Methods for Valuation of a Business by Rodney Wincaster

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The accurate fiscal worth or the measure of the economic value of a business is termed as the Valuation of a business. The process is significant for various financial purposes. It determines how much a potential financier will invest in a particular business and the amount of return that can be expected.

A business per se or its strategic unit may be valued for one of the following reasons:

â€¢ Prior to a merger or an acquisition

â€¢ To resolve concerns pertaining to estate or gift taxation

â€¢ To estimate the net worth of a business prior to its sale

â€¢ To assess your business before approaching potential shareholders or investors

The Components of Business Valuation

A realistic valuation of a business involves much more than analyzing the preceding yearâ€™s financial statements.

â€¢ It requires a comprehensive analysis of multiple years of business performance.

â€¢ The prospective position of the company in the market against competitors.

â€¢ It also considers the future of the industry based on the economic predictions.

Valuation of a Business â€“ Approaches

There is no particular method employed for valuation of a business. There are various methods used, which use different sources of financial information and a variety of assumptions to calculate the worth of a particular business. For instance, the method could be based on the evaluation of assets owned by a company, the inflow and outflow of cash for the business, or the projected earnings of the company.

Letâ€™s discuss some widely adopted methods for valuation of a business.

The following methods are based on earnings and cash-flow:

1. Discounted or Future Cash Flow Method

This approach is preferred the most by prospective investors of a company due to its accuracy and effectiveness. It is called the future cash flow method because it takes into account the projected financial ups and downs over a specific period and the money that is expected to flow into the company. This will give a fair idea to the investor about the expected ROI and the time they must wait to receive the same.

2. Going Concern Valuation Method

This method weighs the current investment against the future monetary inflows. It uses the financial figures of previous years to speculate the revenues in future, assuming that no change will occur. The conclusion of the method is based on the principle that the higher the amount of potential cash flow, the greater is the value of the business today.

The following methods are based on assets owned by the company:

1. Book Value Method

This method is the simplest, through which the valuation of a business can be calculated from the companyâ€™s financial statements. It requires simply subtracting the companyâ€™s liabilities from its ass owned. The value obtained is the net worth of the business, also called its book value or shareholderâ€™s equity.

2. Liquidation Value Method

This method first assigns a distressed rate to the companyâ€™s assets and subtracts the actual value of liabilities from the resultant figure. Liquidation value reflects the value of a business much lower than the current market rate. It is generally employed only if a business is in serious economic trouble.

In the end, actually a business is exactly worth what the investors are ready to invest in it or buyers are willing to pay for it in the current market scenario.

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Correct a business valuation must be done using the right approach. MBA and Co will help you get a better understanding of your a financial situation.

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