# The Valuation Profession
# A Brief History

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WAVO
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IACVA
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# Introduction

- Accounting is a conservative profession
- A hackneyed joke is that it's the second oldest
- And there may be some truth to this

# Introduction

- Before writing, invention and acceptance of money
- Before the concept of numbers around 7500 BC
- Clay tokens were used to keep track of possessions - grain, animals, tools etc.

# Introduction

- Things one could see, touch, or feel
- In short: Tangible Assets

# Introduction

- Intangible Assets traditionally are excluded from Financial Statements
- Until recently they were lumped in with goodwill  or ignored in a Pooling of Interests

# Introduction

- Plato (427 - 347 BC.) described the concept of value as one of the most difficult questions
- Aristotle (384 - 322 BC) believed that the value of an object existed only in the mind of man

# Introduction

- Seneca (c. 4 BC - 65) paraphrased this as
- "A thing is worth only what someone else will pay for it"
- Thus the origin of the Market Approach

# Introduction

- The Greek and Roman bankers all required the help of valuators
- After the fall of Rome, the Catholic Church evolved into the European dominant entity, permeating almost all thinking

# Introduction

- Banking also existed before writing
- When there are bankers there will be markets
- In the first century BC they traded in foreign exchange, such as between Rome and Egypt, and agricultural futures like grains and olive oil

# Introduction

- It considered land a gift from God, evidence of nature's bounty
- Secular rulers responded by quickly adjusting to this, declaring that all property belonged either to the church or the King, at that time, the state

# Introduction

- Clerical and secular rulers either rented or sold land to the nobility, and from there it trickled down to us ordinary folk
- More productive lands generated higher rent or sold for a better price

# Introduction

- This marks the beginning of the concept of economic rent and the principle of future benefits
- One of the main pillars of valuation theory

# Introduction

- Another is the principle of substitution
- Under ordinary circumstances no one will pay more for an asset than it would cost to acquire or create another with equal or greater economic gain

# Introduction

- Another determination of value also rooted in the Middle Ages is cost of production
- The Church's "just price" was the reproduction cost rather than an exchange value
- It reflected the idea that value was a quality inherent in a commodity

# Introduction

- Buying and selling bills of exchange, government loans & annuities, as well as stocks, financial futures and options were added over the next 2000 years

# Taxes

- Taxes have been with us for millennia
- The oldest known is the tithe in ancient Israel, a 10% levy on animal and agricultural products, paid in the product, or by part of the product

# Taxes

- Substituting money was penalized requiring the addition of "a fifth part" (20%) of the tithe's estimated value to the amount (Lev. 27:31)
- Realizing the benefits of this system, the tithe was justified on scriptural grounds by the Church

# Taxes

- European rulers codified tithing into law; such funds becoming a major source of revenue
- By the 16th century, it was an annual levy

# Taxes

- The Church could, and often did, sell the rights to the tithe on a particular property for a fixed period, normally 20 years
- Future income converted into a capital payment
- The buyer could then resell the rights

# Businesses

- The oldest businesses still around, at least in Europe , are brewers
- Back then beer was the only unpolluted drink
- The earliest still around, started in 1040, in Weihenstephan, Germany
- A clear manifestation of the European spirit

# Businesses

- Others are even more mature
- Kongo Gumi – a Japanese construction company has built shrines since 578
- The oldest manufacturer is a bell foundry in Italy started in 1000 to serve the Vatican

# Finance Theory

- Modern finance originated at two famous medieval banking houses, in Italy and Germany
- Lorenzo de Medici “The Magnificent” (1449-1491) said:
- "The art of banking is to lend money and get it back nearly every time” preferably with interest

# Finance Theory

- Jacob Fugger "The Rich" (1459-1525) advised
  - "Divide your fortune into four equal parts: shares, real estate, bonds and gold
  - Be prepared most of the time, to be in a loss position on one of these parts
  - During times of inflation, be prepared to lose money on bonds and gain in real estate and gold

# Finance Theory

- Periods of deflation will cause losses in real estate, but gains in bonds
- Shares will post varying results over time
- When returns represent a high imbalance, you should reestablish the balance among the four parts"

# Finance Theory

- This requires a thorough knowledge of the value of all assets
- i.e. a Valuator

# Finance Theory

- Until the Renaissance, value was an objective quality inherent in something
- With the rise of humanism, value came to be considered as a function of an item's ability to satisfy a need or desire, another important component of valuation theory

# Finance Theory

- The concept of risk was not understood until 1654
- Then, two French mathematicians, Blaise Pascal (1623–1662) and Pierre de Fermat (1601–1665) developed the "theory of probability”

# Finance Theory

- For the first time people could make decisions, even plausible forecasts, with numbers based on past experience

