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*By Michael Blake, Arpeggio Advisors*

According to data from Pratt's Stats, a leading small business acquisition database used by many professional business appraisers, 85% of business sales are structured

as asset sales. Yet, this fact is largely ignored in most business appraisals. This gap

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- The level (controlling/non-controlling) to be applied
- The basis (marketable/non-marketable to be applied)
- The intended users of the work product
- The premise of value (liquidation, continued operation) to be applied
- The purpose(s) of the appraisal
- The identity of the client
- Hypothetical conditions and/or extraordinary assumptions to be used (if known in advance)

However, most, if not all American professional business appraisal standards are silent on the matter of the structure of the sale – an asset sale or stock sale. There are numerous reasons for the omission of the explicit consideration of transaction structure, some of which are valid.

1. Many appraisals, (especially in gift/estate matters or stock option grants) are performed on minority interests, and the minority shareholder can't practically execute an asset sale.
2. Public company data, including stock prices and discount rates for income-based valuation techniques, are all priced on a stock price foundation. Public shares are generally accepted to price a stock transaction. Applying an asset purchase framework could make the use of such data more difficult.
3. Determining the most likely structure is difficult to accomplish scientifically, and instead would be the product of "informed professional judgment.
4. Determining the impact of an asset vs. stock sale on price requires knowledge of the tax code as well as the tax circumstances of buyers and sellers, which may not be available for any given assignment.
5. In light of the fee pressure prevalent in the business appraisal market, few practitioners are looking for reasons to add more hours to a given engagement.

Nevertheless, in order to maintain the public trust, the business appraisal

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those assets over a period of up to 15 years. On the other hand, in an asset sale the seller will often have a zero or close-to-zero basis for his capital gains, and thus his tax liability increases. Contrast with a stock sale, where the seller may have a higher basis (for example, if he bought the business previously), and thus may realize tax savings.

Whether a purchase takes place as a stock or an asset transaction is the product of negotiation and relative bargaining power between buyer and seller. This is where business appraisers run into trouble. Business valuation (and neoclassical economics) assumes efficient markets, which means that the buyer and seller always have equal bargaining power. The fact that such a high percentage of purchases are structured as asset sales belies the market efficiency assumption. Clearly, buyers are frequently able to exercise leverage in their transactions.

Still, we (as business appraisers) need to overcome our obsession with precision – letting the best be the enemy of the good. Even if we don't get this dynamic exactly right, we can still offer the client a more useful piece of information than that which we are providing under current practices. Some techniques to try:

- Assume the difference between the computed business value and value associated with identifiable tangible assets is intangible value and apply a model to compute the value of the tax savings;
- When using the merged and acquired companies method of the market approach, only use those transactions that are asset sales;
- Use information from sources such as *Pratt's Stats* to estimate a typical percentage of a purchase that might be allocated to intangible assets, and incorporate a model of the tax savings that would accrue to the asset buyer;
- Use an iterative method to estimate the tax amortization benefit that might accrue to the buyer in an asset sale;

- Employ a Nash Bargaining Solution to predict the most likely outcome of

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Michael Blake, CFA, ASA, ABAR, BCA, is the founder of Arpeggio Advisors ([www.arpeggioadvisors.com](http://www.arpeggioadvisors.com)), a boutique business appraisal and corporate strategy advisory firm in Atlanta. Michael's background has included work in venture capital, investment banking, and public accounting. Michael has particular expertise in the appraisal of firms in the fields of professional services, information technology, aerospace, and alternative energy. In addition, he has developed specific expertise in the appraisal of intellectual property and intangible assets. Michael is an active educator. He is a Special Instructor of Business Valuation in the Georgia Tech/Emory University **TI:GER (Technology Innovation: Generating Economic Results) program**. In addition, he is regularly invited to provide instruction on entrepreneurship, corporate finance, and business valuation to graduate level classes at prominent universities across the South.

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