

AGREE OR DISAGREE? ON THE ROLE OF NEGOTIATIONS FOR THE VALUATION OF BUSINESS ENTERPRISES

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ABSTRACT: In the division of labor, economizing valuations require an appraisal of the structure of market prices of goods beforehand. Yet, investment decisions concerning the purchase of an entire business enterprise, for example, necessitate considerations beyond appraisal. An economizing valuation of businesses must be based upon both appraisal and a genuine investment appraisal which provides the valuing person with the marginal price he can barely accept. However, even though the computation of this marginal price is a necessary step towards an economizing investment decision, it is still not sufficient. In case of a company purchase, the price to be paid is unknown beforehand. Therefore, an economizing valuation of firms not only requires both appraisal and investment appraisal but also a negotiation of the final price to be paid.

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Because the corresponding negotiation process must be characterized as a *terra incognita* in Austrian economics, this paper investigates in depth the negotiation between the involved parties as the final step towards their economizing valuations and discusses purposive negotiation tactics.

KEYWORDS: value of the firm, investment appraisal, negotiation, value theory, subjectivism, purpose-orientation, Austrian school, neoclassicism

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1. INTRODUCTION

In an autistic economy, valuation alone is a sufficient condition for economizing decisions (Mises, 1998 [1949], p. 329). In the market economy, however, things look different. In the division of labor, valuation needs to be based upon appraisement to result in economizing decisions (Mises, 1998 [1949], p. 329). While this insight holds true for each and every good to be valued, in the case of financial investment decisions, and particularly concerning the purchase of an entire business enterprise or a substantial share package, acting man's final valuation must be based upon both appraisement and investment appraisal (Herbener and Rapp, 2016, pp. 10–11). Moreover, contrary to the typical purchase of a consumer good, the asking price of a business enterprise is *unknown* beforehand. In cases of particular investment decisions, therefore, valuing persons need to engage in a negotiation about the price to be paid (Matschke, Brösel, and Matschke, 2010, p. 6). Apart from appraisement and investment appraisal, this negotiation is the last condition necessary for this person's final valuation. To date, the Austrian-informed literature lacks a comprehensive analysis of such negotiation process. This paper aims to fill this gap by thoroughly investigating what role negotiation plays for the valuation of, in particular, a business enterprise and how it can be operationalized purposefully.

In order to do so, the paper is structured as follows: In section 2, we will illustrate the requirements for economizing decisions in different economic settings and for different goods. Section 3 will serve to review the status quo of Austrian theorizing on the issue of negotiating in isolated exchanges, to analyze the negotiation process in depth, to illustrate its relevance for valuation, and to discuss tactics for successful negotiations. Finally, section 4 will present the main conclusions which can be drawn from our analysis.

2. VALUATION, APPRAISEMENT, AND INVESTMENT APPRAISAL

Value is neither intrinsic nor objective in any sense; rather, *valuation* is an individual act of comparing and, eventually, ranking alternative courses of action in aiming at particular ends, which is necessarily subjective in nature (Menger, 2007, pp. 120–121). Valuation is reflected in a value scale which varies both from one person to another and—for the very same acting human—as time goes by (e.g., Hering, Toll, and Kirilova, 2015a, p. 24; Olbrich, Quill, and Rapp, 2015, p. 20; Rapp, Olbrich, and Venitz, 2017, p. 16), and is demonstrated through action (Mises, 1998 [1949], p. 95). As a consequence of these facts, Mises (1990, p. 56) rightly rejects the very idea of intrinsic value as “the naive conception of the layman.”¹

Mises (1998 [1949], p. 233) emphasizes that

[i]n order to conceive the market fully one is forced to study the action of hypothetical isolated individuals [...] [and in] studying interpersonal exchange one cannot avoid dealing with autistic exchange.

Mises (1998 [1949], p. 195) defines an autistic exchange as an “action [...] performed by an individual without any reference to cooperation with other individuals.”

In an *autistic economy*, then, economizing decisions are solely made through valuations without further ado, in particular without reference to money prices (e.g., Herbener and Rapp, 2016, p. 7). For example, if Robinson Crusoe had two options to choose from, say, to spend his time either (1) going fishing or (2) collecting berries to satisfy his hunger, he will make an economizing decision solely through preferring either (1) fishing to berry picking or (2) berry picking to fishing based upon his personal preferences.

In juxtaposing an autistic economy with society, Mises (1998 [1949], p. 195) asserts:

¹ On the flaws and fallacies inherent in the investment strategy “value investing”, which claims and is built upon the existence of intrinsic value, see Rapp, Olbrich, and Venitz (2017) as well as Rapp, Olbrich, and Venitz (2018).

Within society cooperation substitutes interpersonal or social exchange for autistic exchanges. Man gives to other men in order to receive from them. Mutuality emerges. Man serves in order to be served.

The exchange relation is the fundamental social relation. Interpersonal exchange of goods and services weaves the bond which unites men into society. The societal formula is: *do ut des*.

