METHODS OF BUSINESS VALUATION

Business valuation is an attempt at estimating the worth of a business venture, enterprise or a company. The need for valuation may arise as a result of any of the following:

i. To determine capital transfer tax (Estate purposes)
ii. Amalgamation or Absorption schemes
iii. To purchase shares for controlling interest
iv. For liquidation purpose
v. For bank lending purposes
vi. To discharge debts and liabilities

Given the nature and structure of companies, there are a number of factors which may influence the value of shares. Some of these factors are within the company itself, while others are in the external environment. These factors include the following:

i. Dividend policy: this influences the proportion of profit that will be paid to shareholders; and hence affect the value of the shares (and ultimately of the business).
ii. Past and potential earnings capability of a business: the better the past and potential earnings (sales, profit) of the company the higher its value.
iii. Market price of the company's shares: this is the amount that a share of the company is trading on the stock exchange. It gives an objective view of value of a business when subjected to the forces of demand and supply.
iv. Value and composition of the company's assets: the actual value of a company's assets provide a tangible estimate of the company's value.
v. Market acceptability of the company's products: the success (or otherwise) of a company's product on the market goes a long way to contribute to the value of the business. The more acceptable the product is, the more revenue that the company will have; and this ultimately may translate to a higher value of the company.
vi. Ownership Structure: whether a business is a sole proprietorship, partnership, or Limited Liability Company goes a long way to influence the level of organisation, structure, survival, and stability; and as such influence the overall value of the business.
vii. Availability of raw materials: for some businesses, the availability of raw materials implies continuous survival and that leaves room for more earnings, which in turn helps the overall value of the company.
viii. Calibre of management: the composition of the management team of a company, by reason of their skills and expertise, can directly affect the performance of the company and hence its value.

Methods of Valuation

The value of a company may be computed in two major ways:

i. Income Basis
ii. Equity/Net Assets Basis

Income Basis

a. **Earnings Yield Basis:** this method values a business on the basis of current/expected profitability of the business.

$$\boldsymbol{Value = \frac{Current\ or\ maintaineble\ Earnings}{Earnings\ Yield}}$$

Maintainable earnings refers to expected profit within the foreseeable future.

b. **Dividend Yield Basis:** This determines the value of a company by capitalizing the current dividend payment.

$$\boldsymbol{Value = \frac{Current\ or\ Expected\ Dividend}{Dividend\ Yield}}$$

Where the earnings yield or dividend yield of the company is not known/given that of a similar firm, or an industry average can be used.

Equity/Net Asset Basis

a. **Net Tangible Assets Basis:** this values a business on the basis of the net book value of the tangible assets less liabilities (including preference shares).

Total Assets	X
Intangible Assets	(X)
Liabilities	(X)
Value	X

b. **Tangible Assets plus Goodwill Basis:** This method includes goodwill in the computation of total assets.

Total Assets	X
Liabilities	(X)
Value	X

c. **Replacement Cost Basis:** in this case the value of the assets is determined on the basis of what it will cost to replace them at current market prices in their current position.

Replacement costs	X
Liabilities	(X)
Value	X

d. **Liquidation/Break-up Value Basis:** this method values assets on the basis of the amount that could be realised from an immediate sale of the asset less amount needed to discharge the liabilities (including preference shares) and realisation cost.

Liquidation value	X
Realisation cost	(X)
Liabilities	(X)
Value	X

e. **Market Price basis:** this method can be employed only for companies quoted on the stock exchange. It considers the market value of the entire shares the company has in issue.

$$\boldsymbol{Value = Market\ value\ per\ share * Number\ of\ Ordinary\ shares\ in\ issue}$$

f. **Net Present Value of Expected Cash flow:** this method values a business as if it were an investment decision, such that the NPV shows the present value of the business.