Family Business Center

Universität St.Gallen

Schweizerisches Institut
für Klein- und Mittelunternehmen

Universität St.Gallen

Total value - towards the true value of privately held and family firms

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Das Family Business Center an der Universität St. Gallen (FBC-HSG) hat sich zum Ziel gesetzt, Familienunternehmen in ihrer ganzen Komplexität zu erforschen und zu betreuen. Dies beinhaltet als universitäre Institution einerseits die Forschung, wobei nationale und internationale Projekte realisiert werden. Zum anderen werden durch das Family Business Center Weiterbildungsprogramme angeboten, die auf die Bedürfnisse und Interessen von Familien und deren Unternehmen zugeschnitten sind.

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Vorwort

Die Bewertung von Familien- und anderen Unternehmen, welche nicht öffentlich kotiert sind und nicht zum Verkauf stehen, stellt eine besondere Herausforderung dar. Denn die Eigentümer können in der Regel nicht von einer Unternehmenswertsteigerung profitieren, denn sie wollen das Unternehmen eben nicht verkaufen, sondern zum Beispiel an einen Nachfolger übergeben.

Damit bekommt Unternehmenswert eine neue Bedeutung. Diesem Thema ist der folgende Beitrag gewidmet.

St. Gallen, im September 2001

Thomas Zellweger

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1 Abstract

Understanding the non-financial aspect of valuation and business returns to owners, and being able to accurately put monetary figures on nonfinancial rewards of businesses and other assets greatly assists brokers, underwriters, and private sources of capital in evaluating and selecting deals. It also helps families and business owners in understanding which projects to fund and how to satisfy shareholders and otherwise allocate resources in enterprises that are 'not for sale.' This text proposes "total value" as an integral concept for private and family firms, which helps to reach the above goals. In addition to the elaboration of the theoretical concept of total value, the text delivers preliminary empirical results on individual financial gains, as a first step in validating "total value" as an alternative concept for value management and valuation in privately held and family firms.

Keywords: Total value, valuation, privately held firms, family business

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2 Literature review

Recent academic literature presents evidence of specific characteristics of family businesses regarding value and valuation (Morck et al., 1988). Mc Conaughy et al. (2001), for example, report that firms controlled by the founding family have greater value, are operated more efficiently and carry less debt than other firms. In another study, Mc Conaughy et al. (1998) present evidence that family relationships provide incentives that are associated with better firm performance. Latest academic research points in the same direction by saying that when family members serve as CEO, performance is better than with an outside CEO (Anderson, Reeb, 2003b). Anderson and Reeb (2003b) found that investors intended to value family firms more highly - on average Tobin's Q, the market value of a company's assets divided by their replacement cost, was 10% higher for this group. A further analysis on the cross section of stock returns for the period from January 1990 to October 2004 of family firms quoted on the Swiss stock market revealed that family firms clearly outperformed their nonfamily counterparts (Zellweger, 2004). During the whole period from 1990 to 2004 the family firm index never fell below that of nonfamily firms.

The above studies deliver convincing evidence that family firms are extraordinary successful, as far as their stock market performance. Although financial value is not a panacea in family firms (La Porta et al., 1999), finance and valuation issues of family firms deserve further attention. In line with Mahérault (2000), this text argues that family firms are a specific field for research in finance.

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3 Which value?

Although the term value is often employed in literature and common language, there is no single accepted definition of value. This confusion is rooted in the different ways in which the term value is defined (Klein, 2004).

For example, value can not only be understood as outcome variables of the value creation process. In contrast, values can also be considered as input variables, such as culture, power and experience (Astrachan et al., 2002; Klein, 2004), which affect the resource (re)combination process within the organization.

This text discusses different concepts of value as outcome variables and asks what kind of value concept is adapted to privately held and family firms which also consider nonmonetary benefits as valuable outcomes of business activity (Ward, 1997). As most privately held firms are also family firms (Frey et al., 2004) the considerations presented in this text are widely valid for both types of firms.

In the finance field, Rappaport, (1996) operationalizes value via performance by referring to the financial outcome of the company. In a recent paper on a firm's value, Villalonga and Amit (2004) define value by Tobin's Q measured as the ratio of the firm's market value to total assets. In contrast, Anderson and Reeb (2003) employ Tobin's Q for the external value and return on assets as the primary performance measure. This way of looking at value reflects the financial business development and its pecuniary effect on the firm's outcome (Meyer, 2002). This has a long - standing tradition in management science.

In contrast, microeconomic theory posits that the value of an asset equals its marginal price. Therefore, the value of the good is defined by the value of the next best alternative (Mankiw, 2004).

