

Peculiarities of the Ukrainian Enterprise Valuation

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1 Introduction

In Ukraine is the enterprise valuation as the field of scientific studies and practice in the phase of the origin. Today the valuation activities mean the service of property value determination in occasions, ordered by legal issues.

In developed countries, like Germany and USA, that stood at the source of valuation theory, the evaluation methods show the tight relation to the political, economical, cultural and historical conditions of the society, or in other words, the term introduced by Diehm biomorphe development².

2 Specific Conditions of the Valuation Origin in Ukraine

The Ukrainian economist T. Momot thinks, that the difficulties in evaluation process are caused because of the volume of necessary information, needed for value determination in comparison to auditing³. We consider the reasons for that fact are to be found in the inner conflict between the market economic character of enterprise valuation, which requires the transparence and information efficiency of the market and the free competition on it, and the actual conditions of Ukrainian economy, that acts to 70 % in shadow, assert some appreciations. This conflict drives to the confrontation between the information function of the enterprise valuation and the striving of some subjects to use the knowledge of firm's fair value for their private interests. This assertion finds its indirect confirmation in the fact of strong resistance of the management, leading the companies to be valued, in letting the experts an access to the relevant statistics and figures⁴.

The low grade of the evaluating activities expansion in Ukraine is stipulated by the deficit of information about the enterprise to be evaluated, as the main resource, by the deficit of qualified specialists, who studied this field in universities. None of Ukrainian State universities offer valuation in their Bachelor or Master courses. The rest of objective reasons are the low development of the national stock market and its low rates of capitalization. Great contribution are made by the high political and economical risks of the country. These reasons curb the use of the international experience as well as studies of native scientists in the sphere of enterprise valuation.

Unlike German theoretical discussion, that takes its beginning in 20s years of XX century and lasts till nowadays⁵, the Ukrainian economists, whose scientific interest touch this area, content with definitions of value, its main kinds and other categories, relevant for enterprise

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² Diehm S. (2003): *Erfolgspotenzialbasierte Unternehmensbewertung durch Marktvergleich*. Marburg& Tectum Verlag, 2003, s. 14.

³ Момот Т. (2007): *Оцінка бізнесу*. Харків, Фактор, 2007, s. 22

⁴ Вовк С. (2003): *Оцінка бізнесу. Європейські цінності*. Українська інвестиційна газета, № 37 (415). - 2003. – s. 8-9

⁵ Vgl. Born K. (1995): *Unternehmensanalyse und Unternehmensbewertung*. Stuttgart, Schäffler-Poeschel, 1995, s. 27-33; Diehm S. (2003): *Erfolgspotenzialbasierte Unternehmensbewertung durch Marktvergleich*. Marburg& Tectum Verlag, 2003, s. 11-18; Drukarczyk J.; Schüler A. (2007) *Unternehmensbewertung*. 5. überarb. und erw. Aufl., - München: Verlag Vahlen, 2007, s. 101.

valuation, given by the native legislator. They are not active in proposing their own point of view on this topic⁶, lend the prepared definitions to their monographies and textbooks, although the legislative point of view aims the special case of valuation, doesn't follow the goal of fair value determination, describes the categories not perfect and not synonymous.

3 Legislative Conditions of Valuation in Ukraine

3.1 History of Ukrainian Legislative Process on Valuation of Enterprises.

The interest on enterprise valuation arose in Ukraine due to the beginning of privatization early in 90s. The value determination of assets, being property of state enterprises, that were sold in private hand, was not a good enough reason to introduce the market valuation of enterprises as an instrument, like it occurred in Czech Republic, Poland and Hungary. During the first privatization wave was the market mechanism of demand and supply in subordinate position. The transformation of the old economy took place under the sign of „wild capital accumulation“, the privatization measures, that supposed the valuation of most state enterprises, didn't have enough might to give rise to the Ukrainian enterprise valuation, like it was in Middle and East European countries.

The economic requirements and suitable conditions for the origin of valuation process intensified about 2000 and in 2001 was the law „About the property valuation“ adopted. After its adoption came the *National Standards of Valuation 1-4* and the “*Method of Property valuation*” in 2003.

