

Progressive Methods of Assessing the Capital Value of Joint Stock Companies in Developed Countries

Khurshid Khudoykulov

DSc, professor, International School of Finance Technology and Science

ARTICLE INFO.

Keywords: average weighted average cost of capital, cost of debt capital, cost of equity capital, expected return, default risk, capital structure.

Abstract

The article examines and analyzes the scientific and practical aspects of progressive methods for estimation the cost of capital of joint-stock companies in developed countries. It also describes methods commonly used in world practice, including methods of cost of equity and weighted average cost of capital. In addition to this, the methods used to analyze the cost of capital of joint-stock companies in Europe and the United States. In particular, the progressive capital valuation was used by the four largest accounting and consulting firms in the world.

<http://www.gospodarkainnowacje.pl/> © 2024 LWAB.

INTRODUCTION

When determining the business value of companies in developed countries of the world, it is explained by the assessment of its capital value. In particular, in the case of 2018, this indicator is 7.0% of the expected return on equity of US companies, 7.16% in Europe, 3.2% in Japan, 9.14% in China, and 9.18% in India. This, in turn, shows the business value of companies in these countries, the level of implementation of investment projects, and the existence of investment potential.

At present, the fact that a single valuation standard has not been introduced in the capital value assessment system of the joint-stock company in our country, the fact that the national valuation standards are not in line with the international valuation standards does not allow determining the real market value of the capital value.

Today, in world practice, progressive methods of assessing the capital value are used to determine the investment potential of large joint-stock companies, business value, the minimum level of expected income from investment projects, and the country's level of riskiness. Developed countries are widely using income and comparative methods to assess the capital of joint-stock companies. Unfortunately, in our country, the cost method is still used to estimate the value of equity capital. Calculation of the real market value of share capital is due to the fact that the system of assessing the capital value of a joint-stock company in our country is not aligned with the international assessment standard, in particular, the methods widely used by developed countries: capital asset valuation model (CAPM), weighted average cost of capital (WACC), weighted average return on assets (WARA) there is no possibility.

In developed countries, one of the progressive methods of calculating the capital value of joint-stock companies is used to determine the expected return on capital of the joint-stock company, discounted cash flows, free cash flows, the cost of debt capital, and the capital budget of the joint-stock company,

as well as to determine the capital structure. The use of these methods serves to identify existing investment projects in joint stock companies in the country where local and foreign investors can invest capital. In particular, these methods show the level of development of corporate governance practices in the country and the credit rating of the national economy in international indices.

LITERATURE REVIEW

Today, one of the most important problems in corporate finance is the assessment of the capital value of joint-stock companies. In developed countries, financial managers use the equity method to evaluate the performance of joint-stock companies. For investors, this method determines the future discounted cash flows of the joint stock company's capital. In foreign practice, the value of debt and private capital is taken into account when assessing the capital value of joint-stock companies. According to Rainer Bole's research, the most important element in evaluating a company's capital value is the debt equity ratio. In particular, the elements of debt capital are the most important component when creating a company's capital budget and assessing its value. According to him, the expected return on debt capital depends on the return on risk-free assets and the return on assets in the debt securities market (Baule R., 2018). Foreign economist Damodaran stated in his scientific research that the most important thing in assessing the capital value of a joint-stock company is to take into account the default level when using the weighted average cost of capital method. This method serves to determine the amount of investment that can be made and the minimum level of income expected from it. In his opinion, the method of capital cost estimation is the most important tool in making investment, financial and dividend decisions in a joint-stock company. (Damodaran A., 2016).

Rajesh Kumar used the weighted average cost of capital method to estimate the cost of capital of a joint stock company, demonstrating the effective valuation of debt and equity capital through this method. In his research, he emphasized the consideration of risk-free asset and risk premium indicators when evaluating the value of private equity. In addition, financial analysts have used bond yields with different maturities to estimate the cost of capital. On the other hand, for risk-free assets, they recommended using the rate of return of long-term treasury obligations. In their opinion, it is emphasized that the determination of the risk premium indicator is the most important process in the assessment of the value of private capital. In particular, the risk premium of a stock is determined by subtracting the average return of the treasury bond from the average return of the stock's market index. At the same time, he researched the method of private equity valuation of joint stock companies by determining the market risk. In addition, the researcher focused in his scientific work on the aspects of assessing the capital value of the joint-stock company using the method of weighted average cost of capital. In turn, he studied the capital of the enterprise into debt and private capital and showed the method of evaluating the debt in the enterprise taking into account the balance value when evaluating the value of debt capital (Rajesh Kumar., 2016).