Necessarily, interpersonal exchange both requires and reveals exchange ratios for the goods and services subject to market transactions. In a monetary market economy allowing for indirect exchange through the application of a generally accepted medium of exchange, these ratios become evident in market-clearing money prices (Mises 1998 [1949], pp. 206, 218, 287, 324). While valuation is a prerequisite for economizing decisions in the *division of labor* too, it is not by itself sufficient. Rather, it must be supplemented by *appraisement*, which aims at the anticipation of the structure of such market prices or—in other words—at the assessment of the purchasing power of the money concerned (Mises 1998 [1949], p. 329). To rank order in value a particular amount of money, say \$1, against a particular good, say an apple, a consumer must know the alternative uses of the dollar, say the purchase of two oranges. Consequently, for decisions in the division of labor to be economizing they must not be based on valuation only; rather, valuation must be well-grounded on appraisement.

While combining both appraisement and valuation usually allows for economizing decisions of consumer goods, there are financial investments, in particular those concerning entire business enterprises, which require additional considerations (for this entire paragraph see Herbener and Rapp, 2016). In buying consumer goods, acting man aims at *non-financial* ends, for example, to satisfy hunger. A person can directly evaluate in his mind the contribution of a particular consumer good to reaching such ends. In contrast, financial investments are mostly undertaken to fulfill *financial* ends. How the possession of a firm, for example, contributes to reaching such ends cannot simply be assessed at first glance, that is, directly by one's mind without economic calculation. In this respect, Menger (2007, p. 255) emphasizes that the "value [of factories] can be determined only after a careful investigation of all the relevant circumstances." Therefore, acting man needs to apply a particular tool of economic

calculation as a decision method, which allows him to evaluate the degree to which the firm contributes to reaching his (financial) ends. Specifically, this tool is to be found in a genuine *investment appraisal*.² Its purpose is to provide the decision maker with the most important financial piece of information he needs for his economizing decision: the marginal price he can barely accept in a transaction without suffering an economic loss (fundamentally Matschke, 1975; further, e.g., Hering, 2014, pp. 5–6). This marginal price is highly individual data, determined by the (financial) ends a person aims at and the (financial) means available to him in reaching those ends. Following investment theory, which is rooted in early Austrian economics (Schmalenbach, 1919, p. 334; Schmalenbach, 1937, p. 27; Hering, 2014, pp. 27–28; Olbrich, Quill, and Rapp, 2015; Herbener and Rapp, 2016, pp. 12–13), it equals the present value of the individually predicted future earnings, discounted with the correct individual discount rate, that is, the internal rate of return of the best alternative use of funds which is derived from the person's consumption preference.³ In reflecting the present value of expected future earnings from a particular person's perspective, the marginal price manifests the contribution a firm, for example, is expected to make in reaching particular ends and, therefore, allows for an economizing ranking against the asking price.

However, in contrast to the regular purchase of a consumer good, for example, an apple in a grocery store, in cases of the acquisition or sale of a firm, the asking price is unknown beforehand. Consequently, a person cannot establish his final value scale beforehand. Therefore, to rank the business concerned against a certain amount of money and, eventually, to act accordingly requires a negotiation about that price beforehand.

² Note that the application of investment appraisal to compute the present value of the expected financial benefits of a particular course of action does not prohibit valuing man from complementing this financial analysis with considerations outside of the mere financial sphere. For the role of non-financial aspects in investment decisions and their impact on valuation, see Herbener and Rapp (2016, p. 11).

³ In this respect, Herbener (2011, p. 14) notes: "As a temporal being, man distinguishes between sooner and later. He can, therefore, judge the value of attaining an end sooner differently than attaining it later. Just as the principle of preference is implied by man's finitude, time preference is implied by his temporality."

3. NEGOTIATION AND ITS RELEVANCE FOR VALUATION

3.1 Catallactics and the Status Quo of Austrian Theorizing

Whately (1831, p. 6)—objecting to the formerly established term “political economy”—originally introduced the term “catallactics” to frame the sphere of economics and defined it as the “Science of *Exchanges*.”⁴ Following Whately’s (1831, p. 6) definition of man as “[a]n animal that makes exchanges,” catallactics, then, ultimately deals with exchanges conducted by acting man in the marketplace. As Mises (1998 [1949], p. 233) describes it:

[T]he task of this branch of knowledge [is] to investigate the market phenomena, that is, the determination of the mutual exchange ratios of the goods and services negotiated on markets, their origin in human action and their effects upon later action.

It was Mises who revived the term “catallactics” (Rowley, 1994, p. 289) integrating it into his broader analysis of human action, that is, praxeology (Mises, 1998 [1949], p. 233). Mises (1998 [1949], p. 3) concludes:

The economic or catallactic problems are embedded in a more general science, and can no longer be severed from this connection. No treatment of economic problems proper can avoid starting from acts of choice; economics becomes a part, although the hitherto best elaborated part, of a more universal science, praxeology.

