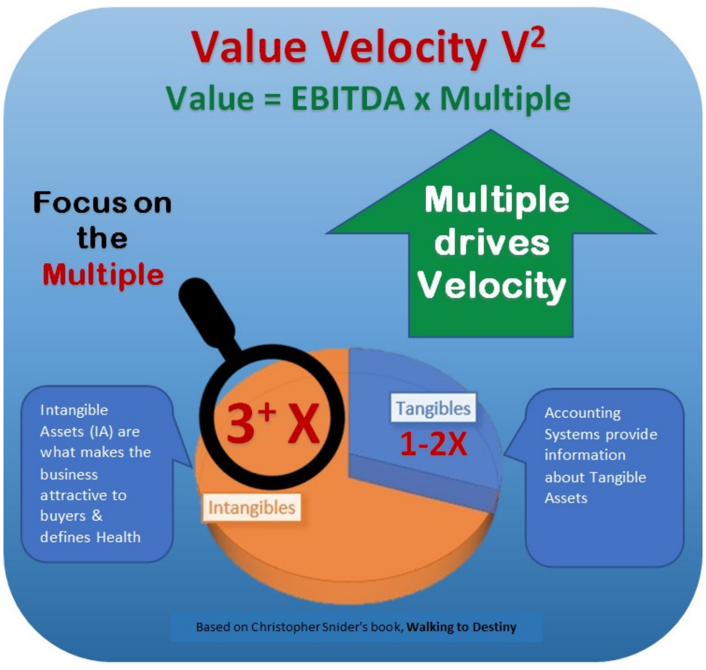


The best objective measurement of business health is to value the business since valuation of a business considers all factors making a business healthy. Value is important to your business in every stage of the business cycle from Start-up, to Growth, to Exit.

**How does business value define the health of the business?**
Valuation of a business is based on everything that would make a buyer interested in buying the business. There are several methods to value a business but most will generally first value a business using a simple formula (Value = EBITDA x Multiple). Here EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) which is basically cash flow is multiplied by a "Multiple". The starting multiple is generally the average multiple of what business have been selling for in this business's industry. However, this industry multiple is just a starting point, and is adjusted up or down determined mostly by the Intangible Assets.

Let's look at a simple example to show how value, and more specifically Intangible assets, defines the health of a business.

- This business is in an industry where other businesses like them have been selling for around 6 times EBITDA.
- So if EBITDA is $1 million (**tangible asset**), the industry **multiple** of 6 would dictate a sale in the area of $6 million - if the business is ATTRACTIVE TO BUYERS (**intangible assets**).
- Let's assume there is one problem the buyers have found during their due diligence having to do with **intangible assets** - the business operations and sales are nearly 75% dependent on the owner who is in bad health and will exit at the time of sale. This one intangible asset will reduce the multiple from 6 to maybe 1 or 0, depending on the willingness of the buyer to buy this unhealthy business.
- Yes, this example is real and does happen a good bit.

This example helps explains the above graph in more detail. You can clearly see "Focus on the Multiple" of Intangible Assets is very important to value. The business owner in this example made the mistake many owners make - looking at the Tangible Assets as the driver of value. The owner of this business could have had a healthy business if s/he would have simply paid attention to the Intangible Assets and brought on a couple management and sales people who could continue to keep the company on course if s/he left the company, or became incapacitated.

A few more important points to understand about this example and the above chart are:

- Intangible Assets generally provide about 60% to 70% of value, compared to around 30% to 40% from Tangible Assets. Remember, intangible assets are everything (other than financials) which makes the business attractive to buyers.
- Intangible Assets are generally made up of five asset groups:
- **People** - People include every person who contributes their skills to the business. These not only include leaders and employees, but can also include people like contract providers and purveyors.
- **Customers** - Getting customers costs money to acquire and to keep, so there is a retained value in each customer and making them an asset. Also considered under this category is such things as turnover, dependence on a small number of customers, scarcity of target customers, quality of revenue streams, and more…,
- **Social** - Social is everything about what "others" think and believe about your organization and brand. This category includes a lot of different sectors (e.g. present, past, and potential customers, local community, industry, competitors, present, past, and potential employees, purveyors, lending community, and more…). Another important social asset is social communication method(s) (e.g. advertising, marketing, social marketing, CRM, and more…). Also included in this asset group is everything about your brand.
- **Systems** - Systems can be many things, but they are much more important as size and complexity increase. However, it is important for nearly every organization to have systems such as training, accounting, inventory, buying, and customer transaction systems. Another important asset in this asset group is documentation of business and operational processes.
- **Intellectual Properties** - Intellectual properties can be many different things, but can be very important to adding multiples to your valuation. These can include such things as proprietary items and processes, copyrights, patents, and more…

The "**Multiple Drives Velocity**", and therefore the speed of value (the reason why we use the term Value Velocity ($V^2$)) . Much like this owner, a lot of owners mistakenly believe they are "saving money" and "making more profit" if they do it all themselves. This short sited view will usually save the owner money for a short period of time, but will normally end up costing the owner a lot more than they know. In this example, it cost them everything they had worked so hard for over many years.

**Summary**

- The best objective measurement of business health is to value the business,
- Tangible Assets (accounting information) generally drives 20% to 30% of business value,
- Intangible Assets (what makes a business attractive to buyers) generally drives 70% to 80% of business value,
- Multiples drive the value of business,
- Intangible Assets are the biggest drivers of multiples,
- Improving Intangible Assets is the fastest path to higher multiples and therefore **Value Velocity ($V^2$)**.