PRACTICE MANAGEMENT

Taking the Leap from Valuation Analyst to Value Growth Advisor

By Kevin A. Papa, CPA, CVA, ABV, CVGA

When a business valuation professional delivers an opinion of value report, the engagement is generally complete. In most cases, the business owners eagerly await the final report, but in only a fraction of cases does the valuation professional have the opportunity to present the conclusion of value and explain the underlying fundamentals. Unfortunately, this often short-changes the owners (who are rightfully proud of their efforts), depriving them of the opportunity to learn how the valuation professional assessed their company. Business owners are an actively interested and attentive audience, and business valuators are well-equipped to educate them about ongoing cash flows and systematic and unsystematic risk, and to help them truly understand the fundamental risk analysis and opportunities that an appraisal offers.

In addition to existing valuation engagements, thousands of companies that do not seek a valuation analysis are in desperate need of value growth services. Many of these businesses do not understand the valuation process and do not even know how their companies' valuations are affected by risk. Some may be recurring clients of your own firm. Finding these businesses and assisting them will open a whole new market to your practice, and your existing skills as a valuation professional are ideal for this kind of work. Some valuation professionals may be intimidated by this type of work. But with a comprehensive program and a general understanding of business fundamentals, this type of work can be professionally satisfying and rewarding.

A professional with a valuation credential has a powerful tool. The combined knowledge of accounting, finance, economics, risk assessment, and financial analytics provides a toolkit that opens doors to insightful conversations about the financial future of clients' businesses. Guiding clients through the process of learning how to grow value in their businesses is really special. Countless times in my practice, I have sat across from a client, discussing either a valuation that has exposed an issue or a problem the client has identified in the business. After further discussion and analysis, it becomes obvious that there is no easy or clear answer.

How many times have we experienced this conversation?

> Professional (six months after year-end): "Hey Sally, I noticed your profit margin dropped two points last year."
>
> Sally: "Yes, it's a real problem for us. Our competition is undercutting us and our CFO and COO aren't speaking. I really don't know what to do. We need them both and our customers want lower prices."
>
> Professional: "Gee, that sounds awful. Hope you get that worked out soon. I'll be back in six months to see how things are going."
>
> Professional drives home, thinking, "I want to help, but what can I do?"

Your client's lament is an opportunity for you to apply your special skills and help the client develop a comprehensive business plan to escape his or her predicament, lower business risks, and increase the value of the business.

The valuation analyst is skilled in assessing business risks and diagnosing strengths and weaknesses. This risk assessment process aids the analyst in developing an appropriate cost of capital to value the subject entity. We consider a variety of factors in assessing company-specific risk premium (CSRP), some unique to the business, others not.

Your CSRP considerations may already include the following:

- Is the business impacted severely or moderately by changes in economic conditions?
- Is the business location increasing or decreasing risk?

- Is management depth shallow or deep?
- Are barriers to entry into the market high or low?
- Is the industry growing or contracting?
- Is competition fierce or tame?
- Is management quality high or low?
- Is financial performance strong or weak?
- Is financial position stable or unstable?
- Is the customer base concentrated or diverse?

For the analyst conducting a CSRP analysis, the above questions are fundamental and drive conversations with management. The answers drive a complex thought process and exercise of professional judgment that leads the analyst to a cost of capital and ultimately a valuation conclusion; the end of the valuation process.

Stepping into the Value Growth Advisor Role

Understanding the CSRP is fundamental to the valuation process. Recognizing that changes can be made at the business level to reduce the CSRP is the beginning of the consulting process. And assisting the business owner with consultation that, over time, will reduce the CSRP, represents the ongoing value growth process.

Imagine meeting with a long-time business owner client to deliver a valuation report. You valued the business equity at $1.5 million using a cost of capital of 25 percent. The 100 percent business owner confides in you that he thought his equity value would be $3 million. You outline the valuation process, the valuation approaches you considered, and the methods you applied. You discuss the CSRP and all the factors you considered. You explain that the company's management team is thin and weak, its manufacturing equipment is old, its computer systems are antiquated, its historical financial performance has been erratic, and it relies heavily on a few large customers. The business owner understands and asks for help. You do not know where to begin, yet you know the business valuation could be improved significantly if some changes were implemented.

You want to help. How will you do this? Where do you begin?

Value Growth Process

The value growth process begins with a deep dive into company-specific risk. This deep dive is very likely further than you have ever gone in analyzing the CSRP. You should begin with a full-day meeting with the company's senior management team, ideally held off-site to prevent distractions. You explain to the management team that the meeting is the beginning of a new chapter for the company. Their input is critical to the process and you require complete and total honesty. You coach the CEO that nothing said in this meeting can be held against any person. The room is a "safe zone" that requires collaboration and honest assessments of both good and bad.

During this meeting, you explore the headwinds and risks facing the business. You ask the management team a carefully planned series of questions about the business and require the team members to grade themselves. The participants

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deliberate and agree on their answers. You document the answers and keep the team focused. During this day, you cover hundreds of provocative, risk-based questions. This is an extremely powerful session, which exposes strengths and weaknesses that correlate to risk.

Your approach should be very systematic, and should examine each of the eight primary functional categories that drive business value. A business can still function if these categories are out of balance. It may even be consistently profitable. But it will never rise to its greatest valuation potential until all eight categories are fully developed and in balance with each other.

