WALKING TO DESTINY

USING COMMON SENSE SCORING 4CS EXAMPLE

Look at the graphic below. Which company would you say is more valuable?

4C	Company A	Company B
Human Capital	3	4
Customer Capital	3	4
Structural Capital	2	4
Social Capital	3	4
Total Score	**11**	**16**
Average Score	**2.75 (46%)**	**4.00 (67%)**

It's common sense, right? The company on the right, Company B, has more substantial talent, customer relationships, processes, systems and financial structure, and culture. Company B has a higher intangible value and is very likely to receive a higher multiple in the range of multiples within their industry.

Company B is likely performing better financially and has better growth potential because it has better talent, stronger customer relationships, processes, systems and financial structure, and culture. It also achieves a higher multiple because its risk is lower, and its earnings and growth are much more defensible and predictable than those of Company A.

Company B's lower risk can also, to a large degree, be attributed to its above-average intangible capital (4Cs). It has a more capable management team that can ensure the business performs independently of the owner. It is likely that its customer relationships are contractual and established with the company versus being dependent on the owner. Company B has a deep, defensible position with its customers, and its likely a greater percentage of its customers are producing recurring revenue. Its systems and processes are well-documented and understood by the employees who can produce a predictable outcome repeatedly to a standard that meets its brand and gives it the ability to scale. And finally, it is very likely, given the strength of these other capitals, that it has a great culture.

If the range of multiples in this industry were a low of 4.0x and a high of 10.0x, Company A might receive a multiple of 4.0x, and Company B might receive a multiple of 8.0x. (Note: not 10 because they are not best-in-class which is 72% or above.) If they were both producing $3 million in recasted EBITDA, Company A's valuation would be $12 million (4.0 x $3 million) while Company B's valuation would be $24 million (8.0 x $3 million)—double Company A's value. If you were the owner of Company B, you would have an additional $12 million in your pocket once you exited your business.

But there is an even more present tense benefit beyond knowing where you place in the range of value and your present business value. In addition to knowing where you land in your industry's range of value today, you can also quantify how much value gain is possible using value enhancement. Company A could achieve a value gain of $12 million by moving its score from 11 to 16 (46% to 67%).

This difference in harvestable business value could mean the difference of $480,000 in annual investment income after exit versus $960,000, which is quite a lifestyle difference.

To improve Company A's scores, we would identify any value factor that achieved a score of 3 or below and devise a strategy and action plan to improve it to 4 or above. By periodically going back and rescoring your value factors, you can quantify the expected increase in value, what I call the value gain.

There is another significant benefit worth noting. It is very likely that if Company A were to move its score from 11 to 16, it would also experience an increase in earnings. Why? Because Company A would be improving the things that lead to a better-performing business. The 4Cs—Human, Customer, Structural and Social Capitals—are leading indicators.

Taking our example further, let us assume that improving the strength of the 4Cs not only raises our multiple, but also has the impact of raising Company A's earnings by 20%, or $600,000, to $3.6 million annually.

Company A	Before Value Enhancement	After Value Enhancement	Value Gain
4Cs Score	**11**	**16**	
Recasted EBITDA	**$3,000,000**	**$3,600,000**	
Multiple	**4.0x**	**8.0x**	
Business Value	**$12,000,000**	**$28,800,000**	**$16,800,000 (+140%)**

The combination of increasing the multiple while increasing earnings results in a $16.8 million value gain for Company A—2.4 times its present value. That alone is substantial. But let's not stop there. The owner of Company A is also now achieving additional earnings of $600,000 each year!