BUSINESS VALUATION CAPSULE: HIGHEST AND BEST USE

One of the silent assumptions in business valuation is the principles of best and highest use. The highest and best use of a non-financial asset is central to the valuation premise used to measure the fair value of a business entity or an asset. One inherent assumption that business valuers make is estimating the fair market value of a business entity is the expectation that the business operators will combine the assets and resources in the best way to yield the highest value to market participants. The principle of the highest and best use also applies to non-financial assets which generate value to market participants on a stand-alone basis. If the highest and best use of the asset is determined based on its usage on a stand-alone basis, the fair value of the asset is the price that would be received in a current transaction to sell the asset to market participants to use the asset on a stand-alone basis. There are also instances where even though an asset or a business will yield the highest value on a stand-alone bases, a much higher value can be achieved when the asset is combined with other assets or a business. To the business valuer, the best use of combining assets and resources on future economic benefits is considered in determining future expectations from the asset or business. Based on the principle of best use, when a stand-alone asset can generate most value in combination with other assets, the business valuer assumes that the market participants already have the complementary assets required for the asset to be put to the highest and best use.

Thus, the fair value measurement of a business or a non-financial asset assumes that the highest and best use of the asset is to use it as a stand alone or in combination with other assets and liabilities. The highest and best use therefore informs the future economic benefits that the asset or business unit can generate and the associated fair market value.