YOUR GUIDE TO VALUE MATURITY

A Mental Model for

Personal Prosperity

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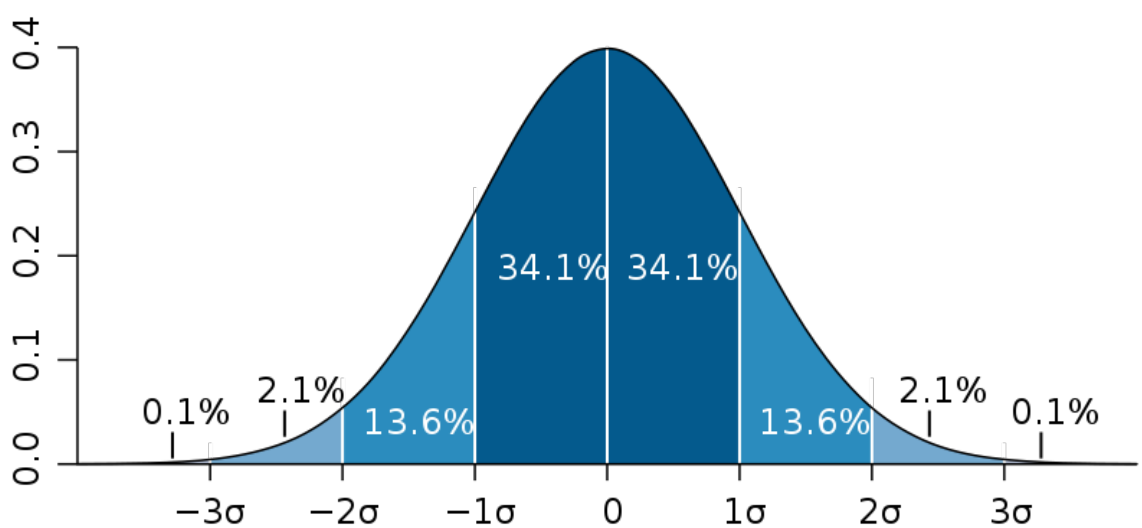

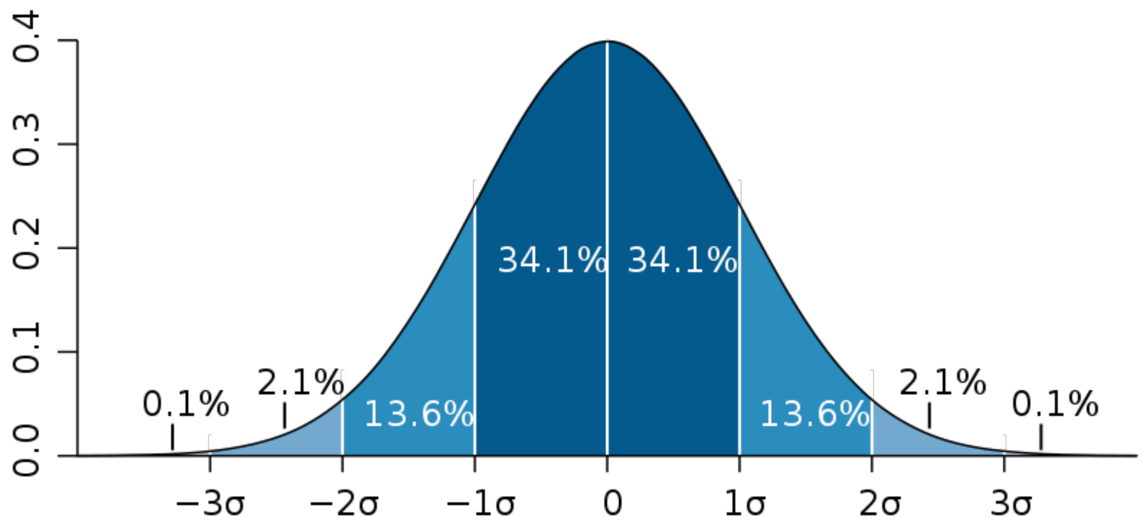

Multiples in an Industry Follow a Normal Distribution, in a certain range dependent on the characteristics of the industry in which the business is competing. This multiple is multiplied with your EBITDA (Earnings Before Interest Taxes Depreciation Amortization) to determine the value of your business.

