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Investment Attractiveness of the Company: Definition Approaches and Assessment Methods

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***Abstract* – The problem of assessing the investment attractiveness involves the work of numerous analysts of various companies over a long period. In this regard, there are many approaches to the definition of the term "investment attractiveness". Thus, it is necessary to stick to such definition of investment attractiveness, which takes into account the type of investor, company profile and investment objectives in the given time. This paper analyzes the investment attractiveness of the valuation methods of business entities, including classical and author's. The paper also identifies their advantages and disadvantages. In modern works, the authors take into account the industry specifics. In the conducted research, the authors revealed that the existing valuation methods directed to measure the effect of the investment project and allowed defining instruments of its increase for internal investors.**

Keywords – investment attractiveness, valuation methods, factors, types of investors

I. INTRODUCTION

At present, Russia has created favorable conditions for financing the real sector of the economy, since the economic sanctions imposed by the West have led to the priority of investing in domestic production. The state provides support to Russian producers in order to counter Western policies. In this regard, the issue of the competitiveness of Russian enterprises, its evaluation and forecasting, as well as increasing their attractiveness as investment objects, is particularly relevant.

At the same time, during the period of global crisis, there is a question of permanent underfunding and a lack of investment resources. Russian companies have to copy with the task of mobilizing and concentrating the necessary funds, channeling them to the most significant investment projects to counter the negative effects of the financial crisis, and, as a result, improve the country's image. Under these conditions for enterprises it becomes relevant to assess their strength, competitiveness and investment attractiveness for the purposes of forming sources of financing. For third-party investors, in turn, it is important to determine alternative investments, which can be companies with different investment attractiveness.

Thus, the research extend the methods and methodology for assessing investment attractiveness is more than relevant at the current stage of development of the Russian economy. Unambiguous interpretation of terminology in the field of evaluation of investment attractiveness, classification and selection of evaluation methods for enterprises of various industries, factors shaping the growth of investment attractiveness for a particular company are the priority tasks in shaping the investment strategy of investors.

In modern economic literature, investment attractiveness is of great attention.

Currently, the issues of assessing the investment attractiveness of Russian regions and industries, the effectiveness of individual investment projects and the formation of investment resources of an enterprise through various external sources of funding are most fully developed.

Modern scientists as I.P. Dovbiy [1], Yu.V. Sevryugin [2], V.A. Teplitsky [3], O.V. Titova [4], E.A. Fedorov [5] presented in their scientific works the features of assessing the investment attractiveness of enterprises in different industries. In the domestic literature, there has been a steady tendency to study assessment issues in a sectoral context. However, the electricity and telecommunications industries have become the most

popular. The rest of the industry and especially the service sector – have not received adequate coverage.

Thus, a number of important theoretical aspects of investment attractiveness of enterprises are in need of further development and implementation. In particular, there is no unified approach to the definition of the term "investment attractiveness" of an enterprise for non-public companies, service companies in the industry. The attention to the definition of investment attractiveness for a specific group of investors is insufficient.

Practical methods of calculating the investment attractiveness of enterprises, leading consulting and investment companies, are to be a trade secret, a wide range of domestic scientific community is not available and not adapted to the Russian economic conditions. Thus, the scientific and practical significance of the problem, its insufficient development led to the choice of the research topic and the main areas of work.

II. METHODS

We have different points of view on investment attractiveness, the most interesting to a particular researcher. A detailed analysis of the interpretations of the term "investment attractiveness" in modern and classical literature singled out several main directions for its definition:

- financial (accounting) approach, using mainly indicators of financial and economic activity of the enterprise;
- risk approach based on analysis of the risk-return ratio;
- market approach based on the analysis of information about the dynamics of the company's shares and the amount of dividends paid;
- integrated (combined) approach that systematizes the main significant factors of investment attractiveness, not necessarily based only on financial information;
- cost approach, focusing on the growth of the cost characteristics of the business.

Proponents of the financial approach associate investment attractiveness, primarily with the structure of equity and debt capital or with a set of coefficients characterizing the financial condition of the organization, for which the approach deserved universal censure, because does not take into account environmental factors.