In the psychological field however, value refers to a core concept rooted in one's personality in early years, stable over time and situations, leading to beliefs and guiding action (Rokeach, 1973; Rosenkind, 1981; Klein, 1991).

In the family firm and therefore many privately held firms, value can also have a sociological dimension. In this type of firm, values not only have the role to direct and legitimate managerial decision making but these shared values also give a sense of belonging, honestey,

loyalty, trust and respect within a family firm. These values are collectively referred to as embodying a family culture. If one uses the concept of organizational culture and shared values as a means of analyzing the internal operating environment of a firm, the alignment of values was found to serve to differentiate between an inner team and peripheral employees (Haugh, Mc Kee, 2003).

The appropriateness of the above definitions for privately held and family firms raises several concerns.

First, the approach typically taken by practitioners engaged in financial valuation assumes that a hypothetical buyer will be purchasing the firm. As such, this supposedly *objective* valuation is geared toward what a buyer's expectations would be regarding the riskiness of the firm's cash flows. Of course to complete a transaction, a buyer and seller ultimately have to agree on the valuation, or purchase price, and market transactions validate the methodology used to determine the firm's value. However, these same methodologies fail to address the value of a firm to an individual who is not offering the firm for sale, but rather, intends to keep the firm in the hands of family for the succeeding generation and for generations thereafter (*subjective* value). If family shareholders tend to prefer strategies that result not only in the maximization of monetary wealth (similar to shareholders of nonfamily firms), but also in the maximization of the private benefits received from the firm such as reputation, management autonomy and independence (Lyagoubi, 2003), value and valuation should not exclude these nonfinancial dimensions of value as they are essential to the assessment of subjective value. Similarly, Neely and Adams (2004) state that business performance is itself a multi faceted concept and asks for performance measurement systems that take more than just the economic criteria into account. This request is based on the assumption that the output of the economic organization is not merely monetary. This text agrees with Klein (2004) who assumes the nonfinacial output of the company to be more important for big, long - term oriented and personally engaged shareholders than for the small anonymous shareholder with a short - term investment perspective. Therefore, particularly privately held and family firms with less dispersed ownership structure are more likely to concentrate on relevant nonfinancial outcome.

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Second, subjective value is difficult to measure as it is biased by the individual's goal set. The difficulty lies not only in the measurement of the sheer diversity of individual goal sets but also in the nature of the goals. Goals are often grounded on values, e. g. independence and control over the firm, and are thus difficult to measure and to convert into monetary units.

Third, if values are rather stable, emotions can change over time (Klein, 1991). Thus the emotional value an individual or a family attributes to its firm can change over time. For example, the decrease in harmony within a family that formerly harmonized very well is expected to have an impact on the valuation of the firm in the eyes of the individual family members, depending on his / her position in the dispute. Thus, an important factor of value to the family does not satisfy the stability condition set up by traditional finance researchers (Spremann, 2002).

Fourth, the next best alternative might be an insightful concept in microeconomics. However, in the case of a firm for example owned for generations by the same family a next best alternative to the ownership and control might simply not exist. In other words, the monetary exit costs a family is facing can be very high due to failing or inefficient capital and labor markets (Schulze et al., 2000). In addition, nonmonetary exit costs can be high as well, if exiting the family firm induces for example a loss in social prestige. Therefore, for many family firms a corresponding next best alternative to the present situation is simply not conceivable. In addition, a next best alternative can be very diverse for different individuals. For example, a co - owner / manager of a family firm could perceive the continuation of the firm as the next best alternative to its sale, although the firm does not perform at all. On the other hand, a financially motivated sibling could consider the sale of the equity stake at the highest price as the next best alternative.

Fifth, as mentioned earlier, financial value is not a panacea to family entrepreneurs - however not only because they strive for nonfinancial goals. As family entrepreneurs rather consider their firms as an asset to consign to their relatives in the future, they will hardly ever be able to capitalize on an increase in firm value. In contrast, in many cases family entrepreneurs financially profit only from higher dividends (Schulze et al., 2003a) and other individual gains, like amenities and perks.

In sum, a valuation methodology in a case such as this requires an understanding not only of standard valuation methodology, but also of how to quantify, in monetary units, the owner's own preferences regarding these (and other) nonfinancial issues. Herein lies the dilemma, and motivation for this text and further research projects.

4 Total value: some preliminary remarks

The above considerations revealed that values other than the financial one are predominant in a family firm's management decisions such as profitability, low debt level, family wealth, survival and independence of the business (Ward, 1997). The term "total value" is intended to summarize the aforementioned values, a term, which can be considered as a multi - faceted concept to describe the main references for entrepreneurial activity in the family firm.

