Discount for Lack of Control

Introduction

When performing a business valuation, several discounts should be considered that may need to be applied to a business's value. Below we will explain what a discount for lack of control means and when an investor, valuer or other user of valuation information, should be aware of it.

Discount for Lack Of Control

The DLOC is a discount applied to the value of a company when an investor purchases or holds a minority amount of the total amount of shares issued and hence lacks decision-making power. This is in comparison to a majority shareholder that benefits from the ability to control decisions within the company and thus has an associated control premium attached to their majority shareholding.

Purpose

The purpose of the discount is to establish the value of the minority interest, due to the lack of control and decision-making ability. Often the company is valued as a whole, then a discount will be applied relative to the company's whole value, for the minority interest. If there are only 2 shareholders, the remaining value is attributable to the majority shareholder and captures their control premium.

Example

Engineering LTD has two shareholders Jack and Paul. The company has been valued in total at $100.000. Paul seeks to sell his percentage of ownership that covers 30% of the total amount of shares (having a minority control interest, while Jack has the majority controlling interest). An investor is interested in valuing Paul’s ownership, including a discount for lack of control for holding the minority of the total amount of shares.

Shareholders	Company	Total Amount of Shares	Share Price	Percentage of Shares	Ownership Amount	Total Value
Jack	Engineering LTD	1,000	$ 100	70%	$ 70,000	$ 100,000
Paul				30%	$ 30,000	

Table		
Control Premium		30%
DLOC		23%
Ownership Amount X DLOC	-$	6,923
Minority, Marketable Value	$	23,077

$$DLOC = 1 - \frac{1}{1 + \text{control premium}}$$

$$\text{total discount} = 1 - [(1 - DLOC)(1 - DLOM)]$$

Note: For this example, we assumed a 30% control premium. This is established by analysing the control premiums paid from acquisitions of public companies, compared with noncontrolling interests. The DLOC was then calculated using the formula above, for a total of 23%. This is an absolute discount of $6,923 and the total minority value is $23,077.

Conclusion

Discount for Lack of Control should be applied to shareholdings of investors that hold a minority interest of a company. It is important to use relative statistics (historical control premiums) in developing a discount for lack of control and if it is applicable to your business's valuation.

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