Notice the considerable disparity between the low performers and the high performers. Value Creation Owners plan to be in the tail on the right hand side of the curve. Most businesses tend to be clustered around the average. When EBITDA and your multiple increase simultaneously, you achieve an exponential increase in value.

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This guide was written to accompany a quiz designed to assess your value maturity, which is a good mental model to use for evaluating how your business and financial life are progressing.

If you would like to take the test it can be accessed at:

https://exitplanning.online/your-business-success-quiz/

The quiz was designed to sort the scores into quartiles. The quartiles were determined by your risk profile. The first quartile is where you would like to be. This quartile represents business and financial practices which are more likely to reduce your personal financial, and business risk.

SCORE	QUARTILE	MATURITY LEVEL
15-22	1St Quartile	Highest
23-29	2nd Quartile	Med. High
30-26	3rd Quartile	Med. Low
37-44	4Th Quartile	Low

The way this is constructed may seem a little odd. Usually you think you should aspire to the highest score, but in this case a high score means high risk. As you progress up the value maturity continuum you want to protect what you have accomplished. This means as you and your business mature the goal is to create a low risk source of stable cash flow so that you can create the life of your dreams.

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INTRODUCTION

WELCOME TO THE START OF YOUR NEW FUTURE

The Value Maturity Quiz that you just took was designed to perform a very basic assessment of what stage of Value Maturity that and your company are in.

Companies and their owners must navigate through a series of different stages to reach a state of maturity. Each of these stages creates different needs for personal development and leadership capabilities for the individual and the company to reach their potential.

Younger companies are just trying to achieve product/market fit and really don't want to be constrained by any rules that get in the way of the customer creation process.

As the company grows, the founders no longer are in charge of all of the roles that need to be filled. This requires a Mindset Shift where delegation of responsibility is required and a Management Function needs to be installed.

Shifting from freewheeling entrepreneurial culture to one that has to follow any sort of rules is a major cultural shift. But, it is required for the company to progress towards maturity. The alternative is stalled growth and the potential for the company to fail.

Mature companies are by nature more bureaucratic since they have figured out their value proposition and are focused on delivering it at scale.

This is why you saw questions about policies and procedures, job descriptions. Think of it this way, would you rather buy a company that comes with an operating manual or would you just want to figure it out on the fly.

An issue for many mature companies is that they become too bureaucratic. They lose their focus on the customer which leads to organization dysfunction.

If you choose to proceed on the journey towards becoming a Value Creation Owner we will discuss these issues in great detail.

NOTE:

This is a very basic assessment. It is intended to provide a very high level overview of issues that commonly occur when working with business owners. The first step *towards solving any problem is a good definition of the problem. The more you learn the more you will understand the nuances of the problem that are important.*

THE FIVE STAGES OF VALUE MATURITY

Value Maturity is a mental model, developed by Chris Snider at the Exit Planning Institute, which describes the stages a business must pass through to maximize the value of your business. These five stages are: Identify, Protect, Build, Harvest, and Manage.

1. *Identify, you need to have a good estimation of the value of your business. Most likely, this is the most significant asset in your portfolio, for most business owners it represent 90% of your wealth. Once you know this number and you have identified what the financial requirements for your next act are, then you can identify the gap that you need to fill to realize your vision of the future.*

2. *Protect is managing personal, financial, and business risk. You need to understand your risk profile and work to decrease the amount of risk you have in each of these areas. The exercise in risk reduction improves the value of your business. Low risk businesses with steady cash flows and good margins are going to receive the highest multiples and attract the interest of investors.*

   Understand the there is a 50% probability that you will be impacted by one of the 5 D's: Death, Divorce, Disability, Disagreement or Dissolution. Have you thought through what would happen in each of these scenarios? If not you should do some reflection on what would happen if any of these did occur.

   Which of these risks do you face from a personal, financial, and business standpoint?

