Valuing Small Businesses

Valuing the very small company can often be more challenging than valuing a large firm or corporation. These types of valuations most commonly arise in the divorce cases, although they also are frequently present in shareholder litigation, partnership dissolutions, and similar litigation. Often, client budgetary restrictions are an overriding consideration. However, attorneys and valuation analysts can work together from the outset of an engagement to meet client budgets and provide credible valuation. Here are a few areas where communication and cooperation can be the most helpful.

Valuation Standards. Just like attorneys, accredited valuation experts are bound by standards of professional conduct. However, none of those standards distinguish between a valuation for a small business (and perhaps small budget) and a larger business. Once engaged, valuation analysts often find themselves caught between performing a complete and credible valuation, complying with the applicable standard(s), and keeping the job within a client's budget. In litigation settings, most valuation analysts expect to be cross-examined on whether they adhered to the proper standards. If not, a lack of client funds will be no defense, and the analyst's credibility as well as the client's case could suffer.

Managing Expectations. Proper client screening is just as important in the valuation as in the legal context. Valuation analysts can help retaining attorneys to inform the client why the appraisal is necessary, its potential costs and the benefits that will inure to the case. Clients—especially in the divorce setting—will often suffer from misplaced expectations or assumptions. These clients need to receive the proper information and guidance from their professionals as to the scope of the valuation engagement, its process and the problems it can solve—as well as those it can't, including creating value in a business when in reality there may not be as much as the client anticipated or hoped.

Discovery & Access to Records. Few things can drive up litigation costs and conflict faster than trying to compel another party to comply with applicable disclosure and discovery rules. At the same time, the other side may be genuinely frustrated by receiving an overly broad and generic discovery request. Valuation analysts can work with attorneys and the client from the outset of the case to narrow and tailor the scope of production, so that the experts will receive all of the documents they need—and none of what they don't. Documenting clear, successive requests for production to the opposing party will also help in the event a motion to compel or an interim motion for fees becomes necessary.

Professional Protection. Communication and documentation are likewise critical to ensuring that both the attorneys and analysts meet the appropriate standards of care when valuing a very small business—with perhaps a small client budget to go with it. There are rarely any shortcuts in a valuation procedure that pay off in terms of case outcome or client satisfaction. By documenting every action and notifying each other whenever problems or roadblocks may arise, attorneys and the experts will help maintain their own credibility as well as their client and referral sources.

Case Study. Often, our initial due diligence reveal discrepancies concerning the integrity of the accounting records and tax returns presented. In these instances we often reconstruct one or more of the financial components to best determine the business's financial capacity. Within our website we have presented two case studies that illustrate both common and the not so common approaches to these concerns.

To learn more about MSG's business valuation, forensic accounting and litigation support services, please visit our web site www.msgcpa.com and our blog www.forensicperspectives.com.