Ever since Carl Menger’s (1871) fundamental work, Austrian economists have approached market phenomena progressively by distinguishing various forms of interpersonal exchange, based on the structure of both the supply side and the demand side of markets. Apparently, the simplest case of interpersonal exchange one can imagine consists of one particular seller and one particular purchaser only and, thus, has been labeled “isolated exchange” (Menger, 1871, p. 179 [2007, p. 197]). The investigation of such isolated exchange has been used frequently as a starting point to gain deeper understanding of market transactions in more complex

⁴ Rothbard (1951, p. 946) similarly defines catallactics as “The Theory of Voluntary Interpersonal Exchange.”

circumstances (e.g., Menger 1871, pp. 175–212; Mises, 1998 [1949], p. 324; Rothbard, 2001, pp. 106–126). However, Austrian economists characterize isolated exchanges as rather rare and occasional while mainly occurring at early stages of the emergence of civilization. For instance, Menger (2007, p. 197) notes:

This case, which could be termed isolated exchange, is the most common form of human trade in the early stages of the development of civilization. Its importance has survived to later times in sparsely populated backward regions and it is not completely absent even under advanced economic conditions, since it can be observed in highly developed economies wherever an exchange of goods that have value only to two economizing individuals takes place, or where other special circumstances economically isolate two persons.

Mises (1998 [1949], p. 324) describes such isolated exchange as “an occasional act of barter in which men who ordinarily do not resort to trading with other people exchange goods ordinarily not negotiated.”

However, even in highly developed economies, such as our own, isolated exchanges turn out to be much more than merely occasional acts. Most of the firms or larger share packages being bought and sold in the market are subject to situations, in which there is neither competition on the demand side nor on the supply side; the latter being impossible anyway due to the uniqueness of the asset concerned, at least as long as the potential exchange concerns a share package exceeding 50 percent of a company’s stocks. Therefore, the Austrian investigation of isolated exchange matches the circumstances in which most presumptive sellers and presumptive purchasers of a business enterprise find themselves. In consequence, it seems worthwhile to review the status quo of Austrian theorizing on the catallactics of isolated exchanges in order to ascertain which fundamental insights can be drawn from previous analyses for the assessment of the role of negotiations for the valuation of firms.

In a monetary market economy, “objective prices [...] are reflections of subjective values” (Ritenour, 2016, p. 21). Mises (1998 [1949], p. 324) explicates, prices

are determined between extremely narrow margins: the valuations on the one hand of the marginal buyer and those of the marginal offerer

who abstains from selling, and the valuations on the other hand of the marginal seller and those of the marginal potential buyer who abstains from buying.

Due to the lack of competition on both the supply side and the demand side within isolated exchanges, however, “the ratio of exchange is determined only within broad margins” (Mises, 1998 [1949], p. 324). These margins result from the individual marginal prices of both the presumptive seller and the presumptive purchaser (e.g., Olbrich, Quill, and Rapp, 2015, p. 31). Austrian economists have concluded that catallactic analysis proper cannot say with certainty what the final price involved parties eventually agree upon will look like (Mises, 1998 [1949], p. 324; Rothbard, 2001, p. 109); one thing catallactics can tell us, though, is that if the exchange is finally conducted, the given margin must have allowed for a mutually beneficial agreement, and that the final price is established somewhere within that margin. For instance, Menger (1871, p. 177 [2007, p. 195]) concludes:

Hence, whatever the price that is finally established for 40 units of wine in an economic exchange between A and B, this much is certain, that it must be formed between the limits of 80 [the seller’s minimum price in this example] and 100 [the buyers maximum price in this example] units of grain, above 80 and below 100 units.

Böhm-Bawerk (1930, p. 199) forms the following general proposition:

In isolated exchange—exchange between one buyer and one seller—the price is determined somewhere between the subjective valuation of the commodity by the buyer as upper limit, and the subjective valuation by the seller as lower limit.

Accordingly, Mises (1998 [1949], p. 324) underscores that

[c]atallactics, the theory of exchange ratios and prices, cannot determine at what point within these margins the concrete ratio will be established. All that it can assert with regard to such exchanges is that they can be effected only if each party values what he receives more highly than what he gives away.

Similarly, Rothbard (2001, p. 109) emphasizes that

[a]ll analysis can say about this problem is that, since the exchange must be for the mutual benefit of both parties, *the price of the good in isolated exchange will be established somewhere between the maximum buying price and the minimum selling price* [...] We cannot predict the point that the two will agree on, except that it will be somewhere in this range set by the two points.

