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"ASSESSING THE VALUE OF THE ENTERPRISE" METHODS AND INSTRUMENTS

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Abstract

Making the right investment decisions regarding sale and purchase of the company, or joining of any other enterprise, it is necessary that the decisions in question has to be taken based on the assessment of the value of the enterprise. Assessing the value of the enterprise must be in accordance with recommendations of the International Standards value assessment of the enterprise. Enterprise value evaluators must conduct the assessment, in accordance with basic principles: assessment of the enterprise as general economic and that assessment cannot be made based on the results achieved, but on the basis of expected results. In this paper will be discussed modern methods of assessing the value of the target company, and that in: asset-based methods, methods based on the economic value and combined methods. Many investments are made based on a detailed investigation and organizational Value Evaluation. As reviled in the study, the disadvantage of methods based on the accounting value is static approach. It disregards the principle of generating value for the owner of the purchasing enterprise, respectively, for merger. Hence, they are not without shortcomings. The main issue with them is the difficulties to provide the initial offering price. Rather, they provide oriented information regarding the creative potential of the future values.

Keywords: Enterprise value, enterprise assessment, evaluation methods, principles of assessment, economic value, market value, predictive enterprise value

INTRODUCTION

Assessing the investment alternatives is one of the financial management activities. Thus, it represents the foundation for making a quality management decisions. Investment decisions regarding the sale and purchase of the company or joining of any other enterprise, is an inseparable activity from the problems of assessing the value of the target company.

The contemporary paradigm of enterprise management can be characterized as intensifying orientation towards the concepts of flexible management and the maximization of the owner's assets (maximizing the value of the enterprise). Flexible management means a dynamic approach to decision-making processes. Therefore, it is different from the traditional approach, which implies the immutability of made decisions without putting the new circumstances which was created into consideration. On the other hand, the orientation toward maximizing the owner's assets (the maximization of enterprise value) foresees the implementation of the new system of business success measuring. However, this was included within the concept of management based on maximizing the value (Value Based Management - VBM). The concept of management based on maximizing the value suggests the implementation of contemporary performance measures based on the concept of economic profit, rather than on the concept of accounting profit. Therefore, the most important and viable measurer of business success is economic value added.

This aim of this paper is to present the practical application of modern methods of assessing the value of the enterprise which will be illustrated with an appropriate example for the assessment of the value of "Enterprise X". Besides traditional assessment methods, based on the transferred amount, this paper will also apply other methods of assessing the value of the enterprise. These methods include: methods based on the discount flow expected profits; methods based on the discount flow net cash; and combined methods. Subsequently, the involvement of these methods of assessing the value of the enterprise will definitely have a positive impact on the quality of business decisions in general, and the investment decisions in particular.

LITERATURE REVIEW

It is deliberated that one of the most significant decisions, if not the most essential, of many managers is putting values on enterprises. Organizational value is an economic measure reflecting the market value of a company as a whole business. As noted by Throp (2010) "it is the sum of claims of all security holders: common and preferred equity holders, minority shareholders, debt holders, and others". Considering the organizational value from this perspective, one may buy the enterprise value of a company after the buyer settle with all the security holders that are engaged, in one or another way with the evaluated organization (Thorp, 2010). A more simplistic view of enterprise value is as the sum of a company's market capitalization and its net debt.

As argued by many (Gorenak & Košir, 2012; Bradburd & Richards, 2013;Hulten&Hao, 2008; Corrado et al. 2006; Hall, 2001; Black & Lynch, 2005; Hulten & Hao, 2010), an enterprise is a business and therefore the enterprise value is an amount of the whole organization's value and needs to be seen as such. It is assumed by many to have more practices than market capitalization, since it takes into account the value of other elements that may affect the overall value of the organization, such as organization's debt(and also adjusts for minorities and associates) to make it suitable for ratios above the P&L interest line such as EV/sales, EV/EBITDA and EV/EBIT. It is important to emphasis that the corporate value consist of different measurements and elements that constitute the overall value and is calculate by: market capitalization (all share classes) + net debt (and other liabilities, such as pension deficits) + minority interests – associates (both fair value).There are three types of enterprise value: total, core and operating (Suozzo et al,.2001, p.24).

