Week 8 question 2 investment valuation

Finance

Investment Valuation Though US GAAP asserts that investment valuation of assets should be lower than cost or the market value, there are several advantages of using the market value to value assets. Market value valuation is especially advantageous while computing leverage ratios. Leverage ratios provide information on a companies' solvency. For example, dividing the total debt with the total assets gives the debt ratio which indicates the percentage of assets financed by debt (Damodaran, 2012). Market value generally increases the economic worth of a company which is computed by subtracting the total liabilities to the total assets then adding the owner's equity. Since the assets are already highly valued the economic value of the company is therefore high and this makes it more attractive to investors.

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The use of market value to value investments has its disadvantages. Though the financial statements may indicate that the company is doing well this may not be the case. In cases where the use of market value inflates the economic value of the company, the company is then exposes to more tax liability in which case the company would pay more tax than it is actually capable of paying (Escaffre, Foulquier & Touron, 2008). Moreover, inflating the economic value of the company makes the company's shares more lucrative to investors who buy more shares based on this observation. However, should the company revalue its assets at lower than cost, the investors may drastically sell off their shares which may irrevocably damage the company's reputation. The fall in economic value would be interpreted as a business failure thus it would no longer be a viable investment.

References

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