Chapter 1
Introduction to Business Valuation

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ABSTRACT

This chapter is an introduction to the book and provides basic information to help readers in the following chapters. This book analyzes all kinds of problems and develops solutions in firm valuation process. The needs and purposes of firm valuation are briefly explained. Basic Concepts, such as Cost, Price, Value, Valuation, Evaluation, Free Cash Flow, and different types of value, are explained. Face value, issue price, fair value, intrinsic value, market value, book value, going-concern value, liquidation value, replacement value, enterprise value, and equity value are explained within the different types of value. Then, "financial statements" and "elements of financial statements", which will form the basis of all valuation approaches, are explained and emphasized. The value drivers for businesses are discussed. Business valuation approaches' general features are given.

INTRODUCTION

The question of what the value of your company is a strategic subject in a firm's ongoing activities. Although many senior managers and the owner of the companies know accurately the value of capital assets, vehicles, machines, cars, or more simply the computer that they uses, when the question is asked about the value of the company, which is the main subject of them, they often give answers rarely accurate and questionable. In real life, the value of the company is an important tool not only for selling, acquisition or merger but also for making medium and long-term plans properly. The main purpose of finance managers is to maximize the market value of the firm, and thus the maximum amount of money that will remain to shareholders. The managers who exhibit a value-based management approach will determine factors affecting the value of the company, which are called value drivers. And they will give importance to these issues in the company's medium and long-term strategic plans.

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Although the business valuation is not a new issue, its importance increases. The business valuation has become a more professional subject in need of legal action, buying the firm, mergers, acquisitions, taxation and many legal cases. It may cause many rights losses as long as the valuation not being done professionally. For example, a shareholder who wishes to withdraw from the partnership will receive a lower amount when the value of the share is not determined correctly. Or, if an accurate value is not determined in the sales of the company, an unfair situation will arise between the buyer and seller. These examples can be reproduced. Therefore, the business valuation has become more professional and valuation techniques has become more advanced in the business and academic world.

In this chapter, it is explained the needs and purposes of valuation, parties benefit from valuation, financial statement concepts, other concepts of valuation and the business value drives. Thus, the aim of this chapter is to give general knowledge about firm valuation as an introduction of this book titled "valuation challenges and solutions in contemporary businesses".

THE NEEDS AND THE PURPOSES OF VALUATION

There are many reasons for businesses to need valuations. For instance; purchasing a new business, acquisition, merger, selling your existing business, initial public offering, privatization, credit rayting, determining the values of Intellectual Property rights such as trademark, patent, copyright, and registered transactions, in the process of bankruptcy and liquidation, tax issues, disputes between shareholders, withdrawal from the partnership, adding new shareholders to partnership, transfering equity in your existing business to a family member or key employee, determination of the share values of existing shareholders, long term financing plannig, and financial reporting are some reasons to need and purposes of firm valuation. AICPA (American Institute of Certified Public Accountants) states that the valuation is accurued for numerous purposes such as *"transactions, financings, taxation planning and compliance, intergenerational wealth transfer, ownership transition, financial accounting, bankruptcy, management information, and planning and litigation support long term financing"*.

However, company owners and senior managers should have an idea about the firm value without these specific reasons as well. The established business and the point where this business comes is an important success for owners. The time, effort and capital of company owners dedicated to the business over the years have often grown into their most significant asset.

Companies that have reached a certain maturity after making a serious labor and capital investment need to make an effective planning to sustain these achievements. There are three vital components to this effective planning: i. Knowing your business value, ii. Protecting your business and key employees – Business succession and protection plans allow you to prepare for the unexpected, as well as the future success of your business, iii. Protecting your lifestyle – Retirement, income protection and legacy and estate planning solutions help you and your family maintain your lifestyle. Because the value of your business is such an integral part of effective planning, that's a great place to start. You probably have a good idea of what your business is worth. Therefore, the business valuation is a great start towards sustaining your business' success.

It is very important to know the value of the company and determine the factors affecting this value in order to make a correct and effective planning and to keep these plans up to date. For this reason, company valuation has become an important issue for effective long-term planning of your company except for a number of specific reasons, which are explained in detail below.

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