In contrast to "utility" a term used by former researchers (Vos, Forlong, 1996), total value better describes the vital references for entrepreneurial activity in family and privately held firms and stands in contrast to the mono - dimensional traditional financial value often considered as the main goal for managerial activity. Consequently it is appropriate to analyze a family business' success by its ability to maximize total value.

5 Valuation methodology

Whatever traditional valuation technique one might consider, none of them is able to fully cope with all the specificities outlined above. Discounted cash flow method could for example be adapted for term structures. However, all major valuation methods fail to address the subjective perspective.

The empirical study performed here calculated the market values of 59 privately held Swiss firms, all in the construction industry, with EBIT multiple method, applying a multiple of 6, which was derived from publicly quoted firms in the same industry (http://pages.stern.nyu.edu/~adamodar/) and accounting for an illiquidity premia, plus an investigation with practitioners of three corporate finance firms in Switzerland (Price Waterhouse Coopers, Ernst & Young and Helbling Corporate Finance). Discounted cash flow

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method was not applicable as data on future cash flow development were not available. The mean objective market value of the firms amounted to 1.27 million Swiss francs. The valuation did not control for differing leverage levels which potentially affect firm values by the tax shield of a leveraged capital structure, as this effect was very small.

All of the 59 firms analyzed were privately held firms and had 9 to 210 employees. The family entrepreneurs were questioned as members of focus groups that meet five times a year to exchange management and business related experience.

None of the 59 controlling owners were willing to sell their firm at the price the market for corporate control valued them. All of them mentioned that the market value calculated was below the total value they would assign to their firms.

Of course, the entrepreneurs' answers in an open group discussion can be flawed by groupthink effects (Janis, 1972). Similarly, a bias in the answers could be derived from the fact that asking for these properties and the entrepreneur's preferences raises awareness for the concept of total value.

Nevertheless, this preliminary investigation delivered three noteworthy results. First, the answers reflect that valuation methods applied by anonymous investors do not deliver satisfactory results to capture the total subjective value an entrepreneur assigns to his firm. The entrepreneur's understanding of value was not reflected in the prices calculated with the applied traditional valuation method.

Second, the discussion revealed that the respondents did not display much interest in the discussion on the right valuation technique and the resulting value of their firms. Therefore, this investigation delivers further evidence that financial value in the traditional sense is not a panacea to family entrepreneurs. Capitalizing on an increase in firm value was impossible to them as they rather considered their firms as an asset to bequeath to future generations (Casson, 1999; Chami, 1999; Becker, 1981).

Third, the investigation revealed that the entrepreneur's subjective value is in many cases higher than the objective value calculated with traditional valuation techniques.

The concept of total value strives to integrate the above findings and is defined as the market value of the company (MV) as determined by traditional valuation techniques, individual financial gains (IFG) and emotional value (EV).

$$TV = MV + IFG + EV \qquad \textbf{Formula 1}$$

TV: Total subjective value to the owner

MV: Market value according to discounted cash flow method or other accepted financial valuation technique

IFG: Individual financial gains as perks and payments

EV: Emotional value of the firm to the owner

Thus, total value argues that the value an entrepreneur really accounts for consists of the market value calculated with traditional valuation techniques corrected by two effects: first, the individual financial gains (IFG) an entrepreneur earns in the form of perks / payments, and second, the emotional value and costs associated with being entrepreneur.

Whereas literature on the market value of companies is available in abundance, the following subchapters address the significance and the possible measurement of emotional value (EV) and individual financial gains (IFG).

6 Emotional value

Emotional value results from the nonmonetary gains and costs earned from controlling a firm. Emotional value for example comes in the form of private benefits received from the firm such as reputation, management autonomy and independence (Lyagoubi, 2003). However, emotional value can also be affected negatively, when for example the same properties display negative valuation. For example, in litigious families, quarrels and the associated negative private benefits can supposedly affect emotional value negatively.

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However, simply aggregating emotional gain and cost to derive a "net" emotional value bears a major shortcoming. Aggregating implies a compensating effect between different positive and negative properties. For example, this could mean that less freedom of decision could be compensated by a higher reputation for the owner - manager. Adding up the values attributed to different properties has been criticized in literature as “the sum is more than just the addition of parts” (Klein, 2004), when externally validating this way of index building. This can be due to an individual's loss aversion, which states that a loss (emotional cost) in a valuable good looms larger than a comparable gain (emotional gain) of the same good (Kahneman, Tversky, 1991).

Firstly, to measure emotional value it seems appropriate to build one single index, weighing the properties of the family business as seen by the owner (-manager) by him- or herself. Just as individuals are able to quantify their overall happiness with life (Myers, Diener, 1996; Frey, Stutzer, 2001; Kahneman et al., 1999), entrepreneurs need to be asked a fundamental question about the overall value they attribute to their firm. Afterwards, multivariate regression analysis will allow finding the variables affecting emotional value.

