



## Specific Company Risk Premium

Congratulations, you have completed the basics of business appraisal. We will begin to get into more intermediate level topics dealing with business appraisals, methods, terminology, etc.

In a previous education piece, I had talked about the development of the Discount Rate to be applied to a business's future revenue streams. If you did not receive that issue, refer to our education section on our website at [www.mybbsgroup.com](http://www.mybbsgroup.com). The discussion on discount rates is listed as the April 2007 education piece.

Below is the build-up method, which we discussed, in determining the discount rate. As you notice, each part can be determined using a specific source to build the discount rate. However, the specific company risk premium is based solely on the judgment, experience, and research of the appraiser.

<u>Description</u>	<u>Rate</u>	<u>Source(s) of Rate</u>
Risk-Free Rate of return	4.6%	20 year U.S. Treasury Bond rates
Large Company Equity Risk Premium	7.10%	Ibbotson
Small Company Risk Premium	5.80%	Ibbotson
Industry Specific Risk Premium	3.42%	Ibbotson
Specific Company Risk Premium	8.00%	Appraisers informed judgment
Discount Rate	29%	Rounded

The Specific Company Risk Premium is included in the build up method to compensate buyers/investors for risks that can not be diversified away. Such risks include, but are not limited to limited liquidity, few potential buyers, and usually unlimited owner liability.

This is one of the reasons why the development of the specific company risk premium is based on the appraiser's judgment, experience, and research. Since there is no established procedure or source for measuring the specific company risk premium, it opens the door to scrutiny. This is especially true in situations when the appraisal is used for tax or legal issues.

Even though there is not an established procedure for measuring the premium, there are three sets of recognized specific company risk premium factors developed by three different appraisers. The three sets of factors are known as: 1) the Black/Green factors, 2) the Warren Miller factors, and 3) the Gary Trugman factors. An indepth discussion of each set of factors is beyond the scope of this education piece. However, such factors include, but are not limited to economical, management, competition, industry conditions, and financial.

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