

## Tangible and Intangible Dimensions of Business Value

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### Abstract

*The profound structural changes occurred in the global economy and also in the national one – globalization, dematerialization, crisis, etc. – impel us to watch critically not only the managerial practices on different levels of economic organization, but also the theoretical scaffold that inspired them. The „disembodiment“ of the processes and the economic value exert particularly pressing effects within the meaning of the purposes of reviewing the concepts and the theoretical models of most management sciences. The financial management of the enterprise does not only represent an exception, but contrariwise is situated in the vanguard of this conceptual renewal inasmuch as it is the area that took the mission to answer some fundamental questions:*

- *What does it represent in the present the economic value and, consequently, the business' value?*
- *What are the main factors (inducers) of business' value?*
- *What are the means of stimulation the increasing of the business' value?*

*The problem of the financial management is more complex, but we must recognize that the other concerns are, directly or indirectly, just some subordinate derivatives of these three crucial issues, and the economic dematerialization require us to revise, sometimes radically, the traditional views focused on them.*

**Keywords:** goodwill, intangible assets, intangible investment, intellectual capital, fuzzy sets.

**J.E.L. Classification:** G34, L21, M21, O16.

### 1. Introduction

The interest in the study of goodwill as a tool for diagnosis, valuation and reorganization of business is generated and enters in the area of these concerns: it is evident the fact that an increasing part of the value of modern companies is intangible, and the goodwill represents the global financial approximation of the intangible capital held by enterprises.

With the New Economy the approach of the valuation of the enterprise means, first of all, to understand, in a manner as rigorous and as objective as possible, which are

the causes that generate the goodwill or the overvaluation. Basically, this equates with the estimation of the economic value of the intangible assets of the enterprise, identified over the value of its tangible assets. Undoubtedly, the tangible assets, after making the corrections and the adjustments necessary to establish their „fair“ value, constitute by definition a solid basis for determining the value of the enterprise to the extent that these assets are easily identifiable and verifiable using the traditional tools of accountancy. In the case of the intangible elements which generate additional economical overvaluation of the „patrimony value“ provided by the tangible assets, things are completely different. Most of the times, the financial accounting does not offer a relevant image and does not capture properly the „intangible patrimony“ of the enterprise. Consequently, neither the financial management, which is responsible for the efficacy of the decisions with regard to the use of resources, is too sensitive to these issues of utmost importance for the good functioning of the enterprise. In this way, we observe a hiatus with the tendency of enlargement between the accountancy value and the market value (global).

## **2. Literature Review**

The interest in the study of goodwill as a tool for diagnosis, valuation and reorganization of business is generated and enters in the area of these concerns: it is evident the fact that an increasing part of the value of modern companies is intangible, and the goodwill represents the global financial approximation of the intangible capital held by enterprises. Despite this reality and the fact that abroad are taken substantial efforts in studying the intangible component of the enterprise and its financial implications, in Romania, we recognize so far an acute shortage in this area.

In order to develop this material were consulted a lot of bibliographical sources, many of which are signed by renowned authors - Edvinsson, Lev, Ross, Brillman, Martory, Copeland, Mouretsen, Tobin etc.

## **3. Theoretical Background**

In formulating this article is a retrospective and above all relevant material synthesis field. I made assumptions and conjectures in the context of the mission management sciences emergence of knowledge-based economy. Vectors are also proposed to explore possible means.

## **4. Paper content**

### ***4.1. The structure of economic value in knowledge-based economy***

A company that controls an attractive market share, which has a technological progress, which has developed strong operational skills (trade, management, innovation etc.) or which was endowed in a certain way with other rare competitive factors, obtains a higher real value of its theoretical value. Empirical studies ascertained that, on medium or on long term, a rate *Market value/Accounting Net value* over unitary is not only the index of some profound changes in the processes of creation of the economic value or the

expression of some permanent dysfunction on capital markets. It also reflects the decline of accountancy's traditional instruments and financial management, which largely ignores the intangible capital of the company.