While any sound attempt to deduce a generally applicable law of how the price eventually established will look like in isolated exchange is doomed to failure,⁵ Austrian economists have at least named potential determinants of that price. Particularly, they have pointed to the fact that the opposing parties will engage in a process of negotiating about the final price (Menger, 1871, p. 177 [2007, p. 195]; Gross, 1884, pp. 46–47; Schullern-Schrattenhofen, 1889, p. 31; Böhm-Bawerk, 1930, pp. 198–199; Rothbard, 2001, p. 109) which will be influenced by both the negotiators' abilities (e.g., Endres, 1995, p. 4) and their position within the negotiation (e.g., Gross, 1884, p. 131).⁶ For example, Menger (1871, p. 177 [2007, p. 195]) while coining the term "*Preiskampf*"⁷ ("price duel"; "price conflict"; "price war") states that

it appears equally certain to me that the outcome of the exchange will prove sometimes more favorable to one and sometimes more favorable to the other of the two bargainers, depending upon their various individualities and upon their greater or smaller knowledge of business life and, in each case, of the situation of the other bargainer.

Similarly, Rothbard (2001, p. 109) analyzes that the finally established price "depends on the data of each particular case, on the specific conditions prevailing. In particular, it will depend upon the *bargaining skill* of the two individuals."

⁵ We classify the attempts to formulate a general bargaining theory as unsound for such "bargaining theory [is] rarely applicable in the real world" (Rothbard, 2011, p. 365).

⁶ With reference to Hermann (1874) and Schäffle (1873), Gross (1884, p. 131) argues that "whether or not the price will approximate the minimum or maximum limit, apparently depends on the position the entrepreneur has within the price duel, whether his position is superior to his counterparty's one or not" (authors' translation).

⁷ This term has been frequently used by Menger's disciples Gross (1884) and Schullern-Schrattenhofen (1889), see Streissler (1972, p. 437, footnote 54). For more recent applications see, for example, Spitznagel (2013, p. 22).

Moreover, Böhm-Bawerk (1930, p. 199) explicates with more detail:

According as in the conduct of the transaction the buyer or the seller shows the greater dexterity, cunning, obstinacy, power of persuasion, or such-like, will the price be forced either to its lower or to its upper limit.

Rothbard (2001, p. 363) notes that “[l]ittle of value has been said about bargaining since Böhm-Bawerk” (footnote 27) and that “[e]conomists have always been very unhappy about bargaining situations of this kind, since economic analysis is estopped from saying anything more of note.”

Unlike economists in the tradition of Menger, Böhm-Bawerk, Mises, and Rothbard, however, neoclassical economists have attempted to overcome this barrier to economic analysis by formalizing the bargaining process. This development has been a natural extension of their formal-modeling approach to explaining human behavior. To construct a mathematically tractable model of human action, neoclassical economists assume economic agents, instead of human persons, whose simulated behavior is determined by stipulated underlying conditions, namely, the agent’s utility function and objective circumstances whose value in an agent’s behavior is determined by its utility function. Neoclassical economists have modeled every functional type of human action as optimization under constraint: consumption, production, and exchange. Price setting eluded formalization, however, until the advent of game theory after the Second World War. Before that time, neoclassical economists typically assumed the existence of an auctioneer compiling bids and offers made by all buyers and sellers in a market, then computing the equilibrium price, and finally announcing the price after which all trades would be made.⁸ Since the early 1950s, neoclassical economists have developed game-theoretic models of bargaining.⁹

As Rothbard notes in the quote above, economists in the tradition of Mises have considered bargaining an entrepreneurial activity

⁸ See Hahn (2008) for an overview of the Walrasian auctioneer in general equilibrium theory and Negishi (2008) on advancements beyond *tâtonnement* as a process of price setting in neoclassical economics.

⁹ See Serrano (2008) for an overview of game-theoretic bargaining.

not subject to economic-theoretical laws.¹⁰ Such laws describe the universal, cause-and-effect structure of human action. Under adequately competitive conditions, for example, the level of the price of a good is completely determined by the preferences of buyers and sellers, which in turn are subject to the laws of utility. The preferences of the marginal traders are so near to each other that no bargaining range exists. Any seller can always sell to the marginal buyer if any buyer attempts to negotiate for a lower price. And any buyer can always buy from the marginal seller if any seller attempts to negotiate for a higher price. If a market is inadequately competitive, then a bargaining range will exist and the level of price will be determined, not solely by the laws of utility which are universal principles of human action, but by the particular conditions of person, place, and time in which bargaining takes place as noted above in isolated exchange, the extreme case of an inadequately competitive market.

Although it is indeed true that catallactics has no means to completely determine the actual final price in any isolated exchange, additional theoretical insights can be discovered about isolated exchange in cases of investment appraisal in contrast to cases of valuation (and appraisal) alone. The following two sub-sections are devoted to a praxeological investigation of the negotiation process between a presumptive seller and a presumptive purchaser in the special case of an entire business enterprise.