   PERSONAL

- *Death*
- *Disability*
- *Divorce*
- *Disagreement with partners*

- *Disagreement*
- *Health*
- *Accidents*
- *Family Tragedies*

FINANCIAL

- *Market Risks*
- *Diversification*
- *Personal Loans/Debt*
- *Personal Lawsuits*
- *Loss of Earning Power*
- *Long-Term Care*

BUSINESS

- *Customers*
- *Key People*
- *Business Interruption*
- *Economy*
- *Distress Partner*
- *Disagreements*
- *Environmental/Safety*
- *Technology/Machinery*
- *Owner Dependence*
- *Data/Information*
- *Compliance/Legal*
- *Loans/Debt*

3. *Build, value is created from increases in cash flow (EBITDA) and improvements to your multiple This is about improving intangible capital. The focus here is on creating Knowledge Capital. The mental model for Knowledge Capital focuses on four areas: Human—the value of your talent; Structural—the value of your systems and intellectual property; Customer—the value of your customer relationships; and Social—the value of your brand and culture.*

4. *Harvest, at some point in time, you will want to move on to your next act. Maybe you have another company you want to start. You might want to travel to places you have always wanted to see. Maybe it is time for the next generation to take over the business. There are many exit options which we will talk about later. You need to understand the options that are available to you and pick the one that fits best with your needs.*

5. *Manage, at this point you are reaping the rewards of the value you have created. This allows you to focus on creating your legacy and focus your attention on what creates joy in your life.*

Note: In my model Business Mastery and Personal Mastery are two of the domains of Value Creation Mastery. Value Maturity is a good starting point for understanding how you need to manage the wealth generated by your business and your personal wealth.

The Five Stages of Value Creation Mastery

1. *Learning, exposing your mind to a new set of concepts, skills and tools to apply to issues you will be facing on your journey.*

2. *Applying, to be effective, your new knowledge needs to be applied to real world problems. You will make mistakes which is a great way to learn.*

3. *Adopting, based upon what you have learned, you will need to replace old habit with new habits. The more you learn the more you earn. Disciplined action begins with your habits.*

4. *Integrating, the knowledge you will learn in this program needs to form the basis for your thinking. Things like how to add more value for your customers, how to become more efficient, and how to develop the culture and leadership in your business.*

5. *Becoming, someone who sees the world through the lenses of The Value Creation Mindset. You will become the person you want to be, getting the most value that you can out of life.*

The importance of how you think

It all starts with if you don't think it will work, it will not. If there is something that you really want then you need to focus on what it takes to get you there. Next comes the realization that all "knowledge" is somewhat flawed. What we perceive as knowledge is our perception based on our own unique journey through life.

We even think things without knowing we think them. Somewhere along your journey through life you adopted certain mental models that you are not consciously aware of. This is where blind spots are born. For example, you could have a limiting belief that you are not even aware of.

So, it is a characteristic of a good leader to examine different points of view to elicit a good understanding of the elements to be addressed when making decisions.

Some Thoughts to Help Guide Your With Your Business Transition

1. *Clearly define your goals, objectives and timeframes. If you don't know where you are going, then you have a significant problem to start with.*

2. *What does your life look like after you sell your business. You really need to spend some time thinking of this question. About 75% of businessowners experience a sense of profound loss after selling their business. You will be replacing your business life with a new life. Plan carefully and make it happen.*

3. *Make sure that you have good control of your numbers. Ideally, you want to have a solid set of financial statement going back three years. Being able to show a prospective buyer a Balanced Scorecard can also enhance the value of your business. You should also have documentation of your strategic plan.*

4. *You need a team of advisors. The larger the sale the more complex the negotiations become. Certified Exit Planning Advisors are trained to act as a project manager for creating and harvesting value from you business. CPAs are responsible for the financial, You need an estate attorney if you plan to pass assets to the next generation. A business transaction attorney when you negotiate the sale. One word of warning here. Sometimes professionals that you deal with operate outside of the scope of their knowledge. For example, an attorney that is a generalist can help with your understanding of contract language, but a business transaction will understand the nuance and implications of the language. Bottom Line: Get the right person for the job.*

5. *Understand your timeline. The more time you have to plan, the better off you will be. Ideally, Start with you need 3 years of solid financials. If your financials are not up to professional standards then you need to get that fixed quickly. Also you need to think about who is going to replace you. How much time will it take to get them up to speed? The actual process of selling your*

business may take 6 months to a year. Then there is your personal timeline, are you prepared to stick around to help transition to new ownership?

