



The Importance of Knowing What Your Business is Worth

“Business valuation is the heart of investing and risk management and without it you are blind.”

-WARREN BUFFET

There's one question many business owners should ask themselves: *“What is the true value of my business?”* It's an important question because, whether you realize it or not, the value of your business will have a big impact on both personal and professional aspects of your life. So, knowing the answer is vitally important.

Your business may be your most valuable asset, so it is important that you develop a proper understanding of its value. When you know what your business is worth, you have a more realistic perspective from which to plan for the future direction of the business, as well as the future income needs of you and your family. Once you know the value, you can put in place more effective plans and strategies for future growth, succession planning, retirement planning, and estate planning.

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Do you really know what your business is worth?

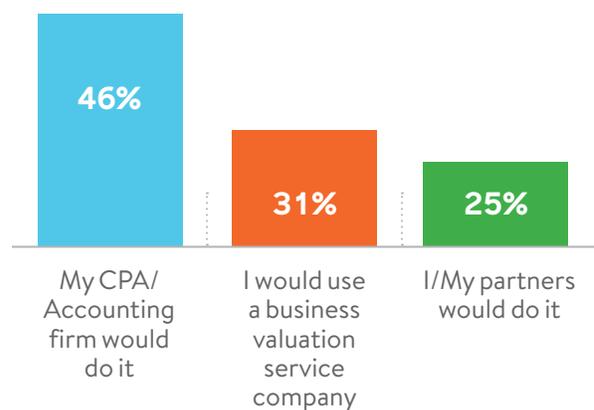
According to the 2018 MassMutual Business Owner Perspective Study, 63% of business owners say they have had their businesses valued in the last three years*.

However, our research leads us to believe that many business owners, even the ones who say they've had their businesses valued, don't know what their businesses are truly worth. That's because one out of every four business owners say they valued their business themselves.* And, when business owners value their businesses themselves, they tend to over or under value it by a substantial amount.

If your business will pave the way for a secure financial future, knowing its value is critical. In fact, business value is the foundation upon which a sound business plan is built. But when that foundation is weak because of an inaccurate valuation, it can lead to issues, such as:

- Underfunded buy-sell agreements
- Retirement income shortfalls
- A lack of liquidity in your estate
- Inequality in the distribution of assets to your heirs
- Disagreements among family members and co-owners

WHO DO BUSINESS OWNERS TURN TO FOR BUSINESS VALUATION?*



*2018 MassMutual Business Owner Perspectives Study



Why is it difficult for owners to value their businesses themselves?

There are different ways to value a business, and the purpose of the valuation will dictate the method that is most appropriate.

But, what's difficult for a business owner to gauge when evaluating their own businesses are the intangible assets, which can account for as much as 80% of a business's value.*

These intangible assets that drive a majority of the value to your business are called the "Four Capitals":

- **Human capital:** the caliber of your management team and employee talent.
- **Customer capital:** the loyalty of your customers and their likelihood to deliver recurring revenue and referrals.
- **Social capital:** your brand recognition and reputation in your community.
- **Structural capital:** the written documentation of what makes your business unique and run efficiently, such as patents, trademarks, procedural manuals and standard work.

*Exit Planning Institute, State of Owner Readiness Survey, 2018

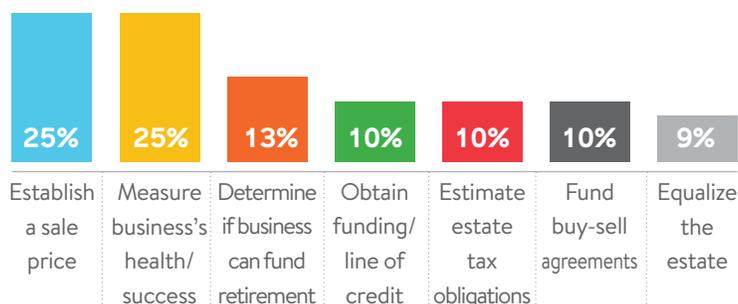
When do you need to know what your business is worth?

