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Why Do Private Firms Linger on the Selling Block?

By Marc Vianello, CPA, ABV, CFF, and Paul Murray, CPA

The time it takes to market and sell a privately held business continues its downward trend. The length of time depends on many factors, but there are three key variables: industry, price, and the month the sale listing appears. This is revealed in the latest update of an ongoing study, *Marketing Period of Private Sales Transactions*.

Background: The business valuation concept of marketability deals with the liquidity of ownership interests. How quickly an owner can convert an investment to cash represents the period of time it will take the seller to liquidate an investment. The time period can vary greatly depending on the standard of value in play. For example, liquidation sales can occur quickly and can result in much lower prices than orderly sales. Selling periods for the latter usually are much longer than for liquidation sales as sellers explore the marketplace of potential buyers in the hope of realizing prices greater than liquidation.

The certainty that the seller will realize the estimated sale price (value) of an investment represents the price volatility of the investment during the period that it is being offered for sale. If market prices for similar investments fall dramatically while the marketplace is being explored, then the seller will have lost the opportunity to lock in the higher price that existed at the time the sell decision was made. Conversely, if the sale price is fixed for some reason (e.g., a listing agreement) and market prices for similar investments rise dramatically during the marketing period, the seller will have lost the opportunity to realize the increased value.

In every sale transaction, the "quickly" and "certainty" variables work together when determining the value of an investment. Relative to immediately marketable investments, the estimated freely traded value of illiquid investments must be discounted to reflect the uncertainty of the time and price of sale. This uncertainty is reflected in business valuations by what is commonly referred to as the discount for lack of marketability (DLOM).

The economic costs of time and price uncertainty can be reduced to the price risk faced by an investor during the particular period that an illiquid investment is being offered for sale. Public investments with no price volatility have no DLOM because they can be arbitraged to negate the risk of a period of restricted marketing. Conversely, volatile investments that are immediately marketable can be sold at the current price to avoid the risk of future volatility. The illiquidity experienced by the seller of a nonpublic business interest during the marketing period therefore represents an economic cost reflective of the risk associated with the inability to realize gains and to avoid losses during the period of illiquidity. Longer marketing periods expose the potential value of the business to adverse events in the marketplace and adverse changes in the operations of the business that require a greater DLOM to equate the investment to an immediately liquid counterpart.

Two databases of private company sale transactions used. The annual update to our

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study presents our findings regarding the time it has taken to sell different populations of privately held business.[1] For this purpose, we have assumed that the asking price of each business was reasonably estimated. We then considered the marketing time periods of the businesses by the industry, price, and listing date.

We obtained a database of 7,928 private company sale transactions from Business Valuation Resources' *Pratt's Stats* database and a database of 10,381 private company sale transactions from the *BIZCOMPS* database.[2] The population of the *Pratt's Stats* transactions occurred from February 1992 through the end of 2011; the population of the *BIZCOMPS* transactions occurred from March 1995 through the end of 2011.[3] For each transaction, these databases report an associated Standard Industrial Classification (SIC) code, sale initiation date, sale closing date, and asking price. Each *Pratt's Stats* transaction also listed a market value of invested capital (MVIC). The average time that elapsed from the initial offering date to the closing date of these transactions is 211 days for the *Pratt's Stats* transactions (up from 200 days in the previous study) and 214 days for the *BIZCOMPS* transactions. The standard deviation of the reported periods is 98.6%, or 208 days, for the *Pratt's Stats* transactions and 82.2%, or 176 days, for the *BIZCOMPS* transactions. Exhibits 1 and 2 show the distribution of the amount of time it took to consummate the sale transactions in the two databases. The data are split into 30-day increments for presentation and analytical purposes.

Exhibit 1 shows the distribution of sales of the population of *Pratt's Stats* sales. The peak of the graph is 972 sale transactions, which occurred from 61 to 90 days to sell, which is 12.3% of the population. Database analysis indicates that

1 For a discussion of methods of estimating price volatility for a privately held business interest, please refer to our paper titled "Estimating Private Company Price Volatility."

2 Jack R. Sanders, CBA, CBI, CMEA, CVA, is the collector and author of the *BIZCOMPS* database.

3 Any sales initiated after Dec. 31, 2009, were excluded from both databases to avoid skewing our analysis with only short period sales in the subsequent years.

one standard deviation to the right of the mean encompasses marketing periods up to 419 days, which is 88% of the population.

Exhibit 2 shows the distribution of sales of the population of *BIZCOMPS* transactions. The peak of the graph is 1,161 sale transactions, which occurred from 61 to 90 days to sell, which is 11.2% of the database. Database analysis indicates that one standard deviation to the right of the mean encompasses marketing periods of up to 390 days, which is 88% of the population.