6. *How are you going to sell your business. Do you have anyone who has expressed interest in your company in the past? Should you use a business broker or an investment banker. Understand the process*

7. *How do I get the best price? It is essential you have realistic expectations of the value of your business .*

8. *How will I protect confidentiality?. At a minimum, always use a comprehensive confidentiality agreement for all prospective buyers.*

9. *Who will help you with your financial affairs, both during and post transition? This may be your existing advisors – you will need to consider what the most tax-efficient structure is to maximize sale proceeds and how you will subsequently invest them.*

HAVE YOU HAD YOUR COMPANY VALUED BY AN INDEPENDENT, KNOWLEDGEABLE PARTY?

Understanding the value of your business is vital for planning for your future. If you are a normal business owner, most of your assets are tied up in your business. It is likely that you have had to or will have to pledge your personal assets to attract the financing required to grow your business.

If you are counting on selling your business to fund your retirement the sooner you understand what the current value is and what you need it to be to fund the lifestyle you desire, the more time you have to make it happen.

The problem for most business owners is that you have 90% of their assets tied up in their business and you don't have an accurate understanding of what the true value of your business is.

In fact, the number one reason that business don't sale is commonly referred to as the Value Gap. The Value Gap is the difference between what you think your business is worth and what an investor is willing to pay.

There is a lot more that goes into a business valuation. The ValueMax program goes into much more detail the topic.

What type of business appraisal you should get is highly dependent on your particular set of circumstances.

For example if you have built a large business and have partners, you should regularly value your business so your buy/sell agreement can be kept up to date. If you are getting close to your exit, you should make sure that your expectation of value is consistent with reality.

HAVE YOU AND YOUR FINANCIAL ADVISOR DETERMINED HOW MUCH MONEY YOU WOULD NEED TO INVEST TO SUPPORT YOUR CURRENT LIFE STYLE IF YOU RETIRED?

This is really important.

An issue commonly seen with business owners is that they are able to make a nice living from the salary and profits from their business, but the income they can generate from investing the proceeds of selling their business are substantially lower than their current income.

I call this the Value Gap Trap. The best thing you can do is avoid the Value Gap Trap altogether. You can do this by "beginning with the end and mind" and understanding what your future needs will be and having a plan in place to make sure you can support your lifestyle.

Another interesting thing you might discover is that you need less than you think for a comfortable retirement. It all depends on what the next stage of your journey looks like.

Most people are so busy living life that they drift aimlessly and all of the sudden find themselves somewhere that they never intended to be. Don't let this be you.

ARE YOU ABLE TO TAKE A VACATION AND NOT CALL THE OFFICE FOR A WEEK OR MORE AT A TIME?

If not. You are not your business's biggest asset, you are it's biggest liability. I know your special. I know that you are very good at what you do.

But, know this.

No one wants to buy your job. It is too risky. Your probably right, no one can do it as good as you.

An investor wants a business that runs without them providing them with good cash flow from deploying their capital.

Concentrate on building a team that can run the business without you.

Then you really have something.

Welcome to the world of the business elite.

WHAT IS THE PRIMARY SOURCE OF NEW BUSINESS FOR YOUR COMPANY (PLEASE SELECT ONLY ONE)?

What is your customer creation process

The more dependent new business is on your efforts, the more risk to the buyer, it could easily kill the deal. If they do give you an offer it will be lower to compensate for accepting the risk.

The sweet spot is if you can demonstrate customer creation process that is well defined and have the data to back up your claims.

Sadly, many companies struggle because they don't understand their customers well. It is the cause of much lost opportunity.

WHAT HAS BEEN THE TREND FOR YOUR REVENUES AND PROFITS OVER THE LAST FIVE YEARS?

The higher these growth rate the higher multiple that you will receive.

Investors like to have upside potential on their investment.

This is also very important from an ownership perspective. If you are in a market heading South, then you need to decide whether your should stay or go.

Market dynamics are pretty intense as the digital revolution progresses. Solid businesses that exist today are one innovation away from being disrupted.

Be vigilant on what is going on in your market. You need to either innovate faster than the competition or find ways to compete on price, which is never the preferred market position.

