

THE PROCESS OF DETERMINING THE VALUE OF A COMPANY

Jana Kurotová
University of Zilina, Slovakia
jana.kurotova@fpedas.uniza.sk

Dominika Hošťáková
University of Zilina, Slovakia
dominika.hostakova@fpedas.uniza.sk

Abstract:

The process of determining the value of a company is characterized by its time and workload, which is also related to the choice of the appropriate method. The aim of the paper is to analyse the process of determining the value of a company. Secondary research has analysed the steps in which the process of determining the value of the company is going on. By analysing it, we have pointed out that it is a process that requires, in addition to a great deal of time and work that the valued company fully cooperates with it.

Keywords: The value, Value of company, Expert activity, Determining process of value

1. INTRODUCTION

Determining the value of a business is a complex discipline that places expertise on economic disciplines. In the process of determining the value of a company, knowledge is applied in the areas of corporate finance, accounting, financial analysis, macroeconomics, marketing and other factors. Therefore, this complexity makes the issue of determining the value of a business interesting but on the other hand it is quite demanding.

2. LITERATURE REVIEW

Value is the defining dimension of measurement in a market economy. People invest in the expectation that when they sell, the value of each investment will have grown by enough above its cost to compensate them for the risk they took. This is true for all types of investments, be they bonds, derivatives, bank accounts, or company shares. Indeed, in a market economy, a company's ability to create value for its shareholders and the amount of value it creates are the chief measures by which it is judged. (Kotler et al, 2010)

International Valuation Standards define value as the price most likely to be concluded by the buyers and sellers of a good or service available for purchase. Value establishes the hypothetical, or notional, price that typically motivated buyers and sellers are most likely to conclude for the good or service. Thus, value is not a fact, but an estimate of the most likely price that will be paid for a good or service available for purchase at a given time. (International Valuation Standards, 2018)

In the book Business Value Management is value defined as the value which may exist without change, consists of a theoretical assessment based on a comparison of performance and arbitrage that an investor or an evaluator makes in relation to other available assets. Therefore, the value is merely a preliminary, indicative, objective evidence. (Kardos & Jakubec, 2016)

The value of a company reflects the maximum valuation (depreciation) of owners' deposits in monetary terms at a certain date. A company generates value when it can bring returns to shareholders (shareholders) higher than the cost of capital needed to invest in the company. (Harumova, 2008) The valuation of a company is a royal discipline, largely due to the broad scope of the entire profession. In a global market environment, the purpose of determining the value of a company is a company that is perceived as a commodity and is the means of exchange between the buyer and the seller. (Herman, 2014)

Determining the value of a company is called a demanding process for several reasons:

- every company is unique, and it is therefore very difficult to compare it with other companies operating in the same environment or industry,
- the total value of a company is always higher than the sum of the individual assets of the company,
- when calculating the value of a company, an expert does not only work with current values, but also uses past performance and considers the company's revenue potential,
- the total value of a company may also be affected by an expert. (Fetisova, 2015)

Determination of company value can be understood as a process in which by using appropriate methods, an expert can determine the value of a company in monetary terms at a certain date. The value is not equal to the price it is only the most likely estimate. Today's environment requires a thorough understanding of value, considering certain factors such as:

- strong competition which targets to large companies,
- available capital for all companies of varying sizes,
- unstable company environment. (Kardos & Jakubec, 2016)

As mentioned above, the determination of a company value is devoted to experts or expert organizations whose task is to calculate the value of a company by means of an appropriate method. Expert activity may take place in different countries in a different way. In the following, we have described how the expert activity is taking place in Sweden, the Czech Republic and the Slovak Republic.

