SINGAPORE BUSINESS VALUATIONS VIRTUAL ROUNDTABLE

The changing shape of business value

SINGAPORE ACCOUNTANCY COMMISSION
Institute of Valuers and Appraisers, Singapore

PARTICIPATING VALUATION PROFESSIONAL ORGANISATIONS

ASA Providing Value Worldwide

China Appraisal Society

CBV Chartered Business Valuators Institute

SINGAPORE ACCOUNTANCY COMMISSION | Institute of Valuers and Appraisers, Singapore

RICS

OBSERVER

IVSC

1 INTRODUCTION

1.1 There is rising consciousness among investors, management, boards and regulators to consider the impact on a company's articulation of value to its stakeholders in the context of the current emerging trends (please refer to the Appendix). As key stakeholders begin to embrace the broader qualitative narrative, there is a significant gap in measuring the impact of management choices in response to these trends on the overall value of a business. It is now more important than ever to build consensus among valuation practitioners as to the impact and relevance of these issues in measuring the value of a business or an asset.

1.2 On 17th February and 10th March 2021, five Valuation Professional Organisations (VPOs) and the international valuation standard setter came together through the Singapore Business Valuations Virtual Roundtable to deliberate and discuss the impacts of two key trends that have been observed from a valuation perspective:

a | The increasing significance of Intangible Assets; and

b | The growing movement to redefine the value of a business as value to all stakeholders.

1.3 The organisations at the Roundtable were:

a | American Society of Appraisers (ASA)

b | CBV Institute

c | China Appraisal Society (CAS)

d | Institute of Valuers and Appraisers, Singapore (IVAS)

e | Royal Institution of Chartered Surveyors (RICS)

f | International Valuations Standards Council (IVSC)

2 DISCUSSION TOPICS

2.1 The Roundtable focused on the following three topics:

a | As investors, management, boards and regulators recognise the broader stakeholder expectations of a business and call for broader disclosures and measurement of business performance beyond the financial statements, can the current intangible asset valuation practices form the consensus that provides a framework for such measurements?

b | Should valuers in the course of their work give consideration to a broader wholistic concept of value that is anchored not only on cash flows and measurable financial results but also on the strengths and weaknesses of a company's principles of governance, policies and practices to safeguard the planet, focus on people and the wider prosperity of society?

c | How can the valuation profession participate in the broader movement to recognise the value that businesses create (as reflected in the World Economic Forum White Paper titled "Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation", and many other academic, professional and business statements that have been issued in recent years)?

3 DISCUSSION POINTS

The following is a summary of views arising out of the discussions.

3.1 Financial Performance Measurement is at a Crossroads

There are increasing challenges to the concept of "market value" and the measurement of the broader purpose of a business particularly in relation to Environment, Social and Governance (ESG).

3.2 Value of a Business is still the Best Measurement of its Performance and Value Creation

Valuations take into consideration the financial performance of a business, its risk profile and the cash flow implications of the long-term strategies and capital choices a company makes. Value (a dollar amount) can be the common denominator. Definitions and understanding of intangible assets have changed with the evolution of technology and innovation; as ESG metrics continue to evolve, that too should be considered in this light.

3.3 Access to Accurate Input Data for Valuation Models is Critical

In order make the valuation of businesses a sharper and more wholistic assessment of business performance that is credible and reflects all relevant facts and circumstances, access to accurate input data for the valuation models is critical. It is therefore important to view the current debate on limitations of financial reporting standards and traditional financial reporting statements in that context. A relevant perspective is to challenge what additional disclosures provide greater clarity to the income statement and balance sheet and, hence, will be valuable to investors and stakeholders, as opposed to just 'fixing' the balance sheet.

3.4 The Case for an Alternate Valuation Report – Premise and Definitions

Does the definition of 'business valuation' or the 'basis of value' need to change to more explicitly incorporate considerations and preferences of a wider group of stakeholders through an ESG lens? **Should there be an alternate valuation report for stakeholders who are interested in the impact of ESG on enterprise value?**

To ensure comparability and broader acceptability, it is important to establish a consensus among valuers of the treatment of certain aspects of transactions (e.g. L&D expenses which could be capitalised) that will be different from their treatment in the traditional financial statements. For example: **Is now the time to redefine profitability** and adopt a different basis of measuring income and how it drives overall business value? This could include capitalisation of traditionally expensed items such as employee training costs.

Despite multiple taxonomies related to ESG and value, there is broad consensus that valuation is a critical component in communicating ESG benefits and impact. While uniformly addressing ESG and its impact may be difficult, in developing consensus, regard should be given to:

a | How ESG factors map to value (accretive or disruptive adjustment to cash flow streams and/or risk) with a focus on addressing gaps in traditional valuation approaches/ methodologies to develop a 'wholistic concept of value'.

b | Whether weightings should be given to the individual components of E, S and G.

c | Some level of consensus of measures on how ESG impacts value across different companies/ industries/ regions.

d | Limitations to the extent of ESG reporting and disclosure entities are willing to commit to considering the proprietary nature of information, and how subject information can be interpreted.

e | New risks that will emerge with governments formulating new laws and policies on climate change as well as risks associated with greater availability and transparency of data and relevant information. There will be transition (and other) risk particularly for some industries more than others e.g., with the carbon neutral race. Risk impacts value.