7 Individual financial gains

As outlined above, individual financial gains are an integral part of total value. Even if Mc Conaughy (2000) finds that family CEOs have lower levels of compensation and require fewer compensation - based incentives there is evidence, that family firms have further sources of monetary gains than salary.

Analyzing the impact of large controlling positions on firm value, Johnson et al. (1985) find higher positive excessive returns on the sudden death of a founder compared to the sudden death of a non - founder. The authors reason that the positive excess returns are a market response, which anticipates that cashflows formerly going to the founder will accrue to the outside shareholders. Similarly, Slovin and Sushka (1993) report a stock price increase of 3.01% on average in the first two days after the announcement of the death of inside blockholders.

This observation supports the conclusion that founders, although shareholders and family members do not behave in a general shareholder wealth - maximizing manner, still entrench minority or nonfamily shareholders. This is another reason for the existence of agency costs in family and closely held firms (Schulze et al., 2003a and 2003b).

7.1 The role of quasi private consumption

Although there is sufficient empirical evidence for the existence of individual financial gains in family firms, these funds are not systematically considered as an integral part of value. Little is known about the monetary compensation of family entrepreneurs and the exact total amounts the family entrepreneurs are drawing from their firms and for what purposes they are using these funds. In particular, it is of interest to unveil the consumption that is mainly for private purposes but is accounted for in the firm's accounts (= quasi private consumption).

The analysis below on this study's 59 Swiss privately held firms indicates that family firms draw more monetary benefits from their firms than nonfamily firms. Quasi private consumption of family firms in the sample were on average 26'722 Swiss francs, which amounts to 31% of EBIT. For nonfamily firms these figures are significantly lower (Table 1).

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Table 1: Annual quasi private consumption (QPC) in family and nonfamily firms (author)

Data source: Swiss Research Institute of Small Business and Entrepreneurship, University of St. Gallen. The definition of family firms is based on the measurement of Substantial Family Influence (SFI) as defined by Klein (2000).

	Family firms	**Nonfamily firms**
Mean QPC in CHF	26'722 *	7'786 *
Mean QPC in % of EBIT	31% *	0.1% *
Std. Dev. of mean QPC in % of EBIT	149% *	4% *

* Significant difference between family and nonfamily firms.

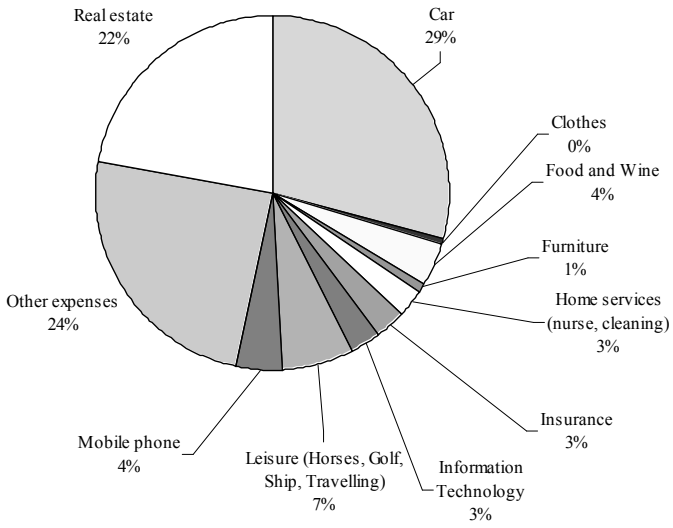
Statistical test applied: Monte Carlo p values < 0.05.

Interestingly, the standard deviation of quasi private consumption of 149% for the family firms is significantly higher for the family firms compared to the nonfamily firms. Some family firms displayed quasi private consumption of three times EBIT. Others displayed a negative EBIT but still took out quasi private consumption at the level of twice the negative EBIT amount.

The above - mentioned funds are used for many purposes and mainly consist of perquisites (Figure 1), as car allowances, real estate investment, telephone expenses, insurance costs, food and wine, leisure activity and further more.

Figure 1: Quasi private consumption and its utilization (author)

Data source: Swiss Research Institute of Small Business and Entrepreneurship, University of St. Gallen.



Although these monetary benefits are accounted for in the firm's bookkeeping, their use is private. Tax issues therefore deserve further attention.

For example, it can be financially tempting for family controlled firms to acquire certain goods in the company name even if its use is mainly private, as such behaviour provides monetary gains to the family in the form of a tax shield. This tax shield is however not due to debt financing as the one found by Miles and Ezzell (1985).