The risk approach is based on the theory of A. Damodaran, analysts associate investment attractiveness with the availability of income from investing funds with a minimum level of risk. The followers of this concept determine the feasibility of investing in an enterprise mainly in terms of net present value, which should have a positive value when the external and internal indicators of the enterprise change [6]. At the same time, an analysis of investment risks depend primarily on the choice of a company by the criterion of least risk by comparing the degree of probability of obtaining benefits, comparing risk and income values. Risk approach is usually a part of other concepts. There is no use in its pure form.

The market approach is very common among researchers analyzing the activities of public companies, because based on the calculation of officially declared market (stock) indicators available for calculation.

An integrated (combined) approach focuses not only on the financial component, but also on the analysis of market information about the company. Proponents of this approach interpret the investment attractiveness of an organization as a set of objective features, properties, means, and capabilities that determine the potential effective demand for investments. When implementing an integrated approach, the following key indicators are:

- the ratio of share price to earnings per share;
- the ratio of market capitalization to revenue;
- the ratio of market capitalization to earnings before income taxes, accrued interest on loans and depreciation.

In an effort to combine advantages of market and accounting approach, the integrated approach also combines the inherent drawbacks of them.

The cost approach depends on the company's capitalization, as one of the most objective indicators of its activities. In investment management, the most frequently mentioned is the Stern-Stewart concept (EVA-concept), which abstracts from accounting profit, reducing payments to economic income. At the same time, the indicator of EVA for the public companies can be calculated on the base of open market information available to any analyst. Thus, the concept of EVA partially focuses on market indicators, so it can fairly be the market approach.

Thus, the diversity of approaches to assessing and determining investment attractiveness, in our opinion, comes down to two big groups:

- based on the financial condition of the company (in the narrow sense);
- based on external factors and the financial condition of the company (in the broad sense).

Studying various approaches to the definition of investment attractiveness, we can conclude that this concept depends on the purpose of its definition in specific conditions and the type of investor that analyzes it.

III. RESULTS

In accordance with the objectives of the present study, we analyzed classification types and kinds of investors and financial sources based on ordering the received information contains the following group (Fig. 1).

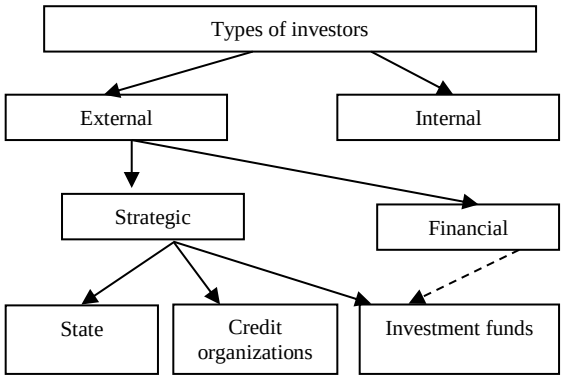

Fig. 1. Types of investors

Considering the above classification of investors, investment attractiveness is a system of long-term investments of various types and forms (portfolio investment, tax incentives, direct subsidies, etc.) aimed at establishing the required scale, structure, sources of production, directions use of investment.

In this paper, we adhere to the above definition, considering it the most optimal. At the same time, we propose that investment attractiveness will be an integral indicator calculated for a particular company based on information of its financial sustainability, efficiency of its resources and organizational, economic characteristics that determine the feasibility of investing in ones.

When managing the investment attractiveness of the company, it is necessary to take into account the factors affecting it. As a rule, researchers divide factors into internal and external ones (Fig. 2).

