

How to Choose Online Software to Value Your Business



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Within this document, we discuss the key features you should look for when choosing online valuation software. We will also explain the different types of valuations, how they work and which type to use for which application. Who is this for?

This guide is written for small to medium size business owners that need a reasonable estimate of the value of a business. Why value a business?

There are many reasons to know what a business is worth and to get a valuation. Some are legally required like divorce, issuing stock options, death of a business owner (IRS), gifts of private company stock (IRS), all of which require a *formal* valuation. Other reasons include understanding how your business decisions impact the business value (value is not just cash flow!), raising capital, securing loans, re-structuring or selling your company, estate planning, and life insurance needs.

Depending on your needs, there are two types of valuations—formal and ballpark.

Formal Valuation

Anytime there is litigation, the IRS is involved, or you need a *PRECISE* number that can be defended—you *must* get a *formal* valuation from a certified professional valuator. This valuator will typically spend 30 plus hours and decide which of the dozens of potential analysis, approaches and valuation data should be used and then must follow generally accepted valuation standards that specify hundreds of steps that must be considered. The valuator can also help you interpret the valuation results. However, a formal valuation typically costs about \$5,000, can take several weeks to complete, and requires extensive data gathering from the business owner and the accountant.

Ballpark Valuation

There are many circumstance that do NOT need a formal valuation. For these, you may wish to consider a *Ballpark* valuation. This approach provides a *reasonable* estimate that will get you within the “range” of your business value. It can be valuable for the following occasions:



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- When you want to understand how strong your business operations are and how your decisions are impacting your business value (This is EXTREMELY useful!)
- When you need to raise new capital or obtain loans
- Wish to change the structure of your company
- Expect to sell all or part of your company
- Need to consider a company acquisition
- Plan a tax strategy
- Plan an exit strategy
- Develop an estate plan
- Purchase life insurance or buy/sell insurance for the business
- Consider legal action when you want a ballpark of the value involved
- To determine the approximate value of your business in a divorce (not for court)



Among the existing *Ballpark* Valuation Services, there are two general approaches:

1) Finance Based and 2) *purely* Market Based.

1) Finance Based.

These web products typically use a highly simplified financial analysis to create a ballpark valuation--compared to hundreds of steps required in the formal valuation process. However, even if they used ALL the steps, without a *certified*

valuation professional the result still won't be equivalent (since it can take years to learn all the nuances, plus you still need someone to interpret it). However, some of these products suggest their value is almost as good as a formal business valuation but they are not.

Using only a small subset of the formal valuation process, not following valuation standards and not having a *certified* professional perform the valuation, does not provide the rigor or accuracy of a formal valuation—so these products are not appropriate for things like the IRS, litigation, giving stock options, etc.—period.

Second, because these products are based mainly on financial analysis, they are still overly complicated and require a lot of financial input and perform complicated financial analysis. Many also do a poor job at assessing the strength or weakness of a company beyond the financials (which is crucially important). But just as important... they require a financial professional to interpret the results since most business owners don't speak "financialese".

It sort of kills the simplicity of a Ballpark valuation if you can't understand, interpret or use the results!

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2) Purely Market Based. An alternative to the finance based model is a *purely* market based approach. This approach uses a database of actual business sales called “comparable transactions”(think of an MLS for businesses, which looks at what other businesses have sold for) and adding ONLY other factors that a business buyer typically considers when buying a business (which are all market based). These simple and easily understood “other” factors include the down payment amount, how desirable the business is, the length of the lease, strength of ongoing accounts, the business’s ability to pay off a loan, competition, business complexity, location, management strength, etc.

The foundation for a purely market approach is the comparable business sales database, which is much like a Multiple Listing Service (MLS) used for home sales. This data is available from a few sources and shows what other businesses in the same industry have previously sold for. This is NOT complex financial analysis or theory, it’s simply what real businesses sell for – which is also the single best indicator of what a business could sell for (and why this is called the “market” approach).



