Analysis of the Main Methods of Business Valuation

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Abstract: An effective business management policy relies on a clear understanding of all current business processes, on the analysis of weaknesses and strengths of the operation of the enterprise and continuous monitoring of the entire environment of the company with its potentials and possibilities. An important indicator of the company's profitability activity is its value, since this indicator indicates the income of the owner. Valuation of a business gives a chance to determine the real market capitalization. For the owner of the enterprise, business is another opportunity to assess the management policy properly. For third-party organizations, business valuation allows to see the investment attractiveness of the enterprise. Business valuation methods are widely used by many successful organizations to analyze and identify potential opportunities and eliminate emerging business problems, as well as to develop strategies that can increase their market value. In this article, we look into and analyze the main methods of business valuation that can be potentially used in the programs of value-oriented enterprise management. The main positive and negative aspects of three business valuation methods of business valuation are analyzed.

Keywords: business, method, analysis, valuation, enterprise, state, cost

JEL Classification: E30, K20, L21, L84

INTRODUCTION

The main distinguishing feature of the economy of modern Russia in its present state is its instability. The current geopolitical situation, the sanctions imposed by the world powers on the Russian Federation and reciprocal counter-sanctions introduced by Russia, and other external factors create high ambiguity and

nebulosity in the development of business processes. This negatively affects the overall economic development of the world community.

Inflation processes affect the state of enterprises: they reduce the total cost of companies' property, hinder the increase in funds accumulation for capital investments, there is a predominance of short-term interests of companies. In these conditions, the management of the business value and its effective evaluation become a priority.

Important ways of managing the cost of business are related to the basic methods of evaluation.

In our state, the concept of managing the value of business only goes through the stage of development, which is closely connected with the study of the practical aspects of valuation methods. The legislative basis for assessing the value of property and businesses has been evolving since the late 1990s to the present. During this time, the federal evaluation standards were developed. This legal framework currently determines the conditions for applying the main methods of valuation of business and their effectiveness. Defined by the law approaches and methods for assessing business have been criticized by many researchers. Their criticism stems from a considerable difference between the modern reality of property management and the essence of the techniques that were introduced several years ago (Higgins, 2011; Silnov, 2016; Tereshchenko *et al.,* 2017).

In general, business valuation is a process that allows to identify and determine the real market value of company's capital. The emergence in the economic system of such processes as privatization, the stock market, the insurance system, the system of commercial banks that give loans against property actualizes the need to work on correct valuation of business (Mamycheva, Kobersy, Korenko, Novikov & Mandrik, 2017).

According to another definition, the concept of valuation of business should be understood as an act or stage of determining the value of a business or the share of shareholders and investors in the capital.

Activities related to determining the value of business can become a continuous process that is necessary to determine the impact of investment and innovation activity on the real market value (the price of shares), when selling a business, and when determining the amounts to be paid for the insurance of an enterprise.

In connection with the appearance of independent owners of enterprises and businesses in Russia, there is an increasing need to determine the correct market value of capital.

In order to obtain a reliable result after analyzing the valuation of business, several methods must be applied.

If condition is not met, the final result may be incorrect, i.e.:

– application of only one method of direct estimation of expenses for business formation, estimates only this one type of expenses;

– assessing a business by using the method of estimating future earnings may also yield false information, because when an investor makes financial investments in a business and evaluates the final result, he does not take into account all expenses incurred by the enterprise to achieve this result.

Therefore, in order to assess the real market value of a business rationally and correctly, it is necessary to use several methods - estimating costs, future returns, the price of capital, taking into account data on similar enterprises and sectors of economic systems.

MATERIALS AND METHODS

The theoretical and methodological basis for writing this article is made up of publications and reports, modern scientific approaches to the study of methods of business valuation in the economy of the Russian Federation, as well as the works of Russian authors on the organization and development of business processes, enterprises and other economic systems. Methods of analysis of comparative characteristics, groupings, the system approach on the basis of correlation and comparison of theoretical and practical material are used.

The research methodology is based on the dialectical method, system and strategic approaches to the analyzed objects. Scientific provisions, conclusions and recommendations made in the article are founded on the use of combined methods of historical and logical analysis, comparison and synthesis, induction and deduction, economic-statistical method and expert assessments (Sergeevich & Vladimirovich, 2015).

The information base of the research is comprised of the laws of the Russian Federation, official publications of state statistics, publications of governmental bodies on the methods and techniques of valuation of business, taking into account the specifics of the enterprise, as well as thematic collections and directories, information published in scientific journals and periodicals, resources of the Internet.

DISCUSSION

The estimation of the market value of a business is an orderly process aimed at achieving the goal of finding and determining the monetary value of a given object, taking into account the potential and real income (profit) that it received in specific conditions of the market with an increasing level of competition.

The main goal and objectives of valuation of a business as a tool of the market system, is the formation of a reasoned opinion and independent from other parties (subjects of valuation) about the price of a property (the object of valuation).

The need for assessing the value of business is found in virtually all of interactions between the market and its objects: when buying and selling enterprises and structures, and their shares, reorganizations during merger or acquisition, and in many other business processes.