As noted by IMA (1997) enterprise value (EV) is an economic measure reflecting the market value of the whole business". It is a sum of claims of all the security holders: debt holders, preferred shareholders, minority shareholders, common equity holders, and others. Enterprise value is one of the fundamental metrics used in business valuation, financial modeling, accounting, and portfolio analysis. Previous studies implied the conjoint performance measures of the sales level, the overall market value, organization profit, and net margin when comparing companies. It is considered the potential impact of operate/nonoperate decision not just on the companies themselves but on shareholder value; that is, the financial rewards earned by shareholders in these companies. The measures we incorporated in our analysis are described on the next page (IMA, 1997; Advisors, 2009).

Enterprise value (EV) tries to measure the 'true worth' of a business. More comprehensive than the market capitalization, it is often referred to as the takeover value — the amount of money required for an acquirer to buy a company at current market price, inclusive of cash, debt, and other items associated with a business. These factors affect the transferable enterprise value of SMEs. Whereas publicly traded companies can leverage price discovery mechanisms to uncover their EV, privately owned businesses do not have this mechanism at their disposal. Thus, the information gap is especially pronounced for small companies where intangible value drivers are often hidden and difficult to measure given the lack of a generally accepted valuation framework (Bradburd et al., 2015).

Reasons for value assessment of the enterprise

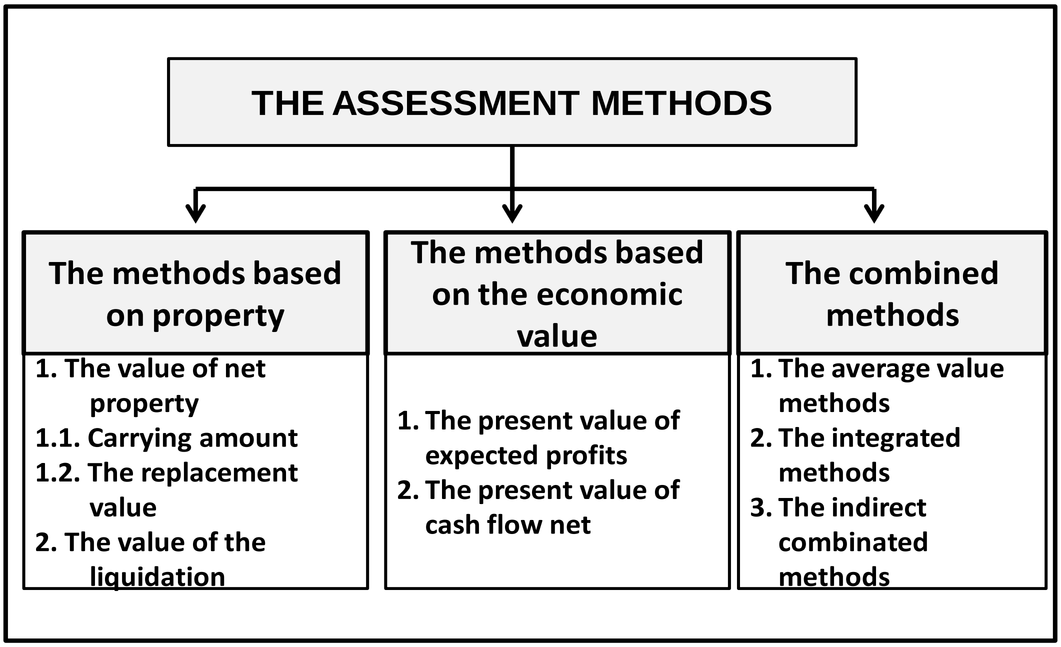
In market economy conditions, other goods as well as enterprises are the subject of trading. Thus, their sale and purchase is necessary to determine the price for the determination of which is necessary to assess the value of the enterprise. Assessing the value of the enterprise gives answers to the following questions: What the enterprise possesses? What the enterprise wins? What makes it special? The theory and practice have shown that the assessment is more of a "skill" rather than the exact or specific knowledge. So, according to the methods applied, the results obtained may vary and provide different outputs. However, nowadays, the principles for assessing the value of the enterprise are defined with the "international standards for assessing the value of the enterprise." The basic principles which should apply to any evaluator are, first, the assessment of enterprise as a general economy. Secondly, the assessment cannot be made based on the results achieved, but on the basis of the expected results.