3.5 Recognising the Value of Intangible Assets

Intangible asset valuation is important both to recognise the assets that a business generates that are not measured through generally accepted financial standards as well as to provide better understanding of the relationship between the market value and intrinsic value of a business. Current intangible asset valuation methodologies are appropriate to value all types of intangibles including those which are not presently recognized by accounting standards (e.g., internally generated intangibles), given such practices are already generally accepted. However, valuers may need to reconsider certain additional aspects which include:

a | Do we need to broaden our definition of intangible assets, which are defined today more in the context of financial reporting as opposed to social and other assets that are relevant to broader stakeholders?

b | Do we need to refine or adjust current methodologies or create new ones? This could allow measurement of broader stakeholder-relevant intangible assets such as diversity in workforce as well as reflect the rising importance of intellectual property and R&D which may remain under measured due to regulations or financial reporting or perceived risk or uncertainty?

c | Do we need better corporate disclosures for internally generated intangibles? This may not necessarily be a value but at least certain key characteristics.

4 GETTING A SEAT AT THE TABLE

Acknowledging the aforementioned discussion points and the complexity of the matters, there is strong desire by the VPOs with its inherent skillsets to contribute to the evolution of responses to such movements – from a standard-setting and regulatory perspective. In navigating a way forward, the VPOs plan to take a common position and become an influencing group.

APPENDIX 1
SYNOPSIS PROVIDED TO ROUNDTABLE PARTICIPANTS PRIOR TO THE EVENT

Context

Technology and innovation have enabled businesses to create significant value and a capacity to measure unprecedented aspects of business performance. There is also a growing debate among investors, management, boards and regulators to recognise the importance of non-financial disclosures and measurements to further build trust with all the stakeholders of businesses and elevate business success to be achieved through adherence to more wholistic environmental, social and governance standards. The presumption being that failure to adhere to such standards will ultimately diminish the economic success of businesses in the long term and destroy value rather than create it. All these trends are gaining accelerated momentum and require us to recognize that the shape of business value has changed considerably in recent years.

Trend 1 : Growing significance of Intangible Assets

In the past, the value of a business was determined in large part by its tangible assets. In a manufacturing-based economy, the logic of this approach was evident: property, plant, and machinery were critical components required for success. Today, however, technology and innovation have become the growth accelerators for businesses. This significance is reflected in the value of intangible assets that make up the market value of businesses. Intangible assets now represent c.90% of the market value of the S&P 500 (1 July 2020) compared to 17% of market value in 1975[1]. The use and applicability of intellectual property and intangible assets have evolved significantly over the years, from a primary focus on defensive competitive behaviour to being core to business strategy and an important financial asset. This reflects the global trend where companies increasingly rely on intangible assets (IA) to deliver value. Intellectual Property, itself a component of intangible assets, account for more than US$380 billion in global trade receipts for royalties and licensing fees.

Given the unprecedented increase in the commercial application of intangible assets, it becomes imperative to understand their value generation capacity and effective utilisation. There is a growing recognition among global corporates and investors that there is significant value that is generated by businesses that is not necessarily expressed in the current financial statements, which are limited by the underlying financial reporting standards. Long-term value objectives of businesses as well as possibilities that many business models can create due to technology and innovation have created an environment for many to look for alternative frameworks to address this gap.

Trend 2: Growing movement redefining value of a business to all stakeholders

The COVID-19 pandemic has exacerbated the underlying economic and social inequalities amidst growing concerns of the impact of climate change. This has been evident in the speed at which value can be augmented or impaired when certain fundamentals are changed, including the disruption to the traditional expectations of core business models.

These are critical gaps for investors, capital markets and economies that give rise to an opportunity to measure, express and monetise value that are created but not expressed through traditional financial measurements. It is driving the necessity for many to seek alternative narratives so that investors, management, employees and other broader stakeholders have better appreciation of the real value of a business.

The International Business Council of the World Economic Forum (WEF) issued a white paper titled “Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation” in September 2020 that seeks to address this. The white paper leveraged on the four pillars (Principles of Governance, Planet, People and Prosperity) in the UN’s 2030 Agenda for Sustainable Development and further identified another 21 core and 34 expanded metrics and disclosure.

The report mentions that a company’s value is increasingly reflected in the off-balance sheet intangible assets and value drivers associated with economic and social prosperity. It further adds that most businesses are not fully capturing these intangible assets and value drivers and by measuring and reporting on aspects of prosperity more holistically, companies and their stakeholders can become better informed to protect and enhance assets that contribute to sustainable value creation.

Many other points of view and statements have also been issued in this context, highlighting the importance and momentum of this movement. In this regard we note that five leading framework and standard-setters have committed to working together on a corporate reporting system[2], IFRS published a consultation paper on the creation of a Sustainability Reporting Standards Board[3] which drew a record level of responses and the IVSC too published its “Perspectives Paper: ESG and Business Valuation” in March 2021, promoting the consideration of the ESG aspects of a business in valuations[4].

1 *Ocean Tomo “Intangible Asset Market Value Study” 1 July 2020 interim update to its Annual Study of Intangible Asset Market Value*

2 *CDP, the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board (SASB)*

3 *https://www.ifrs.org/projects/work-plan/sustainability-reporting/comment-letters-projects/consultation-paper-and-comment-letters/#consultation*

4 *https://www.ivsc.org/files/file/view/id/1928*

SINGAPORE ACCOUNTANCY COMMISSION

Singapore Accountancy Commission
10 Anson Road, #05-18 International Plaza, Singapore 079903
Tel : +65 6325 0518 **Fax :** +65 6226 3386

VISIT OUR WEBSITE
www.sac.gov.sg

FOR ENQUIRIES, CONTACT US AT
enquiries@sac.gov.sg