

EVALUATING THE VALUE OF A BUSINESS A BASIC PROBLEM IN EQUITIZATION OF STATE ENTERPRISES

by Dr. ĐÀO DUY HUÂN & MA. TRẦN ĐÌNH PHUNG

Equitization seems the inevitable in transition from the centrally planned economy to the socialist-oriented market economy. The present problem is that the slowness and difficulties in the process of equitization have affected unfavorably the economic renovation. Causes of this situation are a lot: some enterprises don't like to be equitized, some fear that there would be no buyers for their shares, many directors fear to lose their position and interest, lack of a stock market, the public didn't interest in share buying...

One of the big obstacles to the equitization is the problem of evaluating the value of business: How can we evaluate it exactly? How many ways of evaluation are there? How can the enterprise's assets be evaluated in order to provoke the public's attention? And on the other hand, how can it be done to protect the government's interest?

In this article, we would like to present some methods of evaluating the value of business.

Commonly, the value of a business comprises 3 parts:

- Value of the business' tangible assets.
- Value of land used by the business.
- Value of intangible assets of the business.

Basing on this way of differentiating, we will have the following ways of evaluating value of a business:

1. Calculating value in exchange of physical assets of a business:

This is an important basis for evaluating the value of a business. There are many ways to calculate the value in exchange of physical assets of a business:

a. Basing on the market price: It is the current price of these assets in the market at the time they are evaluated. Each asset has its own price and there is no price for all of the assets of a business. It's a mistake to evaluate an overall price for every kind of asset of a business.

The following formula is usually used for calculating the assets of a business:

$$G = \sum_{i=1}^n G_i$$

Where G is the total value of assets of business basing on the market price.

G_i is the market price of each asset.

n is the number of assets.

This way of calculating is simple but didn't consider all of these assets as a system. Therefore it's usually used in case of dissolution of a business.

b. Basing on recovered value: Recovered value of an

asset is the amount of money to produce the same or similar asset on the day of evaluation. But in fact, because of technological development, it's hard to find a new asset which is identical to the old one. Thus, in evaluation, the invisible deterioration of assets should be taken into account.

c. Basing on adjusted value: this method is officially used by the government in the plan enclosed with the Decision No 202/CT promulgated on June 8, 1992.

This method assesses the value of an asset basing on the current price which is indirectly or indirectly adjusted to the market price in order to estimated this asset more exactly at the time of equitization.

- Assessing the value of assets of a business (not including land)

+ First stage: There are two cases of this process:

If the capital of this business is allocated by the government then the value of its assets is the value of allocated capital plus (or minus) the increase (or decrease) of capital until the day of equitization with the capital preserving coefficient taken into consideration.

If the business hasn't received capital from the government yet, then the value of its assets is the value which was revaluated on Jan, 1, 1990.

+ Second stage: Assessing the value of assets more exactly by calculating their value in exchange and various advantages of the business:

In the first stage, although the value of assets was compared with the market price, but the profitability of the business isn't taken into consideration, especially in Vietnam where it's hard to affirm sources and conditions of machines and equipment. According to a Ministry of Light Industry's survey of 727 machines and three production lines in 42 factories, 76% of imported machines were produced in the 1950s or 1960s; over 60% of them have been amortized already; 50% were renovated and a lot of them have gone out of production long time ago. Thus, we can't have an unique way of evaluation or unique coefficient for all kinds of assets.

In order to have a persuasive evaluation, we have to combine this method with the others.

- Assessing the value of land of a business:

Land, up till now, has been considered as a special means of production and its value is never evaluated seriously. But in fact, land always has its own price and it can be traded, especially in the market economy. Therefore, in evaluating the value of a business, the price of its land should be taken into account.

There could be two ways of calculating the value of land:

- It is considered as part of the value of the business

and as the capital brought in by the government to joint stock company. This value should be restimated every five years. This way fulfils two requirements:

+ According to international practices, land is considered as part of the physical assets of a business.

+ According to Vietnam constitution, the ownership of land can't be changed hands.

This way is used now in joint-ventures between Vietnam and foreign parties.

The price of land is evaluated, but the land won't be equitized. The government will lease that area to the would-be joint-stock company. The joint-stock company will pay annual rent for the use of that area.

These two ways of calculation have one disadvantage: the state enterprises usually occupy more land than they need, on the other hand, the price of these areas is usually high because of their convenient positions. If the price of land is added, the value of the business will be too high. This will make the share dearer and make the share selling more difficult. If the high rent for the use of land is added to the production cost, the company can suffer losses or can't make desirable profits.

