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Pragmatic Advisors

The Region's Leading Advisor on Family Business

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Engaging a yearly valuation of your business is a critical exercise that every Family Owned Business should undergo for various reasons. Be it to understand and dollarize what is at stake, sell to strategic partners, provide liquidity for minority shareholders or transfer the business to the next Gen, the valuation exercise indeed paves the way for an informed exit, growth or succession strategy.

Yet, the unique challenges facing Family Owned Businesses, which we have touched upon in our earlier position paper, lay their heavy aftermath on the business valuation. The complex interaction between the family, the ownership and the business, augments the risk factors underlying the business and therefore dictate sort of discounts on the value of the business. Such discounts are mainly related to two impediments exclusive to Family Owned Businesses

“LACK OF MARKETABILITY” DISCOUNT

To start with, Family Owned Businesses do not enjoy the luxury of a ready market for their shares. Unlike public companies whose shares are traded in regulated markets, Family Owned Businesses face the lack of marketability syndrome. Marketability here is defined as the ability to quickly convert an investment into cash at a known price and with minimal related costs. Such a syndrome brings to surface the very first discount, the “Lack of Marketability” discount, which is a downward adjustment to the value of the Family Owned Business to reflect its reduced level of marketability.

The “Lack of Marketability” discount has the largest monetary impact on the final determination of value as it typically varies between 30 to 50 percentage points depending on the attractiveness of the Family Owned Business.

“LACK OF CONTROL” DISCOUNT

The second impediment that affects value in Family Owned Businesses mainly revolves around control. To crystalize such impediment, it is imperative to dive deeper into the prerogatives of ownership control. Those include:

- Appointment of senior management and determining their compensation
- Setting policies that affect the course of the business
- Acquiring or liquidating assets
- Leveraging from the banks
- Selecting people with whom to do business with or award contracts

- Making acquisitions, liquidating, selling out or going IPO
- Declaring and paying dividends
- Changing the by-laws

Reflecting on the above, it becomes obvious that a controlling ownership stake enjoys very valuable rights, which explains the rationale why families in Family Owned Businesses aspire to retain such control. In line with the above, the valuation of a non-controlling ownership interest does not enjoy similar rights and is therefore subject to what is referred to as the discount for “Lack of Control” or the “Minority Interest” discount. Despite a spirit of cooperation allowing minority shareholders to exercise some control over a professionally-run Family Business affairs, this control is still far from absolute enforcing the need for a “Lack of Control” discount. The latter is applied mainly to hedge against the absence of control over the direction of the business. The bracket here can range from 20 to 40 percentage points TIME FOR A REALITY CHECK

While such discounts may sound nothing but nuisance for family members especially on the verge of a minority exit to a financial or strategic buyer, data shows that their aggregate value, in most Family Owned Business valuations, gravitates around 40 percentage points.

Such value waiver typically creates owners’ crave for compensation through the typical “What about my Goodwill” recourse? Unfortunately, Goodwill is not valued separately and is, in most cases, considered as already factored into the performance of the business.

For more information on Okeili&co Next-Generation advisory efforts, please write us to engage@okeili.com