Industry variations. We separated the sale transactions into the 10 two-digit SIC code divisions corresponding to the broad industry groupings shown in Exhibit 3. The spread between the fastest-selling and slowest-selling industry groups is 76 days in the *Pratt's Stats* database and 60 days in the *BIZCOMPS* database.

Exhibit 1. Distribution of Marketing Periods Pratt's Stats Database

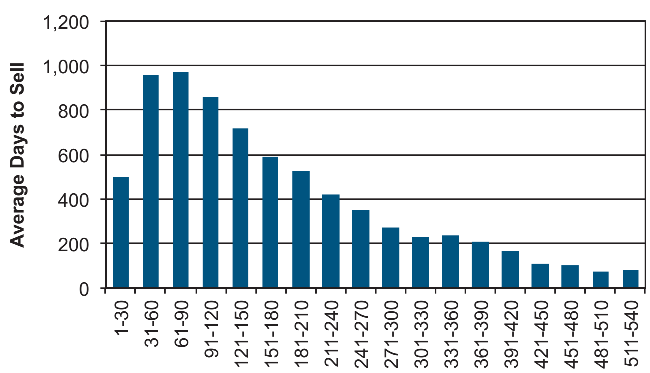
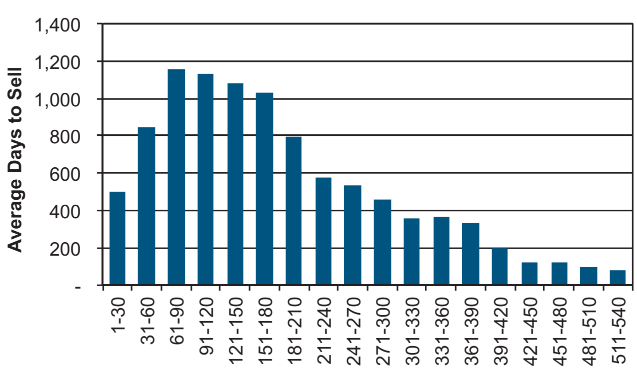


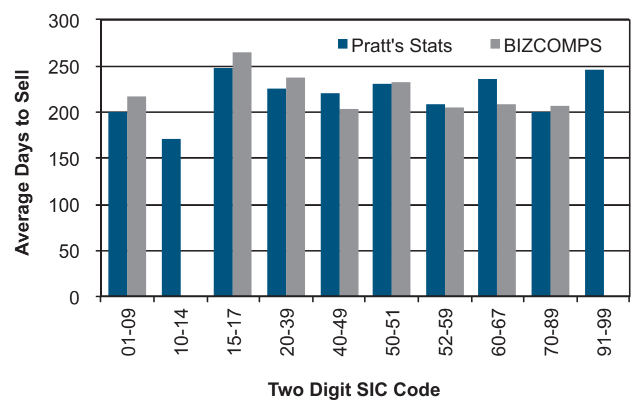
Exhibit 2. Distribution of Marketing Periods BIZCOMPS Database



The construction industry group had the longest average marketing period in both the *Pratt's Stats* and *BIZCOMPS* databases: 248 days and 264 days, respectively. The finance/insurance/real estate and manufacturing industry groups also had marketing periods longer than the mean in both databases.[4]

Businesses reported in the mining industry sold relatively quickly, in an average of 172 days, but are based on only nine translations in the *Pratt's Stats* database. The *BIZCOMPS* database contains no mining industry transactions. The retail and services industry groups also had marketing periods shorter than the mean in both databases. The *Pratt's Stats* and *BIZCOMPS* databases had inconsistent results relative to the mean for the agriculture/forestry/fishing, transportation/communications/electric/gas/sanitary services, and finance/insurance/real estate industry groups.

Exhibit 3. Average Marketing Period by SIC Code



Key to SIC codes
SIC Code: Group

01-09: Agriculture, forestry, and fishing
10-14: Mining
15-17: Construction
20-39: Manufacturing
40-49: Transportation, communications, electric, gas, and sanitary services
50-51: Wholesale trade
52-59: Retail trade
60-67: Finance, insurance, and real estate
70-89: Services
91-99: Public administration

4 We are ignoring the public administration industry group since it represents the sale of just two businesses.

The above results show that average marketing periods are materially different for businesses operating in separate industries. The widely varying standard deviations of marketing periods add to the differences that can be expected when comparing one business to another.