Tab. 1: Legislative Documents in the Field of Enterprise Valuation

| The legislative base of valuation | adopted by | adopted on |
|---|-----------------------------------|-------------------|
| Decree „About the order of the expert prosecute fort he valuation of state property during the founding of enterprises with international Investment “ | Cabinet of Ministers | 20.07.96 |
| The Method of valuation of State corporate rights | Cabinet of Ministers | 2.08.99 |
| The Method of property valuation during the Privatization | Cabinet of Ministers | 12.10.00 |
| Law of Ukraine “About the property valuation, valuation of property rights and valuation activities in Ukraine“ | Parliament | 20.07.01 |
| Decree „About the expert monetary valuation of ground lots“ | Cabinet of Ministers | 11.10.02 |
| „About the confirmation of the order of the expert monetary valuation of ground lots“ | State Commitee of Ground Property | 9.01.03 |
| National Standard 1 „Basics of property and property rights valuation“ | Cabinet of Ministers | 10.09.03 |
| The Method of property valuation | Cabinet of Ministers | 10.12.03 |
| National Standard 2 „Immovable property valuation“ | Cabinet of | 28.10.04 |

⁶ Siehe Момот Т. (2007): *Оцінка бізнесу*. Харків, Фактор, 2007, с. 23-24; Костюченко В. (2008): *Консолідована фінансова звітність: міжнародна практика. Теорія та практика*. Київ, Центр навчальної літератури, 2008, с. 389; Хаустова В., Курочкіна І. (2009) *Оцінка бізнесу економічних суб'єктів*, Харків, Інжек, 2009, с. 16-26

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|--|----------------------|----------|
| | Ministers | |
| National Standard 3 „Valuation of whole property complexes“ | Cabinet of Ministers | 29.12.06 |
| National Standard 4 „Valuation of property rights in intellectual property“ | Cabinet of Ministers | 3.10.07 |

Source: <http://www.kmu.gov.ua>

The methodical recommendations, listed above, regulate the valuation in privatization occasions, on occasion of founding the enterprise, based on state or communal property, valuation of Stock Companies, whose owner is the State and other specific situations. They are not suitable for the valuation of private enterprises, because the classical questions of value determination stay without answers. The classical enterprise valuation is oriented on market value of the property and whole property complexes. Till nowadays there is no functioning market for these specific objects, that could be helpful in this operation.

The National Standards of valuation have more general character. It concerns mostly Number 1, which shows the basics of Ukrainian valuation. The Standard reflects the typical features of Ukrainian economical system and was adopted by the Cabinet of Ministers, not by the auditors, who should set this procedure under control. In Ukraine no fundamental research and studies have been carried out in field of valuation. The legislator takes the experience of American valuation and borrows it. We think, the necessary premises, as for example the efficient stock market, the transparency of information for market subjects have not been formed. That's why the American valuation methods can not function in a right way or the functioning is limited.

The National Standard Nr. 1 defines the categorial apparatus, the kinds of value, main principles and methodical approaches to valuation. Different Approaches offer different valuation procedures and kinds of value determined. (see Table 2).

Tab. 2: Correlation of the Main Categories in National Standard 1.

| Approach | Cost-based | Profit- based | Market- based |
|--------------------------|---|---|---|
| Principle | Utility principle, substitution principle | Expectation principle, principle of the most efficient usage | Substitution principle, principle of demand and supply |
| Conception | Calculation of Present value of the reconstruction costs of the objects, corrected at the sum of depreciation | Calculation of Present value of the expected profits from the most efficient usage of the object, incl. the sale income | Analysis of similar objects |
| Valuation Methods | 1) Reconstruction 2) Substitution | 1) Direct profit capitalisation 2) Discounting of Cash Flows | Comparison method |
| Kinds of Value | Reconstruction Value Substitution Value | Market Value, Investment Value, Liquidation Value, Value of Liquidation | Market Value of comparative objects and object to be valued |

Source: National Standard 1 „Basics of property and property rights valuation“, <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=1440-2003-%EF&check=4/UMfPEGznhheVE.ZiDcru/qHI4V6s80msh8le6>

The National Standard Nr. 1 names also the main information sources and gives the survey of methods, that are used in different situation. These methods don't except each other, but supplement each other.

