Chapter 14

The Valuation Challenge in Entrepreneurship

Business Valuation

['biz-nəs val-yə-'wā-shən]

A general process of deter-mining the economic value of a whole business or company unit.

WHY? business valuation

1. Buying or selling a business, divisions, or major assets.
2. Establishing an employee stock option plan or profit-sharing plan for employees.
3. Raising growth capital through stock warrants or convertible loans.
4. Giving a gift of stock to family members.
5. Structuring a buy / sell agreement with stockholders.
6. Attempting to buy out a partner.
7. Going public with the company or privately placing the stock.

Reasons for the Acquisition

1. Developing more growth phase products by acquiring a firm that has developed new products.
2. Increasing the number of customers by acquiring a firm whose current customers will broaden sustainability.
3. Increasing market share by acquiring a firm in the company's industry.
4. Improving or changing distribution channels by acquiring a firm with recognized superiority in the company's current distribution channel.
5. Expanding the product line by acquiring a firm whose products complement and complete the company's product line.

Analyzing The Business

(many closely held ventures have the following shortcomings)

1. Lack of management depth.
2. Undercapitalization.
3. Insufficient controls.
4. Divergent goals (entrepreneur's vision differs from the investor's)

CAPITALIZATION

OVER CAPITALIZATION

UNDER CAPITALIZATION

FAIR CAPITALIZATION

Overcapitalization

[ˌō-vər-ˈka-pə-tə-ˌlīz-ˈā-shən]

A situation wherein a company raises more capital than is justified by its size and value.

Causes of Under Capitalization

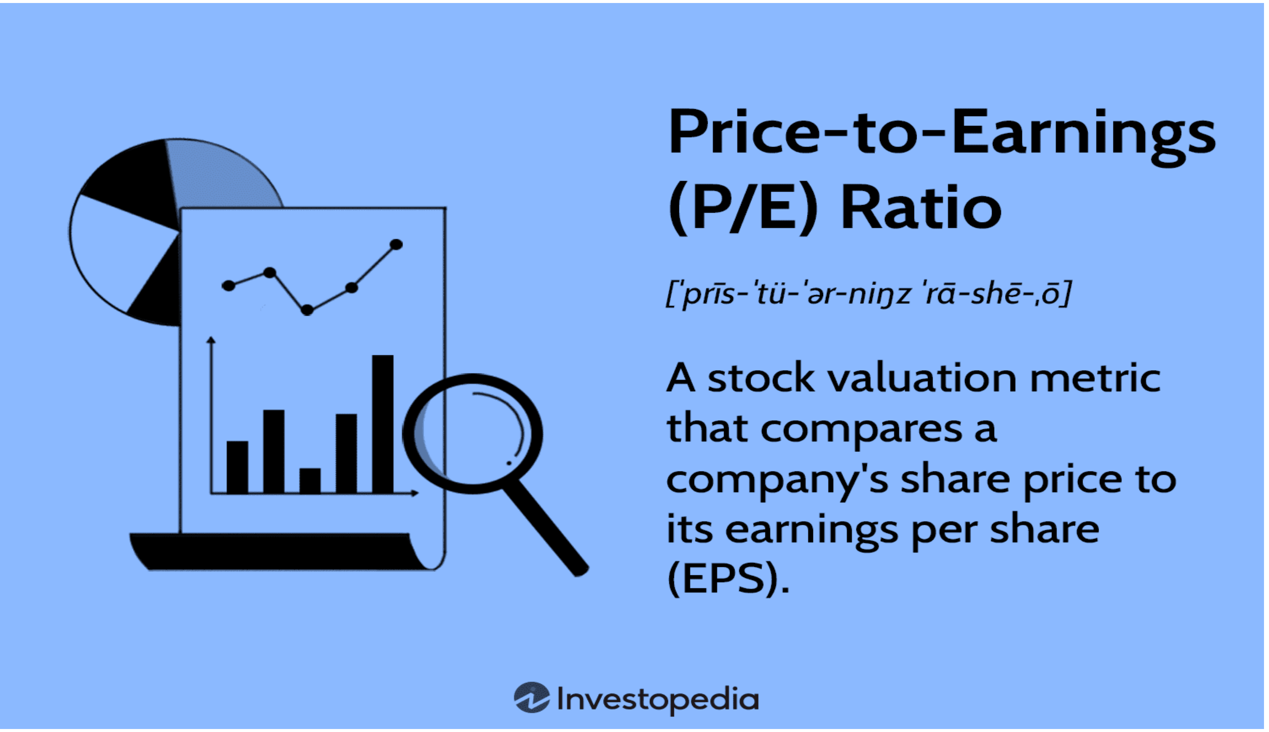
- Under estimation of earnings
- Use of high capitalization rate
- Promotion of company during Deflation
- Under estimation of capital requirements
- Conservative dividend policy
- High standard of efficiency
- Low promotion expenses

