



Corporate Finance vs. Private Capital Markets Theory

Business appraisal training is based a lot on Corporate Finance Theory. This is in direct conflict with the subject that encompasses most of our engagements, small privately held businesses.

What is the definition of a small business? There are many definitions of what is considered to be a small business. To answer this question, we will refer to the Small Business Act. The Act says that a small business is "one that is independently owned and operated and which is not dominant in its field of operation." The law also states that the definition will vary from industry to industry. How is that for a straight answer? For more detail, I will refer you to the SBA's Table of Small Business Size Standards.

Is it correct to solely use the Corporate Finance Theory in the appraisal of a small privately held business? To answer the question, we will refer to two books. The first by Chris Mercer titled Integrated Theory of Business Valuation and the second by Rob Slee titled Private Capital Markets. The principals behind each theory are listed below.

Corporate Finance Theory Chris Mercer	Private Capital Markets Theory Rob Slee
Growth	Return Expectations
Risk / Reward	Authority and Motives
Alternative Investments	Value Worlds
Present Value	Capital Access
Expectational	Transfer Options
Sane, Rational, and Consistent	Inefficient Markets

The Private Capital Markets Theory, in a nutshell, says that privately owned businesses are run differently than publicly owned and traded corporations. This can be illustrated in the fact that public companies are ran to maximize profits for their investors, while private businesses are ran to minimize taxes to the owners.

To answer the question presented above, my opinion is that a combination of both would be used to conduct a business appraisal. To the degree that I would use either one, is dictated by the appraisal engagement and the business itself.

We will talk more about the Private Capital Markets Theory in future educational pieces.

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