DO YOU HAVE A SPECIFIC PLAN REGARDING WHAT YOU WOULD LIKE TO DO AFTER YOU SOLD YOUR BUSINESS (PLAYING MORE GOLF DOESN'T COUNT)?

A disturbing fact that Exit Planning Institute uncovered in their State of Owner Readiness Surveys is that 75% of business owners profoundly regret selling their business after the transaction.

So, this one is about you.

If you are like most business owners I know your business is at the center of everything. In a sense, it is who you are.

You have an emotional attachment to it. It is your creation and to you it is priceless.

Then there is the cold, hard reality of a business transaction. It is objective, maybe a bit subjective, but definitely not emotional for the investor. It can be very subjective and emotional for a business owner if they don't have an objective sense of reality.

During this whole process you will need to do a lot of mental work.

This is a huge transition. As with any major transition, the more effective your planning, the smoother the transition.

You need to understand what is going to be at the center of your Universe when you no longer commit your time to your business.

And, trust me, the golf is great for a while, but too much of anything can become a drag.

If you do this right, you will be rewarded with greater happiness.

DO YOUR TOP 5 CUSTOMERS ACCOUNT FOR MORE THAN 30% OF YOUR REVENUE?

This one is all about Cash Flow.

A major risk factor in any stream of cash is the potential of losing a major customer. With a major customer, any disruption in their business can have a direct impact on yours. Or, if they simply choose to go with another vendor, it can lead to difficult decisions on how to cut expenses.

A well-diversified customer base has a positive effect on your multiple, a concentrated customer base has a negative effect on your multiple.

Think of it like a portfolio of stocks. You never want to have too much in one stock.

HAVE YOU IDENTIFIED WHICH EXIT OPTION IS THE MOST APPROPRIATE FOR YOU?

Following are the most utilized Exit Options. There are many options available. Understanding what these options are and the Pros and Cons of each is an important element to be studied to achieve the most effective transition.

The other important element is what you want your legacy to be. This will help guide your decisions on how you design the transition.

INTERGENERATIONAL TRANSFER

About half of all business owners want to keep the business in the family. The reality is that less than a third of these businesses are actually transferred to their heirs. The numbers become more dismal with each successive generation. According to the Family Firm Institute 30% of family businesses survive into the second generation, 12% survive until the third generation, and only 3% survive to the fourth generation.

Keeping the business in the family has benefits. It preserves the family's business legacy, it can be planned for, it is less costly than other options, if done properly it can reduce the potential for disruption, and usually both the buyer and seller are motivated to create a successful transition.

These potential benefits are often offset by some thorny issues. Family dynamics often come into play, this had become even more difficult to deal with as blended families become more common.

The next generation often does not have adequate funds to purchase the business. This requires that the present generation of ownership finance the endeavor which can be a risky bet on the ability of the next generation to successfully run the business.

Often, the price received for the business is less than could be received if the business was sold to a third party.

Another consideration is that employees who have been loyal to the present owners may not be so loyal to the next generation. All of these factors can make an intergenerational transfer a risky business decision.

The good news is that the risk can be managed and mitigated with a good plan. Keeping the business in the family can be done, it just adds another layer of complexity. It is sometimes hard to deal with objective reality when dealing with family matters. Objectivity and open communications will help ensure a successful outcome.

MANAGEMENT BUYOUT

Selling to your management team may be a good option. They understand the business you have created and know how to run the business. The toughest issue will be establishing value. This is where professional valuation experts can render a fair opinion.

SALE TO EXISTING PARTNERS

I often see the scenario where one partner wants to continue and the other wants out. Ideally, you have already identified a value in your contingency plan. It would be in your interest to get a plan in place. Otherwise you might find yourself with a partner you did not anticipate.

SALE TO EMPLOYEES

In certain situations this could be a very viable option. This is often done through and Employee Stock Ownership Program. Be mindful of conflicts of interest on this one. This is an option that will hit your financial advisors commissions so they may not even bring up the topic for consideration.

SALE TO THIRD PARTY

Depending on the size of your business here is where you engage a Business Broker or an Mergers & Acquisitions specialist. If you have done all the work you need to do from a Value Creation perspective it should go pretty smooth. If you have not you may find yourself in Due Diligence Purgatory for longer than you care to be.

