FRAZEE IVY DAVIS

Briefing: Business Valuation - Formalities

If Bill Clinton can force you to think about "what the meaning of the word 'is' is," then shake your head in dismay at the following hyperanalysis of the meanings of *it*, *market,* and *fair*. These words are commonly tossed around among business owners and the assorted advisors who help them navigate the straits of ownership and valuation. For example: "We need to value it." "It's worth whatever the market would pay you for it." "He's entitled to a fair value."

Laws, regulations and agreements inject formality into business ownership. This usually tends to contribute to orderly life and is an enabler of low cost, mass production of entrepreneurs. It also spawns policies, judgments, and orthodoxies about how to deal with the value of a business. Appraisals stem from that formality. Appraisals simulate deals. They require standardized ideas about the subject property, the assumed parties to a transaction, and the boundaries of their motivations. Consider again these three simple words.

- It

"It" varies – that is, what you own has a context in which you own it. Valuation is a matter of circumstances. Because circumstances vary so widely, don't be surprised that there is more than one value of a business. There is more than one way to own it. There is more than one way to operate it. And there is more than one way to understand what the meaning of the word "it" is. For example, owning a business is not the same thing as owning a minority interest in a business. And a business in as-is condition is not necessarily the same thing that a buyer studies. Take care to understand the contrast in circumstances. They affect both valuation meaning and methodology.

- Market

A market accommodates. Market value (a.k.a. fair market value) is a defined tax and regulatory standard of value. Here the market finds the price that a willing buyer will pay and that a willing seller will accept. In this market, everything is symmetrical – information, prudence, time – whatever enables an exchange without any compulsion. Market participants are nameless, and they are untainted by speculation, privilege, misgivings, or stupidity. A market is thereby a fair arbiter of money investments.

- Fair

Fair is evenhanded. A market is presumed to be fair. Alternatively, when co-owners have the misfortune of litigation about value, it usually introduces a legal standard called fair value. Fair value might consider conventional market concepts, but not always. In disputes, fair can be defined in case law, which varies by state. Disputes about valuation injuries are always rooted in asymmetrical conditions that have allegedly allowed one party to exploit another. Therefore, fair is whatever an open-minded court determines to be evenhanded. Different factors are relevant to different courts.

Valuation terms and phrases are in buy-sell agreements, operating agreements, joint ventures, and stockholder agreements. They even come up in conversation. If language is ambiguous or misused, it can paralyze a transaction. We therefore advocate clarity.

If you would like to know more, then please contact any of us here at Frazee Ivy Davis.