



A CHARTERED BUSINESS VALUATORS' JOURNEY

From Value Theory to Stock Markets to Fair Market Value

EXECUTIVE SUMMARY

To reach a determination of *fair market value*, it helps to have first traveled through the broader concept of value, or value theory, and have tested valuation conclusions in real markets. This article traces my journey toward understanding value, a journey that began in the early 1990s when I encountered Georg Simmel's text, *The Philosophy of Money*. That serendipitous starting point led me to a career as an institutional investor and later, as a professional business valuator dedicated to determining *fair market value*. This article describes the story-arc from a student interested in the metaphysical underpinnings of value, to an equity analyst and money manager making investment decisions in real markets, to a valuation expert applying that experience within notional markets for private business owners and their advisors. I hope to provide context and insight into unseen considerations facing business valuers, and offer business owners, lawyers, and accountants a richer appreciation for how theory, practice, and experience intersect when determining *fair market value*.

FOUNDATIONS: SIMMEL AND MARX

My introduction to value theory came through reading Georg Simmel in my early 20's. Simmel was considered a founding father of sociology, and a philosopher. Even after all these years, what stayed with me as I read *The Philosophy of Money*, first published in 1900, was the description of *desire* and *distance* as being pre-conditions of value – in essence, linking value to metaphysical constructs. This got me thinking and additional elements of value he mentions like *sacrifice*, *exchange*, *objectification*, *social relations* and *objective culture* took a back seat at that time. In simple terms, for something to have *value*, it must be both desired and somewhat distanced from us; the latter meaning we can't readily get/buy it. For example, a Rolls Royce has value beyond the quality of craftsmanship because of people's *desire* for the vehicles and the fact that the price tag is largely beyond the reach of most, creating a sense of *distance*. The perceptions of *desire* and *distance* are a good starting point for appreciating metaphysical underpinnings of value.

Years later I read Karl Marx, the philosopher, economist, and sociologist who continues to be read some 140+ years after his death. When reading from his text, *Capital: Critique of Political Economy*, I focused on trying to understand what lay at the crux of his value theory. While Marx can be discussed and debated endlessly, I considered *surplus-labor time* as being that crux. In simple terms, as an employee, the time you spend working to cover your wages would be considered '*necessary labour time*'. Any additional time you spend working that does not accrue to you in the form of wages is considered '*surplus labour time*'. This *surplus labour time*, whether applied to producing a product or offering a service, is sold in the market and those revenues are not distributed to you, rather they stay with the company employing you, and some portion may trickle down to the bottom line and accrue to the business owner(s) as profit. This is one framework for understanding value in the context of production and ownership, as well as linking value theory to economic profits – and wealth creation.





While Simmel and Marx provided the theoretical framework linking human perception and economic production to value, it would take me reading Benjamin Graham's writings to bridge those ideas into an extended appreciation of value in the context of modern market forces and the world of investing and business valuation.

GROUNDING: GRAHAM AND STOCK MARKETS

Having worked in the institutional money management field, first as an equity analyst then as a portfolio manager, and having earned the Chartered Financial Analyst (CFA) designation, I felt confident undertaking business valuations that led to the allocations of large sums. Yet, surprisingly, it wasn't until some years into my career when I read Benjamin Graham's, *The Intelligent Investor*, that all the pieces began falling into place.

Graham remains a legend to many and is widely considered the father of securities/business analysis after publishing *Securities Analysis* in 1934 and *The Intelligent Investor* in 1949. Graham is known for his influence on investment legends like Warren Buffett, Charlie Munger, Peter Lynch, Walter Schloss, and Charles Brandes, the latter I was fortunate to have worked for from 2002-2005. Graham's influence on me took the form of extending the philosophical, economic, and sociological framework of earlier thinkers when he expressed value, or what he called *intrinsic value*, as the consideration of the present value of all future cash flows that an investment/business is expected to generate, and to some degree, a consideration of tangible assets that underpin any particular business. This articulation of business/investment value, combined with the real zinger, his concept of a *margin of safety*, resonated with practical significance.

Margin of safety can be considered the difference, or cushion, between a determination of intrinsic value (the stand-alone value of a business) and the price at which a reasonable investor or business owner would consider buying into a particular business. This combination of *intrinsic value* and *margin of safety*, in my mind, broadly links with professional business valuers' concepts of *fair value* (stand-alone value) and *fair market value* (*fair value* plus certain market considerations impacting notional valuations). In short, Graham is a good segue into how business valuers consider key elements such as cash flows, assets, liabilities, risks, control, and liquidity in the context of *fair market value*, that will be discussed next.

