

Private Business Valuation: Emphasize the Science, Not the Art of It

By Timothy Olivieri | December 14, 2017

I currently work as the principal gifts prospect research analyst at Cornell University, and every time I find myself meeting with colleagues outside of work, my ears perk up when the conversation turns to a certain topic: private business valuation. My alertness stems from the fact that I came to Cornell from a prior life as a risk analyst.

As a risk analyst, a big part of my job was valuing businesses. When I first arrived at Cornell, a manager sat me down, gave me a company name and said, “OK, value this business.” My first reaction was, “Whoa now, nothing more than a name?” While I had experience in valuation, I also had had countless tools at my disposal — not the least of which were audited financials from the companies we were acquiring. There, in a neatly bound Price Waterhouse Coopers folder, I knew the pages well and simply made my way down the list to fill in the cells of the spreadsheet that my team and I developed specifically for this purpose.

What was being asked of me at Cornell, and in prospect research in general, was not business valuation — at least as I knew it. This was some shooting from the hip that would have put Doc Holliday to shame.

Lack of Structure, Lack of Progress

Three years ago, business valuation in our Cornell shop was more art than science. Some researchers used business multiples. Others relied solely on comparison of private entities to publicly traded peers. Some used a combination of these and resources like D&B Hoovers.

During a staff meeting at Cornell, we were having a difficult time trying to reconcile some conflicting information regarding a hotel valuation. It seemed odd to us that, at a university with one of the best real estate investment programs in the country, we were grasping at straws every time the need for a complex valuation came up.

In my former life as a risk analyst, we had a precise process with reasonably accurate numbers on hand. This Cornell work was more art than science. Valuations often varied greatly from researcher to researcher; there was no consistency to how our baseline assumptions were made. Sometimes we went into a case with nothing more than a street address at the ready. One thing was certain: My previous experience in business valuation was not going to help me much here.

Nevertheless, the idea of a quick sight valuation of a private business was unfamiliar, and highly uncomfortable, to all of us. This was an opportunity for our research shop to improve

processes and refine our product. We wanted science over art. We wanted assurances over gut feelings. Perhaps most importantly, we wanted our clients to be confident in the information we were giving them, and we wanted to ensure that our products were serving the best interests of our institution.

Stepping Into Science

Our first and easiest step was to recognize that our current roles did not align with business analysts in the private sector. More accurately, the work we were doing was better aligned with the work of business brokers, who negotiate the sale and purchase of businesses. These brokers need to arrive at an accurate valuation during their initial assessment. Down the road, like the analyst, they will have financials to review. However, in starting the conversation with a potential buyer, they need to have a number in mind that is in the right league. In aligning ourselves more with business brokers, we felt it necessary to pick up their essential book: the Business Reference Guide (BRG), the go-to business reference guide. We had flipped through a reference copy in the library of our School of Industrial and Labor Relations and felt it might come in handy for our current hotel valuation dilemma. We later bought a prior-year edition for our office.

The biggest step we took toward progress, however, was meeting with a professor at our Cornell School of Hotel Administration who just so happened to be an expert in valuing hotels. While the BRG is an invaluable reference filled with various rules of thumb and “quick” valuation methods, hotels and hotel development projects were more complex. We were also dealing with issues of ownership. Prior generations of Cornell researchers had always assumed that having your name on a New York City skyscraper meant that you owned a majority of it. We needed expert advice in approaching these complex cases. While we did not want to undervalue a prospect’s assets, we felt it equally unacceptable to wildly overestimate a prospect’s wealth and potentially waste a gift officer’s time in cultivating a large gift that was simply beyond their means.

These meetings were not easy to set up. We are fairly certain that one of our associate vice presidents burned through a perfectly good favor on our behalf. When we sat down with our industry expert, we came away with a book full of rules of thumb, general valuation guidelines, quick valuation methods and, perhaps even more impressively, a list of data resources we had no idea existed on campus.

This single meeting and Cornell produced eCourses that followed, built upon our existing hotel valuation standards. Shortly after we finalized our new processes and unpacked all the information we received from our industry expert, our newfound knowledge was put to the test. Using research that predated almost every employee in the office, a gift officer

came to us wanting to know if she was on the right track with a prospect who was previously thought to be a billionaire. The basis of this assessment was that a large building in New York bore his family name. The assumption had been that he, or his family, must own at least 51 percent to enjoy these naming rights. We reassessed and arrived at a far more modest capacity that we felt was much more defensible. In particular, we stated that ownership was unlikely to exceed 15 percent in this case. This was a major shift, and the gift officer was not prepared to accept such a drastic change in strategy. She met with the prospect and presented her original proposal unaltered by our revised report. That proposal was ultimately rejected based on the prospect simply not having that level of capacity. He also clarified that he and his family only owned 12 percent of the skyscraper.

Now, what of the BRG? It became my personal pet project. We were unsure of its value for nearly a year after we began experimenting with its use. Then I was asked to prepare a valuation of a company that had just been sold with undisclosed terms. It was a chain service business and there was only one comparable sale in that industry; the "comparable" company, however, was twice the size. I built a valuation using some of the rules from our guide. I distinctly remember my finger hovering over the "Send" button for quite some time before I sent off my prospect analysis into the world. Two weeks later, the gift officer confirmed our valuation (our \$50 million valuation was less than \$1 million off). During a meeting with the prospect, he confirmed the sales price.

This one success was our most prominent. We used that simple book as an invaluable tool in constructing some of our go-to valuation models. As with hotel valuation, we did not simply take a sharp turn, however. We built upon the diligent hard work of researchers who came before us. Moreover, this valuation model was developed as a team.

Lessons Learned

Sometimes the answer to the problem lies outside — sometimes just as far as the other side of campus. We went out in search of silver bullets. What we found, instead, was what good can come of a tight-knit group of researchers putting their heads together with an eye on improving processes.

This worked out for us. But what of schools that do not have a world-class hotel school just steps away? While faculty can provide a level of specialized expertise to enhance research processes, this is not the only avenue. Meet with your campus librarians and see if there are subscription-based services available to you that you previously have not utilized. Read the books in the campus library, particularly if they have a copy of the Business Reference Guide and you are not sure if you want to spend the money on your own copy. Continue

talking with colleagues at Apra and beyond, but do not neglect the resources in your own backyard.

There are so many details, tips and tricks, and words of wisdom we can offer to our colleagues that simply cannot fit in this brief article. We look forward to future opportunities to share our work in valuations with the broader research community.