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THE ENTERPRISE GOODWILL VALUATION – RANKING OF POLISH BRANDS

Mirosław BOJAŃCZYK

Vistula University, Faculty Business and International Relations; m.bojanczyk@vistula.edu.pl,
ORCID: 0000-0003-2985-6921

Purpose: Article discusses the valuation of company brands, focusing on Polish enterprises. It delves into the increasing importance of intangible assets like brand value in the modern economy.
Design/methodology/approach: The paper presents a detailed methodology for valuing brands, which includes analyzing financial reports, surveys, and stock exchange data. The study highlights the complexity of brand valuation, considering factors like intellectual capital, goodwill, and market volatility.
Findings: It emphasizes the need for a multifaceted approach in valuation, integrating various methods to achieve a more accurate assessment. Additionally, it presents a list of the most valuable brands in 2021, demonstrating the dominance of certain sectors like technology and retail in brand value. The research concludes that there is no single, definitive method for brand valuation, underscoring the subjective nature of this process.
Originality/value: This paper is base on Polish enterprises, which provides appropriate data. The presented methodology is a original approach.

Keywords: Brand Valuation, Intangible Assets, Financial Analysis, Goodwill Evaluation.

Category of the paper: Research paper.

1. Introduction

Theory and practice of value-based management is not a fad, but a permanent trend of development of modern economics. The need for the valuation of various assets existed for a very long time. Value, exchange value, and value in use are basic economic categories. The development of stock exchanges has increased the amount of assets in trade, and situations when they have to be valued. The quest for enrichment and growth in the value of assets has always been an integral feature of the development of mankind. This is not just a matter of attitudes defined as "homo economicus". To speak about the increase in value, one needs to measure the value first.

In the modern world, an increasingly, important role is played by intangible assets. The importance of intellectual capital (knowledge) and other elements that can be considered components of intangible assets, in comparison to physical capital, is growing.

Brand value can be considered as a critical part of any company's intangible assets. These kind of non-physical assets, such as patents and brand names, are having an increasing influence on a company's overall value. A 2020 analysis found that intangibles made up 90% of the S&P 500's market value, an increase of 22 percentage points since 1995[1].

The article presented below is a consequence of the ranking of Polish brands prepared by the author in 2021, prepared for Rzeczpospolita newspaper. The author used a specially developed brand valuation methodology to value Polish brands. More than 200 Polish enterprises from various sectors were subject to valuation.

Data for brand valuation were obtained from:

– a survey specially prepared for this study,
– financial reports of companies sent by the companies themselves,
– financial reports posted on enterprise websites,
– reports included in the National Court Register,
– stock exchange data.

2. The enterprise goodwill valuation

Falling rates of return on capital invested in the sphere of production, lead to directing capital to the sphere of the new services (the "third wave" of A. Toffler), which define information (the market value of resources related to information and knowledge) as a third kind of matter (in addition, to weight and energy). Therefore, in these companies, intangible resources have a growing importance, in relation to material resources. B. Cornell used the term "organisational capital", by which he means intangible assets and goodwill (Cornell, 1999), p. 21).

Looking at it from the point of view of the financial statements as a primary source of information about the property and financial position of any company, a complaint often appears, that these statements do not take into account the intangible factors. Intellectual capital is the main source of competitive advantage of the modern enterprise. Discussions on how to define and measure intellectual capital, intangible assets, and goodwill, have been pending for a long time. The word "firm" (trade mark) is often used interchangeably, even in professional publications, with the word "company", which can lead to improper identification of goodwill of the company, with the value of the company.

[1] Global 500 Report.

Accounting law defines intangible assets as the right to property suitable for business use over a period longer than one year, acquired by the economic unit, which may include in particular:

– copyrights,
– rights to inventions, patents, trademarks,
– know-how.

Intangible assets also include acquired goodwill. This happens, when there is so-called[2] '**positive goodwill'**. This is defined as the excess of the cost of acquisition over the fair value of the net assets of the acquired company. Such value is amortized. In an opposite situation, **negative goodwill occurs**, which is classified as revenue accruals charging other operating income. It is an attempt of valuation of intangible assets, not included in the balance sheet, and affecting the valuation of the company. These assets include, among others, portfolio of customers, market positions, and others. In many situations, usually after 5 years, goodwill is transferred to the income or expenses, and disappears from the balance sheet of the company.

