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Valuation Pulse

The Missing Value in Your Business

Goodwill

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Valuation Pulse

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BUSINESS VALUATION NEWSLETTER FOR BUSINES OWNERS

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So, you think you have Goodwill???

Goodwill, at times, can be over looked during the process of determining the value of a business. This happens mainly since goodwill value is not something that automatically jumps off the page from your balance sheet or your bookkeeper's business report. But more times than not, there is value. It just needs to be brought out to the light.

Here is a story of a fictious owner and a business just to give an example of where to find goodwill:

Roger Gold built his company from its origin and over the last five years, has seen the growth of his business grow from annual sales of $2,000,000 a year to $15,000,000. Now, Roger and his trusted advisors believe that it may be time for him to either sell his business and retire or sell his business and create a new business venture. Either scenario, Roger is expected to have a significant wealth transfer coming his way.

In preparation for this windfall of wealth, Roger has taken the advice of his trusted advisor to have an independent business valuation completed. At first, Roger believed that he knew the value of his business because he grew the business from the ground up. During the business valuation initial meeting, Roger was asked about his goodwill. Roger's initial response was, "what does goodwill have to do with my business?" A lot actually!

By definition, when it pertains to valuing a business, goodwill is the amount of revenue that the business generates above the tangible assets (revenue generated from name, reputation, customer loyalty, location and products). Within the valuation community, the debate normally begins as to where do you draw the line on what generates revenue and what is responsible for that revenue.

Valuing goodwill is not a new terminology. In fact, goodwill began back in the prohibition era which I like to refer to as the Al Capone era. During this time, the government was closing breweries and distilleries based on the prohibition. However, because of these closings, the government was faced with compensating the owners for the force closing. In doing so, the government quickly realized that these businesses were more than just a building. In many situations, the government identified that some of the businesses generated what is referred to as excess earnings. When comparing the businesses, the government found that there were some businesses generated more revenue with similar products. Some of the additional revenue could be due to and attribution of the business owners or key people in the company. Meaning, people bought their product from this distributor because of who they were, where they were located, the employees that they hired and even the activity they do within the community drove customers to their stores and purchased their products.

Since the Prohibitionist Act, the IRS assisted valuators with a method known as the excess earnings method. Briefly, this is a formula designed to assist in valuing intangible assets in a business. This method can be found in Appeals and Review Memorandum, better known as ARM 34 in 1920.

It is extremely important to have the business owner and the valuation analyst on the same page with the determination of goodwill value and not as important for the business owner accountant. Here is why. The tangible assets (cash, accounts receivable, pre-paid expenses, equipment, furniture) are items that are of financial and physical substance. Those are all items that can be readily available from your accountant and or book keeper.

Intangible assets are more than just the business owner's reputation, the business location, the superior management team and customer service model, all extremely important but not everything. Intangible assets also include items such as:

- Trademarks
- Patents
- Trade names
- Brand names
- Logos or marks
- Internet domain names

The business intangible assets also include technology that the business may or have created. Customer related items such as client list, customer contracts, and to a degree, supplier contracts.

Goodwill should never be taken lightly when it comes to determining the value of your business. Just acknowledging your tangible assets will be a major disservice to not only the business value but to you as the business owner when determining the conclusion of value.

When the time comes, and you would like to discuss the next steps of understanding the true value of your business which includes your goodwill, consult a valuator that understands how to identify and value goodwill. Taking the time to speak with a valuator to provide you expert industry advice and direction may turn out to be one of your greatest investments in your business.

For more information on understanding the goodwill in your business, contact Onyx Partners Group for professional advice at info@opgbv.com or call 973-902-7828 and speak with a valuation expert.

Stephen A. White, CVA has been in the financial industry for over 25 years and is a full-time valuation expert. He is the owner and managing partner of Onyx Partners Group where he specializes in valuation services for small and mid-size businesses. The valuation services cover a variety of areas such as ESOP, purchases and sales, buy sell agreements, SBA valuation and consulting.

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Onyx Partners Group is a member of the National Association of Valuators and Analyst (NACVA)