# Finance Theory

- Over the next 67 years:
  - mathematical underpinnings for risk were developed
  - life expectancy tables created
  - financial markets offering useful share and commodity price data expanded

# The Corporation

- That last trend was spread over the 17th & 18th centuries spurred by the emergence of the business corporation
- Originally called a "joint-stock company"
- Often with a Royal Charter

# The Corporation

- The first, Muscovy Company, was founded in London in 1553 to trade with Russia
- It remained active until the 1917 Revolution
- US corporations began in 1607 when the Virginia Company established the Jamestown Colony

# The Corporation

- The colony eventually thrived but the firm failed and in 1623 became insolvent
- One year later, its charter was revoked and the colony passed to the Crown

# The Corporation

- Several traded European companies prospered
  - The (English) East India Company eventually ruled India
  - The (Dutch) East India Company (VOC) controlled the spice islands (now Indonesia)
  - The Bank of England issued Notes until 1946
  - The Hudson's Bay Company governed western Canada

# The Stock Market

- By 1710, active stock markets existed in London, Paris and Amsterdam
- There were two highly speculative bubbles during 1720
  - The Mississippi Company of Paris
  - The South Sea Company in London

# The Stock Market

- In each, greedy financiers sought profits by exchanging stock at a premium for government debt, offering greater liquidity
- In both cases, the shares had spectacular collapses
- Those irregularities led to market regulation

# The Stock Market

- From 1723 to 1794, London and Amsterdam markets had close financial links in spite of the slow communications
- Stock prices for VOC and major British enterprises were reported at least weekly in an Amsterdam newspaper

# The Stock Market

- However, market movements were often based on rumors, as speculators reacted to them and, like today's traders, affected the market
- During those years pamphlets lamented the unpredictability of stocks
- Some things never change

# The Stock Market

- Brokers and investors became increasingly sophisticated
- The first known example of the ever proliferating "investment self-help" literature was published in London in 1726

# The Stock Market

- "The Money'd Man's Guide or the Purchaser's Pocket Companion” by Richard Hayes, it:
  - Valued stocks according to their discounted stream of future dividends
  - Used tables showing the appropriate discount factors for interest rates and time horizons

# The Stock Market

- Investors engaged in cash trades, futures contracts, even options, sold short, obtained margin credit, formed diversified portfolios and were able to make futures' sales of commodities, enabling them to hedge inventories

# Marketing Theory

- Value representing benefits or the ability to satisfy need, started to be accepted with "The Wealth of Nations" by Adam Smith 1776
- The creator of modern economics, he separated value between:

# Marketing Theory

- **value in use -** "the utility of the object for human purposes"
- **value in exchange -** the ability to "induce people to pay other valuables for the use of them”

# Marketing Theory

- The distinction is still important in interpreting Fair Value
- Smith's emphasis was on cost as the basis of value; to him, money was merely an instrument of exchange, a "wheel of trade”

# Marketing Theory

- One hundred years later (1849) an unsung German, Martin Faustmann (1822 – 1876) developed the last pillar of valuation theory establishing that the value of an asset was the present worth of its future returns, the formula was still used by the forest industry in the 1990's

# Marketing Theory

- Martin's concept was codified as the Discounted Cash Flows method, for valuing mines and mineral reserves, by H. D. Hoskold of England in his 1877 book "The Engineer's Valuing Assistant"

# The Rise of the Accountant

- Except for accurate financial data, most elements of modern valuation and corporate finance theory were in place by the end of the 18th century
- Modern accounting was first described in 1494 by Luca Pacioli (1446 – 1517) a friend of Leonardo da Vinci (1452 – 1519)

# The Rise of the Accountant

- In the 1800 census only twelve people in London claimed the title "accountant”
- The complexity of business and their role grew and by the 1870’s nearly all characteristics of the present profession existed in the British Empire and the US

# The Present Day

- In the 1990's, valuation got the international respect it merited
- The 1997 Nobel Prize in Economics was awarded to Canadian Myron Scholes (1941- ) & American Robert Merton (1944- ) for creating the Black-Scholes Option Pricing Model

# The Present Day

- The originator, Fisher Black (1938 – 1995), also an American, had died
- This model inaugurated the Formula Approach, which is gradually gaining general acceptance

# The Present Day

- Today accounting and valuation are often practiced by the same individuals adopting different viewpoints
  - Accountants look back to understand "what has happened"
  - Valuators look foreword to see "what is likely to occur"

# The Present Day

- A key question – are accountants or valuators to supply the guidance for implementing the valuation concepts of the accounting _______
- The past mainly reflected the thinking of the English speaking countries
- Now they also include the views of other nations