These observations demonstrate that the value of a company cannot be exclusively associated with its formal accounts. The goodwill as a synthetic financial expression of the immaterial elements represents at the same time the unaudited counterpart of a part of the overall value of the company. The very existence of goodwill offers the hardest argument in view of the research the causes of the spread observed between the market value and the patrimony value (accounting) of the company. The correlated tracking of the evolution of the patrimony value, the goodwill, and the overall value of the company may serve as a marker in the foundation of financial strategies, starting from the assumption that the main objective of these strategies is to maximize the firm's value.

The valuation of the intangible capital of the firm does not oppose to traditional approaches – the valuation based on future economical and financial study of performances and the valuation based on the accountant identification of the tangible patrimony elements – but, contrariwise, complements them, in order to obtain, by combining them, the most realistic estimate of the firm's value. The accurate knowledge of the composition of the intangible capital, respectively its accurate dissection in elements of human capital, relational or structural, represents an important premise in making the assessment. This forasmuch the rigorous quantification of the various components of the intangible capital is not always possible. However, a number of general principles in assessing the intangible financial capital are necessary:

- the valuation of intangible elements is not an exact science;
- there are several methods for assessing the intangible elements;
- the valuation of intangible assets is valid only for the assessment study, without regard to possible future elements;
- the classification of the intangible items in "sources" and "collectors" of cash flow;
- the identification of some obvious correlations between the intangible elements generators of goodwill and the economical and financial performances of the firm.

Unlike the tangible patrimony items, which have financial „behaviors“ somewhat similar, predictable and controllable, the intangible elements are characterized by a wide variety of manifestations and hypostasis, which requires some particular steps in their financial valuation. Many experts recognize the capital value of reputation as being almost an equivalent of the goodwill, as all the intangible advantages of the firm are perceived from its outside through the light of its gained reputation. Since the intangible elements generators of goodwill usually have a volatile nature, which does not facilitate accurate financial measurements, are needed specific quantitative techniques, sensitive to quality issues, in order to carry out financial estimates and credible forecasts. Fuzzy mathematics offers, in our conception, numerous openings and opportunities in this regard, including the certainty intervals. Even if it does not offer exact values, but only „ranges“, the certainty intervals make possible however some approximations on the

basis of which the decision maker, clarifying at least the „trajectory“ of the future evolution of a financial value, is able to choose the strategy which will serve his interest the best way possible.

It is well known that the fundamental objective of the financial management is the maximization of the global (market) value of the firm. To this extent, the situations where the decision makers find themselves in the position of choosing between several alternative strategies are quite frequent. If in a stable environment this choice is in fact a simple issue of optimization, the uncertainty magnifies at an exponential rate the degree of complexity of the process. However, the certainty intervals allow the accomplishment of pertinent comparisons between different strategies, even if they are expressed as intervals, and the selection of the best of them.

The certainty intervals treat uncertainty in a very little structured manner, meaning that inside the extremes of the interval one does not know anything about the way in which the possibility varies, which further means that the possibility is considered to be uniformly allocated.

The fuzzy arrays allow the treatment of the uncertainty in a somewhat nuanced manner, so that, even if the estimations of the experts are not expressed by means of a point number, estimations of the most likely previsions can still be emitted, situated inside the extremes of a certain interval (Kitainic, 1993).

The advantage of the fuzzy techniques lies in the fact that they incorporate computational schemes which we consider to be more reliable when treating the nowadays issues in the field of financial management (Bajazdiew, 1996). Of course, the fuzzy arsenal is greater and more complex, but even the few elements that we have used demonstrate the efficiency of this approach to quality and uncertainty – that is, to essential characteristics of the modern financial phenomena.

Since it holds an increasing part of the value of modern firms, the goodwill keeps the right to be regarded as an essential part of the overall business strategy of the company in general and its financial strategy in particular. The explanation for this conceptual reconsideration is the following: the goodwill is the synthetic financial expression of all the company's competitive advantages, respectively of all the relevant and sustainable factors, especially those with intangible (immaterial) nature, which define its strategic position. Usually, an important goodwill as size is associated to highly competitive companies, with excellent strategic positions.