3.2 Negotiation Process and Possible Scenarios

The negotiation about the purchase/sale of a firm, basically, consists of price *offers* executed by the involved parties, either directly or indirectly through the proposal of an appraisal method or corresponding data (Matschke and Brösel, 2013, pp. 615–616). Every potential price offered by one of the parties is the outcome of that party's valuation. Through the action of proposing a certain price, that party demonstrates its particular value scale, that is, how it has ranked the business concerned against the suggested price. Inversely, to the opposing party, the offered price serves as an input variable

¹⁰ The quote (Rothbard, 2001, p. 363) was originally published in 1962, before the game-theoretic treatment of bargaining gained ascendancy in neoclassical literature.

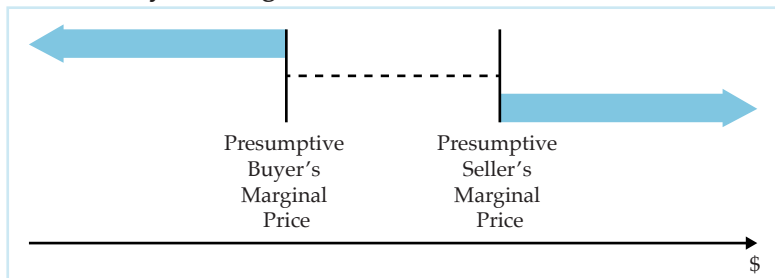
for its valuation. The opposing party compares the quoted price to its marginal price and, eventually, ranks the offered price against the business enterprise in question. Therefore, the negotiation process must be interpreted as a series of repetitive valuations reflected in the proposal, acceptance, or rejection of price *offers*, both from the presumptive buyer's and the presumptive seller's perspective.

In the potential transaction of an entire business enterprise, basically, we can distinguish three scenarios:

1. The presumptive seller's marginal, that is, barely acceptable price exceeds the presumptive purchaser's marginal price; in other words, the presumptive seller needs to earn more than the presumptive purchaser is willing to pay.
2. The presumptive purchaser's marginal price is identical to the presumptive seller's barely acceptable price; in other words, the presumptive buyer may at most pay what the presumptive seller at least needs to earn.
3. The presumptive purchaser's marginal price is greater than the presumptive seller's barely acceptable price; in other words, the presumptive buyer can be willing to pay more than the presumptive seller needs to earn.

In *scenario 1*, no potential area of agreement exists, since the presumptive seller needs to earn more than the presumptive purchaser may pay:

Figure 1: Presumptive Seller's Marginal Price > Presumptive Buyer's Marginal Price



Rothbard (2001, pp. 107–108) illustrates this scenario using two opposing parties' value scales as follows:

Smith would be willing to acquire a horse from Johnson if he could give up *100 barrels of fish or less*. One hundred barrels or less are less valuable to Smith than the horse. On the other hand, 101 or more barrels of fish are more valuable to him than the horse. Thus, if the price of the horse in terms of the fish offered by Smith is *100 barrels or less*, then Smith will make the exchange. If the price is 101 barrels or more, then the exchange will not be made [...] Johnson will not give up his horse for less than 102 barrels of fish. If the price offered for his horse is less than 102 barrels of fish, he will not make the exchange. Here, it is clear that *no exchange will be made*; for at Johnson's minimum selling price of 102 barrels of fish, it is more beneficial for Smith to keep the fish than to acquire the horse.

In this scenario, consequently, the negotiation process will be rather short, since there is no price both parties will accept voluntarily which they will realize fairly quick. In any case, one party will value the status quo higher than the transaction, which will be reflected in the rejection of the deal.

Contrary to scenario 1, in *scenario 2* a potential area of agreement exists, since the presumptive purchaser may offer a price which is also acceptable to the presumptive seller:

Figure 2: Presumptive Seller's Marginal Price = Presumptive Buyer's Marginal Price



If both the presumptive purchaser's and the presumptive seller's marginal prices equate to one another, however, the *only* price acceptable to both parties equals their common marginal price. Rothbard (2001, p. 109, footnote 23) discusses the same scenario and eventually concludes: "Thus, if Smith's maximum buying price is 87, and Johnson's minimum selling price is 87, the price will be uniquely determined at 87."

Given the identical marginal prices, however, while both parties would not suffer engaging in the transaction which might indeed lead them to conduct it at their shared marginal price, neither can the presumptive purchaser benefit from the transaction by paying less than the business is worth to him nor can the presumptive seller benefit earning more than the business is worth to him respectively (e.g., Menger, 2007, p. 185). Consequently, as both parties cannot improve their state of affairs by means of the transaction, they might—as their equally valuable action alternative—simply abstain from undertaking it, that is, no price at all might be established. The fact that conducting the exchange does not make any of the involved parties better off, leads Menger (2007, p. 185, footnote 5) to classify “indifferent exchanges such as this as definitely non-economic since in them the provident activity of men is set in motion aimlessly quite apart from all the economic sacrifices they may entail.”

