



## RAPID ASSESSMENT METHODS. SOME ASPECTS OF THE EVALUATION OF INTANGIBLE ASSETS

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**Abstract** *The rapid assessment methods are applied in a very similar way in the business area: they say a certain rule and then shows a series of circumstances (limitations) that may influence the outcome of the assess or can even make rule inapplicable. In other words, "rules are made to be broken". In the literature, the rapid method is called "standard method" or "simple method". Rapid methods can be found, in English language, under the names "Rules of Thumb" or "Shorthand formulae" (shorthand formula simplified).*

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### 1. ADVANTAGES AND DISADVANTAGES OF THE RAPID ASSESSMENT METHODS

Based methods are called the "thumb rule", which is defined in American Heritage Dictionary as "a useful principle with broad application, but without claiming to be accurate or reliable in any situation"<sup>1</sup>.

The Oxford English Dictionary (quoted in the same work), shows even from the definition the origin: "A method or procedure derived entirely from practice or experience, without any scientific basis, a practical method for approximating". Rapid assessment methods are used in many situations: for example, know that editing a page with text written on two lines spaced between approximately 250 words. Of course the exact number depends on

the size of fonts, page margins, the presence of illustrations or tables. Rapid assessment methods are applied in a very similar and in business: they say a certain rule and then shows a series of circumstances (limitations) that may influence the outcome or to assess the size or can even rule inapplicable. In other words, "rules are made to be broken". Rapid assessment methods are specific to small business (enterprises) and only to the branches, sometimes even only areas, covered. Mainly they are used to evaluate companies for sale - buying. Rapid assessment methods as they say the name, make a rapid assessment, not necessarily exact, a business, more than to give an approximate picture of its value. Another objection that can bring to this type of assessment methods

1 Heather Smith Linton, 2004, pagina 190.

could be the fact that business would be based solely on past information on those businesses and the different habits of industry or business area that is located. Restrictions on use of rapid assessment methods are also represented by the purpose of the assess: they do not apply to assessments for accounting and financial reporting, assessing the contribution of members, listing, international transactions, taxation, obtaining credit, privatization or (re) nationalization, judicial expertise, etc. confined to the initial assessment of the business (enterprise) as a starting point of negotiations for the sale - purchase from private.

Countries with tradition which were and still are quite used these methods of assessment are Great Britain, USA and France, but their applicability is more restricted since IVSC<sup>2</sup> - International Valuation Standards Committee, has developed a particular standard in this field, the International Standard Practice Evaluation 12 (GN 12), as will be explained further.

However, the arguments for the rapid assessment methods are still widely used in business? We appreciate that these methods, in addition to aspects of history, traditions and culture involved, presents some clear advantages:

1. are operational, it requires more time for calculating the value,
2. are simple, does not require laborious calculations or confidential information

(based on a minimum of information, the public generally: book value, gross income, net profit, etc.)

3. give values close to market values of business, the price being determined objectively<sup>3</sup>,
4. not expected to give a rigorous set value:
5. are spectacular, give a quite realistic in a short time;
6. is achieved with low cost, generally not need expert assistance;
7. are neutral, non-partisan, not take any of the parties to the transaction by entering any arbitrary coefficients;
8. transparent, verifiable and predictable for either side;
9. reflect differences in business (enterprises) due to ford, geographical area, local customs and habits, etc.,

part of the treasure of tradition, history and economic culture of the peoples concerned, with widespread.

Because of those certain advantages, business intermediaries use to help customers to set a sale price for their businesses, generally small in size and complexity.

The most important types of rapid assessment methods are:

- multiples of annual gross income
- multiple of annual net income (or cash flow

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<sup>2</sup> International Valuation Standards Committee, lodged in London.

<sup>3</sup> Market value is the estimated amount for which property would change the date of valuation, between a buyer and a seller decided at a specified price target transaction after

proper marketing activity, the parties have acted knowingly, prudently and without compulsion ”;(International Valuation Standards, Seventh Edition, 2005, page 82).

- net treasury, EBITDA = profit before interests, taxes, depreciation and amortization<sup>4</sup>)

- a multiple of book value (from sheet)
- multiple of the unit of production or income (salary, room, seats, subscribers, etc.. ).

Relying heavily on data from the books, the results of these evaluation methods have a greater relevance as the accounts are managed with more accuracy (honesty), and the legal economy and financial - accounting and taxation are more stable. Also have to be considered other requirements that may result in calculating market value. Otherwise, use a single multiplier has no significance. The economy is more stable, more diverse and advanced, it produces more sales transactions - purchase of business (enterprises) and thus appear more and more rapid assessment of their methods, more relevant, more reliable and credible.