T. Momot considers, in different situations the expert must choose the method to work with. It depends on the goal of valuation, what method should be chosen⁷. The complementary use of different approaches gives the most reliable result. The German scientists⁸, with A. Moxter ahead, defend the point of view, that the value of the enterprise can not be determined distracted from the valuation goal. We think, the expert should choose that method as the main working instrument, that correspond to the goal and the information volume given. He should bear in mind, that the main principle of market economy compares the utility and the time and money costs. The valuation procedure is resource intensive, that's why plays this principle a great role.

3.2 The Kinds of Value due to National Standard Nr. 1.

The definitions of value, market value and so on can be found in all legislative documents, listed above in Tab.1. In all studied occasions there is one same thing: they see no difference between value and price of the object to be valued. National Standard Nr.1 shows the wide variety of value kinds. It seems, behind this variety stands the desire to hide the problems of valuation.

Such kinds of value are by the legislator distinguished:

- Market Value – the value, which could demand in situation of valuation object sale on the market of similar assets to good informed purchaser;
- Liquidation Value - the value, which could be gained in case, the terms of the object sale are less then the time needed for ist normal exposition;
- Substitution Value – the present value of foundation costs of the new object, similar to the object being valued, which can substitute it;
- Reconstruction Value - the present value of foundation or reconstruction costs of the new object, similar to the object being valued, in actual market situation;
- Nett-Substitution Value (Reconstruction Value) - Substitution Value (Reconstruction Value) of the object being valued minus depreciation;
- Value of Liquidation – the value, expected fort the object being valued, which has already exhausted its useful functions;
- Special Value – the market value and the increase, that flows form the untypical motivation of the purchaser;
- Investment Value – the value, defined to conditions, requirements and investment goals of the potential purchaser;

⁷ Момот Т. (2007): *Оцінка бізнесу*. Харків, Фактор, 2007, s. 65

⁸ Moxter A. (1991): *Grundsätze ordnungsmäßiger Unternehmensbewertung*, 2. vollst. umgearb. Aufl., Nachdr., - Wiesbaden, Gabler, 1991, s. 9; Seppelfricke P. (2005): *Handbuch Aktien- und Unternehmensbewertung*. 2., überarb. Aufl., Schäffer-Poeschel Verlag Stuttgart, 2005, s. 6-12; Drukarczyk J.; Schüler A. (2007) *Unternehmensbewertung*. 5. überarb. und erw. Aufl., München: Verlag Vahlen, 2007, s. 101; Matschke M. J.; Brösel G. (2007): *Unternehmensbewertung: Funktionen, Methoden, Grundsätze*. 3. überarb. und erw. Aufl., Wiesbaden, Gabler, 2007, s. 85

- Useful Value – the value due to the actual conditions of use, corresponding to the most efficient way of its use

3.3 Criticism and not Solved Problems.

According to the definitions of the National Standard Nr.1, the kinds of value correspond with the different special aims of State. As we see, they are bad structured, have no response to the needs of other valuation subjects, like private owners and purchasers, who make their decisions about the investment in the basis of valuating, company management, that introduces in its leading practice the principles of value-management.

For all listed above legislative documents is one feature typical, that makes them useless for the enterprise valuation: in focus stand separate assets, ground lots, but not the enterprise as the whole. The synergy of different factors and assets, used in a bunch goes lost. We understand, why the legislator this position chose. It is enough for the goals of state enterprises privatization. But its practical importance for the value determination, based on market principles, is small, while it ignores the problems of valuation – prognosis problem and uncertainty problem.

Unfortunately, there is a deficit of concrete recommendations in the National Standard Nr.1, as the instructions for the rate of discount (Profit-Approach) or the instructions, in which cases should certain methods to be chosen. These questions are for the Ukraine not superfluous. Table 3 reflects the variety of return rates on Ukrainian investment instruments.

