



## Bart Basi

*Dr. Bart A. Basi is an expert on closely-held enterprises. He is an attorney, a Certified Public Accountant, and President of The Center for Financial, Legal & Tax Planning, Inc. He is a member of the American Bar Association's Tax Committee on Closely-Held Businesses.*

# BUSINESS VALUATIONS AND THE PROBLEM WITH THE 10th DECILE

## Introduction

Publicly traded companies have a ready market for their stock. Millions of stocks are traded everyday on Wall Street in a reliable manner. It would be difficult to argue that any given share price does not accurately reflect the company's market value. Some companies have existed for 100 years or more and have paid dividends in many years. The behavior of large companies is dictated through specific rules including accounting rules, business judgment rule, and the market itself. These companies represent less risk than an investment in private companies.



## Issues in Valuing Closely-Held, Private Businesses

Most private companies have been in existence for a short time and their continued existence depends on factors such as management, local conditions, customer base, and economic cycle, just to name a few. The behavior of private companies is largely dictated by the owners. The owners have nearly unmitigated rights in making decisions affecting the company. It is with this factor that the risks involved with small companies are much greater than the risks involved with large and, publically traded companies.

Closely held companies are quite the opposite of

large publicly traded companies when it comes to their valuation. Closely Held companies do not have a ready market and are much more difficult to value for any given transaction or purpose. It is to the valuation of a private, closely-held company that the build-up method is used to determine a risk factor. The build-up method is based upon current 20 Year Treasury Bonds, the S&P 500 activity, the size of the company, and the industry. The 20 Year Treasury Bond and S&P percentages are easily established. The Size Factor, not so much. Ibbotson's Valuation Yearbook is an authority on the size premiums that are appropriately used in the valuation industry for determining the risk involved in a private company.

Many professionals are familiar with Ibbotson's SBBI Valuation Yearbook. Within its contents are pages and pages of interesting explanation, a lot of numbers, charts, graphs, and the all critical "size factor risk" that is so critical to valuing private businesses. While many size factors presented are easily explainable due to the size of the company and the market capitalization, the 10th decile and its split into 6 authoritative divisions only serves to complicate the job of selecting a risk factor due to the size of the business. It begs the question; What is the most accurate size decile to be used through Ibbotson's book?