The value determined by the assessor has the opportunity to change under the influence of the market, i.e. supply and demand. For this reason, it was stated that the final value of the enterprise consists of objective and subjective values. To the purchaser, the objective value of the enterprise is the value of the pure substance or liquidation value. Consequently, the subjective value will add or subtract something from the value of the pure substance (or the liquidation value). While to the seller, the value of the pure substance or liquidation value will adjust the assessments of development opportunities. It means that there must be a difference between the value of the enterprise assets and the value of the enterprise as a whole. The reason for this is that the value of the enterprise is determined by way of exploitation and the ways of combining of different property components, which the enterprise uses in their business. The enterprise value will vary depending on the applied assessment methods. Also, the sale and purchase price will be determined in the range between the lowest and highest value that is acceptable to the negotiating parties.

THE METHODS OF ASSESSING THE ENTERPRISE VALUE

In general, it can be said that there is a unique classification method of enterprise assessment. However, this paper will present their classification scheme based on two terms of enterprise value: the value of the property that the enterprise possesses and its economic value. Based on these two views of the enterprise value and the methods of assessment, the enterprise value can be classified into two main groups: a) based on the property value in which the enterprise owns, and b) based on the economic value of the enterprise. Beside these two groups of evaluation methods, there is a third group that can be added or implemented. This includes evaluation methods that combine two possible views on the value of the enterprise as mentioned above. Therefore, the classification of assessment methods of the enterprise value is given in Figure 1.

Figure 1. The classification methods of assessment of the enterprise value



The methods of assessing the value of the enterprise based on asset

The methods of assessing the value of the enterprise based on asset were focused on this present time. Thus, these methods consist of methods of assessing the accounting value of enterprise, methods of assessing the value of substitution, and methods of assessing the value of the enterprise liquidation. For a better evaluation of an organization and in providing more detailed information of each method implemented and assessed in this paper, the balance sheet statements of the accounting value, substitution value, and liquidation value of the enterprise "X" are given in table 1. However, this is used as a sample organization which is to be stressed and analyzed in this paper.

Table 1. The Balance sheet according to carrying amounts, the substitution value, and the liquidation value

No.	Elements	The amount		
		Carrying amount	The substitution value	The liquidation value
	THE ASSET	**16,500,000**	**32,730,800**	**21,713,500**
A	**Short-term property**	**7,560,300**	**6,154,100**	**6,048,200**
I	Cash and cash equivalents	75,000	75,000	75,000
II	Short-term financial placements	2,500,000	2,500,000	2,500,000
III	Receivable accounts	2,300,000	1,688,200	1,688,200
IV	Stocks	1,250,000	737,500	631,600
V	Prepayments	475,100	475,100	475,100
VI	Active time appropriations	960,200	678,300	678,300
B	**Long-term property**	**8,939,700**	**26,576,700**	**15,665,300**
I	Long-term property non-material	41,200	41,200	41,200
II	Fixed property	8,479,300	26,116,300	15,204,900
III	Long-term financial investments	2,500	2,500	2,500
IV	Investments in other long-term properties	394,300	394,300	394,300
V	Other long-term properties	22,400	22,400	22,400
	LIABILITY	**16,500,000**	**32,730,800**	**21,713,500**
A	**Short-term liabilities**	**4,620,000**	**4,620,000**	**4,661,500**
I	Liabilities to short-term funding sources	351,200	351,200	351,200
II	Payable accounts	3,596,700	3,596,700	3,596,700
III	Passive time divisions	672,100	672,100	672,100
III	Liabilities to the liquidation costs	-	-	41,500
B	**Long-term liabilities**	**1,485,000**	**1,485,000**	**1,485,000**
I	Liabilities to the long-term funding sources	1,384,000	1,384,000	1,384,000
II	Other long-term liabilities	101,000	101,000	101,000
C	**Capital**	**10,395,000**	**26,625,800**	**15,567,000**
I	The registered capital	8,050,000	24,280,800	13,222,000
II	Other reserves	1,351,300	1,351,300	1,351,300
III	Retained earnings	993,700	993,700	993,700

According to this method of assessment, the enterprise value was determined by deducting the liabilities from the property. This means that the net property value of the company "X" assessed according to the accounting method is 10,395,000€. Thus, this was carried out by the substitution value method which is 26,625,800€, and the liquidation method which is 15,567,000€.