Expert activity in Sweden

Expertise as a union is a little widespread term in Sweden. The reason is that the position of an expert is not motivated by a social need, but society considers it necessary to ensure legal equilibrium in public

affairs. The notion of "judicial expertise" in Sweden does not exist at all. Everyone can invite anyone as an expert - expert and it is at the discretion of the court what value I attach expert opinion. (Szilagyi, 2000)

The State Office of Kammarkolegium regulates and manages a single register of authorized experts in Sweden. This register includes names of translators and interpreters from other languages to Swedish. The legal need for correct interpretation and interpretation is so socially important that experts in this area are subject to public scrutiny. When determining the value of a company, it is always crucial to judge who is ordering this service. The purchase price is subject to taxation and the valuation is always a recommendation. In the company valuation process, experts build on a dozen valuation models that have their ability to express themselves, but the price is formed in the negotiation process and ability to pay. (Szilagyi & Sedlakova, 2002)

Expert activity in Czech Republic

In 1990, the Chamber of Judicial Experts established in the Czech Republic was a voluntary organization and brought together all judicial experts working in different professions. The Chamber's mission is to promote and defend the interests of experts in relation to state bodies and other organizations and individuals, to participate in the elaboration and consultation of draft legislation concerning the expert's activity. During its period of operation, the Chamber has developed a reputation and is respected by central government authorities. (Komora soudnich znalcu CR, 2019)

There is no law or regulation in place in the Czech Republic that would collectively cover the determination of the value of the company and would be binding. Experts in determining the value of a company are primarily based on economic theory, which is the main source of information for them. Despite the absence of a legislative regulation, there are certain rules that apply at least in part and which the expert should know. (Marik, 2011) These rules are divided into three groups:

- A. *Czech regulation* - they are only used for a limited number of cases
 - Property Valuation Act No. 151/1997 Coll. and following the Decree of the Ministry of Finance of the Czech Republic - the law is binding only for the valuation under the Bankruptcy and Settlement Act and the Law on Court Fees.
 - Czech National Bank's Guideline - this Guideline is designed specifically for company experts but only for expert opinions submitted to the Czech National Bank
- B. *International (IVS) and European (EVS) valuation standards* - these standards include the definition of value and certain framework principles that should be respected in the valuation. They are not binding they are only a set of internationally recognized recommendations. (Marik, 2011)

All these standards are constantly updated and updated, and it is therefore highly necessary that these rules are regularly monitored.

Expert activity in Slovak Republic

In the Slovak Republic in 2003 the Slovak Chamber of Experts was established as a civic association called Slovak Association of Economic Experts. The purpose of the chamber is to promote, protect and increase the professional level of experts and expert organizations in the performance of expert activity. The Slovak Expert Chamber is an interest association of experts, expert organizations and experts whose activities contribute to the development of expert activity. (Slovenska komora znalcov, 2019) According to Act No. 382/2004 Coll. experts, translators and translators are experts engaged in the assessment of various facts having special expertise or experience. It delivers expert judgment, expert judgment at the request of the court or other authorities and for the private sphere. The expert is registered in the Slovak Republic in the list of experts led by the Ministry of Justice of the Slovak Republic. (Act No. 382/2004) In Slovakia unlike the Czech Republic, experts must follow a binding decree on the general value of the property. (Marik, 2011) The determination of the value of a company in Slovakia has been elaborated by its legislative norm and this is the Decree of the Ministry of Justice of the Slovak Republic No. 492/2004 Coll. as amended. The Decree sets out in detail the various methods and procedures that are used to determine the value of the expert.

Determining the total value of the assets of a company and other assets is currently carried out:

- *Physical experts* of individual expert departments when assessing individual assets,
- *Expert institutions and organizations (legal entities)* in the field of "company management" - the activity in this field is carried out by expert institutions, organizations and valuation workplaces that have fulfilled the conditions of professional competence, they have been authorized to

evaluate the assets of companies and have been entered in the relevant list of MS SR. (Decree No. 492/2004) The current requirements for expert activity in this field of expertise considerably exceeded the original framework provided by Act No. 92/1991 Coll. transfer of state property to other persons. (Szilagyi & Sedlakova, 2002)

