

The Role of Business Valuation in Strategic Planning of Activity of the Company

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Abstract This article examines the role of business valuation in long-term planning of activity of the company, contains analysis of the recent publications on strategic planning, the reasons and benefits that companies get from ordering of a business valuation and some specific business situations which may call for a formal valuation study. Business valuation helps chart the course of success, starting with the strengths and weaknesses of your organization, and determines the actions, which will help drive the enterprise value to where it should be tomorrow. The role of business valuation is determined as one of the main roles of strategic planning of activity of the company, because, all companies have limited resources, so strategic planning and task needs to be prioritized to ensure a methodical, realistic approach for company that wants to succeed.

Keywords Business valuation, Strategic planning, Reasons for independent business valuation

1. Introduction

The contemporary development of methods of business valuation proceeds in the direction of satisfying the requirements of modern management. Today value management is one of the most popular concepts of the management philosophies.

The evaluation results of business obtained by analyzing the external and internal information are necessary not only for negotiating about buying and selling, they play a significant role in the selection of enterprise development strategies: in strategic planning, it is important to estimate future revenues of an enterprise, level of sustainability and value of the image; to substantiate investment projects for the acquisition and business development it is necessary to have information on the cost of an enterprise or part of its assets.

2. Analysis of Recent Researches and Publications

The authors of fundamental scientific works on strategic planning are A. Chandler, K. Andrews and I. Ansoff. In recent years, there has been a tendency abroad towards generalization and comprehension of the results of researches in the area of strategic planning and management. In connection with the above, we note, for example,

scientific works of H. Mintzberg, and D. Alstrend Lempel.

It should be noted that scientific literature quite completely and describes the theoretical approaches to strategic planning. But the role of evaluation in long-term planning of the company is covered fragmentarily or even omitted from consideration. Implementation mechanisms of strategic planning, development and application is the matter of consulting companies which have little interest in public discussion of the results.

3. Problem Statement

At the contemporary stage, competition level in all areas of producing goods and service delivery is constantly increasing. Any company needs planning as a dynamic process, to anticipate and take into account environmental changes and adapt the internal production factors for its development and growth. Valuation of the company plays an important role in long-term planning of the company.

4. Purpose and Objectives of the Article

Purpose of this article is to identify and describe the role of business valuation in the long-term planning of activity of the company.

5. Basic Results of the Article

Strategic planning is a process that brings to life the mission and vision of an enterprise. A strategic plan, well crafted and of value, is driven from the top down; considers

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the internal and external environment around the business; is the work of managers of the business; and is communicated to all the business stakeholders, both inside and outside of the company. [3]

Many business owners believe that since their hand is on the pulse of the business, no surprises will come. Unfortunately, they are usually wrong. [13]

As a company grows and as the business environment becomes more complex the need for strategic planning becomes greater. There is a need for all people in the corporation to understand the direction and mission of the business. Companies consistently applying a disciplined approach to strategic planning are better prepared to evolve as the market changes and as different market segments require different needs for the products or services of the company. There is no unique formula or process for strategic planning. There are however, principles and required steps that optimize the value of strategic planning. [5]

The steps in the process described in this article on strategic planning are presented below (Figure 1):

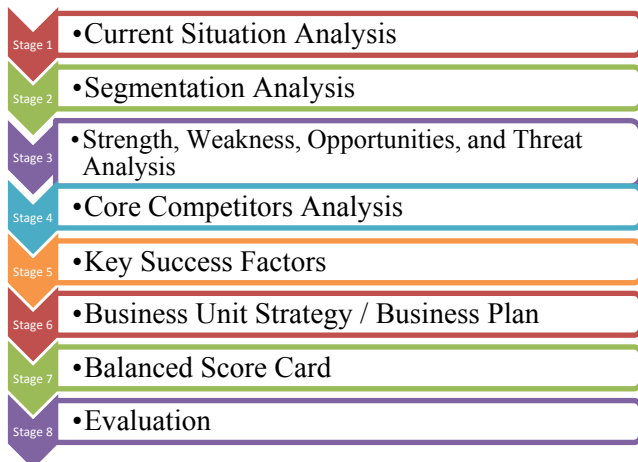


Figure 1. The process of strategic planning

Business valuation is one of the main stages of strategic planning of the company. Based on the assessment of business value company management determines the content and sequence of the implementation of the most important events, makes decisions on complex problems of the company.

