MAXIMISING COMPANY VALUE – AN IMPORTANT OBJECTIVE IN FINANCIAL MANAGEMENT

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Abstract:
The fundamental role of financial management is to maximise the company value. This value cannot be assessed only according to its equity, to the wealth accumulated by the company up to certain moment, but it must also be analysed according to the future investments and projects which the company equity will be engaged in. At the same time, value maximisation also implies protecting and preserving it. Avoiding equity waste caused by a bankruptcy, maintaining financial solvency and equilibrium are in fact the objective of financial management. Consequently, maximising the company value appears to depend on the level of performances provided by the company activities and on the way in which the bankruptcy risk and other financial risks in general are controlled.

Key words: *maximisation, value, company, profit, financial management*

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1. Theories regarding the financial management's objective to maximise profit

The economic theory has identified profit maximisation as an objective of financial management. In the specialised literature, several approaches to the concept of profit have been crystallised. Among the first approaches to this concept there is the etymology of the term "*proficere*" which means to progress, to yield results.

In another approach, profit is „the generic name given to the positive difference between the revenue obtained from selling the goods produced by an economic agent and their cost, considered as an expression of economic efficiency [5]".

Yet, prestigious economists consider profit to be residual revenue, namely „the final or residual element of the difference between the overall revenue and costs, namely what remains from this difference after various amounts are deducted [6]".

Even the statement according to which the company's objective is to maximise profit "*is considered to be a nomological assertion referring to motivation*", which could be deductible from other financial theory elements. Then it was estimated that the objective was rather to maximise the company value. In time, other financial theories and techniques were developed.

In the financial (and economic) theory, the major objective of financial management changed in time simultaneously with the modification in general conditions of the economic and social environment.

A first recommended objective is represented by profit maximisation, considering that the maximisation thereof includes both revenues maximisation, costs minimisation and at the same time an effective company management.

The actions taken to achieve the fundamental objective of maximising the company value also emphasise the major implications which define the role of financial management which is to ensure long-term performances quality and level, to maintain solvency and to control the risks that occur at company level.

Nevertheless, Modigliani and Miller, in a famous article (1958), managed to find an answer to three fundamental thins:

1) Does the company value depend on its financial structure?

2) Is there an indebtedness interest for the company and what is it?
3) Is there an optimal allocation of debts/own capitals for the company value?

It was noticed that the company value is independent from its financial structure under the following hypotheses [5]:

- the financial market is in the situation of pure and perfect competition;
- there is an absence of taxation;
- the same borrowing rate for all;
- all the results are distributed to the shareholders;
- the bankruptcy risks are neglected.

2. The role of financial management in achieving the financial management objective (to maximise the company value)

The role of financial management consists in the task it has to use various instruments which ensure an adequate protection against risks (the economic, financial, bankruptcy risks, which depend on the external environment, which depend on the company specificity).

At the same time, financial management aims at maximising the company value, not only with reference to its own capitals, but also to the future investment and projects which the company's equity will be engaged in.

The wealth accumulated by a company at a given moment is only one of the elements that allow for the appreciation of its value. Thus, we must also take into account the results expected in the future, as a result of using the accumulated equity [7].

Consequently, the company value is a value anticipated in that it takes into account the current value, which is correlated with the forecast future revenues obtained from the company's activities. For this reason, the company value cannot be separated from the quality of the projects its equity is engaged in.

Mastering all the means and tools in achieving the major objective of financial management, namely to maximise the company value, emphasises the important role played by financial management at company level.

Thus, value maximisation has major implications which concretely define the role of financial management. Among the latter there are:

- engaging the equity in investment projects, so that using it will lead to a desired profitability which is as high as possible;
- value maximisation implies protecting and preserving the equity, thus, financial management aims at maintaining a certain degree of solvency and striking a financial balance, obtained on the basis of financial indicators.

3. The equity and financial conception regarding the company value

In the financial and economic practice, there are two conceptions regarding the company value:

1) The patrimonial conception – according to which the company value is determined on the basis of the equity reflected in the balance sheet, and value maximisation is achieved by means of maximising the net equity of the exercise.

