Illustration of
Median versus Mean

Why, in the business valuation profession (specifically relating to business valuation multiples), is it recommended to start with a median value instead of a mean value and then make adjustments (up or down) from the median?

Definitions:

Median: The middle value of a set of values.

Mean: The arithmetic average, computed by adding up a collection of numbers and dividing by their count.

As an example, let's assume the below list is the result of a search and analysis of guideline companies.

Price/Sales Valuation Multiple (sorted from lowest to highest)	
0.45	
0.47	
0.49	
0.49	
0.52	
0.55	
0.55	
0.60	
0.61	*Middle of sorted sample set*
0.62	
0.70	
0.74	
0.76	
0.80	
0.91	
5.30	
10.40	

0.61	Median
1.47	Mean (Average)

In the above example, one can see that the Median is much more representative of the central tendency of the sample set. Outliers (5.30 and 10.40) can dramatically impact the mean (average), whereas the median is less affected. The analyst may also want to consider further analysis of the two outliers and the possibility of eliminating them from the sample set.

It is also important to note that the value the analyst selects (whether it be the median or the mean), is typically a starting point. Based on the financial analysis of the subject company compared to the guideline companies, this value may be adjusted up or down.