3. METHODOLOGY

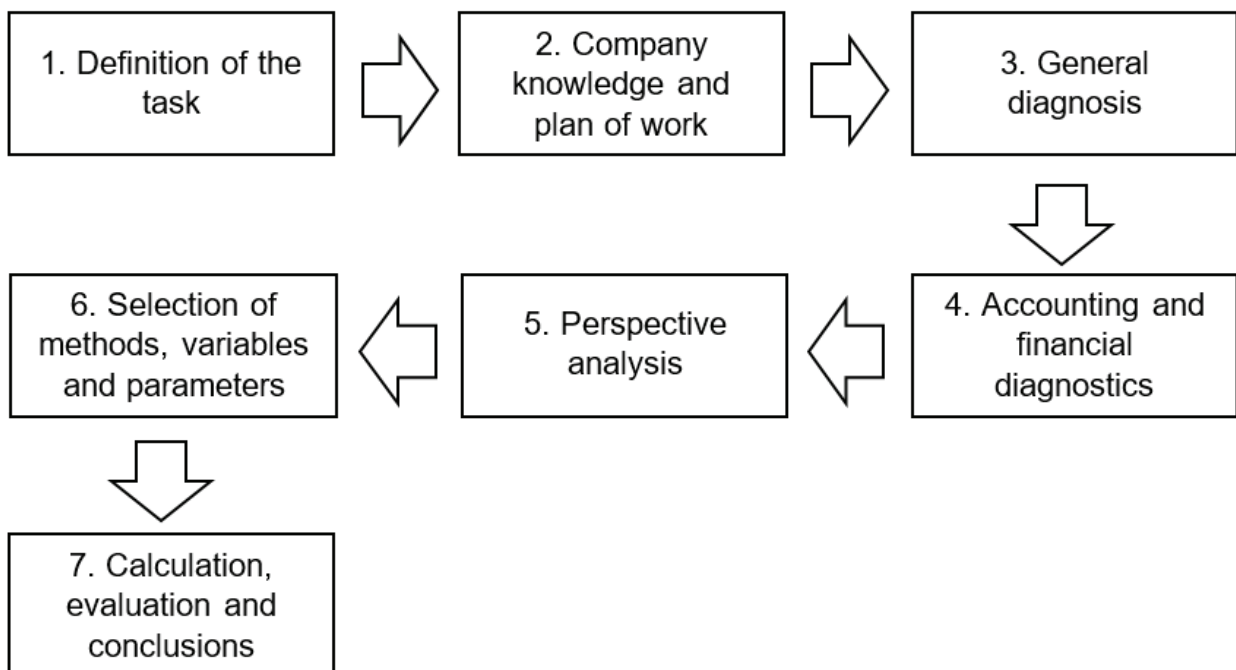
The aim of the paper is to analyse the process of determining the value of a company. To be able to analyse the process, it was necessary to theoretically define the problem of determining the value of the company and the area of expert activity. Secondary research was based on the analysis of the company valuation process. Each step of the process consists of analysing and digesting. The main source from which we drew was the literature that deals with the issues studied. The methods we used in the paper are secondary research, analysis, comparison, method of collection information, method of synthesis and deduction method.

4. RESULTS

Appraisal approach as well as the choice of method and method is not the only activity of the expert before the valuation of the business. Based on theoretical background and practical experience, there is a basic approach to assessing a business that is good to hold. Each expert has its own valuation process. This is because there are no specific rules that must be strictly observed. On the one hand, it is because each expert has his own adopted knowledge and skills for a given valuation purpose. In principle, however, a two to three-step procedure should be followed, in which strategic and financial analysis will be developed. This is followed by a financial plan and, in conclusion, the assessment itself is relevant to the purpose.

The individual steps of the company value determination process are shown in the following figure.

Picture 1: The process of determining the value of the company



Source: author.

In the following section, each step of the company value determination process has been described in detail.

1) *Definition of the task*

The first, very important step is based on explaining what the customer enters an expert that is what the customer wants from the expert. Under the term, we can present a determination of the value of a

company or a determination of the value of certain building structures, tangible assets, intangible assets, land or other components of a company. Part of this agreement is also a term that should be an expert opinion produced by an expert or professional organization.

The first stage, in addition to awarding the contract, also consists of the setting-up of a working group that is involved in determining the value of the company or parts of its assets. Each such team consists of a team leader who coordinates the activities of its participants. The next part is the representatives of the expert organization - the experts and responsible employees working in the company, with which they are preparing to determine its value with their group.