Therefore, the economic system and the state in their activities and communications jointly use methods of assessing businesses of various kinds, since the specific nature of the activities of enterprises depends on the industry and the sector of functioning, the policy of producing goods or services, and on the general peculiarities of the state economy and world markets.

The main basis for considering and characterizing business valuation methods in the management of the value of a company and identifying their main positive or negative impacts is provided by appropriate laws, which currently set the conditions for the application of methods in the valuation of enterprises.

For a more accurate analysis, we will consider the basic methods of business valuation. The first such method is a cost-based approach to estimating the value of a business.

This method of assessing the value of business is also called the method of accumulation of assets and involves determining the market price of the property of the enterprise. The peculiarity of using this method is to that it estimates the cost of the business taking into account the costs incurred. The main feature of the method is that the appraiser determines the value of assets in the market, as well as all the company's obligations. Finding the difference between the value of the assets of the enterprise and the value of the attracted capital, one can determine the cost of business capital in the functioning market, as well as the total price of the enterprise.

An important factor in this method is the fact that the book value of the assets of an enterprise is not equivalent to the value of this business in the market. This requires a revaluation of all available assets of the company. In this procedure, the analysis of the cost, which is indicated in the balance sheet, as well as the cost, which is declared on the market taking into account the period of application and depreciation, is carried out.

The owner determining the market value of his business does not intend to use the property, he acts if he were planning to sell it in parts. This tactic of the owner's behavior is typical for the bankruptcy manager, who repays his debt obligations through the sale of existing assets. Proceeding from this, it turns out that this approach for long-term management is not permissible (Ferraro & Liberatore, 2016).

In the application of the cost method, the following components are distinguished:

- the method of net assets;
- valuation of fixed assets of the enterprise;
- valuation of production assets;
- analysis of financial investments;
- estimation of the liquidation value.

When estimating the liquidation value, the following procedure should be used:

- analysis of the final (latest) statements for the quarter;
- drawing up a sequence of liquidation of assets (assets have varying degrees of liquidity and extent of implementation);
- determination of the marginal revenue from the sale of the assets of the enterprise;
- the final estimations is reduced by the amount of direct costs;
- finding the difference between the liquidation value and the costs incurred in using the assets.

Thus, the method of liquidation value is advisable to apply in several cases: when the company's property is sold urgently in the process of bankruptcy, and when establishing the minimum selling price of a running business. In the second case, the final result of the calculations demonstrates the lower limit of the business value, which may be considered in the formation and change of the enterprise development plan (Grajkowska, 2011).

However, because of the complexity of calculations needed, the method of liquidation value is used extremely rarely.

The second method is the method of comparative approach to estimation of the cost of business.

This method uses enterprises - analogs, market multiples and the capital market, which are predetermined, and take into account the interests of the owner, who operates on the basis of the principle of alternative profitability of investments.

When implementing this methods in business cost management, its limitations become evident - a permanent lack of information resources (Atkinson & Hamilton, 2007).

The only freely accessible data on the property potential of the company are proposals for the sale of the business. Basic data that reflects the real financial position of the business – its liquidity, profitability or business activity can be found rather rarely.

Quotations of securities of the enterprise can also serve as available information about the state of the business; therefore, managers who carry out their activities at the regional level can take this valuable information as a reference.

The method of market multipliers is the simplest and contains the easiest basic calculations to perform. The most common multipliers in the valuation of business are price - profit, price - dividends, price - sales revenue, price - cash flow, and price - book value.

For a holistic application of this method of valuation of business, the 3 main stages are used:

– the identification of enterprises that are identical in scope of functioning;
– selection of the most acceptable enterprises;
– approval of the list of companies for calculating the multiplier.

It is known that many authors develop methods and models of managing business and its value based on this method, although its actual application is limited and not reliable (Mertins & Alwert, 2003).

In the economic system of our state, information on significant proportions of the results of financial activities and the total value of the enterprise's business is not yet easily available (Park & Park, 2004).

Even the best-known researchers do not always mention in their works the limitations and negative aspects of the application of the market multiplier as a tool for controlling the value of domestic enterprises in the conditions of limited and access to information.

Therefore, the application of the method, which is based on missing statistical data, is not appropriate for a specialist, since it does not guarantee the accuracy of calculating the cost of business and the application of strategic management.

In this comparative approach, the method of comparable companies is the most acceptable. In its essence, it considers the value of the enterprise's business and its valuation is done through comparison of the securities (shares) of the valued business with the value of the shares of similar companies.

According to the specialists in cybernetics William Ross Ashby and Stafford Beer, each company represents a self-organizing system that has its own distinctive characteristics in comparison with others, and has unique features that do not provide an opportunity to determine the true degree of comparison.

Therefore, this method can only be used to determine the final value of the shares of the company, when simplifications are not permissible in the management policy.

Another important restriction is the factor of the structure of the managers and owners of the company's capital. This limitation is hardly ever mentioned in the works of theorists and practitioners in the management of internal processes, although the mechanism of dividing the property has a very big impact on the management style.

An analysis of joint stock and limited liability companies showed a high degree of concentration of capital.

