

VALUATION OBSERVATIONS

*Some practical observations from a practicing
business appraiser.*

VLC

Valuation & Litigation Consulting, LLC

*600 E. Granger Road, Second Floor
Cleveland, Ohio 44131*

Vol.5, No. 3

ARE YOU (OR YOUR CLIENTS) WEARING TOO MANY HATS?

You are an entrepreneur, wearing many hats. You are the predominant sales and marketing person. You are the Chief Financial Officer. You are the planner, the innovator, the only one who really understands your position. Wouldn't you like to discuss your decisions with someone? Wouldn't it help to have a confidant whose expertise is in an area different than yours; someone not so intimately involved with the day-to-day functions? If your answer to any of these questions is "yes", you are in need of a Board of Advisors who can provide you with an objective viewpoint. But, what specifically is a Board of Advisors? Where do you find them? What do they really do for you?

A Board of Advisors is a small group of people not connected to the business who advise, counsel and help the business owner. These people are experts in areas other than those that you would normally hire within your company. They have no personal investment in the financial success of the company. It's easier to solve someone else's problems that it is to solve one's own problems. This is because it is easier to see a problem more clearly when you aren't so closely connected. Advisors bring objectivity to the scene. It's easy to lose sight of things when you're on the inside. Someone from the outside, with the right skills, can see a company for what it is. Small business owners are often too close to the problems of the business. Lack of perspective can lead to overly optimistic or pessimistic ideas about how the business is doing. People with different areas of expertise and different viewpoints can assist your thinking and strengthen your ability to manage your business.

Advisory board members are outsiders who can provide an outlet for the CEO to confide in and to discuss sensitive issues. They provide the long-term commitment necessary to evaluate long-range plans and to see them through. If your company is small, two or three outside advisers may be sufficient. For a larger company, seven is about the most you would want so as not to become too cumbersome.

Many people feel the best advisors are accountants and attorneys. The fourth annual Small Business Survey conducted by the Private Companies Practice Section of the American Institute of Certified Public Accountants revealed that small business owners remain committed to CPAs as their primary outside business advisor. One study said that no difference in the general content or the overall quality of advice was found for companies that used lawyers, bankers, customers or vendors. However, there was a significant relationship between the level of accounting advice and the overall success of the company.

The CEO of your key customer and your key vendor are good choices as they have a vested interest in your success. Later, as your business grows, or as you become interested in training successors, it might

be appropriate to include key management personnel in at least some advisory board discussions. It is important to choose the right people for this important position. The right advisor is the one who invests time in learning your business and objectives. This person should also educate you as to your needs and options as well as possible ramifications of your choices.

Where do you find these people? Referrals from respected business confidants prove to be most efficient and effective. But just because a person has been referred to you as a good prospective advisor, be sure to conduct an interview to insure that this is the right person for your business. The interview will tell you if the person has experience with businesses of your size and type, has a work ethic that fits with yours and has the level of intellect that you command. Keep the following points in mind during the interview:

- Does this person think like a business owner, and not just as an accountant, lawyer or banker?
- Is this person familiar with your industry and business in general?
- Does this person demonstrate both the ability and a willingness to understand your particular business?
- Does this person understand your goals and objectives?
- Will this person ask pertinent questions and offer constructive input?
- Is this person genuinely interested in helping you solve problems and identify opportunities?

The members of your advisory board should be paid for their time. Payments should be significant, such as using an hourly rate plus travel expenses. Consider that you will have 3-4 hour meetings occurring quarterly. Your advisor will also have some preparation time throughout the year; interim phone calls, memos and the like to keep the advisors up-to-date with the concerns of the business. It is important that payments not be "token", as this will indicate "token" commitment and encourage "token" performance. You are buying the expectation that your board members will put you on their calendar, prepare for meetings in advance, and come prepared to ask, argue and think with you.