Strategic planning has become increasingly critical for small and mid-sized businesses, because economic trends have created a more competitive business environment. For companies that want to succeed, defining its direction is of utmost importance. [13]

When the time comes, the company's principals, its counsel, or independent accountant should consider the advantages of an independent, professional appraisal by a specialist in the field of business valuation. Some specific business situations (described in the Table 1) which may call for a formal valuation study include:

The following are the top reasons that companies benefit from having business valuation (you can see in the Figure 2):

1. Know what your company is worth. Many business

owners have no idea what their business is worth; and if they think they know, they are probably wrong. Sentiment often gets in the way of good judgment. For a fair and independent opinion, CEOs and owners should obtain a professional business valuation.

2. Understand where your company fits in the landscape. A business valuation will research and provide an explanation of your specific industry and will place your company in the competitive landscape of your specialized market. It will also tell you the market price of publicly traded companies that are engaged in your line of business.
3. Learn the financial condition of your company. Business owners may think they understand the financial health of their company, however having an independent review and analysis including intangible assets can confirm or deny the theories.
4. Make fast decisions on buying, selling, and mergers. If you are faced with the option to buy, sell, or attract capital for your business, you may not have time to wait to have a business valuation completed. Having a current valuation will enable you to strike while the iron is hot.
5. Stay current. The market is in constant flux. It is important to get regular business valuations because your company, your industry and the economy are continually changing. A business valuation report, completed by an accredited valuation expert who is a member of a professional society working in compliance with established professional standards, may be appropriate for use in courts, for financing and for tax challenges as needed. [1]

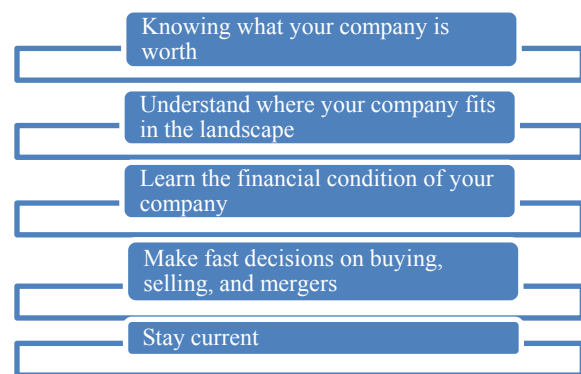


Figure 2. Benefits which a company will receive from independent business valuation

6. Conclusions

Strategic planning or long-range planning, is a management-directed process that is intended to determine a desired future state for a business entity and to define overall strategies for accomplishing the desired state. Through planning, management decides what objectives to pursue during a future period, and what actions to undertake to achieve those objectives.

Successful business planning requires concentrated time and effort in a systematic approach that involves: assessing the present situation; anticipating future profitability and market conditions; determining objectives and goals; outlining a course of action; and analyzing the financial implications of these actions.