The top reasons why business owners want to know what their businesses are worth are to:

- Have another measure of business health/success
- Know if the business has value in the marketplace
- Prepare the business for sale*

All business owners have a desire to know if their business model is working, and what better way to gauge that than to look at changes in value over time. However, business owners may not understand all of the roles a business valuation can play in effective business planning.

REASONS OWNERS WANT TO KNOW THEIR BUSINESS VALUE*



There are other critical times in the lifecycle of a business when it may be appropriate to have an accurate business valuation, such as:

- **Funding a buy-sell agreement** — If you are obligated to buy out your business partner, or his/her spouse, through a buy-sell agreement, you need to agree on a value or formula that everyone is comfortable with ahead of time and have it documented in the agreement.
- **Evaluating retirement income needs** — Your business is most likely your largest asset and a key component of your retirement plan. A valuation can help you reconcile your future retirement income needs with the current value of your business to help identify any shortfall.
- **Creating an estate plan** — For some, planning for a potential tax burden and the impact it could have on the next generation is critical for the long-term success of the business. It's also important to be fair and equitable with how you pass down the assets in your estate to your heirs. Knowing the value of the largest asset in your estate — the business — is critical in helping achieve that goal.

*2018 MassMutual Business Owner Perspectives Study

The difference between “knowing” and “understanding” your business value.

Knowing the value of your business is having a number. Understanding your business value is having a number and understanding what’s driving that number so you can take action and ownership of it.

There are many tools and calculators that can estimate the current value your business. However, these tools typically only factor in your business’s historical financial performance as a basis for determining value, which only tells half the story.

Understanding your value goes further. It involves looking at certain value drivers that indicate the operational effectiveness and efficiency in your business. These value drivers not only help in assessing value, but also can help determine how your business is performing relative to its industry peers and if it is a transferable, or sellable, asset.

Some value drivers are in the owner’s control such as sales and marketing, product differentiation, recurring revenue, and customer satisfaction. While others are more market driven such as barriers to entry, market size, competition, and your industry’s multiple.

When business owners focus on understanding these value drivers, and how they impact and influence their enterprise value, they can better understand the role the business will play in effective succession, retirement and estate planning.

*Exit Planning Institute, State of Owner Readiness Survey, 2018.

Shifting the business value paradigm

At some point, everyone exits their business — either by design or by default.

So when you exit your business either at death, disability, or retirement, how do you want your business valued?

- What you think it’s worth — the “emotional” value
- What you need it to be worth to maintain your lifestyle — the “intrinsic” value
- The forced liquidation value due to a lack of planning

Two-thirds of business owners say “getting full value” is their top exit planning goal.* There are three shifts in mindset business owners need to make in order to help ensure they receive full value for their business when they leave.

- 1. Focus on the value drivers, not just the number. Realize that its not solely a mathematical equation.**
- 2. The health of a business, and its appeal to potential buyers, is tied to its ability to grow future value, not how much current income it generates.**
- 3. It’s the intangible assets that make a business valuable and transferable. A buyer won’t pay what you think or need the business to be worth.**

The good news is proper planning can help reduce potential value gaps created by an owner's over- or under-estimation of the business's value. But before you can embark on a strategy to grow your business value, you should first tackle the risks that could threaten the long term viability of your business. This includes making sure that the business isn't dependant on the owner or any one supplier or customer, all policies and procedures are documented and business protection plans are in place should an unexpected loss of an owner or key employee occur.

By understanding what your business is worth, you can help protect the business you've dedicated your life to building, and help ensure that you and your loved ones receive the full value for a lifetime's worth of hard work, sacrifice, and sweat equity.

A successful business begins with planning for and building a strong financial foundation. Business planning is not something that's done overnight, but having an understanding of the true value of your business is a smart first step toward helping set your business on the road to a more financially secure future.

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