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Discounts for Lack of Control

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When valuing non-voting or non-controlling shares of a privately held company, a discount for lack of control may be necessary. Whether or not such a valuation adjustment is appropriate is dependent, first, on the methods and data used to derive the pre-discount valuation. If the method used has a discount for lack of control "baked in" to the analysis, then a separate, discrete discount for lack of control is not appropriate. For example, a valuation based on a minority owner's cash flows typically results in a minority value, and normally does not require a separate discount for lack of control.

Depending on the data available, the determination of the discount for lack of control may be based on circumstances unique to the business, or on empirical studies, or some combination of the two.

The value of having control is predicated, in part, on whether and how much the controlling owner exercises her control power in ways that are at odds with the minority owner(s)' best interests. For example, the control owner may pay herself excessive salaries, or engage in non-arm's length transactions with related entities. Therefore, the appropriate discount for lack of control could be large or small, depending on the extent to which the control owner is perceived to be impairing the minority owner(s) financial interests. These considerations, along with others (i.e., the terms of shareholders or operating agreements) will help determine the magnitude of the discount for lack of control.

In these circumstances, the discount for lack of control will likely be based on characteristics unique to the business.

Where it is not appropriate to estimate a discount for lack of control from this type of analysis, or where the analysis may need to be supplemented by empirical data, studies are published that may assist in the endeavor. Such studies determine the premium price paid for the acquisition of a controlling interest in a company and compare that to the amount at which the target company's non-controlling shares were trading on the market prior to the acquisition. From this price premium, the related discount can be computed.

Although computing a discount for lack of control from these empirical studies is easy to do, the analyst must use caution in relying on the studies. This is because some portion of the premium is likely to include a component for synergies or other motivations that go beyond the value of control. The presence of these other factors may make reduce the usefulness of these empirical studies for estimating a discount for lack of control.

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