Methods for Venture Valuation

1. Fixed price (two or more owners set initial value)
2. Book value (known as balance sheet method)
   - Set by the business's balance sheet reflects net worth of the firm total assets less total liabilities.
3. ~~Price / earnings ratio~~

first 2 methods only

go to slide 21 skip in between


Price-to-Earnings (P/E) Ratio
['prīs-'tü-'ər-niŋz 'rā-shē-ˌō]
A stock valuation metric that compares a company's share price to its earnings per share (EPS).
Investopedia


PE Ratio
PE Ratio Formula
=
Price Per Share
Earnings Per Share
WallStreetMojo

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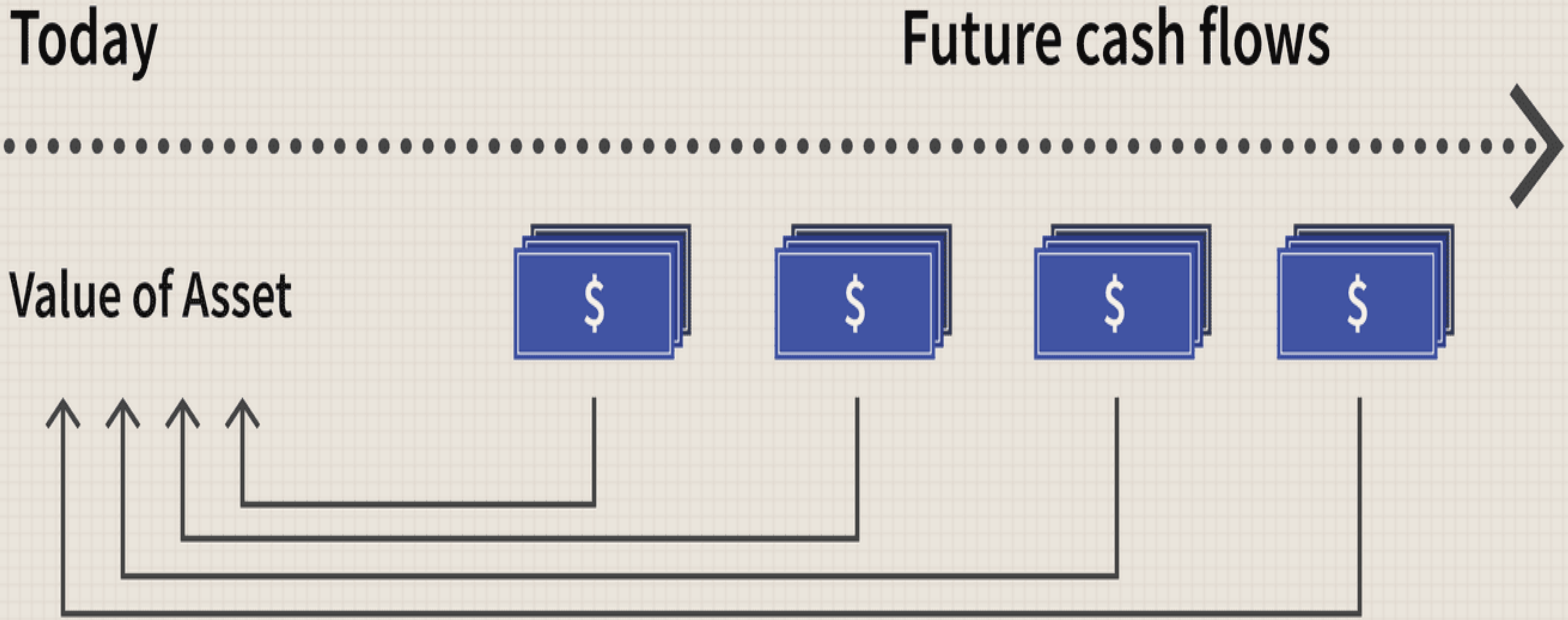
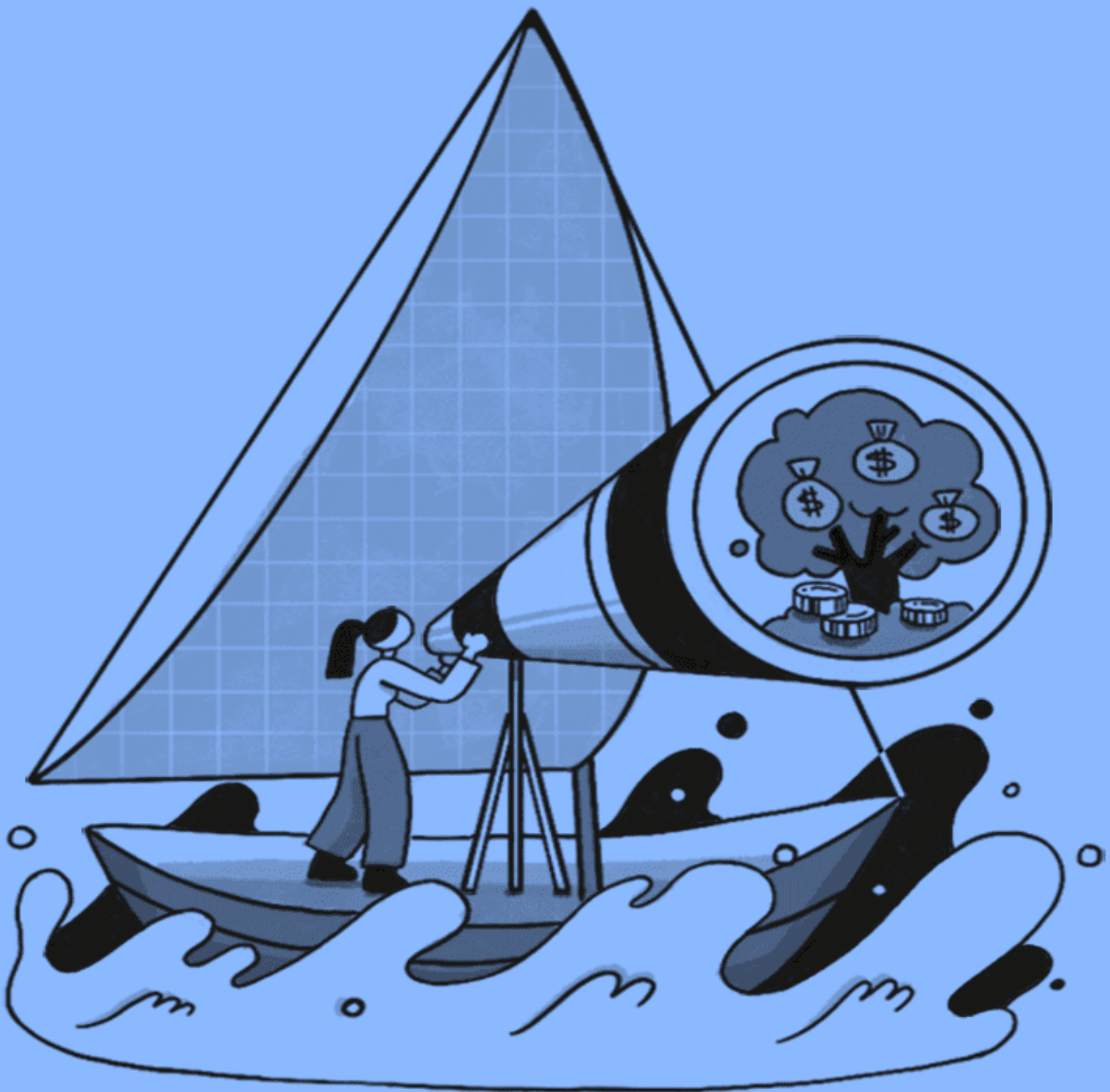
3. Price / earnings ratio.
4. Discounted future earnings.

