

VALUATION

A Call for Industry Specialization:  
An Academic Perspective  
on the Importance of Qualitative Research

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*Methods can be seen as a central support for the trustworthiness and significance of claims made in scholarly work.<sup>1</sup>*

The purpose of this article is to highlight the advantages of specialization in business valuation. Industry specialists have the ability to craft the most insightful questions about a subject company and to understand the corresponding impact on value. We do not attempt to identify which industries or situations warrant the use of a specialist, or who should make that determination. Rather, we challenge the valuation industry to collectively develop a standard for when a specialist is needed.

By adopting an academic perspective on industry specialization, it may appear that we are criticizing the business valuation profession. However, as both academics and valuation practitioners, we understand that the methodologies selected can alter the story being delivered through our value conclusions. In academia, arguments are made and supported through a conversational exchange between theoretical and empirical explanations. So, the intent of this article is not to criticize, but to show how academic methodology adds value to our industry by explaining the importance of connecting qualitative and quantitative analysis through mixed methods triangulation.<sup>2</sup>

In *Designing Research for Publication*, the author explains that research methods provide the “evidence to produce the claims you feel are interesting and significant” and that “the way you collect and use evidence is also taken as a general indication of your trustworthiness as a scholar.”<sup>3</sup> In academia, methodologies are commonly divided into quantitative and qualitative research. Quantitative methods include those in which data is counted, measured, and analyzed across a number of observations. In business valuation, the data analysis that we complete in analyzing similar companies and past transactions with a focus on the numbers, is our quantitative analysis. Qualitative methods examine the “qualities” or characteristics of empirical evidence. In other words, further insights are gained from the numbers by uncovering details within the numbers. In both academia and practice, these insights are typically gleaned from interviewing subjects to understand context.

Both quantitative and qualitative research methods have their strengths and weaknesses (see Table 1). Studies that incorporate both methodologies are considered mixed methods. By using mixed methods, practitioners and researchers alike leverage the strengths of both quantitative and qualitative methods while mitigating their weaknesses. More importantly, users of mixed method practices recognize that all data has both quantitative and qualitative properties.<sup>4</sup>

1 Anne Sigismund Huff, *Designing Research for Publication* (Los Angeles: Sage Publications, 2008), 182.

2 Mixed methods triangulation refers to “research designs that extensively integrate both fieldwork and survey research,” including both qualitative and quantitative research. See Todd D. Jick, “Mixing qualitative and quantitative methods: Triangulation in action,” *Administrative Science Quarterly* 24, no. 4 (December 1979): 602–611.

3 Huff, *Designing Research for Publication*, 182.

4 Anthony P.M. Coxon, “Integrating Qualitative and Quantitative Data: What Does the User Need?” *Forum Qualitative Sozialforschung* 6, no. 2 (May 2005).

**Table 1: Comparison of Quantitative and Qualitative Methods<sup>5</sup>**

Quantitative Research Methods	Qualitative Research Methods
<p>Goals:</p> <ul style="list-style-type: none"> <li>• Inference (from sample to population)</li> <li>• Prediction (past to future)</li> <li>• Description (patterns in large data sets)</li> <li>• Hypothesis</li> <li>• Testing</li> <li>• Generalization</li> </ul>	<p>Goals:</p> <ul style="list-style-type: none"> <li>• Explanation (how or why things happen)</li> <li>• Detail (adding detail and depth to abstract theoretical explanation)</li> <li>• Empathy or interpretation (connecting abstract ideas to human experience)</li> <li>• Exploration (seeking unacknowledged antecedents, unanticipated consequences)</li> </ul>
<p>Ideals:</p> <ul style="list-style-type: none"> <li>• Objectivity</li> <li>• Neutrality</li> <li>• Replicable procedures</li> <li>• Discovery of causal laws</li> <li>• Abstraction</li> <li>• Precision</li> <li>• Rigor</li> <li>• Verifiability</li> </ul>	<p>Ideals:</p> <ul style="list-style-type: none"> <li>• Rich description</li> <li>• Meaning</li> <li>• Qualified arguments</li> <li>• Context-specific descriptions</li> <li>• Reflection</li> <li>• Connection</li> </ul>
<p>Critique:</p> <ul style="list-style-type: none"> <li>• Oversimplification</li> <li>• Unacknowledged subjectivity of definitions and procedures</li> </ul>	<p>Critique:</p> <ul style="list-style-type: none"> <li>• Subjectivity</li> <li>• Sloppy observations masquerading as interpretation</li> <li>• Intrusion of the researcher in all representations</li> </ul>

Too often, we see business valuation practitioners rely heavily on quantitative methods in reaching the value conclusion with minimal concern about context. Some academics also fall into this trap. Academic researchers often exclude qualitative findings even when readily available.<sup>6</sup> In purely quantitative studies, academics often explain the context of findings within their journal articles. Similarly, some business valuation reports seem highly mechanical while still including a company background section describing some of the characteristics of the company that were reportedly considered. While this is useful, it only provides part of the story.

