirement, will it be enough? Are they interested in selling the business to co-owners or key employees for a fair price? What is that price?

Every business owner should obtain a business valuation before they even initiate the business succession process. Thereafter, the business valuation should be updated regularly, at least every other year, because of changing economic environments and the success of the business as a going concern.

2. Business Growth. A business valuation is also necessary when planning for the growth of the business, whether through expansion, mergers and acquisitions, additional investors or owners, expanded physical plants, the purchase of additional equipment, etc. The valuation may help to determine the need for additional investors; set a buy-in price for new co-owners; or determine feasibility of expansion or the need to increase credit. Having a business valuation in hand, along with a business plan, to show the bank will also improve prospects for loan applications.

3. Estate Planning. Often, the business is the largest asset owned. Upon the business owner's death, the value of the business will be included in the calculation of the taxable estate for purposes of determining if federal and/or state estate taxes will be owed. Having and regularly updating the value of the business will help you when you create your estate plan and address the possibility of estate taxes. Life insurance is the most common way to provide for estate tax liquidity or to replace wealth lost to taxes, but you won't know if you have enough unless you know the value of your business.

4. Pre- and Post-Nuptial Marital Agreements and Divorce. In many instances, divorce can be messy, with former spouses fighting for what they believe is rightfully theirs. As a result, the use of pre- and post-nuptial marital agreements is increasingly popular to help avoid bitter disputes. Yet we know that divorce is fairly common. Often the business may be the most valuable asset to fight over, so the business owner will need to know the value of the business at various points, including prior to marriage, during the marriage and immediately upon separation.

Before you go into the valuation process, you should have an idea about what you are going to do with the results and the purpose for the valuation. Professional valuation appraisers or CPAs who have earned their ABV (Accredited in Business Valuation) designations can help you determine what that value is. These services are fee-based and can be relatively expensive depending upon the size and complexity of your business. Other recognized valuation credentials may be acceptable or required depending on the purpose. Lenders may have specific requirements, too.

Your Security Mutual life insurance advisor can also help you to get a fairly accurate estimate of your business's value. Security Mutual has a relationship with a firm called BizEquity, which offers the first patented online valuation service available only through select financial services firms such as Security Mutual. BizEquity creates valuations using the business's financial information, such as tax returns, balance sheets and financial statements. While this valuation report is not meant to be used in litigation or before an IRS audit, it can help to create a baseline estimate to help you start preparing for whatever planning you need to do, including the possibility of hiring a professional valuation expert for an individualized and certified business valuation.

For More Information Contact:



If you're a business owner, contact your local Security Mutual life insurance advisor today to get started on your business, estate or personal planning. Your Security Mutual life insurance advisor will work with your other advisors such as your attorney and CPA to help ensure that your plan is as comprehensive as it needs to be.



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