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VALUATION: What's your small business really worth?

By Dianne Buckner,
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Entrepreneurs pour blood, sweat and tears, not to mention loads of hard-earned cash, into their venture. The company has got to be worth a million dollars! Or is it?

In both sports and warfare, they say the harder the battle, the more valuable is the ground that's gained.

Maybe that's why some entrepreneurs come to believe their company is worth more than it really is. They've poured blood, sweat and tears - not to mention loads of hard-earned cash - into their venture. They've battled competitors, banks, their spouses, customers and accountants - the company has got to be worth a million dollars! Or is it?

There are times it's important to know the true dollar value of your company. You may be selling, or taking on investors, or getting divorced - or perhaps you have taxation or borrowing purposes in mind. Someone is going to need an accurate figure on what your business is really worth.

That can be a tricky proposition. If you watch Dragons' Den, the CBC reality show where entrepreneurs pitch for an investment from a group of self-made millionaire Dragons, you'll know there's an awful lot of arguing about the 'valuation'.

Sometimes the Dragons are keen to invest in a start-up, but they're put off by the value the entrepreneur has set on their company. For example, when a pitcher asks for a $100,000 investment in exchange for 10 per cent ownership in the firm, they are saying the entire company is worth a million dollars. And it's that total valuation that is typically the focus of the Dragons' attention.

In most cases there's a gap between what the Dragons believe is the value, and what the entrepreneur thinks. That can be part of a nail-biting negotiation, as they each try to justify their position using various arguments.

"Watching the show, many times it seems to be a challenge for the entrepreneurs to support their value," observes Peter Weinstein of Stern Cohen LLP. Weinstein has a lot of letters after his name, includes MBA, CA, and most interesting to me, CBV, which stands for Chartered Business Valuator. Who knew there was such a designation?! (I'm sure a bunch of accountants out there in cyber-space are putting their hands up.)

"My position as a viewer is that the entrepreneur may or may not be correct. I don't want to say they're not correct," says Weinstein. "But if they could support their value better it would be to their benefit."

No kidding! Too often, hard-working, creative entrepreneurs in the Den can offer little more explanation for their million-dollar valuation other than their friends and family think that's what it's worth.

"From my perspective, if they could clearly show what the prospective earnings are from the investment and what the potential payoff is, it would make it a little easier to invest and to understand why what they're asking for in terms of money," Weinstein explains. "In all those cases the question is how much are you going to earn? And how confident are you that you will earn that?"

Figuring out what you will earn may be easy if you're an employee and get a paycheque. For a business owner with an established track record, past sales performance or sales growth can usually be projected forward, to get a sense of future earnings.

Making those types of projections is more difficult if you're entering the market with a brand-new product or service.

On Dragons' Den, people often cite data about the size of their market, such as how many people have dentures in Canada every year, how many own dogs, or how many people are buying products on-line. Then they attempt to estimate how much of that market would be willing to purchase their product or service.

"The more analysis goes into projecting earnings, the better off they'll be," says Peter Weinstein. "But if you do more research and gain more confidence in your projections, it certainly adds credibility."

I feel for so many of the pitchers that come on the show with inflated valuations. Their efforts remind me of a book I used to read to my kids. It was called *The White Stone in the Castle Wall* by Sheldon Oberman. It told the story of a little boy living in turn-of-the-century Toronto, who wanted to sell the giant rock he found to Sir Henry Pellatt, who was building a stone wall around Casa Loma. He lugged it across town in a wagon, and up the hill, only to be told it was the wrong colour. But he didn't want to walk away from it, and explained to the gardener "my work has made it worth a lot to me". In the story, the gardener turns out to be Sir Henry himself, who buys the white stone and puts it in the wall anyway.

If only there were such happy outcomes for all entrepreneurs who work so hard! But so-called sweat equity is difficult to quantify.

I asked Peter Weinstein about other intangibles that have come up in Dragons' Den discussions, such as goodwill, and brand. After all, those items can indeed show up on a balance sheet, with dollar figures attached. "It almost always comes down to how much can you earn from that asset," says Weinstein. "So if you can earn income from licensing or selling a brand and earning royalties, then that's where the value of the brand comes from."

So it always comes down to the bucks? I ask. "It does!" he replies.

I hate to say it, but Kevin O'Leary may be right when he says, again and again, "let's talk about the money."