Thus, the government can't ask for an exact price for the land when equitization takes place. This price should be lowered or added to the production cost step by step over many years. This means that subsidization can't be removed overnight and the government can't get a fair share of the cake.

In present condition, when the Land Law hasn't allowed the government to sell land, the first way seems a reasonable one.

2. The combining method

In this method of evaluating, both tangible and intangible assets are evaluated as a whole and not as separate parts.

The scientific basis for this method is that in the market economy, all of profitable elements can be changed into money (profit or income). Thus, the value of a business evaluated under this method depends on many factors effecting on the economic performance of the business (managerial skill, labor force, financial targets, prestige...). In short, it depends on the profitability of the business. This is what the investors interest themselves in.

The general formula of this method for evaluating the value of a business is:

$$V = \frac{P}{r} \quad (1)$$

This formula originates from:

$$\text{Rate of return (r)} = \frac{\text{Total profit (P)}}{\text{Total capital (V)}}$$

In the market economy, the investors usually compare their expected return on capital with interest rate of savings account or of the government bond, or inflation rate... and a principle is formed:

Nominal interest = interest rate of savings account = inflation rate

In evaluating the value of a business before equitization, the formula (1) will be:

Value of business =

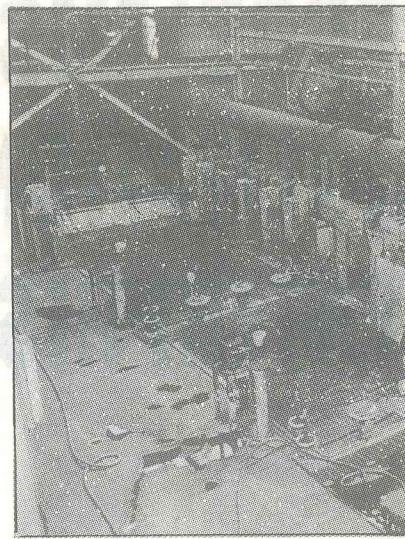
$$\frac{\text{Annual net profit in the next five years}}{\text{Monthly nominal interest} \times 12} \quad (2)$$

According to formula (2), the nominal interest is an invariable number and is known beforehand, then the value of the business is in direct ratio to the expected profit.

However, in fact, the share of profit received by shareholders could be bigger or smaller than the expected number, that is why shares or securities are bought and sold busily in the stock exchange.

In evaluating the value of the business by its profit, the following matters need to be considered:

- The businesses could be arranged in two classes:
- + Businesses keeping on producing their main



products: we can take their financial targets of previous years and their future perspective into account.

- Businesses changing their trade: we can evaluate their value basing on the capability of these businesses and other similar ones in order to reach an exact estimation.

- Asserting the annual net profit: This will be done basing on planned growth rate of these businesses in the next five years.

Under this combining method, there is the second

way of calculating basing on the formula:

Value of the business = Average net profit per year (in the next five years) x capital invested / Average net profit in five years

$$\text{That is: } V_b = \frac{V}{P} \times \frac{Pr}{Pr}$$

In a normal case, V is equal to V_b, that is all of assets of the business have been evaluated exactly and could be equitized.

But the problem is to assert V_b, that means to assert the value of the business before sale. Thus, V_b could be smaller or bigger than V. So we can replace the average net profit in the next five years of the business with that of the industry (P_{ng}). The above-mentioned formula will be:

$$V_b = \frac{V}{P} \times \frac{Pr}{P_{ng}}$$

Or $V_b = V \times \frac{Pr}{P_{ng}}$, where H: $\frac{Pr}{P_{ng}}$

In this formula, V_b is a function of H, that is the value of V_b depends on the varying values of H.

The values of V and V_b could be:

. V > V_b when some assets of the business can't be sold (such as borrowing capital, capital invested in a joint venture, scrapes...)

. V = V_b when all assets belong to the business and can be used for doing business.

. V < V_b when all of shareholders agree to have assets which isn't under ownership of the business sold.

On the other hand, the value of H can vary, so the value of V_b will change accordingly:

. H = 1 \Rightarrow V_b = V when the average net profit in the next five years of the business equals that of the industry.

. H > 1 \Rightarrow V_b > V when the average net profit in the next five years of the business is bigger, and

. H < 1 \Rightarrow V_b < V when it's smaller.

In using this method, there is a difficulty: How can P_{ng} be estimated, because one business can't have the same conditions as the others do?

In short, the method basing on the net profit could produce more exact result than the method basing on the value in exchange. This method is very popular among different countries, but it's hard to apply this method to Vietnam because we lack the real market economy and stock market, and most of the state enterprises are suffering losses. Therefore, we had better combine this method with the method basing on adjusted value of assets ♣