



Business Valuations - Not a "One-Size-Fits-All" Proposition

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Most business owners believe a valuation is something to be concerned about some time in the future when there is "need" for a

valuation. Often there are events that will trigger the need to determine the value of a specific ownership interest. What are they?

These are typically events that will trigger a need for a valuation:

- Preliminary merger and acquisition studies
- Income tax compliance and planning
- Estate and gift tax returns
- Buy-sell agreements
- Securities litigation
- Marital dissolution

However, the value of a business, a business ownership interest or a specific intangible business asset is not a "one-size-fits-all" proposition. There are different *standards of value*, in which the purpose of the valuation determines the appropriate standard of value.

"There are a number of different ways to determine the standard of value. Every valuation is different so these are certainly options, depending on the situation," says [Matt Barberich](#) Manager, [Business Valuation & Litigation Support Services](#).

The most common encountered standards of value are:

- Fair market value: The required standard of value for all income tax, estate tax, and gift tax

valuations. Fair market value assumes, among other things, a hypothetical willing buyer and hypothetical willing seller;

- Fair value: The required standard of value for GAAP financial reporting. Also, fair value is the standard of value in dissenting shareholder lawsuits, defined by state statute and previous case law in the respective jurisdiction; and
- Investment value: The required standard of value when determining value for a *particular buyer and/or seller*. Investment value is typically used in merger and acquisition settings.

In addition, in determining the value of a business ownership less than 100%, certain discounts may or may not be appropriate in the given context, the most common being:

- Discounts for lack of control: A discount applied to the non-controlling business ownership interest's pro-rata share of the value of the entire business; and
- Discounts for lack of marketability. A discount applied to the value of a closely-held business ownership interest, recognizing that no active market exists for a company's ownership interests, and willing buyers and sellers may not be readily present at any particular point in time.

A very serious, but common, error is a valuation conclusion derived under an inappropriate standard of value and/or the application of inappropriate discounts. Frequently, this occurs when there is uncertainty regarding the valuation assignment. Business owners requiring valuation services should be cognizant of these issues and ensure the appraiser is engaged appropriately.

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