

CHANGES IN THE BUSINESS VALUATION INDUSTRY: **OPPORTUNITIES AND PITFALLS**



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EXECUTIVE SUMMARY

The market for business valuation services is growing, and it can provide financial professionals with higher sales and better margins than many other traditional accounting and financial services. This healthy demand and other changes within the industry, however, also pose challenges to the professional trying to start or grow a valuation practice. This whitepaper identifies risks related to industry trends and describes best-in-class practices that valuation professionals can take to ensure compliance with industry standards and to foster both a superior analysis for clients and superior financial returns for their practice.

INTRODUCTION

In recent years, one of the biggest dynamic forces in the business valuation market has been the robust demand for services that is being fueled by numerous economic and demographic trends. This growth, however, is leading to other changes that can have negative effects on a valuation practice if left unaddressed. The rosy industry prospects have attracted fresh competition and innovators seeking to replace the professionals' services with technology as well. Both of these trends can contribute to a price-focused environment. Meanwhile, valuation professionals – whether CPAs, ABVs, CVAs, ASAs, consultants or others – working to capture the opportunities that are available must address the ongoing challenges of growing profitably as they ramp up their services.

INCREASED DEMAND FOR VALUATIONS

Business valuations and other consulting work represent some of the fastest-growing services offered by accountants. The [\\$7 billion business valuation industry](#) as a whole is projected to grow nearly three percent annually through 2019, and industry profitability is 60 percent higher than for accounting services in general. Valuation professionals in the field report even stronger prospects. More than half of the valuation pros [surveyed in 2014](#) by the AICPA's Forensic and Valuation Services Section expected their practices to grow, and the majority expected growth of between 10 percent and 50 percent over the next two to five years. Business brokers, too, expect increases in deal flow.

Much of the demand stems from demographics that are creating turnover in business ownership. The [Pew Research Center](#) reports that 10,000 baby boomers will hit age 65 each day until 2030, and as they do, many will seek help planning the distribution of their wealth, whether that wealth transfer is through the sale of a business, gifts or inheritance. Another researcher calculated a conservative estimate that 18 to 27 percent of all U.S. establishments (those with employees), or between 1.36 million and 2 million [boomer-owned businesses](#), will be for sale in the next five to 10 years.

.....
2 million
baby boomer
businesses
for sale

INCREASED DEMAND FOR VALUATIONS (CONT.)

The U.S. economy's improvement in recent years has also made it more attractive for firms to purchase other businesses, helping fuel merger and acquisition activity. In the first quarter of 2015, U.S. deal volume was up 21 percent from a year earlier, according to [Dealogic](#). The [initial public offering market](#) in 2014 was the most active in more than a decade.

Transfers of business ownership are providing a rich source of work generating valuations for the buyers and sellers. Retirements can also trigger shareholder or partner [disputes that necessitate valuation work](#), as can divorces or other business disagreements.

In summary, valuation professionals are finding numerous opportunities to tap into the healthy demand for business appraisals.

At the same time, valuation professionals should be mindful of potential risks related to this growth. Firms that have been offering valuation services for some time may find it more difficult to generate rapid growth and to do so profitably in the coming years, because of increased competition within the market. Therefore, it is critical for valuation professionals to monitor and address some of the potential hazards in the current industry environment.

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2015
Q1 deal volume
up 21%

POTENTIAL PITFALLS TIED TO INDUSTRY GROWTH

In addition to the business-appraisal industry's growth prospects, one of the positive attributes of the market is that it is largely fragmented. No single player dominates the field of providing business appraisals, which leaves wider opportunities to enter the arena and build a business. In fact, nonemployers (sole operators) are estimated to account for the majority of industry establishments and revenue, according to IBISWorld.

New competitors can obviously generate problems for existing firms. IBISWorld projects the number of business valuation firms to increase over the next five years at an annualized rate of 2.1 percent, to more than 210,000 operators. Even for firms that create the new competition, rapid growth can create operational challenges that hurt the bottom line if improperly managed. The average industry profit margin in 2014 was 23.1 percent, but that has steadily decreased since 2010, IBISWorld estimates.

Here are some of the potential pitfalls associated with growth that valuation professionals face:

- **Customer retention:** Accounting firms that are too busy to cope with the demand may outsource valuation requests to other firms and risk losing the client altogether.
- **Too-rapid growth:** Rapid growth in a service can cause a firm to be overtaken by simply managing the workload. Instead of finding the time to build in efficiencies and capabilities, professionals may find themselves struggling to keep up, making it difficult to incorporate effective strategies and actions for long-term growth and profitability.

POTENTIAL PITFALLS TIED TO INDUSTRY GROWTH (CONT.)

