Letters to the editor response to “A Call for Industry Specialization: An Academic Perspective on the Importance of Qualitative Research”

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Abstract:
The Value Examiner (July/August, 2021): The following letter is in response to “A Call for Industry Specialization: An Academic Perspective on the Importance of Qualitative Research.”

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VALUATION

Letters to the Editor

The following letter is in response to "A Call for Industry Specialization: An Academic Perspective on the Importance of Qualitative Research," by Kipp A. Krukowski, PhD, CVA, ASA (retired), and Lawrence Justin White, Jr., PhD, CVA, which appeared in the May/June 2021 issue of The Value Examiner. *The authors' response follows.*

In Defense of Generalists

To the Editor:

I am not sure of the intended audience for Messrs. Krukowski and White's article. The introduction states that "the purpose of this article is to highlight the advantages of specialization in business valuation." It provides some examples and ends with a challenge to the valuation industry to "collectively develop a standard for when a specialist is needed."

The authors' discussion of combining qualitative and quantitative information as a basis for concluding as to a company's or an interest's value is informative. A well-written valuation report will tell a story and lead the reader to agree with the analyst's conclusion. I have read many valuation reports that are nothing more than a dump of information obtained from various sources to check the boxes of the report writing standards. There is no explanation as to how this information relates to the conclusion of value. This type of report is sometimes generated from a service that allows the analyst to enter the numbers and push a button. If these analysts are the audience for the article, then the authors provide good guidance. Every business exists in an industry and an overall economic environment. The numbers do not tell the whole story.

However, I would be the first to stand up against any effort by the valuation industry to develop a standard for when a specialist is needed. The authors do not explain how this would be accomplished or what industries would require a specialist. The multitude of available credentials is already confusing to the public. Would lack of a "specialist" credential preclude an analyst from accepting an engagement? As the authors note, professional ethics standards require an analyst to consider whether he or she has the expertise to accept an engagement or can gain that expertise. How is one to become a specialist in an industry unless one first performs a valuation in that industry? When accepting an engagement in an unfamiliar industry, most analysts consult other analysts with specific industry experience. It is easy to find such experts, as they have written books and articles and presented CPE webinars. In my experience, they are willing to provide guidance or even review a report.

The authors refer to sources like First Research, IBISWorld, and the Business Reference Guide. They seem to imply that these sources are not sufficient; that the analyst needs "industry experience and specialization to enable the practitioner to dissect answers to industry-specific questions." The examples presented in the article do not bolster their argument for specialization. I compared information provided in the First Research reports for each industry example to the "unique business characteristics" presented in the article. The First Research reports include all the points raised in the examples. Information from these reports, combined with general business knowledge, can provide the analyst with the ability to challenge assumptions provided by the company and advisors in these industries. I cite First Research here because it is the source I use. Their reports provide a list of interview questions as well as industry background data, financial metrics, and references for further research. IBISWorld is similar. The Business Reference Guide is helpful for Main Street businesses and franchises but it is not as detailed as the other two and should not be relied upon as a single source of industry research.

For bars and restaurants, First Research reports:

> To open a bar or nightclub, a location must have proper zoning from local government. Community resistance to new bars and nightclubs is common due to anticipated problems with drunken patrons, noise, and

> parking issues. Companies may need both a standard liquor license to sell alcohol, and a pouring license to serve alcohol for consumption on-premise. Multiple types of liquor licenses dictate what types of alcohol a bar can sell, and the availability and cost of licenses can vary greatly. Licenses to serve beer and wine tend to be less expensive than to serve hard liquor. Some communities issue a limited number of liquor licenses, and companies may have to buy one from an existing licensee. Local municipalities may also require an entertainment license to provide TV programming, live music, or dancing. Local laws typically dictate days and hours of operation.[1]

For Manufacturing—Machine Shops, First Research reports:

> How many shops does the company operate? Very few companies have more than one operation. What types of machinery does the company have? Drill presses, lathes, milling machines, and machining centers are typical, and come in many varieties. What sorts of work does the company specialize in? Many shops own machinery with special applications. How large a geographical area does the company serve? Because of the need for close technical consultation with customers, the geographical area served is usually small unless the company provides highly specialized work. What end-use industries are major customers?[2]

For Amusement and Theme Parks, First Research reports:

> Amusement park operators offer various types of rides such as roller coasters, tower and "kiddie" rides, and water slides...Rides, shows, shops, and food outlets are generally intermingled to encourage cross selling. A typical park is spread over 100 to 300 acres; flagship parks that include hotels and multiple attractions such as water parks and safaris may be several hundred to thousands of acres. Many parks operate only for a portion of the year because of weather. Parks open year-round may also operate hotels, stores, condos, golf courses, or other facilities in the vicinity...How much land is owned at each site? Is there room for expansion? A large park may sit on 100 to 300 acres; regional parks that include multiple attractions such as water parks and safaris may have a thousand acres or more.[3]

Information from the above-mentioned sources—coupled with common sense, overall business knowledge, good financial information, and open access to management—is sufficient to allow a "generalist" to provide a credible valuation in these industries. Had the authors used examples like hospitals, banks, or oil and gas drilling companies, they might have made a stronger argument. Those of us holding business valuation credentials are professionals and should have the leeway to decide whether we are competent to accept an engagement. Specialization happens organically as an analyst becomes known in an industry by performing valuations, writing, making presentations, and posting on social media, and through word of mouth. There is no need to add more credential letters to the existing alphabet soup.