International accounting standards (IAS 38) define intangible assets more precisely. The inclusion of an intangible asset in the balance sheet, must meet several conditions:

– ability to identify (separateness),
– exercising of control,
– future economic benefits,
– the ability to reliably determine the value.

This approach to goodwill, used in accounting, is a consequence of the principle of double-entry bookkeeping. It is, in the opinion of some, a factor artificially created for the convenience of accountants, in connection with acquisitions transactions (goodwill is the difference between the price paid and the fair value).

The use of accounting regulations to determine the value of the company is limited. These regulations include only goodwill on enterprise acquisition, or an organised part of it. Therefore, only the goodwill generated internally, is partly taken into account, without taking into account the entire value of the company.

Goodwill is, therefore, perceived differently by accountants, who treat it as a component of intangible assets (positive goodwill), and measure only in specific situations, and differently by those, who carry out valuations of companies, not based on accounting regulations. The latter are looking for value-creating factors, not included in the balance sheet of the company. There is, therefore, a need for a broader approach to the valuation, and for a more integrated company's balance sheet, if the reports are to accurately reflect the company's economic and financial position.

[2] Define by accounting law.

Goodwill has no intangible nature, is associated with the particular company (not present by itself), and is often independent of the cost of company acquisition. It is unstable, and has no direct ability to create profit. This leads to wide differences of opinion regarding the valuation of goodwill (very subjective nature of the valuation).

The gap between the market value and the book value, is commonly referred to as ‘goodwill’. Goodwill with such a definition, is calculated as the difference between market value and book value. This can be expressed using the following formula:

$$\frac{G}{BV} = \frac{MV}{BV} - 1$$

where:
G – goodwill (goodwill),
BV – book value of the company,
MV – market value.

Such an approach does not, however, include the fact that some elements of goodwill can be included in the book value. In 2009, Brand Finance Company performed an analysis of 37,000 companies listed on 53 stock exchanges. The value of the company was divided into tangible and three groups of intangible assets.

Table 1.
Structure of the total value of companies, USD trillion

Specification	2001	2002	2003	2004	2005	2006	2007	2008
Tangible assets	11.2	12.3	12.9	14.1	14.7	16.8	22.0	20.5
Goodwill - the result of take up	2.2	2.5	2.7	3	3.4	3.8	4.8	3.7
Disclosed intangible assets (excluding goodwill)	1.2	1.4	1.4	1.5	1.7	1.9	3.0	2.7
Undisclosed intangible assets	16.4	11.8	17	19.4	22.3	25.4	29.8	6.7

Source: Brand Finance Global Intangible Finance Tracker 009.

Analysis of listed companies shows, that in many cases, the market value of companies is significantly higher than their book value. This shows the importance of intangible assets, not included in the balance sheets of companies, for the value of the company. Ignorance of these values in the financial statements, is a consequence of difficulties in their correct valuation, resulting in high variability and subjectivity of financial results.

It should be emphasised that this difference does not necessarily indicate the presence of positive goodwill, but it could indicate incorrect (under-valued) accounting valuation of assets. Book valuation may be correct, in terms of the applicable rules, but not necessarily, in terms of actual or market value of the property. In this situation, the widespread acceptance that the difference between the market value and book value is the firm (trade mark or goodwill) value is wrong.

The big problem is, therefore, correct valuation of intellectual capital and other intangible assets. According to T. Copeland, T. Koller, and J. Murrin (Copeland, 1997) organisational capital value can be evaluated, based on the ability of its individual elements to generate income. Part of the goodwill may be brand (trademark). In this respect, too, there are some differences. Some point to the diversity of companies and brands, not treating the brand as part of goodwill.

One area of use of the company trade mark is doing franchise business, namely granting by one entity to another entity, the right to conduct business under its own name, using a proprietary trademark in exchange for remuneration. Derived from the same income, franchise value may be the basis for the valuation of the trade mark, or even the entire goodwill. This does not mean that several issues regarding the valuation, itself, do not appear here, but is merely a statement of fact, that the conditions for making such a valuation (listed in accounting regulations) and taking into account the results in the financial statements, exist.

Evaluating the trademark as a part of the goodwill may be easier, than the valuation of goodwill. There are several methods of valuation of the trademark:

1. Cost method:
   - historical cost,
   - according to the replacement cost.
2. Income method:
   - discounted cash flow,
   - brands premium,
   - licence fees (royalties).
3. Market methods:
   - comparable market value,
   - comparable rate of royalties.