Foreign economists Michela Arnaboldi, Giovanni Azzone and Marco Giorgino based their scientific work on the possibility of carrying out the process of evaluating the value of capital using the weighted average value of financial assets and capital (Michela A., Giovanni A., Marco G., 2015). The use of the method of valuation of financial assets depends on the shareholders of the joint-stock company. However, using the weighted average cost of capital method shows that the shareholders and creditors of the joint-stock company are interconnected. According to them, the debt capital value of the enterprise should be evaluated taking into account the risk-free asset as well as the credit default spread. In joint-stock companies, the process of evaluating their capital value is carried out using the methods of debt and private capital and weighted average cost of capital. Many economists, including Stefano Caselli, have emphasized this point: "In assessing the capital value of the enterprise, the value of private and debt capital and the weighted average value of capital should be evaluated. These valuation methods are used in determining the perspective of the enterprise and its valuation, as well as in the calculation of freely discounted cash flows. While the equity method calculates discounted cash flows

taking into account the company's debt, the weighted average cost of capital method does not take into account the company's debt capital when determining discounted cash flows. In the calculation of these methods, balance sheet data of joint-stock companies are used" (Stefano C., 2010).

According to the research of economists Mark Bertonech and Rory Knight: "Evaluating the capital value of joint-stock companies takes into account the value of private and debt capital on the balance sheet of this company." According to them, debt capital should make up 40 percent and private capital should make up 60 percent of the capital of the joint-stock company. Researchers have shown in their research that it is possible to evaluate the cost of capital using the weighted average method of capital (Marc Bertoneche, RoryKnight., 2011). In our opinion, it is not for nothing that financial managers in rapidly developed countries widely use the method of evaluating financial assets and calculating the weighted average value of capital when assessing the capital value of a joint-stock company. The use of these methods allows to fully determine the value of private and debt capital of joint-stock companies.

The Goldman Sachs Group, which is one of the largest financial institutions, uses the financial asset valuation model to determine the value of private capital of joint-stock companies. On the other hand, when assessing the value of private equity, it calculates the result of multiplying the risk of securities by the premium for market risk, adding it to the return on risk-free assets, and adding the sovereign return to the resulting result. The method of estimating the value of private capital is reflected as follows.

Equity value = sovereign return + return on risk-free assets + (stock risk* market risk premium).

Today, Damodaran's method of capital cost estimation is widely used in the assessment of the capital value of joint-stock companies in developed countries. In our opinion, this method can evaluate the real value of the capital of the joint-stock company. This method is used to estimate the cost of capital, especially by taking into account the country risk premium, inflation rate and credit rating. Due to the development of the financial market in developed countries and the high impact of macroeconomic indicators, macro- and micro-level indicators are taken into account when assessing the value of capital.

Research methodology

The research uses the method of assessing the capital value of joint-stock companies of developed countries. Analysis of financial asset valuation method, market risk, and risk premium and debt capital value indicators necessary for capital value estimation of joint - stock company was carried out.

Analysis and results

Today, in developed countries, several modified models of the method of assessing the capital value of a joint-stock company based on the characteristics of its capital are used. Therefore, as one of the most popular models in developed countries, financial asset valuation (SAPM) and weighted average cost of capital (WACC) models are widely used by financial managers and companies providing financial consulting services to evaluate the capital value of a joint-stock company. Also, the use of the financial assets valuation method in determining the capital value of a joint-stock company in developed countries allows the joint-stock company to determine the value of private capital, the market risk of capital, the premium for market risk, and the expected return on capital. The weighted average cost of capital method serves to determine the cost of debt capital, capital structure, capital budgeting and discounted cash flows of a joint-stock company. Moreover, these methods are also effective in making decisions for corporate finance at the same time. Capital cost estimation methods are also widely used in practice for stock market risk assessment, portfolio management, and investment portfolio selection.

In our scientific research, we tried to carry out analyzes in accordance with the methodology of capital value assessment in the practice of capital value assessment of joint stock companies of developing countries. As part of our research, the indicators of capital values of joint-stock companies of the USA and European countries were analyzed based on the financial asset valuation (SAPM) model. Analysis of the state of capital value of 6052 joint-stock companies in European countries is reflected in the table

below (Table 3).