Discounted future earnings





DCF

[ˈdē ˈsē ˈef]

A valuation method used to estimate the value of an investment based on its expected future cash flows. DCF analysis attempts to figure out the value of an investment today, based on projections of how much money it will generate in the future.

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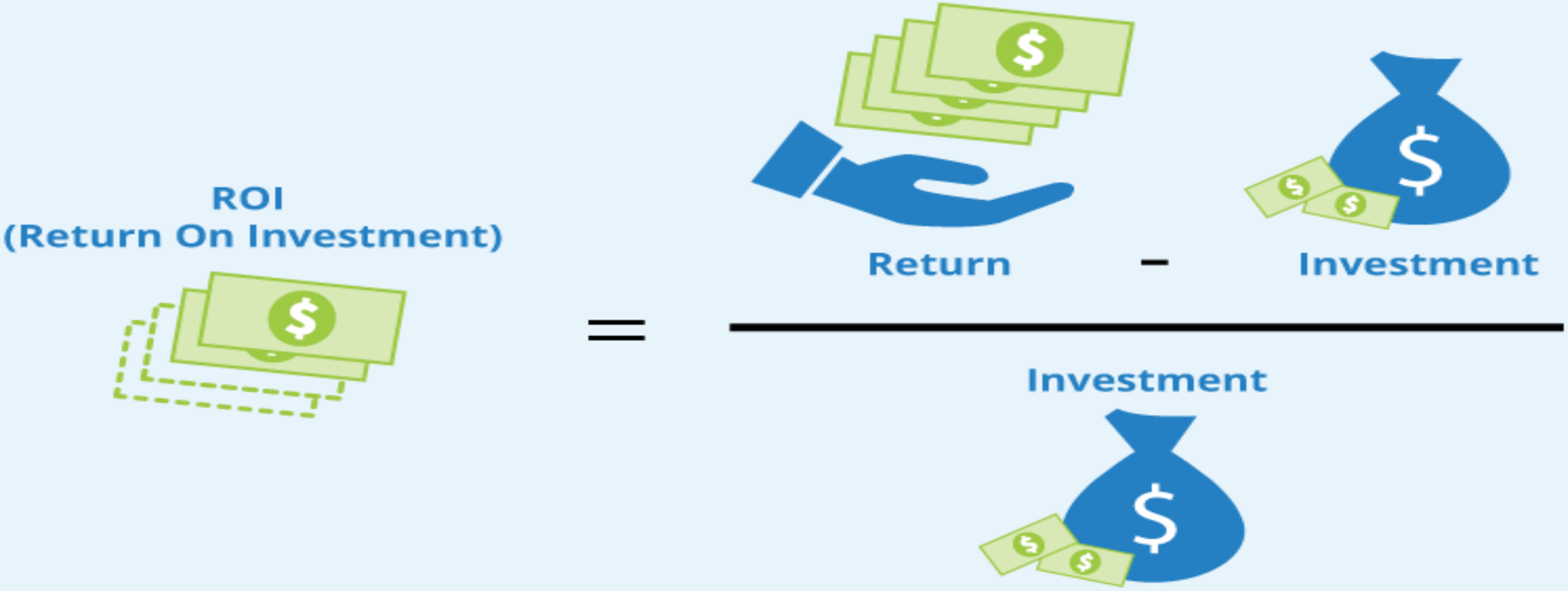
5. Return on investment (ROI)