## 2. METHODS BASED ON MULTIPLE INCOME

Closest theoretical and methodological framework for these methods consists of the discounted cash flow method (DCF - Discounted Cash Flow) because it quantifies the amount of future revenue (and hence value) of the business using current income (capitalization), or show the present value of a future cash flow (update). Same make a quick assessment based on current income

multiplication, only instead of a percentage rate cap / update, it uses a multiplier.

The first step in using an income multiplier is similar to the first stage of applying the DCF method: the choice of base, type and size of the gain to be multiplied. Probably the best basis for the calculation of earnings is the cash flow (net treasury), but not always have all the information to calculate exactly. Therefore, because cash flow is not immediately visible in the financial reporting of small companies<sup>5</sup>, rapid assessment methods in different areas should find and use a different basis of calculation. It is generally advisable to use current or historical net income or earnings (profit) before falling interest and taxes (EBIT)<sup>6</sup> and EBITDA to approximate two cash flows. Evaluating a company where the owner has an excessively high salary and / or give himself other great benefits granted in addition to salary (car service, health insurance premiums, etc.) will need to make some adjustments to make these revenues comparable to those of other firms in the same area.

A second step is to choose the size that will be applied multiple income type selected. This multiple will be chosen depending on the degree of business risk, as where we choose the share capitalization rate risk or to update the DCF method. In general, the multipliers value is in the range 3 to 5 times, coinciding with a profit rate of 33% per year for a gain multiplied by three times, or with a profit

4 Earnings Before Interest, Taxes, depreciation and Amortisation. These methods are consistent and comparable value obtained by rapid assessment methods, with market values, which include the sales comparison approach, income capitalization approach (including discounted cash flow

analysis) and cost approach (International Valuation Standards edition seventh, 2005, page 81).

5 All accounting systems, financial reporting required for small and medium-sized balance sheet (with annexes) and profit and loss account.

6 *Earnings Before Interest and Taxes.*

rate of 20% per year for a gain multiplied 5 times. This approximates the capitalization rate or update that could derive from a theoretical construct more sophisticated, such as the DCF method. We could watch the size of these multipliers also from the angle of view of the expected duration of the investor to recover their investment: for example, an investor who has paid for a business of five times its net profit is expected to recover their investment in 5 years.

### 3. OTHER RAPID ASSESSMENT METHODS

Historical book value of assets is representing the owner (enterprise value - V), which is calculated by subtracting liabilities (D) of total assets (A), resulting in net assets accounting (NCA) or equity ( $C = V = A - D$ ).

The carrying amount includes all net profits of past years, if the company did not pay dividends to owners. Thus, according to the payment of dividends, we can use the book value (net asset accounting) to evaluate the multiplier (if dividends were paid) or without multiplier (if you have not paid dividends).

Book value problem is that it does not necessarily reflect market value and no goodwill value internally generated business. As a method of using multiple versions of gross income are multiple method income of a production unit (room in the hotel) or the method of multiple net profit a worker (truck driver), as a special highlighting the role and importance of factors for successful

business in different sectors. A quick assessment can be considered the brand valuation method, developed by specialists of the company Interbrand Group PLC London, entitled "Method net profit multiple historical one"<sup>7</sup>.

### 4. THE ROLE OF THE BUSINESS INTERMEDIARIES

Business intermediaries work closely both with sellers and buyers of business in order to facilitate transactions. Thus, the seller, intermediary helps to determine the amount of business (enterprise) and develop its marketing plan for it to identify potential buyers. When a client (potential buyer) makes an offer, the intermediary that negotiates with the selling price and other terms of the sale - purchase and helps the buyer to obtain financing. Business intermediaries and business transaction adds value in several ways:

1. develop and implement marketing plan for finding and selecting buyers, which is a time consuming activity,
2. accurate assessment of the business through one of the methods presented above,
3. experience, the database of similar transactions and their contacts to provide access to deep knowledge of the market, thus they managed to find more buyers compete and thus to obtain a better selling price.

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<sup>7</sup> Sorin V. Stan, Ion Anghel, Veronica Gruzniczki, 2006, paginile 142 – 146.

Costs of intermediation activities in carrying out business transactions are:

- a) a fee between 6-10% of the business transaction (another quick assessment!)
- b) a charge for conducting initial assessments and to prepare and implement marketing plan, which may lead to a total cost for the seller between 5.000-10.000 dollars<sup>8</sup>, one that may include recovering the selling price.

## 5. INTERNATIONAL STANDARD OF PRACTICE EVALUATION

To assess these small businesses, there is a particular international standard: International Standard Practice Evaluation 12 - NG 12, entitled "Evaluation of specialized property-generating business (PSGA)". In the globalized world (even step by step, as is the case with the formation of the European Union, for example), the methods provided by this standard tends to replace the use of rapid assessment, as presented here, due to limitations and disadvantages their above.