#### ***4.2. Possibilities for analyzing the economic value created***

To be competitive and to maintain long-term competitiveness, modern companies are required to guide their strategies preponderantly to the accumulation and development of the intangible elements bearers of goodwill. In strictly financial terms, a strategic approach as described above is equivalent with the selection of a certain profile of investment and the choice of a particular financing structure. In the decision-making area, it is about a new arbitration between the imperative to maximize the financial performance and the need to ensure the financial balance at the company level. These mutations of strategic order are caused by the fact that currently the economic values created by firms, even in the traditional capitalist sectors, incorporate a more significant intangible content. And the company's intangible elements cannot be managed

strategically as the tangible assets (physical and financial). In this case, the investments to create them cannot be analyzed and selected in a reliable manner using the classical financial criteria - net present value, internal rate of return, recovery time etc.

If the overall objective of the company's financial strategy is to maximize its value, this actually means the faster growth of the goodwill in regard to the size of the tangible component of the overall value of the firm. Also, this creates an acute need for conceptualization of some appropriate analytical tools designed to properly measure the efficacy of the financial efforts undertaken by the firm. Thus, if the firm is a „machine“ to create economic value, the most pure economic value being the cash flow, and if the most important sources of economic value are so intangible, the goodwill being their overall financial expression, then a new generation of profitability indicators should link directly these two aspects (the cash-flow and the goodwill). We are convinced that such an approach could provide a more precise and more accurate image of the profitability achieved by the firm, thus allowing optimizing the allocation of the available resources. For example, is very useful comparison between the report *Goodwill / Patrimonial value* and the so-called *Q report* conceptualized and proposed by the Nobel laureate James Tobin (Tobin, 1980). Broadly speaking, *Q is obtained by reporting the total value of the company to its patrimonial value*, indicating the extent to which the enterprise, in a given period, by functioning, creates value over the patrimonial value (Black, 2000).

The economic crisis we are going through now, through its dimension and intensity, has shown clearly as possible the numerous profound problems of modern capitalism, presented at a worldwide and macroeconomic, and also a microeconomic level. Undoubtedly, all these issues form a dense network of intrinsic causalities and logics which generate more vicious circles. In fact, just by breaking and dissolving these vicious circles may result the solution to get out of the crisis. Of course, the issue to which we refer to is extremely large and complex, including first strictly microeconomic aspects, mainly related to the way in which an enterprise, located or not in financial difficulty, can significantly improve its organization, functioning and integration in the specific environment in order to obtain the most advantageous global strategic positioning, and, consequently, to increase its financial performance and, ultimately, to maximize its value. Therefore, recognizing that the basic mission of a reorganizing approach is to maximize the overall value of the company, approach however, suggest the rehabilitation and restructuring processes at the microeconomic level from a systemic, integrative and interdisciplinary perspective. This inasmuch as the restructuring of the enterprise is essentially, a large and complex project of organizational change. Undoubtedly, the enterprise is an economic system and, in this aspect, validating its effectiveness can be achieved only with specific criteria, primarily of financial nature. Is necessary, in fact, the placement of the objectives and the financial determinants of the enterprise's restructuring in a more nuanced context. In this way we aim to avoid the reductionism and simplistic reasoning which so often have been guilty of the failure of the restructuring and financial recovery programs of enterprises.

## Conclusions

We see the concept of goodwill as a „cornerstone“ of this intended approach. The explanation is that the intangible assets bearers of goodwill are, in the modern economy, the main drivers of strategic positioning, competitiveness and, ultimately, economic value. At the same time, the success of the restructuring strategies depends crucially on the creation of certain „levers“, the most important of them leading directly to the idea of goodwill. In this way, is extremely important to introduce indicators of testing the feasibility of a corporate restructuring program, which, through the goodwill's value to correlate the dynamics of the financial performances on the commercial development and the accumulation of the intangible capital.

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