We posit that both academics and practitioners avoid mixing qualitative findings for fear it may muddy the waters. However, as business valuation practitioners, the waters are muddied when multiple valuation approaches are used to formulate conclusions. Although using multiple quantitative or “within method” triangulation increases confidence in results,<sup>7</sup> “across method” (mixed method) triangulation is more robust.<sup>8</sup>

<sup>5</sup> Source: Huff, *Designing Research for Publication*, 184–185, Table 9.1.

<sup>6</sup> Alan Bryman, “Barriers to integrating quantitative and qualitative research,” *Journal of Mixed Methods Research* 1, no. 1 (2007): 8–22.

<sup>7</sup> Uwe Flick, “Triangulation in qualitative research,” in *A Companion to Qualitative Research*, ed. Uwe Flick, Ernst von Kardoff, and Ines Steinke (London: Sage Publications, 2004), 178–183.

<sup>8</sup> Abir K. Bekhet and Jaclene A. Zauszniewski, “Methodological triangulation: An approach to understanding data,” *Nurse Researcher* 20, no. 2 (November 2012): 40–43.

**When comparing firms with similar revenues, earnings, and growth, the practitioner may believe that variance within an industry is attributable to value drivers and management, but there may be more to the story.**

As such, having qualitative research insight from either the client or the business valuation practitioner's perspective will ultimately lead to better conclusions.

### **The Story Behind the Numbers**

In most engagements, business valuation practitioners consider all three valuation approaches—asset, income, and market—but may discount or discard approaches that are not appropriate for the subject business. The market approach, for example, is often used to value companies by developing multiples from a data set of comparable sales. Most experienced practitioners know that not all businesses are the same and that there may be more to the story behind the transactional details shown in data. True, some generalizations and patterns may be captured when developing multiples across a number of similar businesses (and there may be some value to analyzing data taking an aggregate approach), but one should not view all businesses within a specific industry as the same. The income approach presents similar issues. For example, company-specific characteristics may moderate or intensify the effects of industry risk.<sup>9</sup> The practitioner may also fall into the trap of assuming homogeneity among similar companies within an industry.

When comparing firms with similar revenues, earnings, and growth, the practitioner may believe that variance within an industry is attributable to value drivers and management, but there may be more to the story.<sup>10</sup> This is why most business valuation practitioners do not merely ask for the financial statements; they also conduct discussions or interviews with management (often including professional advisors, such as their accountants) to obtain better insight into the company, beyond the numbers. Practitioners can refer to secondary research sources, such as First Research, IBISWorld, and the Business Reference Guide, for guidance in developing initial interview questions.

Going through these additional steps is good business practice, but the interview process often falls short due to a generalist approach. In small companies, business owners and accountants label (or record) some expenditures differently. The categorization of these expenses may lead to different interpretations of financial results. Yes, generally accepted accounting principles attempt to alleviate this issue. However, boundaries may be pushed by aggressive accountants who categorize (or charge) certain expenses differently for tax purposes. This insight is often gained through communication with the subject company's management and its advisors to understand the assumptions and categorizations used in the financial statements. Both business valuation generalists and specialists face such situations. The call for specialization focuses on examining the differences between specific businesses in an industry.

From a generalist business valuation perspective, many of the adjustments made to financial statements are at a high level. For example, business valuation practitioners frequently make adjustments to remove owners' personal expenses, account for non-

9 Dennis R. Balch, Keith F. Sellers, and Santanu Borah, "20 Questions: Getting to an Informed Assessment of Industry Risk," *The Value Examiner* (May/June 2011): 22–31.

10 Gary R. Trugman, *Understanding Business Valuation: A Practical Guide to Valuing Small to Medium Sized Businesses*, 4th ed. (New York: John Wiley & Sons, 2016), 248.

cash expenses—such as depreciation, amortization, and taxes—and to reflect fair-market compensation, revenue recognition, and the capitalization of operating leases.<sup>11</sup> But what about identifying patterns—or understanding (or challenging) assumptions provided by the company and advisors—when comparing a subject company to other businesses in its industry? While the secondary research sources mentioned above are useful in developing some industry-targeted questions, often only industry experience and specialization will enable the practitioner to dissect the answers.

