

## **Valuing Privately-Held Businesses: A Comparison of the Pricing Accuracy of Common Valuation Models**

**Michael F. Spivey and Jeffrey J. McMillan**  
Clemson University, Clemson, S.C. USA

---

Business valuation is a fast growing practice area for forensic accountants. This study extends the work of prior business valuation studies such as Boatsman and Baskin (1982), LeClair (1990), and Mastracchio and Lippitt (1996) that have used public companies as proxies for privately-held businesses. We build on past studies by providing empirical evidence concerning the pricing accuracy of two frequently used valuation models — the earning capitalization model and the excess earnings model. In addition, the data utilized in this study was taken from the actual sales of privately-held businesses. The results of this study show that the excess earnings model was significantly superior to the earnings capitalization model in estimating actual sale prices of privately-held businesses.

---

### **INTRODUCTION**

During the past decade, the profession has worked to enhance the business valuation practice area because in today's environment the need for generating an independent valuation of a business can arise for a number of reasons. For example: purchase, sale, or merger of the business, lender security, raising equity funding, resolution of shareholder disputes, equitable division of matrimonial property, bankruptcy, insurance claims, and a variety of tax purposes. Within this fast growing practice arena, the training and skill sets of forensic accountants have made them the preferred choice for many in need of valuing the shares or assets of their businesses. Therefore, many firms offering forensic services have taken serious steps to booster and promote the valuation skills they offer. Recognizing this trend, the AICPA officially began supporting a new membership section, "Business Valuation and Forensic & Litigation Service (BV/FLS)," effective August 1, 2004.

There are many methods one can use to derive an estimate of the value of a business. For publicly traded companies the "market" theoretically provides the surest measure of a company's value. However, such readily available estimates of valuation do not exist for non-