Cost methods are based on the summation of the costs incurred, to promote the brand. The basic problem concerns the difficulty in determining the impact of expenses (including misguided) to create value.

Income methods are trying to estimate future revenues associated with the use of the brand, which is the additional revenue from price premium (the sum of surplus of the prices of branded products over prices for similar, non-branded products). Market multipliers (of earnings historically generated by the brand) are often used, taking into account the fact, that generally, market valuations are considered to be the best method of valuation. One can use market prices for similar brands, or existing licence fees, for comparison[3]. Therefore, either a static approach to the valuation based on the assets of the company, or the valuation of future income streams, is possible. In the first of these approaches, the valuation of the company consists of the net asset value, plus the goodwill measured as profit multiplier (e.g. in production companies), or a percentage of turnover or sales (e.g. in retail companies). In such a situation, company value (CV) is equal:

[3] You can read more about this in: M. Bojańczyk, Enterprise valuation and value based management.

$$CV = NAV + n * NP \text{ or } CV = NAV + \% * S$$

where:
NAV – net asset value,
NP – net profit,
S – annual sales,
n – times the profit.

The first of these formulas is often used for industrial companies, and the second one for commercial enterprises. One can find many modifications of these formulas used in the past. The need to take goodwill into account seems obvious, but the existing methods of its valuation are far from sufficient. The implementation of property methods does not seem to solve this problem. Goodwill, if it exists, must sooner or later, turn into revenues of the company. This leads to the conclusion that the estimation of the value of the company should be based on income methods.

The organisational structure and speed of decision-making are also important. An unstable market shortens the time at the company's disposal to make a decision. This increases the importance of the intangible assets, that increase flexibility in decision-making, and decreases the importance of physical assets, that reduce such flexibility, significantly.

3. The most valuable brands in 2023

There are many institutions around the world that try to value brands using various valuation methodologies. One of the most recognizable is the Global 500 Report. Below are the 10 most valuable brands in 2023.

Table 2.
The most valuable brands in 2023

Rank	Brand	Brand Value (B)	Country	Sector
1	Amazon	$299.3	U.S.	Retail
2	Apple	$297.5	U.S.	Tech
3	Google	$281.4	U.S.	Media
4	Microsoft	$191.6	U.S.	Tech
5	Walmart	$113.8	U.S.	Retail
6	Samsung Group	$99.7	South Korea	Tech
7	ICBC	$69.5	China	Banking
8	Verizon	$67.4	U.S.	Telecoms
9	Tesla	$66.2	U.S.	Automobiles
10	TikTok/Douyin	$65.7	China	Media

Source: Global 500 Report, https://brandfinance.com/insights/global-500-2023-report-published

Looking at brand value based on sector, you can see that tech continue to dominate.

Table 3.
The most valuable brands in 2023

Rank	Sector	% of Total	Total Brand Value (B)
1	Tech	19.4%	$891.2
2	Retail	15.0%	$690.0
3	Media	14.0%	$645.2
4	Banking	10.2%	$467.4
5	Automobiles	8.6%	$397.3
6	Telecoms	7.3%	$334.6
7	Commercial Services	3.8%	$174.0
8	Oil & Gas	3.7%	$171.0
9	Engineering & Construction	3.3%	$149.5
10	Insurance	2.0%	$93.0

Source: Global 500 Report, https://brandfinance.com/insights/global-500-2023-report-published

It is quite difficult to compare valuations prepared by different institutions, because the methodologies are usually described in a rather general way, and detailed assumptions and solutions are not disclosed by these companies.

4. The impact of instability on valuation

Market volatility increases the importance of flexibility, understood as the ability to quickly adapt to changing conditions. Companies that do not have their own production assets with high fixed costs, are more flexible, having the ability to smoothly switch production, in order to quickly respond to new opportunities and challenges of globalization and increased instability.

The enormous instability in the global economy that we are currently experiencing means that many valuation models that worked well in conditions of stability become less adequate in conditions of enormous instability. The pandemic affected, among others, to changes in the demand structure and the financial situation of many enterprises. Aid programs addressed to various industries, regardless of the assessment of their correctness and effectiveness, have a significant impact on the functioning of enterprises. All this makes modelling economic processes and company valuation, including brand valuation, difficult. Crisis conditions require the use of "crisis pricing". Financial results and company valuation based on data from 2019. will probably be completely different than the one made on the basis of the 2020 data.