RECAPITALIZATION

Basically you sell equity so you can take some cash out of the business. Beware that your equity partners may have different perspectives on how to run the business than you do.

INITIAL PUBLIC OFFEING (IPO)

An entrepreneur's dream, build an awesome company, take it public, and cash out with millions if not billions. The IPO is usually the exit strategy from day one, so these company's know the drill in working with investors. A major risk as an owner is becoming to diluted as you go through successive rounds of financing. But, who cares if you end up with a major pay day.

ORDERLY LIQUIDATION

The least attractive option at all, you close down the business, sell whatever assets that anyone is willing to buy, and ride off into the sunset.

DO YOU KNOW HOW MUCH YOU WOULD NET FROM THE SALE OF YOUR BUSINESS?

WHAT DOES OWNER'S NET PROCEEDS MEAN?

Net proceeds is the final cash received by a seller after deducting all the expenses associated with the sale. There are usually fees for investment bankers or business brokers, lawyer fees, accountant fees and typical business expenses that are the responsibility of the seller up to the time of closing.

TAX IMPLICATIONS OF SELLING YOUR BUSINESS

Every business owner I know hates taxes. Who wants to give their hard earned money to the government? This is a very complex topic. You should hire an attorney and an accountant with expertise in business transactions.

The language of the contract for the sale of your business can have a major impact on your tax burden and net proceeds. You need to make sure you understand the implications of what the buyer is asking for, since their interests will be at odds with yours.

This is where the advisors you hire can really make a difference in how the proceeds are accounted for. For example, you might want to make a substantial charitable donation which cements your legacy and helps you maximize your tax burden. The best way to do this is to set up trusts prior to the transaction. It pays to get the best advice you can afford, early in the process. There are things you can do and things you can't undo.

DO YOU HAVE JOB DESCRIPTIONS FOR EACH OF YOUR KEY EMPLOYEES?

This is a high level question related to the state of your company's systems and processes.

When someone buys your company they are in effect buying your team. They want to make sure that you have planned to keep your employees engaged, that you have the right people in the right seats, and that there is a commitment to a future with the company.

They will want to understand your labor costs.

They will want to understand if there are any labor issues that will require additional investment after they buy the company.

They want to be assured that you have a properly functioning Human Resources Function.

HAVE YOU DOCUMENTED YOUR OFFICE, SERVICE, MANUFACTURING, AND MARKETING PROCESSES?

This is another question related to the state of evolution of your company's operations. Since there is a risk of key employees leaving after any transaction, the new owner will want to mitigate this risk by having detailed documentation about what everyone does.

The new owner will want to be sure that they can maintain the same level of value that you are currently delivering to your customers.

HOW IS YOUR HEALTH?

Your health is another risk factor related to your business. If you are in poor health, then there is the risk that there may be times when you are unable to be engaged with the business.

This can be dealt with if you have a team that functions without you. However, you should be seriously considering what your transition plan is. The sooner, the better.

HOW IS YOUR ENERGY LEVEL?

Many business owners reach a state of burnout.

You have spent your life holding your business together and you are tired.

You just want out.

Hopefully this is not you, but there is a pretty high probability that it is.

The thing is, if this is you and you are ready to get out.

You need to do so, as soon as possible, in a calm and rational manner.

Failing to face your reality, can make it worse in this situation.

The worst case scenario here is that you let your mental state destroy your business, leaving money on the table.

HAVE YOU SET A DATE FOR WHEN YOU WOULD LIKE TO RETIRE?

Here is an amazing factoid about Baby Boomers that most people don't know: Baby Boomers think they are going to live forever. Thus, even though they own 63% of the businesses in the United States, most are not actively planning for retirement. The crazy thing is that when they do decide it is time to transition to their next act, everyone is going to be heading for the door at the same time.

You should at least have a plan for when you would like to retire and work towards that date. It is better to plan for sooner and work a little longer than to plan for later and be forced to do it sooner.

Remember, time can be your friend or your enemy, use it wisely.

WHAT IS THE OUTLOOK FOR YOUR INDUSTRY?

The more attractive your industry, the higher the multiple you will receive. If you are in a slow growth industry, you will receive a lower multiple.

Pay attention to what businesses in you industry are selling for. There are also good reference databases that can be used for this purpose.