



## Rates

Last issue, we discussed Discounts for Lack of Control. That was pretty well straight forward and easy to understand. The Discount for Lack of Marketability is quit a bit more complicated and not as straight forward. In fact, there is strong disagreement as to were and when to use a Discount for Lack of Marketability within the business appraisal industry.

### Marketability (as if freely traded)

#### Discount for Lack of Marketability

When people here “marketability” they associate it with the ability to sell an item. In this case, it refers to the business’s level of liquidity. How fast it can sell rather than can it sell. After all, a viable business is always marketable (able to sell) to someone. Just how fast (liquid) will it sell? Business appraisers refer to “marketability” to mean “as if freely traded”. This comes from the possibility that an arrived value may be based on public or “as if freely traded” information.

The Single Period Capitalization Method could justify a discount for lack of marketability. I say could as it would depend on if the capitalization rate was developed using public company information. If you recall, there are a couple of different methods to develop a capitalization rate. The Guideline Public Company Method would use a discount for lack of marketability since public companies were used to arrive at the value.

Remember, when applying this discount or any other, we are trying to adjust the arrived value from a method to match the basis of the target company. If your value arrived at from a method is based on public information and you are appraising a privately held business, a discount for lack of marketability would be justified.

How do you calculate the discount for lack of marketability? That is a good question as there is no clear answer. The discount’s purpose is to adjust the arrived value to make up for the lack of liquidity in the privately held stock. This lack of liquidity can have many contributing factors. However, as usual, the IRS has given us RR77-287 which gives guidance in valuing restricted stocks. As you can probably guess, I will not go into details of the revenue ruling at this time. A second source of information can be obtained from well known studies such as the Gelman Study, Trout Study, Maher Study, SEC Institutional Investor Study, and several others. A third source is of course court cases.

Regardless of the source or the method the appraiser used to determine the discount for lack of marketability, the appraiser must be able to defend the discount based on knowledge, experience, approved methodology, and information researched. Imagine the grin on your face as the opposing business appraiser says that they arrived at the discount rate purely based on studies.

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