



MPSP or Appraisal

Price or Value? One of the most confusing aspects of business appraisal, and for that matter business brokerage/M&A, is the terms used and how they are used. Such an example is the terms: cost, price, and value. The term, cost, usually is not a problem. Cost is defined as the amount of capital required to create, produce, or purchase an item. The confusion comes between price and value. Price is what the seller wants for what they are selling. Value is what a buyer is willing to pay for something in exchange for a future benefit. In theory, all three could be the same figure. Usually, they are not.

There are other factors that separate price and value. Cost and price are both considered to be a fact; however price can be an opinion as well. Value is an opinion, not a fact. For this very reason, I state in the appraisal reports, the value I have arrived at is an opinion and should not be considered a fact.

Okay, in what situations would I provide my opinion of price and what situations would I provide my opinion of value? If I am doing a fair market value appraisal, I provide an opinion of value. If I am asked to determine the Most Probable Selling Price (MPSP), I provide an opinion of price. To better understand the difference, let us look at the major differences in determining price and value.

The MPSP is based on past performance were a fair market value appraisal is based on future expectations. Second, a fair market value appraisal takes into account RR 59-60. If you recall from an earlier issue, we need to consider a discount for the lack of marketability (DLOM) when performing a fair market value appraisal. Refer to the July 2007 issue located in the education section on our website to get additional information on DLOM.

Some will argue that you include a DLOM when determining the MPSP. I argue that it is not, as you are trying to determine the most probable selling price based on a particular cash flow. The degree of liquidity or marketability is not taken into account.

Business Brokers typically will calculate the MPSP, which is sometimes considered the value of the business. Oops, I just used the term value. The reason for this is that a business broker will provide an opinion of price based on the revenue stream of the business. Much like an appraiser would in determining an opinion of value with the previously stated differences taken into account. It is called a price, because it is based on what the seller could expect to receive for their business. A buyer may agree with the price if the value of future returns justifies the price of the business. Of course, the value of the business to a buyer is also dependent on the cap rate or discount rate used by the buyer.

Both price and value are used interchangeably and some would argue with some of the statements that I have made above. When it comes down to it, price is what someone wants for their property and value is what a person is willing to pay for property. Price and value are used synonymous, which is okay as long as you understand what you are receiving.

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