How to Spot A Biased Valuation
By: Russell T. Glazer

Very frequently in litigation where valuation of a business is at issue, both litigants hire a valuation expert. All too often, the opposing experts offer two very disparate opinions as to the value of the subject company. Sometimes, this is the result of legitimate differences in the analysis, perhaps in the expectations of future revenues, profits, capital expenditures, or other financial statement items. These differences are easily identified and can often be understood, if not reconciled. For example, if one expert’s analysis assumes high gross profit margins, and the other expert is using much lower gross profit margins, this different assumption, and its impact in value, is usually easy to quantify. It may be more difficult, especially if the subject company has a short or an erratic track record, for the trier of fact to determine which assumption is more realistic, but at least the issue can be identified and discussed. The underlying cause may be an honest difference in interpreting the company’s prospects, or it may be due to an attempt by one (or both) of the valuators to bias the result.

There are times, however, when, if a business valuators report is biased, the bias is more difficult to spot. An attempt to intentionally drive the value in the desired direction may be disguised in several areas of the analysis. These may include, for example, the development of the discount rate in the Income Approach, or the comparable transactions selected in the Market Approach. The choice of “normalizing adjustments” for excess salaries, owners’ perquisites paid by the business, etc., and the amounts of these adjustments, also impact value. Manipulations in any of these areas could individually have a significant impact on value. Moreover, a series of small such manipulations could, cumulatively, result in a large change in value. These are harder to discover.

The expert’s valuation report should include sufficient detail to explain all such adjustments. The report should describe why the adjustment is necessary, as well as the amount of the adjustment. However, one more component should be included – the valuator should identify the amount of the adjustment and also the reason for the adjustment. This should be supported by empirical data tailored, as much as is practicable, to the specific circumstances of the subject company. For example, an adjustment for owners’ salaries can be based on data from the US Department of Labor, which is a nationwide average of salaries for all companies in a particular industry. Or, the adjustment could be based on surveys of companies in the same industry and size as the subject, adjusted for the subject company’s geographic location. Both amounts are derived from published, empirical data; but the Department of Labor data may be, perhaps intentionally, a poor match for the subject company, while the survey data might be a better fit. Even the survey data can be manipulated. To paraphrase Shakespeare, “the devil can cite empirical data for his purpose.” Thus, a careful review of the valuators analysis and the data used may be needed to reveal bias in the expert’s opinion.

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