

# Business

## THE WEEK AHEAD

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**Q&A CINDY CRAIG**, director of Business Valuation Services for Andersen & Company consultants and certified public accountants in Santa Rosa, discusses appraising the value of a small business

## Getting a grasp on worth of business

**PRESS DEMOCRAT:** What's the biggest mistake small-business owners make in calculating the worth of their business?

**CRAIG:** The biggest mistake is overvaluing their company. Because they started and grew their company, they often think it's worth more than what a buyer would realistically be willing to pay for it.

**PRESS DEMOCRAT:** What's involved in having a business professionally appraised?

**CRAIG:** For an appraiser to give an opinion of value, he or she needs to obtain a good understanding of a business, the industry in which it operates, and the economic climate. We start by



Cindy Craig

getting several years' worth of financial statements and comparing the results of the company's operations year over year. We look at trends and begin to get a sense of the company's performance. Are they profitable? Do they have a lot of debt? How are they

performing relative to others in the industry? We visit the

operations, take a tour and interview the owner as well as key members of management. Our goal is to understand what the company's strengths and weaknesses are; what risks are associated with running this company in this industry; what kind of competitive environment exists; what employee relations are like; what management's expectations for the future are; whether the company has any proprietary processes or products. Essentially, we try to get answers to the kind of questions a potential buyer would ask if they were thinking about acquiring the company.

**PRESS DEMOCRAT:** Why would an owner want to have his or her business appraised?

**CRAIG:** When someone is on the brink of selling their business, it's clear they're extremely motivated to find out what it's worth. But there are a number of other reasons why an owner should consider getting their business appraised. I classify those reasons into two groups: offensive and defensive. Offensive is when a business owner chooses to have an appraisal done to help them achieve something they are consciously striving for. Common offensive reasons include planning to transfer ownership in their business to children through a formal gift-giving program; planning to sell their business, either in whole or in part; and establishing a good buy/sell agreement. Another offensive reason to have your business appraised is to know how much of your total net worth is

invested in your business asset, which can be worthwhile to know from an investment risk perspective. Many owners can then take an offensive approach by starting to address estate tax issues early on through gifting programs. This is probably the least common reason we see business owners asking for an appraisal, although it's something more owners would be wise to think about.

**PRESS DEMOCRAT:** What are defensive reasons?

**CRAIG:** They're done in reaction to something that has happened and the owner needs to respond to. Usually they're done to protect the asset. Common defensive reasons include getting the business valued because of a business dispute among the owners, because of death and potential estate tax obligations, because of divorce and because of liquidity and insolvency issues.

**PRESS DEMOCRAT:** You've said you would like to encourage more offensive appraisals. Why?

**CRAIG:** With offensive appraisals, the appraiser and the business owner are typically working together cooperatively, discussing the business's strengths, risks, trends, expectations and other issues that can impact value. The owner, by meeting with an appraiser before they're ready to sell, can better understand the factors that influence value, thereby taking steps to improve operations to better position their company for ultimate sale. The owner can use the appraisal process as a way of, hopefully, selling their company for a higher price. With defensive appraisals, the environment is frequently negative and untrusting.

**PRESS DEMOCRAT:** How can advance appraisals help prepare for succession in case of sudden death, divorce or other unexpected events?

**CRAIG:** Having an advance appraisal can help minimize or eliminate the likelihood of litigation occurring in reaction to the unexpected event. Having it done as part of the requirements of a good buy/sell agreement can be particularly effective.

**PRESS DEMOCRAT:** What is a buy/sell agreement, and how can it help prevent succession problems?

**CRAIG:** A buy/sell agreement is a legal document that pre-establishes the rules that will be followed when an owner or a company leaves or dies, and typically it provides a framework for establishing the price the departing owner will be paid. Good buy/sell agreements can go a long way toward preventing problems.

Many buy/sell agreements establish value standards to be used and call for appraisals to be done under some type of recurring schedule.

**PRESS DEMOCRAT:** A number of small-business owners in Sonoma County are baby boomers nearing retirement. How long before retirement should they consider having their business appraised, and why?

**CRAIG:** Business owners should be asking how long before retirement they should begin planning their exit from the business, because how they structure their departure can significantly impact their ability to achieve their retirement goals. If the owner intends to sell the business outright to an outside buyer, I'd recommend they get their company valued several years before they plan to sell it. This will help them with their retirement planning and may allow them to make operational changes that could help them increase the value of the company by the time they ultimately sell it. If, however, their intention is to gift shares of the company to children over a period of time, I'd recommend a longer time frame, as much as 10 to 15 years out, because the gifts are typically done over time. For companies that have multiple owners, my advice would be to have a good buy/sell agreement in place, in which case an appraisal would be an ongoing process.

**PRESS DEMOCRAT:** How often should a business be appraised?

**CRAIG:** It depends. The answer will be different for different business owners and at different stages of their life, and it may depend on whether the business has a single owner or multiple owners, whether there's a gifting plan in place, whether there's a stock appreciation rights program, whether there are plans to sell, or what their buy/sell agreement requires. We have clients who get their first appraisal when they want to establish a gifting plan, while others have annual appraisals because it's required by their buy/sell agreements.

**PRESS DEMOCRAT:** What does it cost to have a business appraised?

**CRAIG:** A full appraisal, with a written report to comply with professional standards and IRS reporting requirements, will cost at least \$15,000. It could, however, be substantially higher if the company has unusual or complex business issues, for example, owning a large number of patents. A more limited appraisal, with a briefer report, may cut that cost in half. This also assumes the work is being done in a cooperative environment. If, however, the valuation is being done in a litigation setting, the costs can be significantly greater.

This interview was conducted by e-mail by Staff Writer Mary Fricker, who can be reached at 521-5241 or mfricker@Pressdemocrat.com.