2) *Company knowledge and plan of work*

Determining the value of a company cannot be considered as a process that takes place behind the desk. This process requires the assembled team to be in constant contact with individual workers who can provide the required information if needed. The most important and most useful communication is communicating with a company management that thoroughly recognizes the company from every site. For the process of assessing the value of the company to proceed smoothly, it is necessary for the experts involved in determining the value of the firm to be experienced and to have access to cooperation by the workers of the company.

Part of the step is to draw up a work plan. The work plan is an important document by which the work team involved in determining the value of the company is managing and at the same time this document also talks about how the expert opinion will be carried out. j. in what phases the process of determining the value of a company will be in progress, what will be the binding deadlines that will have to be met to achieve the stated goal.

3) *General diagnosis*

In this step, the expert together with their team will choose the most appropriate approach they will use to determine the value of a company and which will be shaped and specified over time. The issue of determining the value of a company can be approached in a variety of ways which differ amongst themselves in the way of valuation, rating requirements and individual functions. The work team chooses from 4 approaches:

- *Subjective approach* - based on the idea of Cologne School, which says that the value of the company is based on the modifications of the individual functions that give the user results. Such a group of functions includes advisory, decision-making, argumentation, communication and tax functions.
- *Objective approach* - based on three levels of company value determination. The first stage only works with the relevant data that are available at the date of determining the value of the company. In the second step, we deal with facts that concern the future and could affect the value of the company. The last third step works with a subjective view that will be used to determine the value of the company.
- *Market value approach* - works with the idea that there is a market for businesses, and there are more buyers and more sellers on this market. This phenomenon creates certain conditions for determining the market price. In determining the value of a company, the expert then calculates the potential market price, which may also be referred to as the market value.
- *Schmalenbach's approach* - analyses the company based on the values circle. It monitors the company's payment streams and knows where these flows are coming from and where they are leaving. In determining the value of a company, it is based on the balance sheet of the rated entity and its profit and loss statement.

After successfully selecting the most appropriate approach, the work team moves to select the critical areas they will address in the analysis and analysis process. These are mainly economic, business, technical, and management, legal and social connections. In addition to selecting areas, it is also necessary to analyse the macro-environment and industry in which the company operates and to analyse its opportunities and threats that may affect the business of the company.

4) *Accounting and financial diagnostics*

The individual analyses focus mainly on the asset structure, the capital structure, the movement and the resulting cash condition. The main objective of the individual analyses is to find out what is the potential return and potential return of the company. The results achieved are a support for the work team and they will be used at the end of the determination of the value of the company.

When working with the information that a work team draws from accounting, it is necessary to check their veracity. In addition to information verification, the work team also deals with financial and economic analysis, analysing data from the past as well as from the company.

5) *Perspective analysis*

If management has a realistic vision of the future of its company, it is a factor that promotes the good name of the company. On the contrary, if it is found to be a company that has chronic problems, it is possible to choose the corresponding pessimistic approaches and conclusions to determine the value of the company.

Within this point, the work team, especially experts from the expert organization, will prepare an ex ante financial - economic analysis and, in addition, will analyse the short - term and long - term plan of the company focusing on the prospective development and long - term financial plan of the company. The company plan is the basic document on revenue methods when determining the value of a company.

6) *Selection of methods, variables and parameters*

In the penultimate step of determining the value of a company, the work team selects the most appropriate method to determine the value based on the available data obtained by analysing the accounting and financial statements. In determining the value of a company, the working team works mainly with the data they need to accurately quantify the value of the company. Both the method and the data shall be chosen in such a way that the objectivity of the information obtained is not impaired. The work team selects the most appropriate method among the different methods that are grouped into three groups. They are:

Basic methods for determining the value of a company

- the property method,
- the business method,
- the combined method,
- the liquidation method,
- the comparison method.

Yield methods for determining the value of a company

- DCF method,
- DFCFE method,
- DFCFF method,
- method of valuing the entire company as an option.

Other methods for determining the value of a company

- profit capitalization,
- EVA method,
- CF ROI method,
- methods based on market analysis.

7) *Calculation, evaluation and conclusions*

The final step of the company value determination process is the final value calculation of the company. In addition to determining the value of a company, the work team is dedicated to analysing the results obtained during its activities. After analysing the results, they also perform their synthesis and then make a comprehensive summary of the results.