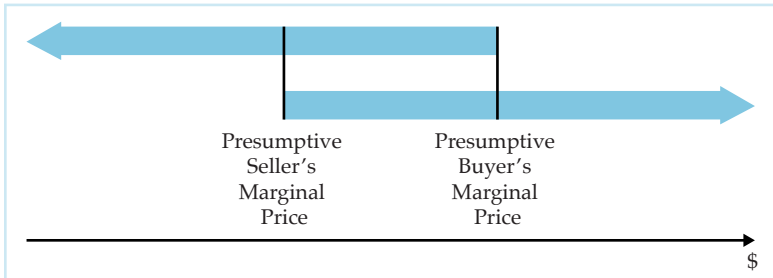
Hence, the process of negotiating between the involved parties might again be rather short, since none of them has an incentive to actually conduct the transaction. Either of the parties’ valuations will most likely become evident in the rejection of the deal eventually. Rothbard (2001, p. 108), thus, concludes that “[i]n order for an exchange to be made, then, the minimum selling price of the seller must be lower than the maximum buying price of the buyer for that good” since, as Menger (2007, p. 194) points out, “[both buyer and seller] will agree to an exchange only if it enables [...] [them] to make better provision for [...] [their] needs than would be possible without the exchange.”

Similarly, Böhm-Bawerk (1930, p. 193) argues that

[exchanges] are not made simply for amusement. People who take the—not always trifling—trouble to exchange the goods which they possess for other goods, do so for a rational and material end, and, in nine hundred and ninety-nine cases out of a thousand, this end is to better their economical condition by the exchange.

Unlike scenario 2, *scenario 3* allows for more than one particular solution to the *Preiskampf*. The potential area of agreement is established because the purchaser’s barely acceptable price exceeds the seller’s minimum selling price:

Figure 3: Presumptive Seller's Marginal Price < Presumptive Buyer's Marginal Price



Any price offer within the range between the marginal prices serves as a potential final price, since each of them is mutually beneficial (e.g., Matschke, Brösel, and Matschke, 2010, p. 10). In discussing the same scenario, Böhm-Bawerk (1930, p. 198), therefore, appropriately claims that “it is certain that there will be an exchange; in the assumed circumstances each of the contracting parties can make a considerable profit by the exchange.”

Owing to the existence of potential prices beneficial to both buyer and seller, the involved parties have an incentive to seriously negotiate with each other about the final price since both parties seek to improve their state of affairs through means of the transaction.

3.3 Negotiation Tactics and Appraisal Methods

Before engaging in negotiation, both presumptive seller and purchaser separately compute their strictly confidential (Matschke, 1975, p. 11; Matschke, 1976, p. 519; Matschke, 1979, p. 18) individual marginal prices applying investment appraisal (e.g., Hering, Toll, and Kirilova, 2015b, p. 1), which, then, limit the range of acceptable prices, that is, the potential area of agreement (Matschke, 1979, p. 57). Since man is a purposeful being (e.g., Herbener, 2011, p. 14), his action always aims at particular ends. Mises (1998 [1949], p. 11) emphasizes:

Human action is purposeful behavior. Or we may say: Action is will put into operation and transformed into an agency, is aiming at ends and goals, is the ego's meaningful response to stimuli and to the conditions

of its environment, is a person's conscious adjustment to the state of the universe that determines his life.

The action of negotiating does not form an exception to this rule; rather, acting man engages in negotiation to reach a certain goal, his negotiation tactics serve a particular purpose. According to the end involved parties aim at, that is, wealth maximization (e.g., Mises, 1998 [1949], pp. 241–243; Rothbard, 2001, pp. 104, 213, 231), both buyer and seller intend to maximize their share of the transaction's benefit through negotiating with each other (Matschke, 1975, p. 11; Matschke, 1976, p. 521; Olbrich, Quill, and Rapp, 2015, p. 32).¹¹ To do so, they will want to reach an agreement at a price as close as possible to the opponent's marginal price, that is, one that is still acceptable since beneficial to him. Rothbard (2001, p. 109) explicates:

Clearly, Johnson will try to set the price of the horse as high as possible, while Smith will try to set the price as low as possible. This is based on the principle that the seller of the product tries to obtain the highest price, while the buyer tries to secure the lowest price.

Even though a price slightly below (purchaser) or slightly above (seller) the marginal price is beneficial and, hence, acceptable, both parties will engage in a purposive negotiation aiming to maximize their share of the gain to be established through the exploitation of the potential exchange. Menger (2007, p. 195) notes:

It is easily seen that A [, given his marginal price of 100 units of grain,] could provide better for the satisfaction of his needs even if he should have to give 99 units of grain for the 40 units of wine, and that B [, given his marginal price of 80 units of grain,] would be acting economically on the other side if he were to accept as little as 81 units of grain in exchange for his 40 units of wine. But since there is an opportunity for both economizing individuals to exploit a much larger economic advantage, each of them will direct his efforts to turning as large a share as possible of the economic gain to himself. The result is the phenomenon which, in ordinary life, we call *bargaining*. Each of the two bargainers will attempt to acquire as large a portion as possible of the economic gain that can be derived from the exploitation of the exchange opportunity, and even if

¹¹ For practice-oriented guidance on how to negotiate, see, e.g., Ury (1991); Fisher, Ury, and Patton (2011); Voss and Raz (2016). Herbst et al. (2018) as well as Nagler et al. (2018) provide some current insights on negotiation management.

he were to try to obtain but a fair share of the gain, he will be inclined to demand higher prices the less he knows of the economic condition of the other bargainer and the less he knows the extreme limit to which the other is prepared to go.

