13 Measuring the value of a business

About this chapter

The principle aim of business activity is often stated as being to maximise shareholder value. In todays' world, businesses are more conscious of their impact, and many focus on the 3 Ps: People, Planet and Profit. Increasing regulation means that sustainability and impact on the environment will rapidly become a requirement for reporting in the annual accounts, and the accounting profession is preparing for the challenges this will bring. Several factors drive the value of a business and in this chapter these factors will be considered, with an evaluation of the alternative approaches for attempting to arrive at an estimate of business value. For businesses with a market listing on the Stock Exchange, the valuation is derived by calculating the market capitalisation value, which is the current share price, multiplied by the number of shares in issue. However, as was discussed earlier in the text, a large proportion of the sector is made up of private organisations. For these organisations alternative approaches for determining business value are relevant. This chapter will consider the application of a variety of widely used approaches to business valuations with a specific focus on hotels, including:

- Market capitalisation methods
- Dividend yield and price/earnings ratio
- Net assets
- Comparable sales
- Earnings multiple
- Rebuild value
- Net present value using forecasted discounted cash flows
- Intangible values
- Impact of sustainability strategies.

Learning objectives

On completion of this chapter, you should be able to:

- Understand the factors which drive the value of commercial real estate
- Use a range of methods to determine an estimate of the value of a business
- Appreciate the difficulties experienced by the hospitality, tourism and leisure industries when attempting to estimate the value of a business.

Introduction

The principle purpose for measuring the value of a business is to provide a monetary measure which accurately reflects the true worth of that business. In general terms, research has indicated that a number of factors determine business value when seeking to purchase an existing commercial asset, and these include:

- Potential for revenue growth
- Construction costs for a new build, in terms of long-term assets and working capital, less the wearing out of the asset
- Value of the intangibles, such as brand or intellectual capital
- Cost control and profit margins – past and forecasted
- Predicted residual value, i.e., the predicted value after, say, 10 years of operation

The issue of business valuations and the choice of appropriate methodology is somewhat controversial in accounting circles and the UK hospitality industry has been particularly troubled in this area.

There are many valuation techniques available and often the most appropriate method will depend on the subsequent use of the valuation. These potential uses include providing a balance sheet figure for accounts preparation purposes as well as setting a value for acquisition purposes, for insurance assessment, for investment monitoring purposes, such as return on capital employed measures, and possibly to provide a figure to banks as the basis of collateral valuations when raising a loan. The most appropriate method depends not only on the end purpose of the value but also on the size and type of business. Hotel valuation experts, HVS, estimate that the last significant economic event, the global financial crisis in 2008/09, depressed European hotel values by an average of 23% resulting in a recovery period of some six years. According to HVS, the factors influencing buyers and sellers and the determination of hotel price can be summarised as illustrated in Table 13.1.

Table 13.1: Factors influencing willing buyers and willing sellers. *Source*: www.hvs.com/article/8876-the-impact-of-covid-19-on-the-european-hotel-sector

Downwards Factors	Upwards Factors
Unprecedented revenue and EBITDA decline	Improved business operating model
Economic recession	Return of positive operating leverage
Longer recovery of MICE business	Yield-hungry funds creating competition
Uncertainty regarding normal travel patterns	Low cost of capital likely to continue
Potential for prolonged recovery, re-infection	Some lenders will wait for values to rise before losses are recognised
Cash drain may force owners to sell	

HVS report that in 2020, the year of the COVID-19 outbreak, hotel values in Europe saw average declines of between 5% and 15% compared with the previous year. In general, hotels in gateway cities with a stable infrastructure have seen less decline, whilst hotels with weak offers have been the most severely impacted.

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