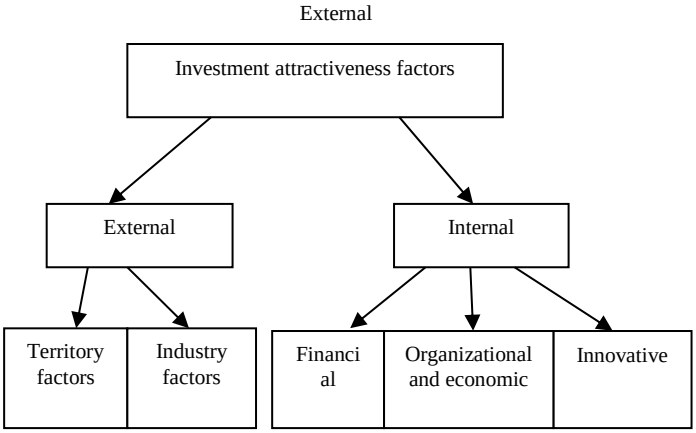

Fig. 2. Classification of the company investment attractiveness factors

In the process of a detailed analysis of these factors, we concluded that the special consideration of external factors must be, if necessary, the choice of investment, where the objects are various public companies in the industry. In the context of this work, where the object is not a public company, we consider it expedient to focus on internal factors and their dynamics. The internal factors include processes and phenomena measured and evaluated by financial indicators, organizational and economic characteristics of the enterprise, the degree of product innovation, the stability of cash flow generation, the degree of diversification of the company's products, etc. To form a clear position on accounting for the whole complex of factors, we propose to divide the concept of investment attractiveness at the micro- and macro levels (Fig. 3).

This scheme shows that if the investee is a company without taking into account external factors, investment attractiveness is indispensable. In the case of research at the micro-level, when the object of investing is an investment project in a particular company, it is necessary to focus on internal information.

Within the framework of the concepts of determining investment attractiveness, there are various methods for evaluating investment attractiveness. They can be classical and author's ones. The most famous of the modern classical methods are the models proposed by D.A. Endovitsky [7], V.A. Babushkin [8], Yu.V. Sevryugin[2]. Based on them, modern researchers offer their more advanced models, adapted for a particular industry, group of companies, specific investment objectives. These include the integral method of Yu.V. Sevryugin, the complex method of N.A. Kazakova.

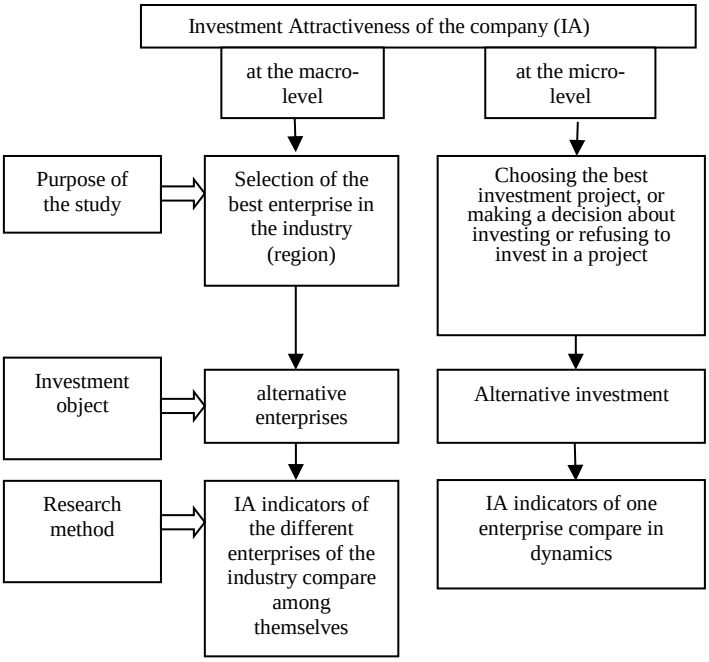

Fig. 3. The scheme of the sequence of consideration of factors affecting the micro - and macro level on the investment attractiveness of the enterprise

According to Yu.V. Sevryugin, the investment attractiveness of the enterprise is measured by an integrated indicator based on a qualimetric approach. The first stage has a set of factors influencing the resulting indicator (investment attractiveness) in the form of wood properties, i.e. creates their hierarchical model. The author of the model determines the significance of the factors as a correlation and regression analysis of the financial statements of industrial enterprises. Thus, the most significant are the following financial ratios: ratio of debt and equity, current liquidity ratio, asset turnover ratio, net profit margin, return on equity net profit.

Further, for each factor, weighting factors are determined and an estimate of the calculation error is made. At the next

stage, the values of absolute indicators for each factor are determined and brought to a single measurement scale, i.e. use qualimetric processing tools for quality information. In conclusion, the final indicator is following:

$$IA = \sum_{x\max}^{xi} \quad (1)$$

where IA – an indicator of investment attractiveness; i – number of factors; xi – scoring of i-factor based on its weight; x max – the maximum possible total score.