The work team gives the result to the client in the form of an expert report, which contains the results achieved regarding the actual value of the company. The judgment also includes the opinion of the team on the outcome and advice on how to proceed with the company steadily developing value, or in the event of adverse results, what steps should be taken to adjust the value of the company. (Kardos & Jakubec, 2016)

5. CONCLUSION

In the analysis, we concluded that when determining the value of a company, it is necessary for the leading expert together with his team to examine the company from the inside first and collect data from strategic analysis, financial analysis, business plan, and so on. In addition to collecting information, the basis for each valuation is the most accurate estimate of the future of the company. For the work team to determine the future of the company, it is necessary to carry out the strategic analysis on which the company's financial plan is based. In addition, it is necessary to examine the internal and external environment in which the company is located. The work team focuses on factors that most influence the rated company, for example, competition in the sector in which the company operates, relationships with suppliers and customers, or the state of the economy where the company is located. Based on such a detailed company analysis, it is therefore highly necessary for an undertaking that has ordered such a service to cooperate fully with the work team and to provide them with experienced employees who can provide the necessary information.

After the company analysis, the work team approaches a general picture of the status of the rated company and can determine the value of the company under review. To determine the value of a company, the work team can apply different methods. As we mentioned in the analysis, there are many methods to determine the value of a company, so it is necessary to choose the method that best matches the nature of the rated company and at the same time the work team has enough information needed to use the chosen method. The most used group of methods is a revenue pool.

In conclusion, however, we note that determining the value of a company is the process in which the created work team does not specify the exact value of the company. It is not possible to accurately determine the value of a company because there are many objective and subjective factors that the leading expert cannot quantify with their team. It is necessary for the presented result to be taken only as an indicative result because the result of determining the value of a company is the value in the form of an estimate which a working team has achieved by using a specific method, but it nevertheless represents only a greater or lesser approximation to the actual market value of the company.

ACKNOWLEDGEMENTS

This paper was supported by the project 1/0653/18 VEGA business sustainability as a prerequisite for prosperity.

REFERENCE LIST

1. Act No. 382/2004 Coll on experts, interpreters and translators, and on amending and supplementing certain laws.
2. Decree No. 492/2004 Coll. on the determination of the general value of the assets.
3. Developing and communicating the Valuation (2018, July 31). Retrieved from <http://anzvps.api.org.au/documents/ANZVPS-04.pdf>
4. Fetisová, E. (2015). Podnikové financie – praktické aplikácie a zbierka príkladov, *Wolters Kluwer*, pp. 35.
5. Harumová, A. (2008). Stanovenie hodnoty majetku – hlavné aspekty ekonomickej, znaleckej a expertnej činnosti, *Iura Edition*, (pp. 24-25).
6. Harumová, A. (2016). Stanovenie hodnoty I, *Business Valuation Institute*, (pp. 24-28).
7. Heřman, J. (2014). Stanovení hodnoty podniku, *Royen Trade*, (pp. 7-8).
8. Jakubec, M., Kardoš, P. (2016). Riadenie hodnoty podniku. *Wolters Kluwer*, (pp. 26-27).
9. Koller, T., Goedhart, M., Wessels, S. (2010). Valuation: Measuring and managing the value of companies, *McKinsey & Sons*. pp. 3
10. Komora soudních znalců ČR. Podmínky členství (2018, October 15). Retrieved from <http://www.kszcr.cz/podminky-clenstvi.html>
11. Mařík, M. (2011). Metody oceňování podniku: process ocenění základní metody a postupy, *Ekopress*, (pp. 18-20).
12. Slovenská komora znalcov. História (2018, December 3). Retrieved from <http://www.skz.sk/historia/d-1002/p1=53>
13. Szilágyi, M. (2000) Výber článkov ekonomických znaleckých odborov – Znalectvo, *EDIS*, (pp. 45-50).
14. Szilágyi, M., Sedláková, I. (2002) Ekonomické a právne aspekty stanovenia všeobecnej hodnoty podniku, *EDIS*, (pp. 231-240).