Marketing periods by sale year. The *Pratt's Stats* database reports sale transactions commencing in 1991 and extending through 2011. The years 1991 to 1995 were not used in our calendar-year analysis since very few transactions were reported for those years. Excluding 1991 to 1995 reduced the *Pratt's Stats* database population from 7,928 to 7,848. The *BIZCOMPS* database reports sale transactions commencing in 1993 and extending through 2011. The years 1993 to 1997 were not used in the calendar-year analysis since very few transactions were reported for those years. Excluding 1993 to 1997 reduced the *BIZCOMPS* database population from 10,381 to 10,287.

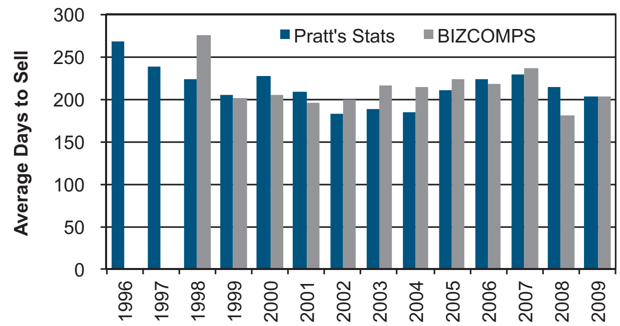
Exhibit 4 shows a recent decline in the average selling period over time. In 2007, the *Pratt's Stats* database indicates that it took an average 228 days, and the *BIZCOMPS* indicates that it took an average of 237 days, to sell a business. By 2009, the average time fell to 204 days and 202 days, respectively.

Effects of asking price. Generally, the average number of days to sell a privately held business increases as the asking price increases. Both the *Pratt's Stats* and *BIZCOMPS* databases provide the transaction asking price. The range of asking prices of the resulting transaction population was from $3,456 to $70,000,000 (for *Pratt's Stats)* and from $15,000 to $35,000,000[5] (for *BIZCOMPS).*

We combined the two databases and split the transactions into 20 groups based on asking price of approximately equal numbers of sales. Exhibit 5 shows the average days to sell for each asking price group.

When the asking price is under $55,000, the average days to sell is 174 days for the *Pratt's*

Exhibit 4. Average Marketing Period by Year of Sale Initiation



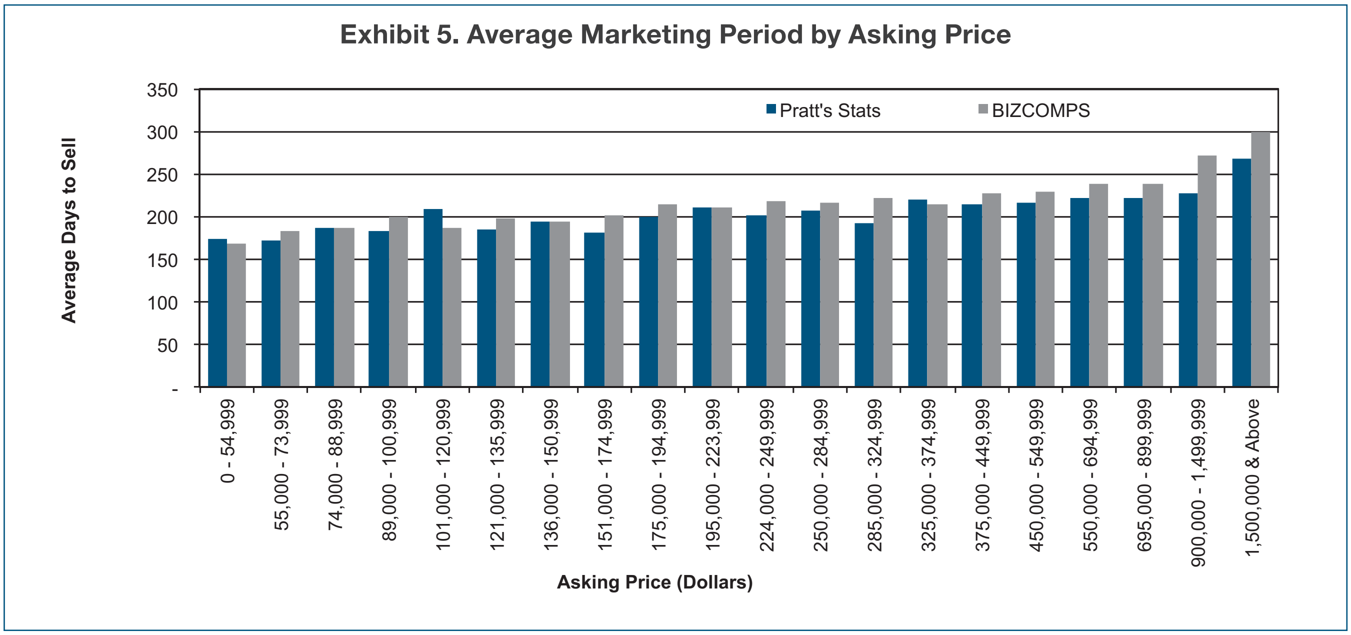
Stats database and 168 days for the *BIZCOMPS* database. The length of the marketing period gradually increases until the asking price is greater than $1,500,000 when the average days to sell is 268 days for the *Pratt's Stats* database and 300 days for the *BIZCOMPS* database.