The eight categories[1] are:

1. Planning. A business without a strategic plan has no direction. Focus on the quality of the plan, which should address business strategy, target market, competition, barriers to entry, and market development. It should be written by and with the input of the entire management team to be effective.

2. Leadership. A business needs leadership to drive the plan. Focus on the quality of the company's leadership, from the highest level (board) through the managerial team members. This involves assessing corporate culture, communication, and succession planning (management succession, not ownership succession).

3. People. A business needs the right people in the right positions. Begin by analyzing the organizational structure with a view toward strategy, implementing teaching and learning, incentive programs, policies, and procedures.

4. Operations. A business operation must be organized and measured. Identify an optimal operating strategy. Is the company a low-cost provider or should it follow a value-driven business model? Supply chain, quality controls, efficiencies, policies, and procedures must all be aligned in order for the company to scale.

5. Marketing. The business must be able to find customers or have new customers find the business. Document a strategy that addresses positioning, branding, and the amount of financial resources devoted to the plan. Assist management in carrying out the plan.

6. Sales. Focus on the quality of the sales plan and strategy. Be sure that the sales effort is regionalized and that the sales team is well-trained, with a comprehensive strategy consisting of projections and full knowledge of the customer base.

7. Legal. Structure and documentation is critical. Be sure that the company has protected intellectual property; that all filings, licenses, and disclosures are current; that contracts and agreements are signed and up to date; and that litigation risk is reduced to the lowest level possible.

8. Finance. Focus on the quality of the financial budgeting and reporting systems. Be sure that the finance team is capable and is following a defined strategy; that internal controls are developed and documented; that information systems are efficient and effective; that financial reporting is current; and that key financial metrics are measured, communicated, and used to drive incentives throughout the organization.

It is easy to see that a company with all eight of the above categories fully developed and working in tandem will enjoy a lower risk profile (CSRP) than would otherwise exist if the same company were weak in one or more of the above areas. Weakness in any category will prevent a business from achieving peak performance.

Each of these categories covers thought-provoking qualitative questions that expose and quantify risk (CSRP). There are many consulting systems, variations, and techniques available to facilitate such a meeting.[2] Some analysts develop their own questions and methods for identifying risk areas.

After the meeting, you should analyze management's risk assessments (grading) and prepare a report that illustrates the strengths and weaknesses in the company's entire operation, correlates management's risk assessments to a CSRP, and provides a calculation analysis. You should deliver your report to the company's owner and demonstrate how improvements in the company's weaker categories will reduce CSRP, thereby reducing the cost of capital and increasing value. Every valuation analyst has the skill set to complete this first step.

Facilitating the Value Building Process

Most business owners will immediately recognize the benefits of completing a value building process. The management team has already identified major weaknesses

1 The eight fundamental categories presented in this article are derived from the Master General Framework of the Certified Value Growth Advisor (CVGA) program. *See* https://www.corporatevalue.net.

2 The Value Opportunity Profile, for example, is a proprietary, web-based application designed to aid advisors in conducting the management interview, calculating value, and reporting to the client. https://www.corporatevalue.net.

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that must be corrected in order for the business to grow value. In virtually every instance, the company business plan must be developed or redeveloped and brought to life.

The next phase is a facilitation process. The valuation analyst may or may not be comfortable initially with this process. The advisor's professional network is integral to moving forward.

Collaboration and Use of Experts

The value growth advisor is not required to be the know-everything consultant. There is no such person. It is important to work with collaborators who excel in areas that you do not, such as corporate attorneys, CFOs for hire, marketing professionals, sales consultants, operations (lean/ISO) experts, and human resources experts. The value growth advisor's strength is knowing how improvements will increase value and selecting the right experts to help the company achieve that objective.

Behavior Assessment

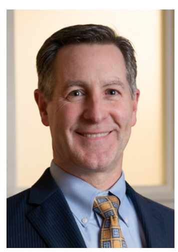
Early in the process, you should assess management behavior, body language, and facial expressions as part of an analysis that identifies the strengths and weaknesses of each member of the management team. This exercise helps the management team understand and accept their respective differences and traits, which, in turn, will help them to communicate better and work together to achieve common goals. A well-run company will be balanced in all of the eight categories.

The Advisor's Role

The value growth advisor's role is to guide a company and its management team through the changes it must make to grow value. You bring people together and guide them through an organized, proven process. The management team members will motivate each other. You identify the weakest fundamental areas that need improvement, guide management in improving these areas, and work with experts in your network who possess the skills to support you in coaching the management team through its transformation.

Typically, the process unfolds in biweekly meetings over one to three years, during which time the company transforms and grows to new heights. Ideally, at the end of the process, the company will become an industry leader with world-class systems in place, and you will have served as the trusted advisor the business owner truly needs. The company's unsystematic business risks will diminish and the CSRP will be lower, while profitability increases and the business performs at the highest level possible. This combination of higher profits and lower risk will increase value exponentially from where the company started in the value growth process.

Understand that not every business owner will make a commitment to grow value. But the right candidates will need little persuasion. Look for business owners with a passion to be the best and a willingness to grow value relentlessly. VE



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