Comparable business sale data provides a range of what businesses sold for in a specific industry (based on Price to Earnings and Price to Revenue Ratios). However, this price range still needs to be narrowed down to the price for your business, so a purely market based approach incorporates other “Market” based factors to determine how strong or weak the business is and what the Ballpark value is.

The process is pretty straightforward, the comparable business sales data provides the range of values from real business sales and the other market factors (methods) narrow down the range to a specific value. This ENTIRE process is based on what the market says a business is worth, without complex, theoretical, or confusing financial analysis.

Why is using ACTUAL business sales (comps) so important?

Some valuation products claim to use “comps” but don’t show any individual comparable sales or their averages, ranges, etc. Using and providing the details of comparable sales is a “key” to unlocking business value and without them a business valuation is lacking a crucial ingredient. A valuation process that keeps the comps data, comps process and comps results completely *hidden* is the absolute weakest (and least useful) way to use comparable data in calculating value. If your real estate agent told you they came up with the value of your house based on comparable sales but refused to show you any of the comps or how the comps related to the value of your home, what would you say?

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Of course, the foundation of the market based approach requires something that can't be calculated through just financial analysis—you must have actual comparable business sales data! No comps—and you're back to using complicated financial analysis which is useless unless you speak "financialese".

When looking for a ballpark valuation, here are five areas you should consider—especially if using an online business valuation service:

- Uses Purely MARKET-BASED Methodology. Combines business sales comps with other market-based factors to estimate your company's value (many alternative online valuation services don't have comps—so they resort to using complex financial analysis).
 - Uses and SHOWS Actual Industry Comps (previous business sales). Uses a comprehensive database to show you what other companies sold for and how your company compares.
 - Requires Minimal Sensitive Data. Does not require your financials or other sensitive data that you would rather keep confidential—this ensures your business details remain your own and results remain confidential.
 - Transparency. Should provide transparent data, analysis, theories, and approach to formulate your valuation—helping you feel more confident in the final results while minimizing hidden "black box" calculations.
- Designed for Non-Valuation Professionals. Your valuation should not require an accounting professional to compile and interpret the results. It must be easy to understand and have no "financialese".
 - No Financial Statements. Should not require years of financial statements or an accountant to compile the data before you can do an assessment
 - Simple Input Values. Should only require input values that business owners typically already know, such as the length of their lease, the strength of ongoing accounts, the ability to pay off any loans, the general competition within the market or area, etc.—without having to consult an accountant or update old financials.
 - Easy to Understand Results. The report should be easy-to-understand and show what the business might actually sell for based on actual previous business sales (comps) of real businesses in the same industry
- Easy to Use. The valuation should include easy-to-understand questions—so you can quickly understand your company's worth.
 - Guided Questions. The application should guide you through all the questions needed to complete your report—without requiring professional help.
 - Easy to Find Input Data. Should only require information that you typically already know (without spending hours trying to compile financials or complicated research).

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- **Credentialed Valuers Provide Support.** It would be helpful if support staff are actual certified professional valuers—so they can not only help you with the program, but can also help you to understand the input and interpretation of data.

Phone and Email Support. Get the help you need, when you need it—even by phone without extra costs.

User Guide. Detailed help files guide you through the process from data entry to understanding your final report.

- **Training.** Training provided online via webinars and video tutorials.

Referral network of professional valuers. Offers access to a network of valuation professionals if you need referrals to experts for further assistance.

Added to these important features, it's important to look at the cost per report. Many systems come at a high cost per report and don't provide market comps.



Summary

Anytime there is litigation, the IRS is involved, or you need a PRECISE number that can be defended—you must get a formal valuation from a certified professional valuator. However, when you need to consider a company acquisition, plan a tax or exit strategy, develop an estate plan, purchase insurance, raise capital, re-structure your company or consider selling all or part of your business—a ballpark valuation is often the best option.

Find an Advisor to Help You Today!

Interested in obtaining a ballpark valuation for your business? Click the link below to find a financial professional who can help you. Just tell us where you're located and the type of business you're interested in having evaluated and we'll make the introduction.

[Learn more](#)