Despite the fact that there are differences between these two forms according to the principle of organization and activity, their management style is identical, which in turn has a detrimental effect on the application of innovations in management.

One more method is the income approach.

Recently, the interest of many economists has been shifted towards the income approach in the process of business valuation; in particular, special attention is paid to the method of discounting cash flows. The focus is the ability of an enterprise to generate cash flows in future projects, rather than the results of past achievements.

The use of the income approach is also observed in estimating the market value of unidentifiable assets, which is carried out not only by the costs of their formation, but also in the field of establishing results from the implementation and application of the asset.

This method involves calculating the basic discounted indicators (dynamic), where the net present value indicator (net present value) is important.

The application of the income approach entails the use of modern management technologies that allow gaining extra profits.

Thus, when valuating a business that employs innovative technologies and modernization in its development, it is advisable to apply this method, since the main focus is the valuation of only 'real' business. In its essence, the income approach determines the combination of all economic and mathematical methods, which are focused on establishing the expected profit from the sale of the object of evaluation in the prospective period.

The main economic meaning of this method is the forecast of future revenues that will be received in the framework of the evaluated business process.

The use of the discount method entails bringing the income to its current value. In this case, the profit of the business is the result of the net discounted income, that is, the total price of the functioning enterprise, which reflects the amount of current values in the course of the forecast period.

RESULTS

The choice of the main method for evaluating the cost of a business is made depending on the current and future revenues of the enterprise whether or not they can accurately calculated, whether the organization has significant liquid material or financial assets, whether the enterprise has a base of customers for the manufactured products.

If a reliable and accurate forecast of the revenue side of the business is impossible or its material and financial assets are very large, and the results of the organization's functioning are directly dependent on emergency situations, e.g. with the conclusion of a contract, then the valuation method based on the analysis of assets and the method of the net asset value and liquidation value is applicable.

If the situation develops in such a way that the profit and income of the enterprise can be reliably provided and determined, its assets mostly consist of equipment and finished goods, the consumers' demand for products is stable, then the most acceptable methods for valuation will be the method of estimating the business value based on the analysis of income: the method of discounted cash flow, capitalization of revenues, excess profits, or comparative method, using valuation multipliers, such as price-earnings, price – cash-flow, price - dividend payments, etc.

If there is insufficient information on comparable companies, the most reliable and simple methods, though at the same time requiring careful application, are the capital market method (for estimating the value of minority shares) or the method of transactions (for controlling stakes in general) or the method of industry coefficients (based on the use of sectoral ratios between certain financial indicators).

When a comparative method for estimating the value of a business cannot be applied, business valuation will be done using the method based on the direct analysis of revenues – the method of capitalization of incomes (it is used when the rate of income growth is calculated to be moderate) or the method of discounted cash flows (it is applied assuming that future cash flows will be amenable to the reasoned analysis, the expected changes in the economic situation or business system will be sufficiently different from the current ones, and that the cash flows will have a significant positive value).

Despite the fact that the economic system has a large arsenal of modern methods for assessing the value of a business, not any one of them can be treated as a universal one. Each method and approach has both its advantages and disadvantages, limitations, and shows the market value of the organization in its specific way.

The type of the value to be set, the purpose of the evaluation are, of course, shown by determining the criteria for the choice of the method, but one should not forget that the objectivity of the valuation will be greater if several methods are applied simultaneously.

Business valuation must become the basis for solving the set tasks when developing programs and strategies for the formation and development of the enterprise, for assessing the effectiveness of management, assessing the effectiveness of the organization and determining the real value of one share. This suggests that the existing methods for assessing the value of businesses must be constantly improved, and new methods of calculating the basic indicators of the effective performance of enterprises be found.

Continuous business valuation should be as simple to carry out; its results should be clear and reliable. To apply the methods, discussed above, it is necessary to use the management accounting data.

Valuation of a business must meet the requirements of the simplicity of calculation, the validity of the findings; it must be done periodically and give sufficient information. Therefore, it is necessary to develop and apply a new methodology for determining the growth rates of cash flows or to collect forecasts for short and long-term periods. It is also necessary to conduct market revaluation of all fixed and intangible assets taking into account the current market situation.

CONCLUSION

Taking into account the considerations above, we can draw a conclusion that the modern process of formation and reorganization of strategies of business processes does not make sense without attracting and applying innovative technologies and management techniques, including those related to business valuation.

Business valuation is a stage that completes a comprehensive analysis of an enterprise (company). This procedure is objective, however leaving many questions open.

The existence of a large number of methods for business valuation is explained by the fact that each of the methods has its positive and negative sides, limitations, influences from the market segment, which was reflected above. Therefore, valuation of a business and managing its value cannot be exact.

Stemming from the basic methods of financial analysis and assessment of the position of enterprises, the concept of business value management is now viewed as an independent approach to strategic management of the potential of an enterprise.

Business valuation of enterprises is universal in its use, therefore, it has received recognition throughout the world and it is actively used in Russia, too.

Business valuation system and its main methods are becoming more and more widespread, thereby demonstrating the many possible options for its implementation.

Particularly topical are the combined use of several business valuation methods, analysis tools and the latest approaches to business value management.

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