- **Quality assurance/Compliance:** Management of documentation and staff can become more complex and time-consuming, making it tougher to ensure service quality and compliance with industry standards, such as SSVS No. 1.
- **Client management:** Managing expectations and building relationships may require new skillsets, but compressed schedules may make gaining these skills difficult.
- **Pricing-focused competition:** As more appraisers (via investment banking, consulting, law firms, etc.) enter the industry in response to revenue growth, pricing competition increases.
- **Disruptive business models:** Business valuation software producers are targeting business owners and other clients of preliminary value studies. “Many small businesses use low-end business valuation software to help determine a ballpark estimate before a professional is contracted,” according to IBISWorld. “This software directly competes with operators in the Business Valuation Firms industry and has contributed to low growth in profit margins over the past five years.”

These types of challenges warrant forward-looking actions by valuation professionals. With myriad demands on time and attention, what are some actions that can pay dividends?

BEST PRACTICES AND APPROACHES

There are three general approaches that valuation professionals can adopt to help address many of the challenges encountered in the current environment. Sageworks has identified these best practices by speaking regularly with valuation professionals who are focused on ramping up their business and by working for years with consultants to providers of professional financial services, such as accounting.

Develop specializations

The first approach involves focusing the valuation practice on a specialty service or industry. In the same way other professional service industries (such as medical care or legal work) can benefit from developing a niche service, so too can valuation professionals. Specialized knowledge and experience allows more effective, targeted marketing to win new business, and it cultivates a referral system that can maximize business development efforts. It also provides more insulation from [pricing pressures](#). “Industry operators that focus on specialized or complex valuation services, where competition is lower, tend to experience less price-based competition,” according to IBISWorld researchers. Healthcare appraisals and valuation work tied to litigation are two areas where a niche focus can be advantageous, the research firm says. “Ultimately, business valuation firms that specialize in niche services will be able to generate higher returns than more generalized operators in the industry.”

Specialized knowledge of an industry or a certain type of valuation (e.g., for partner disputes, for acquisitions) can also protect against the threat of wholesale replacement with do-it-yourself software.

BEST PRACTICES AND APPROACHES (CONT.)

Develop repeat business

A second approach that business valuation professionals can incorporate is to focus on building current relationships so that they [generate repeat business](#). Many clients may consider a business appraisal a one-off purchase, especially if the first time they encounter a valuation professional is when they are exiting the business.

When valuation professionals work in a consultative role, rather than working to execute an engagement, they may discover opportunities to offer repeat valuations or to expand into related services. For example, accountants who offer valuations have numerous opportunities to consult with the business client and incorporate appraisal services – whether those are [calculation engagements or more formal valuation engagements](#). These opportunities include:

- Identifying what the owner perceives is the value of the business and contrasting that with what the owner acknowledges he or she would pay if buying a similar business at arm's length. Discussing this “[value gap](#)” can generate a calculation engagement that opens the door to improving the business value over a longer time period through strategic and financial management.
- Identifying financial risks to the long-term value of the company, and showing the business owner how addressing those can boost the firm's valuation. For example, owners with weak partnership agreements may not understand the implications of vague descriptions of how the business would be valued in the event of a dispute or the sale by one partner.

BEST PRACTICES AND APPROACHES (CONT.)

Building repeat business may give those specific customers more leverage over pricing, but the efficiencies gained by developing new engagements (not just for valuations but also perhaps for other financial or advisory services) without additional customer-acquisition costs can offset some of that impact. Furthermore, it solidifies the firm's role as a trusted advisor and protects against incursion by competitors and disruptive technologies.

Develop efficiencies

A final best practice for addressing challenges related to the growing valuation industry is to build it for speed and profit. That is, take time to set up and adjust your practice so that you can reduce redundancies, errors and wasted effort. Valuation professionals who are too busy to step back and reflect on how to improve efficiency and effectiveness may survive, but they are unlikely to thrive.

Some key aspects of the valuation engagement that can benefit from process improvement efforts are:

- Requesting, tracking and reviewing the necessary documents
- Developing and documenting reasonable assumptions for projections based on historical trends and expected future occurrences
- Spreading tax returns and financial statements
- Accessing robust, up-to-date industry data against which to benchmark the subject entity
- Identifying and documenting the reasoning behind selecting appropriate market comparables (public and private)
- Calculating a discount
- [Report writing and proofreading.](#)

BEST PRACTICES AND APPROACHES (CONT.)

Some aspects of valuation engagements can be more easily systematized or streamlined, particularly ones that consume large amounts of time.