Thus, NG 12 provides that this standard is targeted exclusively to assessing PSGA-sites, but should be used in accordance with the provisions of other international valuation standards, such as:

- NG 1: Assessment of the property,
- NG 3: Evaluation of plant, machinery and equipment;
- NG 4: Evaluation of intangible assets,
- NG 5: Evaluation movable,
- NG 6: Assessment of the enterprise,

NG 9: discounted cash flow analysis.

The assessment also PSGA also the subject of an international standard for assessing IVS 1 - Market value as basis for evaluation, and if the aim is to record PSGA value in financial reporting, then apply the provisions of international standards for financial reporting applications IVA 1 - Assessment of Financial Reporting. PSGA are considered as individual business (itself) and, currently, are assessed on their potential profit before interest, tax, depreciation and amortization (EBITDA) to reflect the activity of a reasonably efficient operator, often using DCF method or using a capitalization rate applied to EBITDA.

PSGA extra profit generated more than market expectations, and which may be assigned to the business manager<sup>9</sup>, will not be included. The specific situation of the manager, on the fiscal position, depreciation policy, the cost of borrowed capital and capital invested in business is not taken into account in establishing a base of comparison for different properties and different management. Although the techniques and concepts are similar to those commonly used for valuing business, truly, with the amendment that PSGA assessment disregards tax liabilities, depreciation policy, the cost of borrowed capital and capital invested in the business, assessing PSGA based on other input data than the underlying, typically, an enterprise evaluation. Evaluation results can be shared between different parts of PSGA assets to financial

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<sup>8</sup> In U.S.A.

<sup>9</sup> It's about goodwill (goodwill) personnel manager.

reporting, establishing property tax and, when requested, for property lending.

## 6. EVALUATION OF RAPID METHODS OF INTANGIBLE ASSETS

Intangible assets are measured by rapid methods in two ways:

- a. Directly and individually, or
- b. Indirectly and globally, in all business / enterprise.

In the first case, intangible assets are assessed individually or the enterprise value is represented by their value, or those value plays an important part in determining the total amount of enterprise. When car dealers, one of two methods for assessing the business determine its value in terms of its goodwill, calculated as an amount representing 1 to 3 times the business gross profit (EBT). Alcoholic beverage outlets are evaluated by two rapid methods, which take into account the value of a license for the sale of alcoholic beverages, its cost calculated. The value of such stores is calculated by adding twice the amount the owner an annual retains for itself (SDC), the license cost and value of stock.

In the second case, by this method of assessment is implicitly recognize intangible assets in the total value of its business, whether exclusively owned or related business and the personality of the manager, staff, etc. that further work remains in the acquired company that sold.

## 7. CONCLUSION

Even if these rapid assessment methods have a solid scientific foundation, they also got a spread, utility, applicability and importance that can no longer ignore them. For business owners, appraisers, business intermediaries, employer groups, trade or profession, consulting firms, professional evaluators, research institutes, teachers, etc. they have great value and relevance, and therefore should not be looked. These methods can provide a fairly accurate picture of a business as a starting point for planning transaction. Certainly these methods must be combined with other methods, themselves in need, as noted, thorough analysis, adjustments and interpretations for each case. Also, these methods may be alternatives to turn to check the reliability of results obtained from other assessment methods. Another advantage, quite importantly, the rapid assessment methods is that not collide with the provisions of the International Valuation Standards, they may have methods that produce similar market value, based on market comparisons and income multiplication or profits.

However, for recognition and reliability, these methods of assessment should be imposed on companies traded in an active market<sup>10</sup>.

Their reliability and accuracy it is not so high that it can be used for purposes of registration in accounting, financial reporting preparation, listing on stock exchanges, international transactions,

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10 An active market is a market where all conditions are met: (a) items sold in the market are homogeneous, (b) can always be found willing buyers and sellers, and (c) prices are publicly available"; (International Accounting Standard No. 38

in volume 2002 International Accounting Standards, Economic Publishing House, Bucharest, 2002, page 38-10).

obtaining bank loans, evaluating the contributions of members, privatization or (re) nationalization, evaluation legal or tax purposes, etc., where more precise methods should be used. Their area of application is the assessment of business than for sale - purchase them from private.

In conclusion, the importance of rapid assessment methods and business affairs lies in three major aspects:

- theory: historical significance;
- methodology: is simple and fast,
- practically: can be useful to Romanian companies acquiring small companies in the UK, U.S., France , etc..

Regarding Romania, to extend the application of these rapid assessment methods is necessary to stabilize the economy, reducing inflation, keeping proper accounts, increasing the number of sales transactions - purchase of business and performance criteria for active market (within the meaning of IAS 38, above).

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