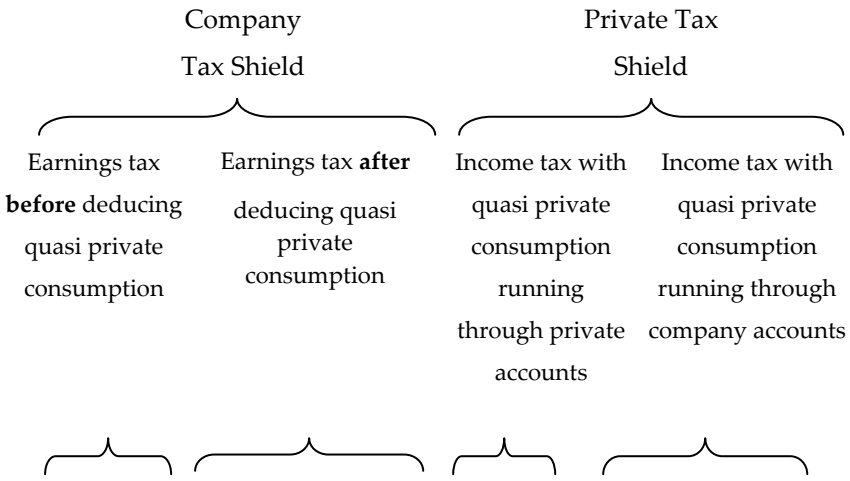
It would be inappropriate to consider quasi private consumption directly as individual financial gain. Because traditional valuation methods already account for all cash flows deriving from the business (as discounted cash flow method), adding quasi private consumption directly to market value would mean counting these cash flows twice. Therefore only the tax effect of quasi private consumption can be considered as individual financial gain. Entrepreneurs have the possibility to earn a positive tax shield out of consumption allocation as such quasi private consumption lowers the earnings tax burden of the firm (= company tax shield). At the same time, reduced expenses in private accounts increase the income tax burden for the private person (= private tax shield).

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Therefore, in order to analyze the monetary gain of consumption allocation for the individual entrepreneur, one has to investigate the tax effects on the company *and* the private accounts.

Individual Financial Gains = Company tax shield - Private tax shield **Formula 2**

Controlling managers of family and privately held firms behaving rationally often take advantage of their possibility to pay quasi private consumption with company money. In most industrialized countries earnings tax rate (ETR) is between 15 and 47% (Ernst & Young, 2003). Consequently, the annual individual financial gains due to tax shield out of consumption allocation can be defined as follows:



IFG = CE * ETR - (CE - QPC) * ETR - (I * ITR) - (I + QPC) * ITR

IFG = QPC * (ETR - ITR) **Formula 3**

With: IFG: Individual financial gain; CE: Company earnings; ETR: Earnings tax rate; QPC: Quasi Private Consumption

For the 59 analysed firms, the integration of IFG as the second element of total value results in an average increase in total value of 14% (Table 2).

Table 2: Market value and individual financial gains of Swiss privately held firms (author)

Data source: Swiss Research Institute of Small Business and Entrepreneurship, University of St. Gallen.

EBIT	A	211'878	
QPC in % of EBIT	B	31%	
QPC	C = A* B	65'682	
ETR	D	46%	
IFG annual	E = C * D	30'214	
MV	F = 6 *A	1'271'268	100%
MV + IFG total	G = F + 6 * E	1'452'551	114%

QPC: Quasi private consumption; ETR: earnings tax rate, estimated with 46% (Mishra, Mc Conaughy, 1996); MV: Market value, estimated with 6 * EBIT; IFG: Individual financial gain total, estimated with 6 * IFG annual

The amount of the annual individual financial gain is measured by applying Formula 3, however, the total individual financial gain is accounted for by applying the same valuation method as employed for the measurement of market value (industry multiple of 6).

By allowing a certain part of their investments and expenses run through company accounts, value is therefore not destroyed but rather transferred to family members, for tax purposes. As mentioned above, those values are generated by the business activity and become part of total value. In that sense, the individual financial gains explained by quasi private

consumption adds a further, extrinsic dimension, to the discussion of motivating family business managers to run their businesses at lower compensation levels.

7.2 Limitations regarding the proposed measurement of individual financial gains

The concept of quasi private investment to measure individual financial gains is theoretically and empirically persuasive. Nevertheless, the following limitations should be respected.

Firstly, the size of the tax shield depends on the legal framework since it determines the kind of items and their maximum value that can be acquired via company accounts. In other words, what is considered as a justifiable investment in line with the company's principal business activity.

Secondly, in the long run only healthy companies can unlock the advantages of tax shield, as there is a risk of illiquidity if money is spent on items that are not vital to a company's survival.