Weight coefficients of a qualimetric model of an investment attractiveness of an enterprise, Yu.V. Sevryugin identified based on in-person survey of strategic, portfolio and financial investors and summarized in an integral table. Ranking point of each factor depends on simple rules of translation into a single measure: a high-level indicator - 3 points, an average level - 2 points, a low level - 1 point.

Also noteworthy is the integrated method for assessing the investment attractiveness of N.A. Kazakova. The method shows analysis of the financial and economic activities of the enterprise. Depending on the state of key parameters, an enterprise uses a 5-point system in the context of three areas:

- economic potential and financial condition ;
- working efficiency;
- characteristic of business development .

As a result, each score obtained for all three areas, weighted according to the following formula:

$$IA = 35\%B1 + 35\% * B2 + 30\% * B3 \quad (2)$$

where B1 – weighted total for the first direction; B2 – weighted total for the second direction; B3 – weighted total for the third direction.

All indicators (group of indicators) within each direction are equivalent; the maximum amount of points is the same - 5 points. Also, expertly invented weights deserve censure when agreeing the result in Formula 2.

Supporters of the market concept of investment attractiveness of D.A. Endovitsky and V.A. Babushkin propose to use market capitalization as an indicator of investment attractiveness. The total market values of the issued shares of the company refer to the capitalization. In other words, this is a conditional calculated value, reflecting the possible sale price of the company. For companies whose shares are listed on the stock exchange, it is not difficult to determine the market capitalization. If the investor is external, he is interested in the company as an investment object, and then this indicator is quite informative, if we compare it for several alternative enterprises. However, many investors are not interested in the specific value of capitalization, but in its change in dynamics, as well as factors affecting it. The authors hypothesized the impact on the company's capitalization of such factors as total assets, equity, sales revenue, operating profit, net profit, EBITDA, operating cash flow, the amount spent on the acquisition or modernization of assets (CAPEX), the total amount announced dividends. By embedding each of these factors into a linear function and performing a pairwise correlation-regression analysis, the authors proved their relationship with the RTS index, and, therefore, with the company's capitalization. However, the sequence of influencing factors may be different, and, according to the authors, in each specific situation it is necessary to conduct a factor analysis of capitalization growth.

The most popular tool for measuring investment attractiveness, especially when addressing issues of financing strategic development, has recently been EVA — economic value added, which is usually calculated as the difference in net operating profit after taxes, but before interest is paid, and the weighted average cost of capital multiplied by invested capital [9].

The value of the company increases in case EVA takes a positive value, i.e. when the expected return on equity is above the average price of capital [10]. Accordingly, the same statement applies to the investment attractiveness of an enterprise: the higher the EVA index is (in dynamics, in comparison with other projects or companies), the higher the investment attractiveness of a project or company is.

This indicator is universal, it can be interesting both for internal investors (founders of a company) and external ones, it can be compared both in the industry by company and in dynamics for a particular company. With this indicator it is easy to determine the growth reserve of the company, because increasing EVA of the company increases the investment attractiveness of the company.

According to well-known methods of calculating the indicator EVA, the manager can increase the investment attractiveness by optimizing the cost of raising capital, reducing unprofitable production (savings and optimization of current costs) [11].

The cost method also includes the concept of value for a shareholder – the Rappaport method [12]. To implement it, the company is determined by the market value of the income approach based on discounted cash flow model. To determine the discount rate, the companies use the capital asset pricing model (CAPM) or arbitrage pricing model (APT) [13]. On the one hand, forecasting the company's cash flow allows us consider the company's prospects, on the other hand, it introduces a share of subjectivity in forecasting the cash flow components, and, in general, in estimating the total value. Thus, the investment attractiveness of the company, calculated on the basis of the Rappaport method, may be subject to fluctuations not because of the actual state of affairs of the company, but because of subjective arguments in predicting the calculated values.

In more modern there are many works devoted to this topic. The authors try to take into account industry specifics, in particular, the authors E.A. Fedorova, I.V. Esipenko use the methods of correlation and regression information processing derived a model of dependence of the investment attractiveness of a power company, as which they understand its capitalization, of various factors: the company's capitalization,

share capital, payables, turnover ratio; revenue, operating profit EBIT [14].