— Judith H. O'Dell, CPA, CVA

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1 First Research, *Bars and Nightclubs,* industry profile (Dun & Bradstreet, March 29, 2021).
2 First Research, *Machine Shops,* industry profile (Dun & Bradstreet, April 26, 2021).
3 First Research, *Amusement Parks and Arcades*, industry profile (Dun & Bradstreet, May 24, 2021).

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Authors' Response

To the Editor:
We appreciate the opportunity to respond to the letter to the editor, "In Defense of Generalists," submitted by Ms. O'Dell. Her response to the article highlights the importance of continuing the dialogue on the topic, as there are differing viewpoints among practitioners. We also appreciate that Ms. O'Dell agrees with our central argument that "numbers do not tell the whole story," and that qualitative analysis enhances a business valuation.

As we state in our opening paragraph, "We do not attempt to identify which industries or situations warrant the use of a specialist, or who should make that determination," as this was not the intent of our article. To be clear, our article does not propose a solution that would involve a specialist to be credentialed, as implied by the letter to the editor. We agree with Ms. O'Dell that "the multitude of available credentials is already confusing to the public," and though we are not recommending a solution in our article, a credential is not one we would endorse—unless the industry provides further evidence that this would be the best solution. Our article states that we are challenging the valuation industry to collectively develop a standard for when a specialist is needed.

While we would like to believe most analysts consult other analysts for guidance, we believe many readers have reviewed reports where it appears that is not the case. And though we agree that in many cases experts are available and willing to provide guidance, that does not necessarily mean such practitioners seek such guidance. There are many reasons practitioners fail to consult others on business valuation projects, including tight turnaround times, low-margin projects, lack of a professional network, and fear of being viewed as incompetent.

As Ms. O'Dell points out, our article does refer to sources such as First Research, IBISWorld, and the Business Reference Guide for secondary research. We are actually strong supporters of using these sources to help in understanding industries and to assist in developing questions for business owners and their representatives. While we list questions in our three industry examples, our point is that it is not just the questions that matter, but understanding the response to the questions, and then potentially asking follow-on questions to fully understand the response and the corresponding implications. Similar to the approach used by successful litigators, a series of questions are asked to clearly understand the response and true implications.

For example, selecting one industry to illustrate, we can look at an issue that is plaguing some automotive manufacturers today—semiconductors. Semiconductors have affected production, which has a direct effect on sales, profitability, and, ultimately, valuation. Asking a manufacturer being valued whether the company has high supplier concentration is not enough. The manufacturer may respond that "no supplier makes up a significant percentage of the components we purchase." But what if a small percentage of a vehicle consists of a single component that comes from one supplier—a question that may fall off the radar of many generalists. It is essential to ask whether any components are single-sourced and whether production is dependent on those components. One part of an automobile can, and has, shut down production. How can this risk be mitigated? Can the part be dual-sourced? Is there intellectual property preventing two sources? What if there is a fire at the plant where the part is made? Can production be shifted to another plant or are there unique toolings or molds that exist only at this plant or can be run only on specific machines? How much of the critical part is maintained in inventory? If new tooling needs to be manufactured, what is the lead time to produce it? How quickly can parts be made on the tooling afterwards, assuming that they need to go through the Production Part Approval Process (PPAP) and signed off on by the supplier quality engineer?

The list of questions goes on, and it is highly likely they will not be listed in the secondary sources. (Note: One author was a buyer in global purchasing in the automotive industry and had to deal with such issues when a fire at a single-source supplier destroyed tooling that existed only at that plant.) While we agree that the listed secondary sources are useful in developing basic questions, the key is to understand the implications of the response and know what to ask next.

We agree that "the above-mentioned sources coupled with common sense, overall business knowledge, good financial information, and open access to management" are important, but we submit that these factors are not always sufficient to provide a credible valuation. We believe that identifying the situations in which they are, or are not, sufficient warrants a continued dialogue among those in the valuation profession.

— Kipp A. Krukowski, PhD, CVA, ASA (retired), and Lawrence Justin White, Jr., PhD, CVA VE

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