ROI
(Return On Investment)
=
Return - Investment
Investment

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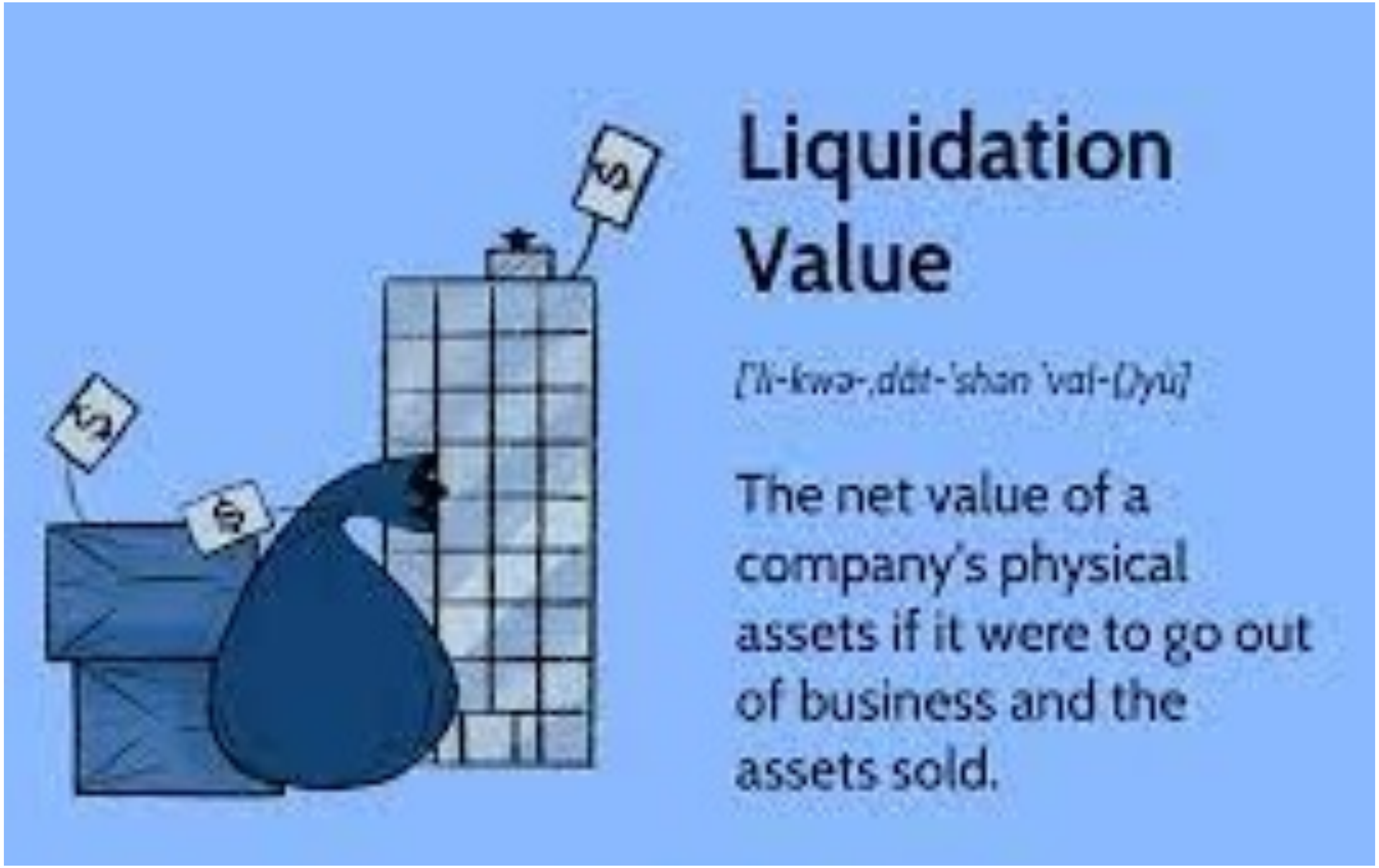
4. Discounted future earnings.
5. Return on investment (ROI)
6. Liquidation value


Liquidation Value
['li-kwə-ˌdā-shən 'val-(ˌ)yü]
The net value of a company's physical assets if it were to go out of business and the assets sold.

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5. Return on investment (ROI)
6. Liquidation value
7. Market value

Market Value Added (MVA)

[ˈmär-kət ˈval-(ˌ)yü ˈa-dəd]

The difference between the market value of a company and the capital contributed by all investors.

What is this venture worth?

1. Present the net cash flow projections for this business for next five years.
2. Use a present value rate of 24 percent.

Additional factors in the valuation process

(next three factors that may influence the final valuation of the venture)

1. Avoiding start-up costs
2. **Accuracy of projections**
   - Always projected on the basis of historical financial and economic data.
3. **Control factor.**
   1. The degree of control, an owner legally has.
   2. If 100% control then more value of the firm.
   3. If 50% control then value is according to that share.


Thank
You!