



Examining the Discount-Premium Puzzle of Private Company Valuation: The Case of China

Louis T. W. Cheng,^a Simon Mak^b

a. School of Accounting and Finance, Hong Kong Polytechnic University, Hung Hom, Hong Kong

b. Ascent Partners, Hong Kong Trade Centre, Hong-Kong

Abstract: In this study, we argue that private M&A deals with a premium are not just an outlier problem, but an interesting empirical research issue worthy of further investigation. We believe that in a less developed stock market like China where listing opportunity is limited due to government regulation and intervention, private deals with a premium can be a more common phenomenon. Furthermore, a strong growth element in Chinese private transactions may increase the probability of receiving a valuation premium as well. Another contribution of our study is local relevance. A comprehensive study of private company valuation using local China data provides a useful reference for industry professionals and regulators to evaluate private transactions. A significant portion of our sample exhibits valuation premiums (45% using one-peer matching and 38% with a three-peer matching), indicating that non-liquidity factors dominate a liquidity discount in these private target valuations. Our analysis shows that premium deals and discount deals have their own separate relationships with firm size, deal size, and percentage acquired. Therefore, we conclude that benchmarking private target value using public peers must consider these firm and deal characteristics.

Keywords: Private Company Value of Firms, China, Discount Premium Puzzle; Asset Pricing

JEL: G21, G32, G34, F39

1. Introduction

The empirical issue of private company valuation should be a topic of interest for both academics and practitioners. The issue of finding a relevant approach and possible benchmarks to determine private firm value has become an increasingly important issue in China. The literature concludes that there is a private valuation discount due to lack of marketability or liquidity. In particular, Officer (2007) reports that nearly 70% of private targets are acquired at a