In order to reach a worthwhile agreement, involved parties, therefore, necessarily need not only know their own marginal prices but also need to form an assumption about the opponent's marginal price (Matschke, Brösel, and Matschke, 2010, p. 6; Brösel, Toll, and Zimmermann, 2012, p. 95; Matschke and Brösel, 2013, p. 622).

Within the negotiation about the transaction of a firm, involved parties usually agree upon a certain appraisal method and negotiate about the corresponding input data rather than merely proposing actual price offers as commonly known from, for example, auctions or flea markets (Matschke, 1976, p. 520; Matschke and Brösel, 2013, pp. 615–616). A party's negotiation tactics and its proposal for applicable appraisal methods being subject to the negotiation are neither arbitrary nor random; rather, acting man will select the appraisal method and choose the negotiation tactics he prefers purposefully in light of the overall end of the negotiation process, that is, to reach the most profitable agreement. Basically, every imaginable method, which serves to support the quoting party, can be reasonably applied for that purpose. However, methods that are widely known, generally accepted, arbitrarily adjustable, and considered to result in "fair" and "impartial" prices suit best to convince the opposing party of a particular agreement (Matschke, 1976, p. 523; Matschke and Brösel, 2013, p. 624). In other words, conventional appraisal methods are the best fit for negotiation purposes. In recent years, so-called market-value-oriented¹² methods dominate among business appraisals and, hence, are considered the state of the art (e.g., Olbrich,

¹² Mises (1951, p. 113) emphasizes: "Only the individual thinks. Only the individual reasons. Only the individual acts." Since individual action is the visualization of man's valuations (Mises, 1998 [1949], p. 120), furthermore, only individuals value. Therefore, the prevalent term "market value" is—at best—delusive. Unlike any individual, the market in the aggregate does not and cannot value anything; rather, the market reflects prices resulting from individuals' valuations and actions. Only under the rigid and unrealistic assumptions that underpin neoclassicism, values and prices equate to one another. Only then does a reference to "market value" make any sense. In the real world, however, the term is nothing but preposterous.

Quill, and Rapp, 2015, pp. 6–8). Market-value-oriented methods subsume both (1) neoclassical finance-theory-based *discounted cash flow methods* (DCF) and (2) methods of so-called *relative valuation* (e.g., Matschke and Brösel, 2013, pp. 125–126).

While both concepts suffer from various profound issues and are, hence, of no use to support valuing man in an investment decision (e.g., Olbrich, 2000, pp. 458–459; Hering, Olbrich, and Steinrücke, 2006, pp. 411–413; Brösel, Matschke, and Olbrich, 2012, pp. 241–242; Olbrich, Quill, and Rapp, 2015, pp. 12–17; Herbener and Rapp, 2016, pp. 20–23), they perfectly meet the demand for *negotiation* purposes (e.g., Brösel, Toll, and Zimmermann, 2012, p. 96–97; Matschke and Brösel, 2013, p. 624),¹³ since they are (for whatever dubious reason)¹⁴ generally accepted, adjustable as needed, and seemingly objective. As long as market participants believe in the superiority of such “objective” methods of business appraisal, subjectivists can make use of that misbelief in order to reach a preferable negotiation result (e.g., Matschke and Brösel, 2013, p. 624; Hering, 2014, p. 222).

One exemplary DCF variant, the flow-to-equity method, can be illustrated as follows (similarly Matschke and Brösel, 2013, p. 725):

$$\text{Appraised firm value} = \sum_{t=1}^T \frac{\text{Cash flow to equity}_t}{(1 + \text{cost of equity})^t}$$

To allow for face saving of the quoting party throughout the negotiation, an appraisal method suits best if it incorporates a certain degree of adaptability without seeming questionable (Matschke, 1976, pp. 523–524; Matschke and Brösel, 2013, pp. 620, 665). DCF methods’ adaptability can, for example, be shown by means of analyzing the popular and Nobel Memorial Prize awarded Capital Asset Pricing Model (CAPM) usually serving to deduce the so-called cost of equity,¹⁵ that is, (parts of) the discount

¹³ *Functional business valuation theory* stresses the significance of purpose-orientation for each and any business appraisal. See, for example, Matschke, Brösel, and Matschke (2010) and Matschke and Brösel (2013).

¹⁴ Olbrich, Quill, and Rapp (2015, pp. 7–8) provide some insights on the unbounded popularity of prevalent DCF methods.