### Three Industry Examples

To illustrate the value of specialization, we examine three industries, focusing on several areas in which adjustments are typically made as well as some of the unique business

characteristics that may lead to a higher or lower valuation. (We will ignore some of the characteristics that come into play across all businesses, such as history, key employees, and market demand.)

### Bars and Restaurants

Bars and restaurants possess a number of unique characteristics that may affect value. For example, if the municipality where an establishment is located limits the number of liquor licenses, this may add a premium to the value of the business. Location may play an important role in the success of the business, but it may also limit potential growth. Foot traffic and parking availability may have significant implications. The number of seats in a restaurant may limit the amount of throughput. In addition, a drive-through window or the ease of picking up to-go orders is important for many businesses affected by COVID-19 constraints. The business valuation practitioner should examine inventory shrinkage and determine whether the

11 Kristian D. Allee, Devon Erickson, Adam M. Esplin, and Teri Lombardi Yohn, "The Characteristics, Valuation Methods, and Information Use of Valuation Specialists," *Accounting Horizons* 34, no. 3 (2020): 23–38.



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**Location may play an important role in the success of the business, but it may also limit potential growth.**

amount should be adjusted for unique situations that may have occurred under management. Local competition may either increase or decrease value because customers typically are within close proximity to the business and area businesses will share the market. In addition, many bars and restaurants are cash businesses, so there may be issues of unreported income to consider.

#### **Manufacturing—Machine Shops**

An important characteristic that may differentiate one machine shop from another is whether it has a product or is classified as a job shop. Having a product often leads to more consistent customers and revenue, whereas a job shop's revenues may fluctuate due to the way projects are sourced from customers. The practitioner should analyze inventory closely, segregating between raw materials, work-in-process, and finished goods, and taking into account which items have production value and which are obsolete. Equipment age, condition, and capacity will factor into production level capabilities as well as the marketability of the company. Product-specific questions should focus on patents (and their remaining life) and proprietary manufacturing methods. Global competition, customer and supply contracts, and supply chain issues are all highly relevant to a machine shop's future success.

#### **Amusement and Theme Parks**

All amusement facility owners strive to provide their patrons with an escape from their daily routines, but there are nuanced strategies owners may execute in an attempt to meet patron expectations as well as their own objectives. The attraction type or mix plays a vital role in an amusement park's revenue trends. Dry parks—facilities without water rides or attractions—typically experience sharp increases in revenue when they install a new major attraction. However, that growth is often met with even sharper revenue declines in subsequent years, as the “been there done that” mindset impacts potential returning consumers. In contrast, wet parks—those that feature water rides—usually match dry park revenue increases after an influx of capital, but do not experience the same revenue drop-off in subsequent years. The “been there done that” mindset has less impact on wet parks; patrons are more concerned about cooling off than they are with the novelty of the attraction. Land may also have a significant impact on the value of an amusement park. Although land value is not part of the business valuation, access to surrounding undeveloped land impacts growth. Landlocked facilities that have maximized their attraction footprint will only achieve small incremental revenue growth, whereas facilities with access to undeveloped land (and the supporting capital to fund expansion) can maintain the industry's strongest revenue growth benchmarks.

#### **Conclusion**

The characteristics described for the three industry examples are not all-inclusive, but they provide a sense of how industries and specific businesses can be truly unique. From a technical valuation perspective, accredited valuation practitioners have the skillsets to prepare business valuation reports for all three business types. They have the ability to provide questionnaires, to interview management to gain an understanding of a company's specific operations, and to make financial statement adjustments for inventory, interest, depreciation, and so on.

As the examples illustrate, evaluating companies in certain industries requires the business valuation practitioner to consider unique characteristics and ask targeted questions. Industry specialization can help practitioners ask the right questions and interpret the answers to understand their material effect on a company's financial performance. A practitioner with specialization will know how to peel the onion and ask follow-on questions to understand specific nuances of a subject company that may affect the value conclusion.

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### Evaluating companies in certain industries requires the business valuation practitioner to consider unique characteristics and ask targeted questions.

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External advisors play an important role in helping companies make financial and strategic decisions by providing industry-specific, specialized support.<sup>12</sup> While the quantitative component of the business valuation is important, without the context that comes from thorough qualitative research, the trustworthiness of the value conclusion is significantly weakened, reducing the positive impact that our work can have on decision-making in an engagement. As a profession, we know that professional ethics standards require consideration of whether one has the competence to take on an assignment. A specialist has the expertise to apply robust qualitative analysis to the quantitative analysis for true mixed method triangulation within a business valuation project. **VE**



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<sup>12</sup> James R. Lowry and Joseph D. Chapman, "Critical business problems and advisors," *Journal of Small Business Strategy* 11, no. 1 (2000): 64–73.