Thirdly, the size of the tax shield depends on the individual behaviour of family business managers regarding their incentive to profit from the differing tax rulings. Traditionally, family business managers are meant to follow a "leave in" company philosophy, whereas others rather follow a "take out" philosophy.

Fourthly, one should not fail to consider potential compensation effects as an increase in individual financial gains does not necessarily imply a corresponding increase in total value, as will be outlined in Figure 3.

8 Total value and the true cost of capital

Under normal conditions (period 1 to 5 in Figure 3), total value is larger than market value. This finding is in line with the answers of the 59 entrepreneurs who all confirm that market value was below the personal value they assigned to their firms. However, market values being below total value imply that the cost of capital of these firms needs to be lower. This shall be demonstrated subsequently:

TV = MV + IFG + EV **Formula 4**

According to (Brealey, Myers, 2000) present financial value is generally defined as perpetually discounted cash flows.

$$Value = \frac{FCF}{d}$$

FCF: Expected value of the future cash flows; d: Discount rate, considering the systematic risk

$$\frac{FCF}{k} = \frac{FCF}{r} + IFG + EV \qquad with\ (IFG + EV) > 0 \qquad \textbf{Formula 5}$$

FCF: Free cash flow of the firm; k: True cost of capital for the family entrepreneur; r: Costs of capital for the financial investor

Therefore:

therefore	k < r	**Formula 6**

Solving above Formula 5 for k results in: $k = \frac{FCF}{\frac{FCF}{r} + IFG + EV}$

$$k = \frac{FCF}{TV}$$ **Formula 7**

The above considerations provide a solution to the estimation of the true cost of capital of family and privately held firms based on the concept of total value.

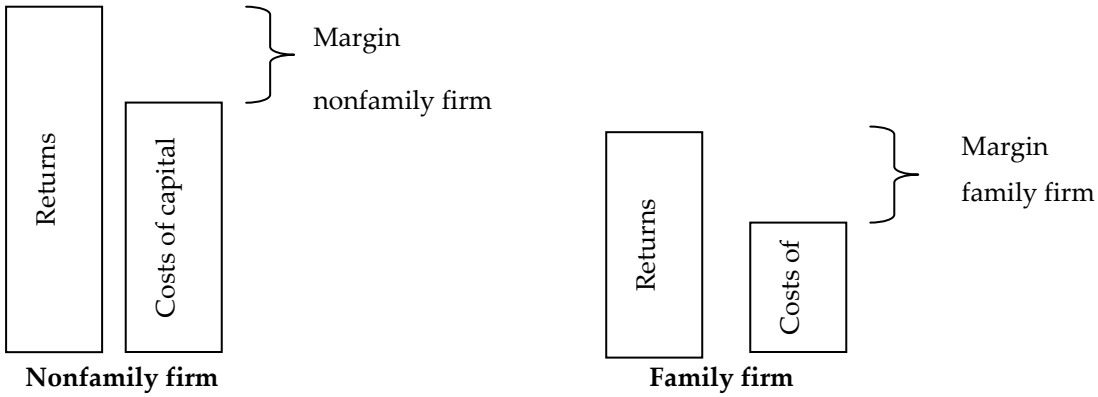
Poutziouris (2001) provides empirical evidence for the found lower costs of capital. He finds that family firms strongly stick to the pecking order theory of financing and he provides evidence for the argument that family firms prefer family and firm internal equity financing as it is the cheapest source of capital. Further evidence derives from studies on the relation of family firms and venture capitalists who find that not only costs but also psychological barriers need to be held responsible for the low use of external equity financing by family firms (Achleitner, 2004). Furthermore, concerning cost of debt, Anderson et al. (2003) provide evidence that these costs are lower for family firms.

Applying lower costs of capital than required in an efficient market environment with rational investors has important consequences on the investment behaviour of firms. In particular, if a company routinely applies a high cost of capital in its project valuations, then it will reject valuable opportunities that it's competitors will be happy to snap up. Setting the rate too low, on the other hand, almost guarantees that the company will commit resources to projects that will erode profitability and destroy shareholder value (Mc Nulty et al., 2002). The finding that family firms display lower costs of capital therefore raises the question whether or not family firms invest in less profitable projects.

The answer to this problem would be insufficient or flawed if the analysis was limited to the costs of capital. A careful investigation of the issue needs to take into account the return of the investment project.

If we consider the margin between the return and the cost of capital of an investment project, it becomes evident that with the costs of capital being lower, the returns of investment projects can be lower as well by keeping the margins between return of the project and the associated costs of capital at least as high as in nonfamily firms. This can be illustrated with Figure 2.