Methods of assessing the value of the enterprise based on economic strength

The methods of assessing the value of the enterprise based on the property value provide the answer to the question: “What enterprise disposes”. Thus, nothing debates about what business results they achieve with the value they have at their disposal. Assessment of the enterprise value methods, which is based on economic strength and value, provides the answer to the question: "What company earns." Therefore, for the economic value concept, the level of financial investment does not matter. However, what matters and what is more important is how much profit it will generate, and what is the cash flow amount that will be generated by engaging the organization’s property in the future. The methods of assessing the value of the enterprise based on economic strength are: a) methods of assessing the value of the enterprise based on the present value of expected profits, and b) methods of assessing the value of the enterprise based on the present value of net cash flow. Assessing the value of the company "X", based on the present value of expected profits method is given in table. 2.

Table 2**.** Assessing the value of the enterprise based on the present value of expected profits

Years	***Net profit***	***Discount factor***	***Current value***
2017	982,000	0.909090909	892,727
2018	1,133,300	0.826446281	936,612
2019	1,345,100	0.751314800	1,010,593
2020	1,790,900	0.683013455	1,223,209
2021	2,110,800	0.620921323	1,310,641
2022	2,100,000	0.564473930	1,185,395
∑			6,559,177
	21,000,000	**0.564473930**	**11,853,952**
			18,413,129

As can be seen in Table 2, the value of the company "X" (i.e. the net asset and its capital, respectively) is based on the present value of the expected profits which is 18,413,129 €.

Assessing the value of the company "X" based on the present value of net cash flow method is given in Table 3.

Table 3. Assessing the value of the enterprise based on the present value of cash flow net

Years	***Cash flow***	***Discount factor***	***Current value***
2017	1,122,030	0.826446281	927,297
2018	1,240,130	0.683013455	847,025
2019	1,217,100	0.56447393	687,021
2020	1,360,300	0.46650738	634,590
2021	1,504,250	0.385543289	579,953
2022	1,629,270	0.318630817	519,136
∑			**4,195,022**
VR	8,746,605	0.318630817	**2,786,938**
Total			**6,981,960**

As can be seen, 6,981,960 € is a profitable value of the company's capital "X". However, this was according to the method of the present value of cash flow net.

Combined Methods

Through combined methods, the link between methods is made based on the enterprise property with the most common method that is used to evaluate the organization's value. Thus, this value is based on its economic strength. Thus, combined methods can be classified into three main groups: 1) the average value methods; 2) integrated methods; and 3) combining indirectly methods.

According to the average value method, the value of the enterprise is defined as the average property value and economic value, e.g. the determined value by the present value method of net cash flow. According to this method, the enterprise value would be determined as follows:

$$EV = \frac{PV + Pc}{2} = \frac{26{,}625{,}800 + 6{,}981{,}960}{2} = 16{,}803{,}880\ €$$

EV= the enterprise value

PV = the property value

P_c = constant annual profits

Form Integrated Methods: The most known and common method is the assessment method of *goodwill*. According to the goodwill method assessment, the value of the enterprise consists of the real value of the property plus the present value of goodwill. The goodwill has value only if it provides the highest profitability to the company compared to the average profitability of the industry to which the company belongs and within which the company operates. Only then, the Goodwill provides a higher present enterprise value of net cash. On the other hand, if the value is achieved, the organization would evaluate its property by market value method. According to this method, the enterprise value can be determined as followed:

$$EV = PV + \frac{Pc - (PV.pi)}{cg}$$

p_i= industry profitability rate

c_g = the capitalism rate of goodwill

CONCLUSIONS

For many enterprises, the process of buying a company represents one of the most important and complicated decision to make. Also, the merging of enterprise with another enterprise as one is an enterprise growth practices which can have a major impact in raising and lowering the image of the enterprise decision-making. The creating of values directly depends on apparent properties and unapparent target enterprise. Therefore, this should be assessed as high precision. Also, the right investment decision or the merging process has to be taken considerably. For this purpose, the management can implement a variety of methods for assessing the value of the enterprise. However, the disadvantage of methods based on the accounting value is static approach. It disregards the principle of generating value for the owner of the purchasing enterprise, respectively, for merger. These shortcomings can significantly be reduced through the application of methods that are based on economic strength of the assessed organization. However, as shown by the indicators presented in this paper, these elaborated methods do not appear to be perfect. Hence, they are not without shortcomings. Their main shortcoming is that they don’t give the right information to management, which should have been the initial offering price. They provide oriented information regarding the creative potential of the future values. It does not mean that such methods should not be applied to assessment, but it is necessary that the evaluation process should be advanced through various forms of combination of the aforementioned methods. Therefore, the combination of assessment methods has significant value, especially when it is implemented in developing countries. In these countries, the methods based on accounting indicators do not show any objective value of the target company.

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