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Are Free Business Valuations Too Expensive?



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We often get approached by business owners asking us to do a free valuation for their business. And they tell us that other business brokers offer valuations for free. Let me tell you, however, why you, as a business owner, should be wary when you receive a “free valuation” offer from a business broker.

Let's first examine the use of the word “free,” which often misleads or deceives customers, especially if it's used as a marketing strategy. “Free” always comes with a catch. Let's look at the following examples:

- Timeshare companies offer free dinners and shows (*if* you attend their sales pitch)
- Restaurants often give free samples (*however*, they expect you to purchase something and you will get booted out if you do not)
- Many online businesses offer free trials (*but* most require a credit card and make it notoriously difficult to cancel)
- Fat-free and calorie-free claims could just be *a misleading label*.
- “Buy one, get one free” is *usually a bad deal*
- Free download is *not actually “free”*

A business that offers something for nothing is usually expecting something in return. Why else would they make such an offer?

The same holds true with a business broker offering a free business valuation. The question is — what are they expecting in return? The answer is simple, yet unknown to many business owners: a long-term commitment with an enormous back-end commission. Notice, however, that the relationship on which this long-term commitment is based has started off with a lure. You have been duped. You have been fooled ... because you wanted something for free.

What's the Catch with Free Valuations?

Brokers carefully prepare “free” valuations to ensure they meet your expectations of value (not those of the buyers'). In other words, they tend to artificially inflate the value of your business so they can obtain you as a client.

In fact, prior to starting Morgan & Westfield, I worked at one of the top offices (I didn't stay there long, though) in the U.S. where I heard brokers openly discuss how “honest” they could be with prospective clients that they did not want to lose. I witnessed brokers playing with the valuation formulas to tweak the results to *please* potential clients. They openly said things like, “No, we can't tell them *that*,” or “Why don't you try wiggling that formula around a little bit?”

Later on, of course, you will be told that your business is not worth what they initially said because of something you failed to disclose. But you are already committed at that point, and you have invested so much time and energy that it does not make sense to wait until the contract expires for you to continue the process. Many brokers include a cancellation clause in their agreement forms indicating that they should receive their commission in full if you attempt to cancel the agreement.

Artificially inflating the value of your business sets up false expectations with you (you expect to sell your business for more than it is actually worth) and starts the relationship off on the wrong foot.

So, Why Do Business Brokers Offer Free Valuations?

First, it is very easy to obtain clients if you offer a free appraisal. There are enough business owners who are willing to be duped by something that is free. Secondly, the business brokerage industry has a very low barrier to entry.

The question now is — are you willing to hand over one of your most valuable assets to someone who is willing to dupe you into a relationship based on a false pretense? I personally and firmly believe that a long-term relationship like this should be based on a solid foundation of trust, honesty and transparency.

Now, don't get me wrong. When I started in the business, I did the same thing. I offered my advice for free. Why not? I didn't have much experience, so my advice at the time might not have been worth that much. Through the years, I've learned, however, that the more knowledgeable and experienced the broker is, the less likely he or she will offer anything for free. And that is because you are guaranteed to receive sound professional advice grounded in years of experience from hundreds of deals closed.

Are free business appraisals common in the middle-market? No. They are very rare. The overwhelming majority of M&A advisors selling businesses valued between \$5 million and \$50 million do not offer any form of free valuation. In our random survey of 44 CPAs, appraisers and M&A intermediaries, only one offered a free valuation to prospective clients. The rest charged between \$2,000 and \$40,000 for a business valuation.

How You Can Avoid the 'Free Valuation' Trap

What can you do to avoid this "free valuation" trap? Should you avoid anything that professional advisors offer for free? No, not necessarily. You should, however, be wary when you see a professional aggressively advertising a free service, especially if that individual also works exclusively on commission.

Here are your options:

- 1. Hire a business appraiser for a verbal opinion of value.** This is a good option, but this is only a wise course of action if the appraiser has actual experience selling businesses. Otherwise, the appraiser's knowledge is largely theoretical. Most business appraisers prepare business valuations for legal purposes and have no experience selling companies.
- 2. Hire a CPA to give you a verbal opinion of value.** Again, this is a good idea, but only if the CPA has actual deal experience. Otherwise, as pointed out above, the advice you receive may be largely theoretical. When valuing a company, it is critical to have your fingers on the pulse of the market and to understand the subtle nuances that will have a large impact on the value of a company. Most professionals without any actual M&A experience lack this fundamental practical expertise. And you need practical expertise here, not theoretical.
- 3. Hire an actual deal-maker, including a business broker, an investment banker or an M&A advisor, for an opinion of value.** Because of the deal-maker's real-world experiences, this option is far superior to receiving a free valuation. You can also hire a second individual to perform a sanity check. It is common for clients to approach us for a verbal opinion of value either because they are considering a sale in the future or they have a potential deal in their hands.

Remember that although valuations are being offered to you for free, you will still have to pay for it in one way or another. A free service always comes with a price — and it's often more expensive than the paid, transparent service.

i This article was written for Business 2 Community by Jacob Orosz.

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