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In
this
Issue



Editor's Column – Updated Levels of Value Chart
Paul R. Hyde, EA, MCBA, BVAL, ASA

The Importance of Synergy and Relative Firm Size
M. Mark Walker, PhD, CFA, CBA

What to Do With the Real Estate Appraisal
Dennis A. Webb, MAI, ASA

Book Reviews for Business Appraisers: COMPETITIVE STRATEGY – Techniques for Analyzing Industries and Competitors
Richard W. Fox, CBA, BVAL

Valuation Discount Analysis for Diversified Portfolios
Rand M. Curtiss, MCBA, FIBA, ASA
Suzanne Bronson, CBA

Professional Practice Valuation: Suggestions for Newer Appraisers
Stanley L. Pollock, DMD, MCBA, JD

Mathematics of Business Appraising
Dr. Thomas C. Stanton, MCBA, FIBA

Editor's Column — Updated Levels of Value Chart

Paul R. Hyde, EA, MCBA, ASA, BVAL

An earlier version of the following Levels of Value Chart appeared in the Summer 2000 issue of *Business Appraisal Practice* in an article entitled "Discounts and Premiums: A Chart to Illustrate them More Clearly." Since then, thanks to comments and suggestions from many business appraisers and class participants, the chart has evolved to the one presented herein.

The quantification and support of appraisal discounts for minority interests in Fair Market Value appraisals has been, and continues to be, a significant challenge in our industry. No one actually buys or sells discounts or premiums. Instead, discounts and premia exist because we don't have the data needed to develop well-accepted business appraisal methods that can assist directly with indications of value for minority interests. This forces us to use appraisal methods, which develop indications of value at levels other than what we need.

The revised Levels of Value Chart helps to explain what level of value is generated by each appraisal method, and illustrates the required discounts or premium necessary to convert the indication of value to the required level. Follow the arrows to see what discount or premium is required to get to the level of value needed for your appraisal. Appraisal methods are listed to the right of the value levels they generate.

There has been some disagreement among appraisers as to what level of value results from each method. Should you disagree as to the level of value generated by a particular method, feel free to make adjustments.

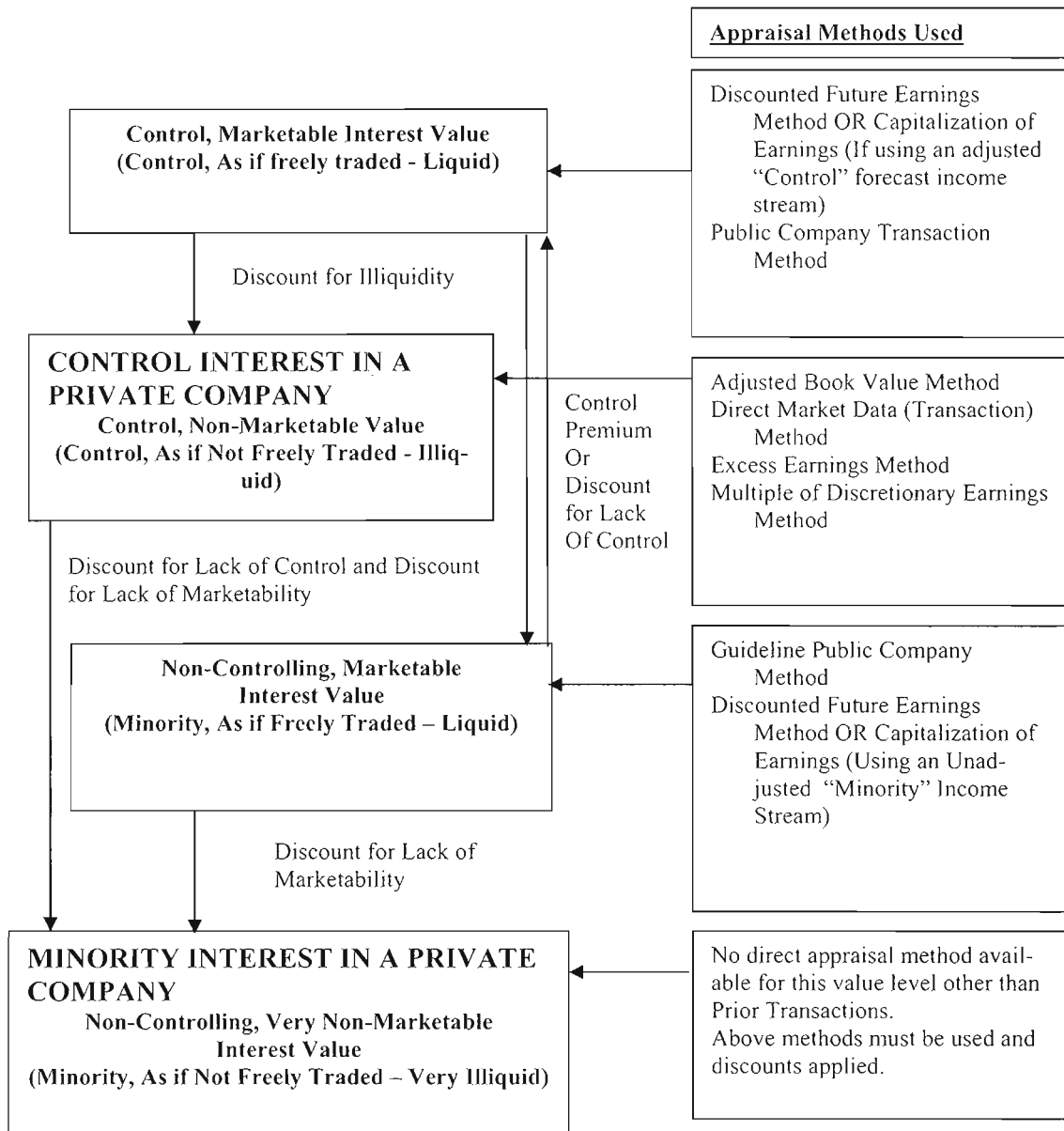
Some income methods are shown as generating both a Control Marketable Value, and a Non-Controlling Marketable Interest Value. I believe this appropriate based on whether control adjustments are made to the income stream.

If a control adjusted income stream is utilized along with a discount rate built-up using Ibbotson data, the resulting value is a Control Marketable Value. Control, as an income stream, was available only to a controlling interest and marketable, largely, because the discount rate came from the public market – a place where investors typically can get cash in three days.

If a minority income stream is used (i.e. an income stream available to minority interests – no control adjustments), then the resulting value is a Non-Controlling Marketable Interest Value. The Discount for Illiquidity is then applied to this level of value to convert it from a Control, Marketable Interest Value to a Control, Non-Marketable Value.

A Discount for Illiquidity, or Illiquidity Discount, is technically a Discount for Lack of Marketability for a Control Interest. However due to the length of the name and the confusion that results from using two Discounts for Lack of Marketability – one for a control interest, and the other for a minority interest. Some appraisers do not believe a Discount for Illiquidity is appropriate, but for me, a business broker of twenty-four years, I'm convinced this discount is appropriate.

LEVELS OF VALUE



Editor's Column — Updated Levels of Value Chart

To learn more about how to calculate and support the actual discounts and/or premiums, I suggest you sign up for IBA's "Developing and Defending Fractional Interest Valuation Premiums and Discounts" written by Rand Curtiss. He comprehends this difficult topic well, and will show you how to explain and defend your conclusions.

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