Tab. 3: Aktuelle Renditensätze nach verschiedenen Inverstitutionsinstrumenten.

| Inverstitutionsinstrumen | Renditensatz |
|--|--|
| 1. Registration Rate of National Bank of Ukraine http://www.bank.gov.ua | 8 |
| 2. Actual Kredit Rate of National Bank of Ukraine http://www.bank.gov.ua | 8,7 |
| 3. Deposit Rate of Commercial Banks in Ukraine http://bin.com.ua | In UAH 13,3 In USD 9,2 In Euro 8,8 |
| 4. Bonds of foreign loan of Ukraine http://www.minfin.gov.ua | 6,58 |

4 Suggestions on Solving Problems.

We are convinced, that Ukrainian Auditor Chamber as the organization of neutral experts, like its German equivalent, Institut der Wirtschaftsprüfer (IDW), should work out and offer the alternative Standards of valuation.

The books of Ukrainian valuation specialists, which can be taken as the starting point for such work, present the American point of view on the enterprise valuation. But the real conditions of Ukrainian economy look more similar to the European, not to American, because the main source of financing are the bank loans, not the stock capital. That's why it is worth, to get acquainted with German theoretical and practical experience.

The enterprise valuation is based on the fundamental problem, that appeared in the sphere of economic science in XVIII century and has been discussed till nowadays, but hasn't been solved. It is important not only in theoretical aspect, what we understand under the value. The

underestimation of this question leads to the earnest consequences to the world economy, when we analyze the fusion of such giants as Daimler AG and Chrysler.

The price is the form of fair value manifestation. It is in subordinate position to value, opposite to the thought of Seetharaman A. und Saravanan S., who write, „prices are what they are only because of what purchasers and sellers expect them to be.” The price is defined by the market mechanism of demand and supply. But if we stare at the enterprise as the whole, the requirement of homogeneous goods, sold on the market, is defeated, the requirement of competitiveness is also not fulfilled. That is the reason, why market prices are the bad indicators of enterprise value, specially in Ukraine.

We think, the orientation on market prices and Market Approach in Ukrainian valuation is the tribute to American style. The reasons were listed in Paragraph 2. Neither function the methods of Profit-Approach, based on Cash Flows all the main value determinant. The uncertainty and risks of Ukrainian economy are so high, that the necessary prognosis horizon too short is, that curbs the use of this Approach. On the actual development level only Cost Approach Methods can serve to the goals of valuation.⁹

5 Conclusion

In Ukraine is the enterprise valuation as the field of scientific studies and practice in the phase of the origin. Because of characteristic features of Ukrainian economy went the process of legislation in this late and slowly. The legislative issues, that regulate the valuation, are oriented on American Business Valuation Standards, although the conditions of the economy don't correspond to the American ones.

The National Standards of Valuation serve the needs of State and are not suitable for the valuation of enterprises in market economy. Ukrainian Auditor Chamber should work out and offer the alternative Standards of valuation, that take into consideration all points of critics. It is worth getting acquainted with German theoretical and practical experience as the alternative to American. That recommendation is objective, because the real conditions of Ukrainian economy look more similar to the European, not to American, because the main source of financing are the bank loans, not the stock capital.

the orientation on market prices and Market Approach in Ukrainian valuation is too premature. Neither function in native economy the methods of Profit-Approach, based on Cash Flows all the main value determinant. The uncertainty and risks of Ukrainian economy are so high, that the necessary prognosis horizon too short is, that curbs the use of this Approach. On the actual development level only Cost Approach Methods can serve to the goals of valuation, although they have some limitations.

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⁹ See also Костюченко В. (2008): *Консолідована фінансова звітність: міжнародна практика. Теорія та практика*. Київ, Центр навчальної літератури, 2008, s. 394

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Summary

The legislation in field of enterprise valuation serves the needs and interests of State and leaves other subjects without its attention. It is oriented in general to the American model of valuation, although it doesn't take in consideration the peculiarities of Ukrainian economy. The fundamental economical problem of value is till nowadays not solved and stipulate the theoretical and practical questions of valuation. After the profound analysis of Ukrainian valuation practice we came to the conclusion, today only Cost Approach Methods correspond to the level of development of economy in the Ukraine.

Key words: Enterprise Valuation; National Standard; Valuation Approach.

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