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VALUATION OF BUSINESS

Abstract. This article describes an increasing importance of business valuation to make effective management decisions that requires company owners regularly to have information about the cost of business. Besides, the process of assessment is essential and interesting not only for business owners, but also for other interested groups such as government agencies, credit institutions, insurance companies, suppliers, investors and shareholders having inherent characteristics in different part of the world that will be noticed in this article.
Keywords: valuation of business, valuation approaches.

It is popular to be questioned by a businessperson, "why should I bother with a valuation of business?" At times, the problem is for the concern over the asking price of an evaluation, sometimes because of the period involved and sometimes simply because the executive sees no purpose in the implementation. Why bother valuing a family business when the owner plans to pass the business on to the next generation anyway?

The actual economy makes it more significant than ever before to be acquainted with an independent third party's value of your business. Management and shareholders of organization should completely think through tracking down a valuation regularly to avoid a potential monetary quarrel with the IRS or fellow shareholders. The modern world economic relations and constant innovations in various aspects of the business increased demand for business valuation. In such a market economy, when all transactions take place at your own risk, each party interested in the hardness of their decision and should be sure in advance, what the price of the transaction will be. Valuation of business and the company is one of the major problems of corporate governance. It allows you to determine the competitiveness and success of the company in the market and it is intended to an indicator of the company's development (Valuing a business, 2008).

Different "Philosophies" on Value

John Maynard Keynes, a distinguished macroeconomists who lived from 1883 to 1946, was concerned and disbelieved in assessment. However, he earned a small fortune by investing in the market during his lifetime. He was some kind of trendy definition as "behaviorist." He was certain that the market reflects mostly the emotions of the investors, rather than financial projections. Nevertheless, one thing that authentic in true in economics is that there will always be another opinion. The world reformed forever the idea on the calculation of intrinsic value when John B. Williams (1899–1989) announced his “Theory of Investment Value” in the late 1930’s.

Nowadays, the differences between these two central schools of thought persist. On one side, we have the rationalists, who believe that every asset has an intrinsic value that can be mathematically appraised, based upon its characteristics in terms of cash flows, growth and risk. According to this view, capital markets are assumed to err in pricing assets in the moment, but correct themselves over time as new information becomes available.

On the contrary side, we have what can be called the “possibilists,” who think it is unmanageable (or near impossible) to estimate the intrinsic value of an asset. As an alternative, the value of an asset is whatever the market is possible of paying for it, based upon its characteristics. This means that rationalists will prefer a financial determination of value through complex calculations, while possibilists will opt for market-based indications of value, such as market multiples (The basics of business valuation: what matters and why, n. d.).

Valuation methods

Defining approach to evaluating is dependent on the primary reasons of enterprise` valuation. In world practice, the most popular and basic approaches are cost, income and market methods (figure 1). Income approach involves determining the present value of future earnings that are expected to contribute the use and possible further sale of the property. In this case, the applied principle of the estimated waiting is used. Although usually a profitable campaign is the most appropriate procedure for the assessment of business, it may be helpful to use a comparative approach and costly. In some cases, costly or comparative approaches can be more accurate and more efficient. Besides, each of the three approaches can be used to verify the estimation value obtained by other approaches. Comparative approach is particularly useful when there is an active market comparable property. Estimation accuracy depends on the quality of the data collected, as applying this approach; the appraiser must collect reliable information on recent sales of comparable objects (Triple trouble: valuating companies, 2008).

In DCF analysis, the value of an asset is the present value of the expected cash flows on the asset. Based on the simple idea that we prefer to receive \$1 today that \$1 a year from now, this method projects a stream of future earnings, cash flow, or asset values and then discounts them to present value. This is the most frequently used method and includes a variety of specific tools and models (e.g. Capital Asset Pricing Model, Arbitrage pricing theory, etc.). A complete DCF analysis relies on a large number of accounting, financial, behavioral and environmental assumptions. At the very least, this method requires estimating the following:

- Life of the asset;

➢ Cash flows during the life of the asset;
➢ Discount rate to apply to these cash flows to get present value.

Approach	MARKET		INCOME	ASSET	
Methodology	Comparable Public Company	Comparable M&A Transaction	Discounted Cash Flow	Forced Sale	Orderly Liquidation Value
Key Factors	• Choice of company set • Multiple • Timeframe (historical vs. forward) • Size, mix of products/services, customers, other comparison items	• Choice of transaction set • Multiple • Length of timeframe • Size, mix of products/services, customers, other comparison items	• Projected cash flows • Cost of Capital • Risk Premiums • Terminal value	• Proceeds expected from an auction or other time-limited disposition of assets, typically piecemeal (e.g., Article 9 or foreclosure sale)	• Prices expected for individual or aggregated assets from reasonable marketing and sale efforts over an appropriate period of time

Source: http://www.turnaround.org/Publications/Articles.aspx?objectID=9780

Figure 1. Valuation Methods

The market approach undertakes that the relative value of any asset can be assessed by looking at how the market values analogous or comparable assets. It operates unprejudiced information on market prices (either from trades or from control transactions) for assets similar to the subject assets. Simple examples include "multiples" of earnings, EBITA (Earnings before interest, taxes and amortization expense), cash flow, revenue, square feet, eyeballs, etc. The economic foundation of this methodology is the so-called "Law of One Price," which states that in decently functioning markets, similar assets should have similar prices.