[Process-improvement strategies](#) are helpful in identifying inefficiencies and developing solutions. This can be a formal endeavor using outside assistance, but you can also benefit from an informal, internal review of the firm's processes. Gaining feedback from both staff and clients, identifying tasks that do not add value and involving others to focus on workflow improvement are important aspects of a successful process-improvement effort.

PROCESS-IMPROVEMENT

strategies

identify inefficiencies

Technology can also generate efficiencies and make it easier to provide sound, sophisticated analysis of the entity. Technology can [automate routine-but-time-consuming steps of valuation engagements](#). Some solutions provide a structured way to train junior-level employees, making it easier to turn that work over to them. This frees up partners or senior-level staff to concentrate on tasks requiring the most experience in high-level analysis or the most professional judgment – the kinds of actions that differentiate valuation professionals from do-it-yourself software. Senior staff members are able to oversee and manage a larger number of engagements, or they may have new-found time for identifying and [securing new valuation engagements](#).

BEST PRACTICES AND APPROACHES (CONT.)

Developing consistent practices is an important part of helping your valuation firm maintain compliance with industry standards, such as the AICPA's SSVS1. By having consistent practices for valuing a business from start to finish, the appraiser can mitigate risk associated with the process because the professionals is able to:

- Track and review all documents that are needed to properly complete a business valuation engagement, which is important for compliance, efficiency, and for managing client expectations
- Minimize calculation mistakes and omissions
- Document reasons for choosing specific assumptions and easily return to the area of the valuation months later without missing a beat
- Leverage prior engagements in the same or similar industries
- Provide a consistent work product to clients

Developing consistent practices, utilizing technology and incorporating process-improvement strategies are also strategies to [improve realization rates](#), which can offset the effects of pricing pressure.

In addition, [technology can actually become a driver](#) of the business. A recent survey of accounting firms by Wolters Kluwer found that most firms that are “very prepared” to address the top trends of the future believe technology will have a major impact on their ability to market the firm and win new clients.

BEST PRACTICES AND APPROACHES (CONT.)

“Valuation professionals focused on ramping up their business are committed to incorporating technology,” said Brad Spence, director of Sageworks Valuation Solution.

“People are [embracing technology](#) as a means of enhancing communication with valuation prospects and clients, in addition to using it as a means of boosting productivity,” Spence said. “Instead of being replaced by do-it-yourself software, these professionals are utilizing technology to solidify their roles as trusted advisors.”

CONCLUSION

Valuation professionals can incorporate numerous best practices to help them start or grow their practice, and to embrace the increased demand for their work. Taking the time to consider and adopt these changes will provide professionals the ability to embrace the challenges of a growing market and firm.

ABOUT SAGEWORKS

[Sageworks](#) provides a professional-grade valuation solution that helps valuation experts reduce errors and save time in performing compliant valuations. Sageworks Valuation Solution helps valuation professionals produce a true value that helps firms comply with SSVS No. 1 standards.

For more information about Sageworks Valuation Solution, please visit:

<https://valuation.sageworks.com/>.

ADDITIONAL RESOURCES

Goddard, Leah. "IBISWorld Industry Report OD4797: Business Valuation Firms in the US." IBISWorld Inc., June 2014.

Morea, Stephen. "IBISWorld Industry Report 54121c: Accounting Services in the US." IBISWorld Inc., March 2014.

AICPA Forensic and Valuation Services Section. "The 2014 AICPA Survey on International Trends in Forensic and Valuation Services." American Institute of CPAs. 2014.

Everett, Craig R. 2015 Capital Markets Report. Pepperdine University Graziadio School of Business and Management, 2014-2015.

McMann, Carey. Baby Boomer Business Owners: Will There Be A Mass Sell-Off? SME Research LLC, September 2012.

Charting a Course for the Future: A Report on Firm Preparedness (Accounting Firm Preparedness Survey and white paper). Wolters Kluwer, CCH. October 2014.

<http://www.wolterskluwer.com/Press/Latest-News/Pages/Press%20Releases/2014/pr27Oct2014c.aspx>

Accessed 6/5/15

ADDITIONAL **RESOURCES** (CONT.)

Whitepaper: Business Valuations: Challenges and Opportunities.

<http://web.sageworks.com/business-valuations-whitepaper/>

Whitepaper: How to Build a Valuation Practice within Your Accounting Firm.

<http://web.sageworks.com/build-a-valuation-practice-whitepaper/>

Checklist: How to Win New Valuation Clients.

<http://web.sageworks.com/valuation/how-to-win-new-valuation-clients-checklist/>

Library of valuation thought-leadership articles on the Sageworks blog:

<https://www.sageworks.com/blog/archive.aspx#cat-Valuation>

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