



Value Variables: Know the Warning Signs

What creates value? As valuation experts, we base our work on expected returns and the risks associated with them. Everything else being equal, the riskier the company, the lower the value.

Risks come in all shapes and sizes. Some directly affect the financial position of a company. Others are more subtle. Here are a few of the common “hazardous conditions” we encounter in our valuation work:

The One-Man Show: If a business is dependent on the knowledge or talent of one key person, its value may be diminished. Formally transferring corporate knowledge or contracting for continued involvement of key personnel could help mitigate this risk. Similarly, if the business is closely held and lacks a viable succession plan, its value plunges. No succession, no success.

Quick Profits Trap: Long-term viability is crucial to maintaining value. If it looks like management is in business only for short-term profits — or if the business is trend- or fad-driven — this is a red flag in terms of value.

Giant Customer Trap: Is the business reliant on one big client? Or even just a few? What would happen if the giant customer found a new vendor? This situation is not unusual, especially for smaller companies. However, it’s a huge risk, and it may be a direct hit to the value of the company.

Yesterday’s News: Businesses need to keep up with their own financial status. If a company doesn’t have financial statements prepared regularly, management is making decisions based on old information. This is a bad sign. At

best, it shows a lack of concern for the ongoing health of the company. At worst, neglect may be hiding ugly financial secrets.

No Roadmap: There's an old saying, "If you don't know where you're going, you'll never get there." A company without a business plan lacks direction and often flounders.

Banking Blues: Bankers, like accountants and lawyers, need to be informed of what's going on in the company. If management keeps its bankers in the dark, the company may be improperly funded and unable to weather future storms.

Out-of-Control Growth: When a company succeeds too fast, it sometimes outgrows its infrastructure, and is then unable to reliably deliver its product or service. The value of the company may suffer if it's not set up to expand.

The Change Factor: No email? No Web site? Companies that don't keep up with common business practices may be in trouble. Bringing them up to speed in terms of processes and technology may be expensive and time-consuming.

Over the Top Ownership: If an owner's personal success leads to big changes in lifestyle, it could be a sign that the business is funding its owners' excesses rather than its own viability. Owners who are living beyond their means may be taking too much out of the business to allow it to succeed in the long term.

Assessing these risks requires expertise and experience. Many of these conditions are reversible; some are not. As business valuation experts, it is our job to look for these warning signs and determine value accordingly.

Interested in learning more about these warning signs or looking for ways to enhance the value of your business? Please contact our office and we can provide more information.