Table 1. Reasons for independent business valuation

Estate and Gift Taxes	Placing a fair, well-documented value on a business interest is essential to minimize potential problems with the IRS.
Estate Planning	It is important to have an accurate value for a business interest to adequately fund a future estate tax liability.
Buy/Sell Agreements	To avoid a potential problem, it is often desirable to have a buy/sell agreement in effect between the principals of a privately held business. Each type of business is subject to different valuation parameters and it is important that the contractual price is fair to all concerned parties.
Partnership Dissolution	When one partner wants to sell, it is often necessary to have an independent appraiser value the interest to arrive at a fair settlement.
Divorces	When the parties have an interest in a privately held business, the fair market value of the holdings must be established for an equitable division of assets. Often, expert testimony is required if a settlement cannot be reached. In some cases a single appraiser may be retained jointly by the parties.
Compensatory Damages	Expert appraisal of damages is necessary in cases where lost profits or diminished business value is an issue. Typical examples include breach of contract, fire, and antitrust violations.
Going Private	When a liquid market never develops for a publicly traded stock, the controlling shareholders may want to eliminate reporting requirements and expense. By law, a fair price must be offered to the minority stockholders.
Leveraged Buyouts	Occasionally the management/employee group would like to buy a company from existing owners, public or private. In this situation a fair price is mandated.
Litigation	An objective appraisal can be invaluable in helping to reach a pretrial settlement. If the matter goes to trial, expert testimony can greatly strengthen a case where the value of a business interest is an issue before a court or arbitration panel.
Mergers and Acquisitions	Selling or buying a company is likely to be the most important decision a business executive may ever make. Setting a fair price, including structuring payment terms to meet the needs of both parties, is necessary for a successful transaction.
ESOPs	Shares of Employee Stock Ownership Plans of privately held companies must be valued by an independent appraiser annually to establish a fair stock price to meet ERISA and IRS requirements.
Leveraged ESOPs	Understanding of specialized valuation concepts is needed to appraise these highly complex financing-pension plans. Knowing what to expect in the second and later years' appraisals is a must when analyzing and establishing a leveraged ESOP.
Public Offering	It is important to establish a public offering price that enables the company to meet its capital goals, yet it is attractive enough to investors that the offering can be fully subscribed. Due diligence examinations done by an independent third party are helpful in satisfying both federal and state regulatory concerns about pricing as well as full and accurate disclosure.
Raising Capital	An independent, objective appraisal may be most helpful in negotiating with venture capitalists or other prospective investors.
Recapitalization	In this method of reorganizing a corporate capital structure, not only must the total value of the company be appraised, the value must also be allocated between the various equity interests before and after the recapitalization.
Stock Options	Establishing the fair market value of stock options to be issued to employees, particularly in a new company, can be crucial to attracting and keeping qualified, motivated employees.
Analysis and Critique of Opposing Expert's Business Valuation Reports	A critique report will identify and analyze what is correct, incorrect, missing and/or misinterpreted in an opposing valuation expert's report. The valuation critique can identify specific issues or provide an overall opinion as to whether the report being critiqued is in fact reasonable. It is useful for an attorney to have a critique report of a valuation report prepared by the opposing side.
Conversion of a "C" Corporation to Subchapter-S Corporation Status	Businesses that are planning to convert from "C" to "S" or "LLC" corporate status should have a valuation done as of the date of the change. If the firm is sold prior to the ten year holding period, there is a tax due on the built-in gain of value from the point of conversion. An independent valuation as of the date of the conversion substantiates the tax calculation for the IRS.
Personal Financial Management	A business represents a typical owner's single most valuable asset. Despite this, most business owners have no realistic concept of the true market value. A valuation enables informed critical decisions, such as proper timing to pursue an exit strategy.
Financial and Tax Reporting	Certain financial and tax reporting situations require qualified, independent valuation services. When a company issues stock options, or transfers or sells equity interests, a valuation is required for the company to accurately report related compensation expense and the recipients to accurately report income.
Minority Shareholder Disputes and Litigation	Situations can arise when a minority shareholder is not receiving any dividends or other return on his investment in a closely held company; and majority owners are receiving substantial sums benefits from the company. In this type of litigation, a comprehensive valuation is a necessity.

Business valuation is one of the main stages of the strategic planning of the company. Based on the assessment of business value company management determines the content and sequence of the implementation of the most important events, make decisions on complex problems of the company.

If a business is overvalued, it will not sell. If a business is undervalued, the seller will not realize a full return on investment. In most cases, a properly priced business will sell and all parties will walk away satisfied. A fair price of the business is the result of an independent professional valuator's opinion.

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