

Know Your Gaps

Three Numbers Every Business Owner Should Know

Business owners should calculate and manage each of the following three gaps. Closing each gap can maximize the value of a business at the time of exit, minimize taxes, and ensure the owners can accomplish their financial goals in the process.

PROFIT GAP

= (Best-in-Class Profit at Your Level of Sales) - Your Actual Profit

The profit gap is the profit you're sacrificing by not operating at a best-in-class level

- Profit is defined as earnings before interest, taxes, depreciation, and amortization (EBITDA)
- To ensure an apples-apples-analysis, actual EBITDA should be re-casted or adjusted for:
 - Extraordinary or one-time events
 - Discretionary expenses that are tied to the owner
 - Expenses currently above or below market rates such as rent, compensation & others

What good could you do in the business with that extra cash flow?

VALUE GAP

= (Best-in-Class Value at Your Level of Sales) - Your Actual Business Value

- The business value gap is the value you're sacrificing by not operating at a best-in-class level
- The basis of the Best-in-Class Value begins with the Best-in-Class Profit at Your Level of Sales
- The Best-in-Class multiple is applied to the Best-in-Class Profit
- Your actual value should be based on your actual re-casted or adjusted EBITDA

How quickly would narrowing your Value Gap close your Wealth Gap?

WEALTH GAP

= (Your Net Worth Goal) - Your Current Actual Net Worth (excluding your business)

- The Wealth Gap is the additional wealth you need to accumulate to meet your personal goal
- For the purposes of this discussion, do not include the value of your business
 - It is not easily converted to cash
 - You may or may not convert it into cash depending on what you decide to do with it
- As you consider your net worth goal, identify:
 - What you truly need to live
 - What you want

How will you bridge the gap?

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