

# How Goodwill Impacts Business Value



Source: Devonyu/iStock

**Takeaway:** *Identifying and articulating the goodwill in your business can have a significant impact on value.*

According to a 2010 study by KPMG titled, "Intangible Assets and Goodwill," more than 50% of the purchase price of a business is typically attributed to [goodwill](#).

Since the largest part of the purchase price of a profitable small business is usually goodwill, it is important to have knowledge and understanding of just what goodwill is and why there is value in it.

Business value is not built solely on the accumulation of [tangible assets](#), such as equipment and machinery, but also on the [intangibles](#), known as goodwill, that contribute to its profitability. The value of a business is determined by its ability to generate [cash flow](#) and the risks associated with consistently producing that cash flow.



Goodwill has a major impact on value because it reduces the risk that a business' profitability will falter after it changes hands. That goodwill value is simply calculated as the difference between the purchase price of the business and the [fair market value](#) of the tangible assets included in the sale.

The following are some examples of factors that can contribute to the goodwill of a company:

- Reputation
- Brand or trade name recognition
- Websites, domain names
- Trade secrets, recipes
- Customer list, exclusive supplier list
- Copyrights, trademarks, patents
- Licenses, permits, regulatory approvals
- Contracts
- Production or order backlog
- Accreditations
- Developed processes
- Proprietary designs, proprietary know-how
- Customized software programs
- Step-by-step training systems
- Customized or proprietary databases
- Published articles or industry press

- Employee skills and experience

## **Customer Lists, Reputation, Word-of-Mouth**

Consider the value of a list of customers that have generated a steady stream of revenue to a commercial landscaping company for many years. This list allows a [prospective buyer](#) to view the business as less risky because [recurring revenues](#) can realistically be predicted. In addition, the company can continue to build upon that [customer list](#) through reputation and word-of-mouth, each of which are components of goodwill. You cannot touch reputation or buy word-of-mouth; they are revenue-generating intangible assets that belong to the company.

## **Proprietary Databases, Processes, Competitive Advantage**

Let's further consider the value of that same commercial landscape company's growing database that contains relevant information about future potential customers. Knowledge is power and what you know about your target market gives you an advantage over your competitors. For example, if the database includes email addresses, low-cost online marketing methods can be utilized to tell your story over time and provide helpful tips to your audience on how they can protect their landscapes this season.

What if details of every business interaction, details of every discussion, meeting or bid are logged into the database? Have details of marketing efforts been tracked and logged? Do you know when the next 'warm' call should be made? Processes that capture this intelligence and the effective and innovative use of the information translates to tangible results such as increased website visibility, rising revenues and increased market share.

A robust database containing proprietary information built by using developed processes that can translate to [future profits](#) is more than just a means to communicate with your target audience — it is a long-term resource that cannot be duplicated and adds to the goodwill value of a company.

## **Name Recognition, Trade Secrets, Trademarks, Branding**

Now imagine buying a restaurant if the business name or secret recipes are not included in the sale. If you had to change the name of the business and are not able to use the recipes that made the restaurant a favorite venue for the dining public, would the business continue to generate the same revenue into the future? One would expect that even the savviest gambler would not take that bet.

Here is an example that most people might remember from not too long ago: the trademarked 'Big Mac' song. The Big Mac secret recipe was [branded](#) with a tune that brought in customers by the millions. What about that name? Would the restaurant have the same value if the McDonald's name was not included? Let's not forget the golden arches trademark.

It, too, brings in hungry travelers and earns big bucks for the business. Those arches are worth more than just the cost of the sign on top of the building. What did Ronald McDonald represent? He was a mascot (trademark) and a figure behind the company's success for almost 50 years. Recipes, names, advertising jingles, trademarks and branding are all intangible assets that cannot be touched or replaced like equipment or machinery, but, nevertheless, [create real value for a company](#).

## **Goodwill, Great Valuation**

These examples help to clearly illustrate the powerful revenue-generating capacity of some intangible assets that make up goodwill. Buyers are usually hesitant to pay too much for goodwill because it is an asset that they cannot touch and feel. The effort put into articulating the goodwill in a business will likely result in a higher [valuation](#) when sold.

**Great Article by:** [Rose Stabler](#) | June 12, 2019

For more information about the valuation and appraisal of Goodwill, or Other Intangible Assets, please contact us at :

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