Business Valuations for Minority Shareholders in SME's

A minority interest is where a shareholder's interest within a private company is such that it does not provide the shareholder with any actual control over the company. A shareholding of less than 50% of the total issued share capital, is regarded as a minority interest.

In a situation where a valuation for a minority interest is required, then it is usually recognized that a discount will need to be applied to the shares. The discount to be calculated will be subject to issues such as a lack of control or reduced negotiability or poor marketability that the shareholding offers. Generally, the smaller the interest, the less bargaining powers available to the minority shareholder and transfers could even be refused in particular circumstances.

Minority shareholders in a small private company can effectively be viewed as being at the mercy of the controlling shareholder(s) in respect of such matters as the declaration of dividends and certain voting rights where at least 50% plus one of the votes is required to pass certain resolutions at general meetings. Minority shareholders are also restricted in their ability to sell or transfer shares or it could well be that there is no market for their shares at all.

Minority interest valuations are sometimes required due to the sale of shares under the Articles of Association which can be voluntary or in some cases forced, such as in shareholder disputes and may even include divorce situations. It is generally viewed that a minority interest is often worth considerably less than the pro-rata value of a company as a whole entity due to the value that is placed upon control. However, what is an appropriate discount for a minority interest in a private company will very much depend on the individual circumstances of the minority shareholder(s) and the company. Each situation will be different. It is important to take into account the fact that there are no firm hard and fast rules to the determination of the level of discount applicable to a minority shareholding. The discount will be very much determined by the specific circumstances of each case. However, the level of discount should be seen to be fair and reasonable.

Where the interest held is under 100%, discount factors will need to be taken into account. The position of valuing such discounts can be quite a challenge as they will invariably involve an element of subjective judgment. When valuing a shareholding in a private non-marketable company that is less than a 100% interest, it is usually appropriate for that interest to be discounted from the full pro-rata value. The level of the discount will depend on various factors, including the size of the interest, the spread of other shareholdings, the degree to which the shareholding is locked in and the pattern of dividend payments, both historic and moving forward. There are in fact, a range of other factors that need to be taken into account in determining the discount and these include such issues as the size of the block of shares held, the right to appoint directors, legal issues including voting rights, ability to influence the business and key economic considerations such as the financial state of the business.

Whilst there is no firm rule to the level of discount calculated, the following range of discounts has been considered as being reasonable in valuing minority interests. However, it is important to remember that one size does not fit all and no two valuation situations are similar, so the circumstances of each case must be considered fully before determining the level of any discounting:-

Over 50% interest	Discount of 5% to 10%
50% interest	Discount of 15% to 25%
26% to 49% interest	Discount of 30% to 40%
10% to 25% interest	Discount of 45% to 50%
Under 10% interest	Discount of 60% to 75%

Discounts for size may be minimal for a shareholding in excess of 75% and can be small for interests of 50% plus 1 up to 75% which reflects the fact that at 50% plus 1 and above, such an interest actually controls the company and an interest of 75% and above can pass special resolutions.

The discount for a 50% interest may well depend on the nature of the other interests in the company. For example, if there are two shareholders each with a 50% interest, then a large discount of maybe as much as 25% may be considered appropriate. Where one 50% interest is the single largest interest and the balance of the interest is held by several small shareholdings, then the discount could be lower at say 15%. In a situation where the 50% interest may have a casting vote, then this would give the shareholder a majority interest and ought to be discounted taking this positive situation into account.

In some situations, a minority interest may have a strategic value, then, in this case such an interest may have significantly more value. Where the value of a minority interest is for the purposes of a dispute or perhaps a divorce, then the discounts stated above may be considered to be on the high side. However, if the governing documents of the company dictate how the shares are to be valued, then these must be adhered to. It is also important any shareholder agreement should be taken into account.

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Stirling Business Solutions Ltd provides an independent valuation service, where business valuations are undertaken by an independent FCCA, FCA or ACA fully qualified Accountant. To request a business valuation report, contact details are:-

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