Equity value (SN, CP) = Total asset – Total debts

2) The financial conception – according to which the company financial value is determined on the basis of the hope for earnings that the company brings along with equity accumulated up to the present.

$$\text{Financial value} = \sum_{t=1}^{n}\left(\frac{CFt}{(1+k)^{t}} + \frac{VR}{(1+k)^{n}}\right)$$

Where:

CF = annual updated cash-flow;

K = updating rate, usually equal to the average market interest rate, adjusted with the risk premium (neutral rate + risk premium) or most often the rate is assimilated to the weighted average cost of the company capital;

VR = company residual value (market value), estimated to remain at the end of its economic life;

t = company's economic life.

In fact, the company value is established as a mixed value which takes into account, to various extents, the two values, namely: the equity and the financial one.

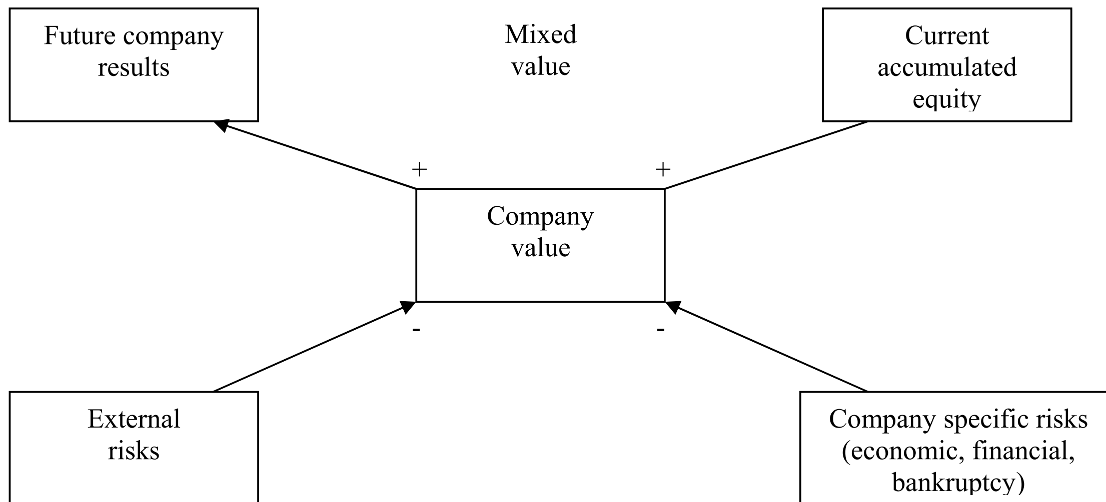

Fig.1. Company value as weighted mean of the two values (the equity and the financial one)

4. Limitations and incompatibilities in the cost reduction and profit maximisation process

Nevertheless, in the company's financial management database, in addition to the general objective (to maximise the company value), various axes were defined which are clear enough to ensure the coherence of the set of decisions taken.

It is necessary that financial management be integrated in the general company policy and find axes that translate the manager's defined priorities into the financial language.

Firstly, a limited number of variables which allow for expressing the financial management must be identified, after which they must be ranked according to priorities.

In this respect, certain limitations and incompatibilities may occur as a result of the diversity of functions to be performed by managers, taking into account costs reduction and profit maximisation. Among these, there are:

- the impossibility to be indebted forever, not only because the markets and banks refuse them, taking the risk into account, but especially for reasons of financial structure, decision-making autonomy and cost;
- financing the increase may translate into an increased indebtedness, which also results in losing the decision-making autonomy, or into the appearance of new shareholders, which results in a change of the balance of power within the capital;

- resorting to indebtedness may improve the financial profitability to the shareholder's benefit (the lever effect) and the degradation of the company's independence to the shareholder's detriment;
- the distribution of dividends penalises self-financing, which contributes to considering its own funds and thus, to improving the indebtedness capacity, but not remunerating the shareholders seriously limits the possibility to resort to them for a increase in capital.

The challenge in financial management is to integrate the various axes taking into account its defined objectives.

In conclusion, company value maximisation appears to depend on the quality and level of long-term performances, on maintaining solvency and on controlling risks (mainly the bankruptcy risk) which occur at company level.

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