¹⁵ Even though frequently applied in the broader sphere of finance, the term “cost of equity” is meaningless. (Money) costs are caused by the *input* factors of, for

rate (e.g., Fama and French, 1997, p. 153; Koller, Goedhart, and Wessels, 2015, p. 286). CAPM's essential conclusion (the expected return of a particular security j (" μ_j ") equals a "risk-free" rate (" i ") plus a risk premium which reflects the surplus of the expected return of the market portfolio (" μ_M ") over the "risk-free" rate multiplied by the beta-factor (" β_j ") can be visualized as follows (e.g., Hering, 2015, p. 301):

$$\mu_j = i + (\mu_M - i) * \beta_j$$

The practically applied data for the "risk-free" rate, the expected market return, and the beta-factor cannot perfectly match the theoretical demands of the CAPM (e.g., Hering, 2017, p. 309) simply because its assumptions are not met in reality as the model has an entirely hypothetical nature (e.g., Herbener and Rapp, 2016, p. 22). Hence, the input data are never correct or false; rather, they are the outcome of a willful choice. For instance, the appraiser will usually select a particular government bond (country, maturity, ...) as an approximation for the "risk-free" rate (Damodaran, 2012, pp. 154–155), and a certain stock index (country, industry, period, ...) as a substitute for the theoretically correct market portfolio (Hering, 2017, pp. 302, 309) which shall incorporate the performance of *every* risky asset rather than merely stocks (Damodaran, 2012, p. 66; Hering, 2017, p. 298). Therefore, CAPM's inherent degrees of freedom alone—apart from other factors within a DCF appraisal such as the estimation of future cash flows or the computation of a weighted average cost of capital—allow for the justification of basically any price offer supporting the quoting party taking into account both its own and the opponent's marginal price.

In contrast to the present-value-based DCF methods, so-called "relative valuation"¹⁶ aims to capture the "market value" of a business

example, a product, such as raw materials or labor. The dividends distributed to a company's shareholders, however, reflect the appropriation of a firm's net income, that is, the *output* of its operations. Therefore, to refer to (money) costs while actually meaning appropriation of net income mixes two entirely different things up and is, hence, both inaccurate and fallacious. For the critique of the term "cost of equity" see also Schneider (1998, p. 1474).

¹⁶ The pleonastic term "relative valuation" fails to describe the special features of this approach sufficiently, since every valuation is in relative terms in the sense that it takes into account at least one alternative course of action.

either based on that business's market capitalization or the market capitalization of or prices recently paid for (seemingly) comparable companies (Olbrich, 2000, pp. 455–457). For instance, one particular variant of “relative valuation” seeks to compute the appraised firm value of a particular company (“A”) through assessing the market capitalization of one comparable company or several comparable companies (“CC”), dividing it by a particular reference figure of the comparable company or the comparable companies, such as the EBIT, EBITDA, or net income, and to multiply the resulting factor with the respective reference figure of the company being appraised (Olbrich, 2000, p. 456). Hence, it can be visualized as follows:

$$\text{Appraised firm value}_A = \frac{\text{Market capitalization}_{CC}}{\text{Reference figure}_{CC}} * \text{Reference figure}_A$$

Comparable to the application of DCF methods, “relative valuation” suits well for negotiation purposes, since this approach incorporates a high degree of both adaptability and credibility. For example, the selection of comparable companies, the assessment of their market capitalization, and the selection of applicable reference figures allow for more or less arbitrary modeling (e.g., Olbrich, 2000, p. 459; Matschke and Brösel, 2013, p. 680). Moreover, the justification of “fair values” based on observable prices in the marketplace appears to be credible (e.g., Matschke and Brösel, 2013, p. 678). Therefore, this approach suits well for negotiation purposes too.

4. CONCLUSIONS

Robinson Crusoe engages in autistic exchange only. His actions aim at substituting one state of affairs by a more preferable state of affairs without referring to other individuals. In such an autistic economy, valuation alone is a sufficient condition for economizing decisions. In a market economy, in contrast, economizing decisions concerning, for example, consumer goods rely on both appraisement and valuation. While economizing decisions concerning investments, for example, the purchase of a firm necessitate both as well, however, they are different in two respects: First, appraisement and valuation are necessary yet not sufficient. Investment decisions require knowledge of the barely acceptable

price, that is, the application of investment appraisal. Second, the final valuation of a business enterprise is infeasible in the first place, since one lacks knowledge of the asking price beforehand. The price, therefore, must be negotiated. Praxeologically, the negotiation process has to be interpreted as a repetitive series of valuations reflected in the proposal, acceptance, or rejection of price offers. To maximize their share of the benefit of the transaction, both buyer and seller will purposefully engage in a negotiation aiming to reach a price which ought to be as close to the opponent's marginal price as possible. To accomplish such worthwhile agreement, application of DCF methods and "relative valuation" suit best as they are both highly adaptable and credible.

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