The functions of an advisory board can be very broad. They help you develop policies for the business. The types of policies that can be instituted with the help of an advisory board can include personnel, pricing and consumer complaint policies. These are routine situations that their importance may be underestimated when evaluating customer service. An objective, outside viewpoint can be very valuable here.

The objective, independent viewpoint is also very useful for any major decision. Financial decision-making is a major decision that invariably will benefit from independent advice. Your advisor will have expertise and experience in obtaining creative financing outside the traditional methods you may be familiar with. Other major decisions that your advisor will have valuable input on are such areas as approving the annual capital budget, annual operating budget and anything with long-range objectives. Your advisors can bring to the table their individual expertise and experiences with their own companies and/or clients.

Management is probably where the entrepreneur needs the outside advisor the most. Succession of the business can be particularly painful to the entrepreneur, whether it be selling the business or passing it on to corporate or family successors. Not only can it be painful to the entrepreneur, but it can also be painful for the family as well. In addition to succession, sensitive issues amongst family members include compensation overall, and shareholders who work within the company versus shareholders who have no role in management. The outside advisor can provide reasonable and logical advice at the most critical times.

The most difficult task for an entrepreneur is to loosen the reins a bit and let someone else help control the business. Open your mind and let a professional's thought analyze the situation with a fresh outlook. As the business world becomes more complicated, the pressure to succeed requires much more savvy, finesse and broadened abilities. More and more, business leaders are able to use each other as a resource.

It's important to get to the root of the problem -- to pinpoint exactly why your company is having a problem. You, as the owner, may be too involved to evaluate the big picture clearly. Not only does the advisory board help the business owner to see things more clearly, but can also build bridges to other kinds of information, such as: What is really going on in the market? What should I know about my competitors? Are new products or technologies making my product line obsolete?

Advisory boards are needed for more than just when a problem arises. One survey found that one-half of the companies surveyed had a formal business plan in place. There appears to be a direct correlation between the preparation of a written business plan and the use of outside advisors. Another study found that the companies that employed structured strategic planning orientations outperformed companies that employed different orientations. This is precisely what a business plan is utilized for. The outside advisors are instrumental in facilitating the organization in achieving sophistication of performance without limiting the owner's management prerogatives.

The advisors play two roles in strategic planning. One involves a process of adaptation; the other is a process of integration. In developing a process of adaptation, the advisor assists the company is adapting to environmental change. This is more common in new ventures and companies in dynamic environments. The process of integration, on the other hand, involves the development of ways to increase organizational efficiency in more mature companies and companies in static environments. Whichever the case may be, the advisor assists the business owner by focusing attention on the planning process. The surveys agree that the quality of planning, rather than the time spent on planning, is the most important determinant of financial performance. Outside advisors should be used to assist companies in developing sophisticated planning processes.

Boards of Advisors are the real thing. Business owners who have created advisory boards and individuals who serve on advisory boards were asked what their experiences have been. Here are a few of the responses:

- ▶ "I don't have a partner or management team, and my board fills this role."
- ▶ "They force me to plan and to pin down ideas that would otherwise just be floating around in my head."
- ▶ "They see opportunities and problems I can't because I'm too close to my business and my industry."

If you would like additional information, or have a question, please do not hesitate to call.

Terri A. Lastovka, CPA, JD, ASA

Ph: 216-661-6626

Fax: 888-236-4907

lastovka@valueohio.com

Member of:



The International Society of Professional Valuers

Terri Lastovka is the founder of Valuation & Litigation Consulting, LLC. Her practice focuses on business valuations and litigation consulting in the areas of domestic relations, gift and estate tax, probate, shareholder disputes, economic damages, and forensic accounting. She draws from a wide range of experiences, including public accounting, law, banking, and CFO. She has received extensive training from the American Society of Appraisers in the area of business valuation and works closely with members of the bar to effectuate practical settlements. Terri also serves as the Director of Legal & Finance for Journey of Hope, a grass roots non-profit organization providing financial support to cancer survivors.