Figure 2: Margins of family firms and nonfamily firm investments (author)



In sum, family firms are able to invest in projects that seem less or insufficiently profitable to non-family firms and still earn the same margins as their nonfamily counterparts. Due to lower costs of capital they are able to seize investment opportunities that are seemingly not profitable enough to non-family firms, without destroying shareholder value as expected by Mc Nulty et al. (2002). Just as Eaton et al. (2002) have concluded, lower (agency) costs of capital could lead to a competitive advantage for a family firm. In addition, as shown above, this helps to build unique investment and business strategies that are just as profitable as those of non-family firms.

Not surprisingly, several large family firms are successful in forestry and scrap business (Ward, 1997), that do not seem very attractive investments to financial investors who require higher return industries due to their increased cost of capital.

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9 Value management and total value

The proposal of a subjective approach to measure the true value of a firm can help to explain the essence of entrepreneurship. This approach changes the scope of analysis from a supposedly *objective* valuation that is geared toward what a buyer's expectations would be to an individual perspective. This is typical for most entrepreneurs who are not offering the firm for sale, but rather intend to keep the firm in the hands of the family for the succeeding generations (*subjective* value).

The resulting concept of total value composed of market value, individual financial gains and emotional value has been outlined theoretically and empirically tested in parts in this text. For example it can help to explain why family business managers continue to run their businesses, even if their direct income is low compared to their compatriots in a non-family business. The mean return on equity measured by EBIT divided by equity, for the 59 privately held Swiss firms analyzed is 3.3%, which is bearly above the internal rate of return of the 10 year Swiss treasury bond, which is currently at 1.87%, and thus well below the average market risk premium ($\mu_m - i$) for the years 1964 - 1998 of 4.1% (Copeland et al., 2000). Still, the entrepreneurs derive value from their activity. The concept of total value gives insight to the entrepreneur's real rationales.

In addition, a further benefit of this research is to quickly and concisely rate the value of a firm when there is the likelihood of a desire to sell and to obtain the accurate price desired by the owners of privately held firms.

If $MV < EV + IFG + MV$ **Formula 8**

Then Keep the company with the family, as $(EV + IFG) > 0$

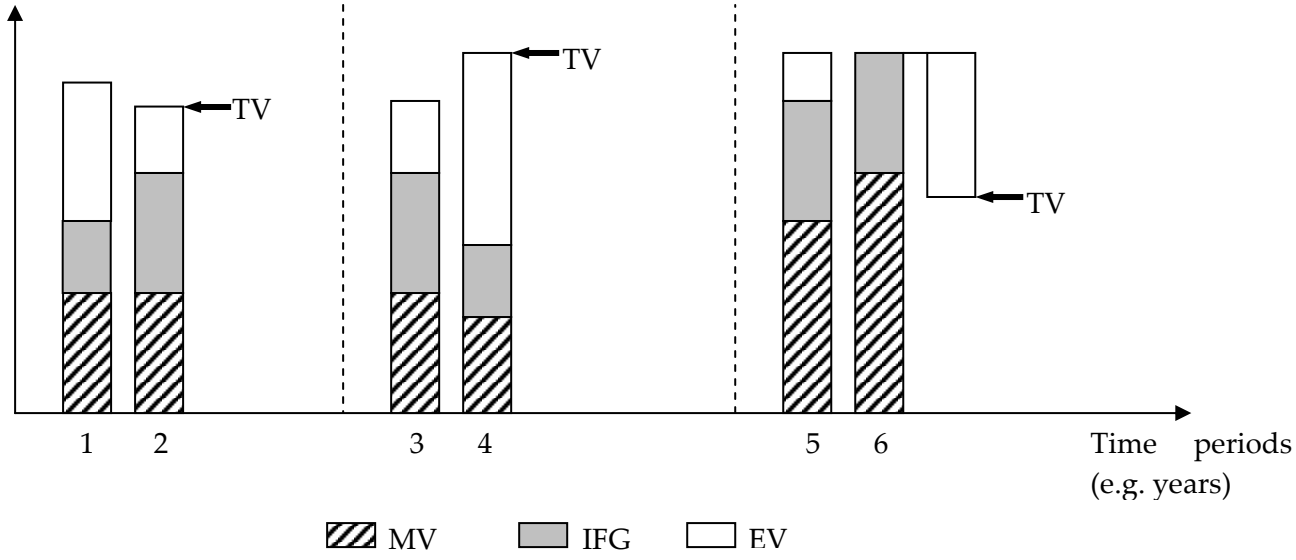
If $MV > EV + IFG + MV$ **Formula 9**

Then Sell the company, as $(EV + IFG) < 0$

In addition, the above considerations enables brokers and underwriters to recognize opportunities to add significant value to firms in which (EV + IFG) start to fall at low levels. It also helps those desiring to make acquisitions determine accurate offer prices as well as offer ranges. Just as importantly, it helps to understand the acceptable returns that owners desire from new ventures within the firm and in acquisitions.