One of the main difficulties in the market method is that choosing comparable companies has need of skill and is often very biased. To find the relative value, it is necessary to have the following information:

- an identical asset, or a group of similar assets;
- a standardized measure of value;
- and if the assets are impeccably comparable, variables to control for the differences.

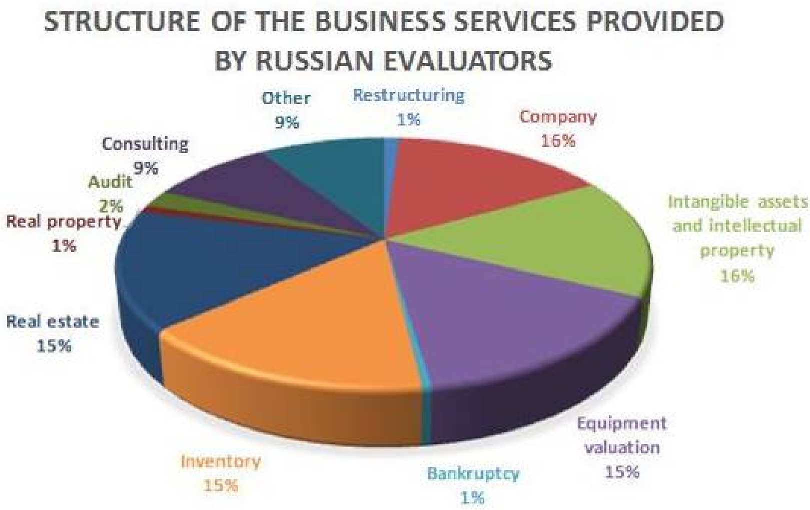
In the cost approach, value is appraised by joining the replacement cost of each individual asset that comprise the business. In other words, if I had been needed to purchase the same assets you have today (taking into account that they are not new), how much would I have to pay for it? For practical reasons, we typically start by looking at the market for new assets because it is likely to be liquid and provide better information. Just the once we have the price of the new assets, we cut rate that price for time of life and effectiveness: we then take off the physical depreciation, the functional uselessness, and finally the economic obsolescence.

Situation on the market valuation services in Russia and Abroad

The following directions mainly represent market valuation services in Russia (figure 2):

• Valuation of Company / Business and securities
• Valuation of assets / fixed assets
• Valuation of real estate
• Evaluation of the cost of equipment and vehicles
• Valuation of intangible assets
• Valuation of investment projects.

The cost of Russian firms and companies, usually measured by the value of their asset, as many prefer to hide profits from taxation. In addition, tangible assets can be laid down for obtaining a bank loan, so their evaluation is of the greatest interest. Usually valuation of any company held in several ways, and then each of them is assigned to a specific weight according to importance. The resulting value is multiplied by the weight, adding up all the figures, in order to obtain the averaged value (Valuation of company).



Source: http://www.appraiser.ru/default.aspx?SectionID=338

Figure 2. Market Assessment of the Russian Federation

In the West, generally experts use a comparative method in valuing of business. Any appraiser has a large database of completed transactions in every industry, and he or she is able, applying a few adjustments, to calculate how much the venture costs. For example, the average price of laundry in the U.S. is 1,7 of annual revenue or 4,15 of annual net profit, the restaurant is worth a third to half of annual sales, travel agency is 0,05–0,1, and shop at home is 0,5 annual volumes sales. Besides, insurance company accounts to 1–2 gross commissions for the year; a real estate firm is 0,2–0,3 gross commissions for the year (Accurate assessment of business, n. d.).

When comparing the Russian and European appraisers, you can see some of the nuances. In Europe, the evaluators take into account the weaknesses in the managerial accounting during evaluating companies or businesses. In Russia a complete, real integration with economic relations is not yet developed. Initially it is necessary to rebuild the managerial accounting of companies to international standard that would correspond to the advanced economies. If Russia is undertaking effort in the international standard, they have a high level and class (Appraisal activity in Russia and abroad, 2013).

In a crisis consumer attitude towards evaluation services has changed. Loan secured d and the share of investment companies have declined. Banking and insurance companies for the purpose of crediting and deposits make the greatest demand for services evaluators. Appraisal activity in the Russian Federation was formed later compared with European countries, but it is well developed.

Conclusion

The relevance of this topic is based on the understanding that the concept of enterprise management that aimed to maximize its value is one of the most prosperous. Since the change in the company`s value for a period of time, being a fundamental feature of the productivity`s economic activities, includes almost complete data that are associated with the company. Realizing the fact that the cost is the resultant criterion, management of businesses should compare the effects of the administrative decision on the functioning of the organization.

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