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GBQ Goelzer Valuation Services

VALUATION observations

Business Valuation: Where One Appraisal Does Not Fit All

By Joseph Borowski, CFA
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Due to the complexity of today's businesses, a comprehensive, high-quality business appraisal is not cheap. Thinking it will save them time and money, some business owners or executives attempt to use one valuation report for multiple purposes (e.g., shareholder planning, buy-sell agreements, goodwill impairment testing, potential M&A activity, etc.). However, in the end, taking this course of action often ends up saving neither time nor money. Relying on a single valuation for multiple purposes can result in inaccurate business values and cause compliance issues, legal troubles, fines and penalties, or some combination of these.

How Per-Share Value Can Differ

In theory, relying on a single business valuation for all purposes seems innocuous. After all, how can a single business have multiple values? However, per-share values can (and often) differ, depending on various factors such as the size of the interest to be valued. A share of a company that has control of operations and/or voting rights is worth more than a share that does not. Further, the value of a 100% interest may be worth more in the context of a business sale than under the fair market value standard that governs many valuations (which assumes financial buyers and sellers).

Subject Interest	Strategic Control Premium?	Discounts?
Controlling Interest (Sale of Business)	Yes	No
Controlling Interest (Fair Market Value)	No	Maybe
Minority Interest	No	Yes

Other Reasons to Use Report for Intended Purpose Only

There are additional reasons why business valuations should only be used for their intended purpose, as follows:

- **Purposes often require different standards of value** – for example, valuations for financial reporting purposes are based on Fair Value, which differs from the Fair Market Value standard that govern estate and gift, ESOP, and other valuations.

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Business Valuation: Where One Appraisal Does Not Fit All (continued)

- **Different regulatory bodies govern valuations for different purposes** – similarly, appraisers must reference the governing agency in their report, whether it is the Internal Revenue Service, Department of Labor, Securities and Exchange Commission, etc. The governing agency is determined by the purpose of the valuation.

- **Different valuation purposes require different levels of support** – appraisers are required to provide different levels of support depending on the purpose of the valuation. A valuation that is only intended to be used internally by management may require just an introductory letter and supporting exhibits. However, for a report to pass a review by the IRS or other agencies, the appraiser must present a thorough analysis of all valuation assumptions and demonstrate a strong knowledge of the company.

What Can Go Wrong

Ignoring the factors above and using a valuation report for multiple purposes can have unfortunate consequences, as illustrated by the following examples:

- **Example #1 – Business Owner "Leaves Money on the Table"** – A business owner is interested in selling his business. He had previously received a valuation for gifting purposes, and thinks his business is worth the pre-discounted value indicated in this report. However, since this valuation utilized the fair market value standard and did not consider the control premiums that may exist in a strategic sale, the business owner has a deflated view of what his business is worth, and agrees to sell it at a lower price that what he could have received.

- **Example #2 – Business Owner Misses Tax-Reduction Opportunity** – A business owner gifts shares of his company to his children, using a per-share value determined by a four-month old valuation that was sought for a potential sale of the company. Since the owner is unaware of valuation discounts that exist in valuations for gifting purposes, the shares are transferred at an inflated price, and consequently, the owner pays more in gift taxes.

- **Example #3 – Botched Shareholder Buy-out Results in Lawsuit** – ABC Company buys out a former shareholder based on a value that was determined by a valuation for gifting purposes (and includes discounts). However, since ABC Company's buy-sell agreement stipulates that buy-outs should exclude discounts, the former shareholder does not receive adequate consideration, and subsequently files a lawsuit once she finds out her shares were purchased at a deflated price.

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Business Valuation: Where One Appraisal Does Not Fit All (continued)

How to Avoid Problems and Save Money

As highlighted in the examples above, relying on a single valuation for multiple purposes can have many negative, unintended consequences. Therefore, it is prudent for business owners and others to use a valuation report only for its intended purpose. Should the user need a report for an additional purpose, valuation firms can normally tailor the report for a lower price than the original (since the appraiser has already performed significant analysis and has a familiarity with the company).

GBQ Consulting has significant experience valuing businesses, business interests, and intangible assets for numerous purposes. The authors can be reached using the contact information below.

ABOUT US

GBQ Consulting specializes in Business Valuation, Mergers and Acquisitions, and Dispute Advisory and Forensic Services. Our Business Valuation group is one of the largest and most experienced in the Midwest. Professionals at our offices in Columbus (OH) and Indianapolis (IN) provide the following services:

- Transaction Support & Opinions
- ESOP & ERISA Advisory
- Succession & Wealth Planning
- Financial Reporting Services
- Corporate Planning & Assistance
- Expert Opinion Valuations

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