Seasonality influence. We considered whether the time of year a sale transaction is initiated makes a difference in the length of marketing periods. To analyze this factor, the sale transactions were grouped based on the month the company was listed for sale.

Exhibit 6 shows that the sales reported by *Pratt's Stats* and *BIZCOMPS* show similar effects of seasonality.

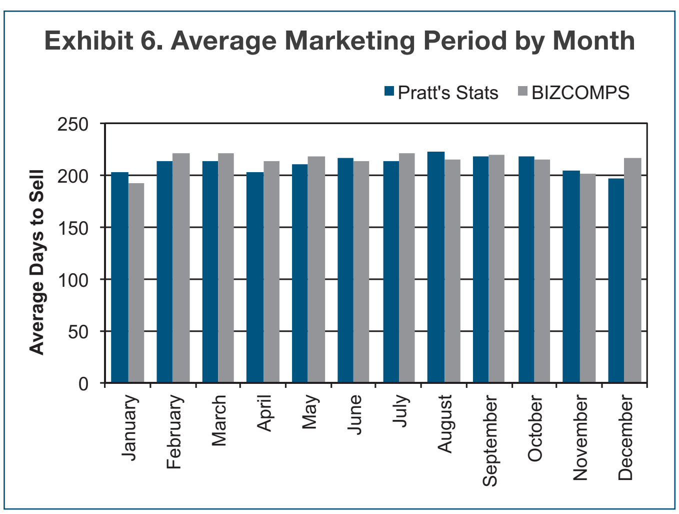
On average, sale transactions in the *Pratt's Stats* database originally listed in August took the longest time to sell, with a mean of 223 days. Sales transactions in the *BIZCOMPS* database originally listed in July took the longest time to sell, with a mean of 222 days. Listings in March for the *Pratt's Stats* database and February for the *BIZCOMPS* database had the highest volatility of time to sell. The months with the shortest marketing periods based on listing date were December, January, April, and November for the *Pratt's Stats* database (averaging 197, 202, 203, and 205 days, respectively), and January and November for the *BIZCOMPS* database (averaging 192 and 202 days, respectively). Possible explanations for these phenomena are proximity to year-end numbers for November, December, and January listings and proximity to completion

5 One transaction had an asking price of $0 and was excluded from this calculation and Exhibit 6.



of tax filings for April listings. Such proximity tends to offer buyers enhanced transparency through more timely financial reporting.

Other factors. Our earlier studies disputed the notions that GDP, inflation, money supply, and demographics explain the marketing periods of privately held businesses. The present study confirmed our prior results. Correlation analysis of selling time against these macroeconomic factors yielded low R-squares, suggesting that annual fluctuations in inflation, real GDP, nominal GDP, money supply, and demographics provide little explanation of the variations in private business marketing periods. For example, there was a recession from March 2001 to November 2001 that possibly explains the longer selling times for those sales that were listed in 2000 and closed in 2001. But the explanation is seemingly contradicted by the decline in the average number of days to sell businesses listed in 2001. Despite the recession, the average business sold faster during 2001 than in 2000. A major recession also started in December 2007. This possibly explains the longer selling times for those sales that were listed in 2007, but the shorter selling times of the 2008 and 2009 periods (still in recession) contradict the explanation. Our conclusion is that the general state of the economy is not a reliable predictor of the time it will take to sell a business.



Conclusion. There is no doubt that many factors contribute independently to the length of time that it takes to sell a privately held business, but industry, price, and month of listing appear to be key contributors. Business appraisers should explore these variables in reaching marketing period conclusions. Broader economic and demographic factors do not appear to be reliable determiners for the period of time needed to sell a privately held business. Business appraisers should also be aware that the *Pratt's Stats* or *BIZCOMPS* databases result in different marketing period conclusions for some marketing period measurements. This fact may open the appraiser to criticism if care is not used in determining the selection of a particular database.

This article presents selected findings from the study *The Marketing Period of Private Sale Transactions: Updated for Sales Through 2011*. For the complete version, please contact the authors.

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