Table 3. State of capital value of joint stock companies of European countries (2014-2019)¹ in percent

Years	Rate of return on risk-free assets	Risk reward	Market risk (beta)	Capital cost of a joint-stock company
2014	2.17	6.88	1.18	10.29
2015	2.27	7.16	1.07	9.93
2016	2.45	6.81	1.04	9.53
2017	2.41	6.01	1.08	8.90
2018	2.68	7.11	1.06	10.22
2019	1.92	6.01	1.08	8.41

Based on our analysis, as can be seen from the data in Table 3, we can see that the capital cost of the joint-stock company was 10.29% in 2014, and 8.41% in 2019. It can be seen that the capital value of the joint-stock company is in the trend of falling from year to year, but in 2018 it reached the highest value. This, in turn, indicates that the income necessary for the implementation of investment projects of joint-stock companies is decreasing over the years. If we look at risk-free assets, the rate of return on government securities in 2014 was 2.17 percent, and in 2019 it decreased to 1.92 percent. However, the risk premium was 6.88 percent in 2014 and 6.01 percent in 2019. This means that the market yield of shares of joint stock companies in European countries is 5 times higher than the yield of government securities.

Conclusions and suggestions

It can be concluded from the analysis that the joint-stock companies of developed countries are using progressive methods of capital value assessment. The main reason for this is the development of the financial market in developed countries, as well as the widespread use of financial instruments in the formation of capital of joint-stock companies. Today, in our country, there are the following problems in assessing the capital value of joint-stock companies:

First, in developed countries, the income method is widely used to assess the capital value of a joint-stock company. However, in our country, the cost method is still used in the evaluation of the capital value of the joint-stock company.

Secondly, in our country, there is a practice of assessing the capital value of a joint-stock company, but there is no uniform assessment standard as in developed countries. In particular, the assessment standards in our country are not aligned with the international assessment standard.

To eliminate the above problems, it is advisable to implement the following measures:

Firstly, it is necessary to adjust the valuation standards of developed countries when assessing the capital value of joint stock companies. This, in turn, allows joint-stock companies in our country to use the income method in assessing the capital value. In addition, it serves to assess the business environment in our country and assess the real market value of capital.

Secondly, it would be appropriate to align national standards in our country with the principles of assessment standards of developed countries. This, in turn, allows to determine the investment potential of the joint-stock company and the risk level of the country, and to determine the risk of the capital of the joint-stock company.

¹ Prepared by the author based on the data of the site <http://pages.stern.nyu.edu/>.

References

1. Baule. R., 2018. The cost of debt capital revisited. *European Financial. Business Research*, Volume 12, Issue 2, pp 721–753.
2. Damodaran, A., 2016. *The Cost of Capital: The Swiss Army Knife of Finance*. <http://people.stern.nyu.edu/adamodar/pdfiles/papers/costofcapital.pdf>
3. Rajesh Kumar., 2016. *Valuation. Theories and Concepts*. Academic Press. ISBN: 9780128025437 pp. 93-118.
4. Michela A., Giovanni A., Marco G., 2015. *Performance Measurement and Management for Engineers*. Academic Press. ISBN: 978-0-12-801902-3. pp. 19-42 .
5. Stefano C. , 2010. *Private Equity and Venture Capital in Europe Markets, Techniques, and Deals*. Academic Press ISBN 978-0-12-375026-6. . pp. 187-204 .
6. Marc Bertoneche, RoryKnight., 2011. *Financial Performance*. Butterworth-Heinemann. ISBN: 9780750640114. pp. 109-136
7. Morningstar, Inc. *International Cost of Capital Report 2010*
8. *Practitioner's guide to cost of capital & WACC calculation: EY Switzerland valuation best practice*. Page 2 of 23. February 2018.
9. *WACC assessment – Reserved Letters Business as at 15 February 2019*. Pages 1 of 15.
10. *Cost of Capital - Newsletter*. Issue 03 2019. Pages 1 of 5.
11. *The PwC Cost of Capital Report* . March 2019 . Pages 1 of 6 .
12. Blajevic O.G., Kirilchuk N.A. *Model otsenki stoimosti capital*. *Scientific journal: Finance, banking, investment - 2016 - №3*, 47-52 p.
13. R.H. Karlibaeva "Ways of effective organization of the financial management system in joint-stock companies" *Autoreferat, T,- 2018*, pp. 1-30;
14. <https://uzbekistan2035.uz/>