

What Is Business Valuation?

The business valuation process is used to determine a fair market price for a business. Evaluating the worth of a business is critical when buying or selling a business or part of its ownership. It is the only way one can accurately judge the value of a business. Many business owners will evaluate their business annually as another way to measure their company’s financial health.

The Business Valuation Process

Running business valuation reports require copies of a company’s historical income statements (five years is ideal) and a current balance sheet. The business owner should also be available to answer a series of questions evaluating the competition, the maturity of the industry, and a number of other outside business conditions.

It is strongly advised to hire a CPA and lawyer specializing in business valuation to assist with the buying and selling of a business. Before reaching this step however, the Indiana Small Business Development Center can help by running preliminary valuation reports that will allow us to suggest a realistic asking price.

Using a licensed valuation program, the Indiana Small Business Development Center, helps clients value their business using four industry recognized valuation methods. Reports are available at all ISBDC regional offices.

Business Valuation Methods

Capitalized Excess Earnings / Business Goodwill

First introduced in the 1920s by the U.S. Treasury Department, the method is designed to determine the value of business goodwill as well as the total business value.

Discounted Cash Flow

The value of the business is established as the present value of the yearly benefit stream and the expected future resale price.

Multiple of Discretionary Earnings/Earnings Multiple

This method establishes the value of a business based on its income.

Rules of Thumb / Comparative Transaction Method

Rules of Thumb are an example of the market-based valuation approach. This method serves as a guide and is helpful in establishing a realistic range for the value of the business.

More Information

Contact your local ISBDC office to learn more. To find your office, visit www.isbdc.org.

Rules of Thumb Valuation Result	
Business type:	
Select business type m	
SIC Codes:	
Standard Industrial Cla	
NAICS Codes:	
North American Industr	
Cash flow:	

Discounted Cash Flow Valuation Result	
Discount, %:	31.77
Required rate of return or cost of capital that makes business purchase worth while	
Expected business sale gain:	\$491,862.20

Earnings Multiple Valuation Result	
Discretionary cash flow:	\$284,836.93
Typically, owners total comp	
Add net working capital:	
Current assets less inventory	
Add non-operating asset	
Assets purchased that do not	
Subtract long-term liabil	
Long-term liabilities assumed	
Earnings track record:	
Low scores (below 2): Lack of	
High scores (above 2): Solid	
Industry growth:	
Low scores (below 2): Broad	
High scores (above 2): Rapid	
Business growth:	
Low scores (below 2): Declin	
High scores (above 2): Robu	
Deal financing:	
Low scores (below 2): All cas	
High scores (above 2): Low d	
Competition:	
Low scores (below 2): Large	
High scores (above 2): Large	
Location:	
Low scores (below 2): Inadeq	
High (above 2): Excellent tra	

Business Goodwill Valuation Result	
Business earnings:	\$62,126.75
Use annual net cash flow as the earnings basis	
Expected earnings growth rate, %:	8.09
Estimated annual average earnings growth rate	
Cash:	\$50,000.00
Cash required to support normal business activities	
Accounts receivable:	\$75,000.00
Accounts receivable adjusted for doubtful or uncollectible amounts	
Inventory:	\$100,000.00
Inventory valued at the lower of current replacement cost or net realizable value	
Other current assets:	\$5,000.00
Other current assets adjusted to their fair market value	
Property and equipment:	\$250,000.00
Adjusted value of the business property and equipment assets	
Other fixed assets:	\$20,000.00
Other fixed business assets adjusted to their fair market value	
Rate of return on net tangible assets, %:	5.0
Required rate of return on the business net tangible assets	
Accounts payable:	\$65,000.00
Value of accounts payable adjusted for above or below market trade terms	

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