Furthermore, it will help develop value patterns that explain entrepreneurial activity in general. For example, setting up value patterns that differentiate between diverse compositions of total value (Figure 3) could give further understanding regarding the subjective rationale of entrepreneurial activity.

Figure 3: Examples of value patterns to analyse entrepreneurial activity (author)



In line with the value patterns outlined in Figure 3 the evolving composition with MV, IFG and EV can have differing effects on the total value to the entrepreneur. It is questionable if an increase in individual financial gains from period 1 to 2 (e.g. excessive pay outs to siblings) really increases total value or if it could also harm the emotional value and therefore offset any positive effect on total value. Similarly, it is questionable if a loss in financial terms (MV + IFG) from period 3 to 4 always reduces total value, or if this negative effect is more

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than compensated by a disproportionate increase in emotional value. Correspondingly, it is questionable if a gain in (MV + IFG) from period 5 to 6 always increases total value, or if this positive effect is more than counterbalanced by a disproportionate decrease in emotional value that eventually leads to strong disincentives to continue to develop the firm and finally to the sale of the company.

10 Conclusion

The above considerations introduced total value as an alternative model that accounts for the subjective value of a privately held firm. It offers an answer the dilemma regarding the quantification, in monetary units, of the owner's own preferences regarding both financial and nonfinancial issues. Total value as defined in the text is composed of market value, individual financial gains and emotional value. Market value is a widely discussed field in economic literature. Concerning individual gains however, the challenge lies in their measurement, which comes in the form of perks and payments and its impact on value. The text examines empirically the relevance of individual financial gains by accounting for the tax effects out of consumption allocation between company and private accounts of the entrepreneur. For a sample of 59 privately held firms in the Swiss construction industry, the analysis found an increase in total value due to individual financial gains of 14%. Concerning emotional value, its importance is based on the consideration that entrepreneurs derive important private benefits from their firms, such as reputation, management autonomy and independence. The measurement of emotional value in monetary terms remains a challenge and requires further theoretical empirical research in three main directions.

Firstly, investigation is required regarding how an increase in the individual financial gains (IFG) and market value (MV) affect emotional value. As outlined in Figure 3, it can be hypothesized that an increase / decrease in IFG and / or MV does not necessarily lead to an increase / decrease of total value. Future research therefore has to be carried out to determine if the three value drivers always aggregate to total value or if there are compensatory effects under certain circumstances, as outlined by the value patterns in Figure 3.

Secondly, the challenge of quantifying emotional value in monetary terms persists. But with the proposed measurement of tax shield on consumption allocation it is now possible to put at least a figure on individual financial gains. Consequently, two of the four variables of total value (IFG and MV) are measurable. As emotional value is hardly directly quantifiable by entrepreneurs, one approach is to measure total value and derive emotional value from it.

Thirdly, one of the goals of this approach is to operationalize the findings on emotional value in order to identify ultimately a restricted sample of variables which allow determining the level and the dynamics of emotional value within a firm, without needing to directly measure emotional value or total value. To this end, multivariate regression analysis is needed to determine the variables that affect emotional value.

In summary, this research in the area of total value provides the following results. First of all, it offers a specific understanding about the values that motivate entrepreneurial activity or exit. In addition, the rationales outlined in Formulas 4 and 5 help brokers and underwriters to recognize opportunities to add significant value to firms where emotional value and individual financial gains plunge to low or even negative levels. Under these circumstances changes in the ownership structures could add significant value.

Furthermore, the results will also help those desiring to make acquisitions determine accurate offer prices as well as offer ranges. In the end, it will help in understanding acceptable returns and the costs of capital that owners desire from new ventures within the firm and in acquisitions.

Finally, the concept of total value gives distinct insight to the subjective value an entrepreneur and also a family derives from their firm. In consequence, it can be argued that total value offers an integral perspective for value management in privately held firms.

The restricted data set of the study presented here clearly is a limitation to this research. At the same time it sheds light on future research opportunities with larger scale empirical studies and provides verification with data on publicly quoted firms.

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12 Appendix

Table 3: Earnings and wealth tax rates

	Effective income taxes on company income (ETR)		Wealth tax for individuals (WTR)	
	lower level	upper level	lower level	upper level
France	33.33%	35.43%	0	1.80%
Germany	39.5%	47%	none	
Italy	19%	34%	none	
Japan	41%	42%	none	
Switzerland	12%	30%	0.1185%	0.711%
United Kingdom	0/9%	30%	none	
USA	15%	35%	none	
	Source: Worldwide corporate tax guide, 2003, Ernst& Young		Source: Supplementary service to European taxation, IFBD, Amsterdam	

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