Each of the described methods has advantages and disadvantages, its scope of application, as well as reveals the reserves for the growth of investment attractiveness. Which of the methods to choose, when making an informed decision about investing funds will become clear only after conducting a full analysis of the financial and economic condition of the company.

IV. Discussion

The above method of Yu.V. Sevryugin is criticized primarily for excessive subjectivism [15]. As a drawback, it is also possible to note the orientation of the model to industrial enterprises producing specific products. When using the model for the purpose of investing in a service enterprise, we should change in some part, which includes product analysis. The advantage of this method is simplicity, the ability to select indicators that are significant in a particular situation, logicality and consistency. This method is suitable for enterprises of any legal form and of any scale, which makes its use invaluable for assessing the investment attractiveness of non-public companies.

We believe that for making a decision on assessing the investment attractiveness, the method of N.A. Kazakova is acceptable because it is simple to implement; no serious mathematical apparatus is required to justify the points assigned as weights of significance for factors. In addition, the methodology toolkit allows you using it for any company, even for non-public ones, information on which market capitalization is not available on the open exchange market. But due to doubts about the expert assignment of weights, this method has not received proper development.

The advantage of the method developed by D.A. Endovitsky and V.A.Babushkin is the analysis of factors affecting the indicator of investment attractiveness (market capitalization), openness and availability of information (from official sources), consideration of the external environment (in the factor analysis this role is performed by the RTS index). The disadvantage is the applicability of the method only for public companies. For small enterprises whose shares are not listed on the stock exchange, as well as for analyzing the dynamics of changes in investment attractiveness in the case of an investment project, this method is laborious, because its implementation will require a manual business valuation, not based on open market data.

Compared with the Rappaport method, EVA seems more viable at first glance. It is most suitable for the management and control of investment projects, despite its focus on financial performance. However, in both models we use the CAPM method, which assumes the existence of a perfect capital market. In general, value models are applicable only for companies whose shares are listed on the stock exchange, or planning to enter it in the near future.

Obviously, the author's method of E.A. Fedorova and I.V. Esipenko is very laborious for making investment decisions in investing capital in a small non-public company. This method is unlikely to work. Moreover, the correlation-regression equation can change the factor values depending on the industry.

V. Conclusion

According to the results of the study, we can conclude that the problem of assessing the investment attractiveness is carried out by analysts of enterprises of different industries for different groups of investors, for different purposes of conducting analytical activities. Therefore, there are many concepts of the term of investment attractiveness, many methods of its evaluation and interpretation of the results.

Having studied the most well-known definitions in the present work we reduce the integral index to the concept of investment attractiveness. It is designed for a specific company on the basis of information including its financial sustainability, efficiency of using its resources, organizational and economic characteristics to determine the feasibility of investing if there are alternative options for the allocation of resources.

The main objectives of the evaluation of investment attractiveness in the above context are:

- determination of the current state of the enterprise and its development prospects;
- development of measures to significantly increase the investment attractiveness;
- attraction of investments within the framework of the corresponding investment attractiveness and volumes of obtaining an integrated approach for the positive effect of the development of attracted capital .

Thus, it is obvious that we consider investment attractiveness as a complex indicator serving for investing in a particular company, an investment project, for deciding whether to attract investments. The researchers need to adhere to such a definition of investment attractiveness, which takes into account the type of investor, company profile and investment objectives in the given time.

In the process of analyzing the factors forming investment attractiveness we carried out their grouping based on the sequence of their consideration. Taking into account external factors, business leaders have an impact on internal factors to increase investment attractiveness or to reach its optimally set level.

The methodological support for evaluating investment attractiveness is quite diverse: there are methodologies based on the definition of integral indicators, cost models, simple financial (accounting) and expert methods. Basically, they are based on an assessment of the integral weighted average of investment attractiveness considering industry specifics.

Consequently, both value methods and integral methods are aimed at measuring the effect of an investment project and allow defining the tools for its increase for internal investors. Their indisputable advantages are simplicity, ease of use and the ability to use for the analysis of investment attractiveness, including non-public companies, unlike other assessment methods.

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