FROM THEORY TO PRACTICE: FAIR VALUE vs. FAIR MARKET VALUE

Having mentioned a few intellectual giants on whose shoulders my understanding of value has been shaped, I wish to distinguish between two practical concepts professional business valuers consider, concepts that many accountants, lawyers/courts and business owners have likely encountered – "*fair value*" and "*fair market value*". While they sound similar, and are related, they can be quite different under certain circumstances.

In Canada, unfortunately, there is no statutory definitions for either term. Valuation practitioners rely on CBV Institute guidance or jurisprudence and in the footnotes, I provide definitions for both terms from the International Valuation Glossary – Business Valuation, a document co-published by the CBV Institute.





A consideration of *fair value*¹ can be viewed as the stand-alone value of a 100% interest (or some pro rata ownership) in a particular business. While adjustments for redundant assets and disposition costs can yield a distributable amount to shareholders in a notional consideration of *fair value*, making it suitable for oppression or dissent cases, *fair value* does not typically consider certain market forces. For instance, *fair value* does not reflect a further consideration of control or marketability discounts, the latter capturing the difficulty in converting common shares of a private company into cash. These additional considerations are, however, typically factored into a determination of *fair market value*², thus making it the standard of value applied in many tax, commercial, and family law contexts.

As mentioned, *fair market value* extends beyond *fair value* to include a consideration of the actual securities/interest and proportion owned, and whether control or marketability discounts or special interest purchaser premium, are warranted. If the ownership stake is 100% of the voting stock, then no control adjustment would be made. However, an interest of less than 100%, particularly interests of 50% or less, may warrant a discount for lack of control – thus reflecting restrictions in unilaterally directing cash distributions and taking other corporate actions. Likewise, a marketability discount may be appropriate for any ownership stake if a business valuator determines it would be challenging to convert a specific private business interest into cash under market conditions prevailing at the valuation date. And finally, if a special interest purchaser can be identified, synergies can be quantified, and if a determination can be made that such a buyer would pay for some or all of these synergies, then an amount above *fair value* may be warranted in a consideration of *fair market value*. These three elements of control, marketability and special interest purchasers are examples of how *fair value* and *fair market value* may differ.

In other words, *fair market value* captures notional considerations of certain market forces that may extend beyond a *fair value* conclusion – thus leading many to view *fair market value* as better reflecting market realism at any given valuation date.

CLOSING THOUGHTS

Valuing private businesses is never just a mechanical process. It involves more than certifications, technical training, and experience valuing businesses. For those charged with determining the *fair market value* of a private business the process involves, and is greatly enhanced by, judgement shaped by both value theory and transaction experience related to real markets.

At Myles Martin & Company, we blend highly regarded certifications including the Chartered Business Valuator (CBV) designation, extensive experience valuing businesses, and a deep appreciation for value

¹ *Fair value: a standard of value commonly considered as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Source: International Valuation Glossary – Business Valuation, updated February 24, 2022.*

² *Fair market value: a standard of value considered to represent the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, each acting at arms-length in an open and unrestricted market, when neither is under compulsion to buy or to sell and when both have reasonable knowledge of relevant facts. Source: ibid.*





theory, with having had real-world experience as participants in actual markets. For private business owners, their professional advisors, the Canada Revenue Agency, and other stakeholders who rely on our valuation conclusions, we view:

- the professional judgment we've forged from real-world experience related to actual markets,
- the contextualization of value theory within the mechanics of economic value creation, and
- the years of business and securities analysis we've amassed,

as being significant contributors to our professional determination of *fair market value* and a large part of our value proposition to clients. To underscore one of the above, the valuation work we produce is supported by having directly linked our valuation conclusions to the allocation of millions of dollars – and as any business owner knows, that is where the rubber hits the road.

Thank you,

D. J. Myles Martin, CFA, CVA, CBV, FMVA
Principal, Myles Martin & Company
Email: djmm@mylesmartin.ca
Phone: (289) 776-8615
Web: mylesmartin.ca

REFERENCES

1. International Valuation Glossary – Business Valuation, updated February 24, 2022. https://cbvinstitute.com/wp-content/uploads/2021/11/International-Valuation-Glossary-Business-Valuation_EN.pdf
2. The Philosophy of Money. <https://www.amazon.ca/Philosophy-Money-Georg-Simmel/dp/0415046416>
3. Capital: A Critique of Political Economy. <https://www.amazon.ca/Capital-One-Critique-Political-Economy/dp/0486477487>
4. Securities Analysis. <https://www.amazon.ca/Security-Analysis-Foreword-Warren-Buffett/dp/0071592539>
5. The Intelligent Investor. <https://www.amazon.ca/Intelligent-Investor-Definitive-Value-Investing/dp/0060555661>

NOTE: This article is informational only and not legal, tax, or investment advice. Facts and rules are summarized at a high level and are subject to change; Myles Martin & Company Inc. is not obligated to update this article. Professional advice should be obtained for your specific circumstances.