These general considerations lead to two key conclusions:

1. company valuation cannot be based on only one method - this has a key impact on the number of questions and the structure of the questionnaire, which was used to value the brands of Polish enterprises;
2. it will probably be necessary to use an expert approach consisting in the possibility of the expert subjectively increasing or decreasing the value of the company, e.g. by 15%;

3. when using two or three valuation methods, it will be necessary to assign weights to individual methods. Their final determination will be made after collecting data from enterprises;
4. if there are problems with obtaining information from enterprises, it may be necessary to simplify the company's valuation model, which will have an impact on its quality.

5. Valuation of Polish brands - main research results

The quality of the obtained result depends on the quality of the information used - what is at the output is the result of what was at the input.

In Poland, there is a great reluctance of enterprises to disclose their financial results. It is very rare to find at least basic financial results on the websites of individual companies. This means that these companies are not transparent and there is often a fear that they may want to hide something. This can unfortunately have an impact on the assessment of brand value.

It is much better to obtain financial data from public enterprises, which, whether they like it or not, have certain disclosure obligations. Such disclosure is rewarded by stock investors through higher valuations of public companies relative to non-public companies. Transparency "pays off".

Financial data can also be obtained from the National Court Register, but not all companies publish them there. Companies that have nothing to be proud of are especially reluctant to do so. The penalty for not including data in the National Court Register is very low, so they do not have to worry about it too much. In May 2021, when valuations were prepared, most companies have not yet published data for 2020.

It is commonly pointed out that brand valuation cannot be based on only one method. When using two or three valuation methods, especially when the results will not differ much from each other, such an estimate can be considered more accurate.

Difficulties in obtaining reliable information and the non-quantitative nature of various phenomena affecting the valuation make it often necessary to use an expert approach, which involves the possibility of the expert subjectively increasing or decreasing the brand value, e.g. by 15%. Such corrections were applied to the valuation of selected brands.

Problems with obtaining information from enterprises resulted in the need to simplify the brand valuation model in relation to the original assumptions. The method used here was mainly based on potential license fees (franchising). The discounted cash flow (DCF) method was used here, according to the following formula:

$$WM = \frac{CF_1}{(1+d)^1} + \frac{CF_2}{(1+d)^2} + \frac{CF_3}{(1+d)^3} + \ldots + \frac{CF_n}{(1+d)^n} + \frac{RV}{(1+d)^n}$$

where:
WM – brand value,
CFn – value of cash flow from possible license (franchise) fees or price premiums in year n.
n – length of the projection period.
d – discount rate.
RV – residual value.

The residual value was determined using the formula:

$$RV = \frac{CFn * (1+g)}{d - g}$$

where g – growth rate after the forecast period.

The obtainable license fees were discounted and added up. The basis for determining license fees was revenue from the sale of the entire enterprise or revenue from the sale of individual brands. The need to use several sources of information resulted in some difficulties in data comparability.

The quality of the results was improved by using sales profitability (the ratio of net profit to net sales) as a factor correcting the final result. It is difficult to accept the estimation of brand value only on the basis of sales revenues without taking into account the margin or profit achieved by individual companies. In selected cases, stock exchange valuations were also used (P/E and P/BV ratios).

In order to obtain information directly from enterprises, a questionnaire was prepared.

Table 4.
Main items in the questionnaire

QUESTIONNAIRE – main items
1/ contact details
2/ net revenues from the sale of the enterprise
3/ net revenues from sales of individual brands
4/ net profit of the enterprise
5/ net profit of the enterprise
6/ net profit of the enterprise
7/ equity of the enterprise
8/ average cost of external financing
9/ asset value
10/ brand relevance index

Source: own study.

The questionnaire was constructed in such a way as to enable the estimation of the value of companies at using the following methods:

a) in the first approach to valuation of goodwill, the difference between the market value and the book value of the enterprise was used. The book value is the value of the enterprise's equity as of the balance sheet date (question 7 of the questionnaire). The market value of the company was determined based on the P/E ratio (stock exchange data for individual industries were used);

b) method based on potential license fees (franchising). The DCF valuation methodology was used here. The obtainable license fees over the 5-year period and the residual value was discounted and aggregated. The basis for determining license fees was the revenues from the sales of the entire enterprise or revenues from the sales of individual brands (question 3 and 4 of the questionnaire). The discount rate was determined on the basis of WACC (question 7 and 8 of the questionnaire);

c) high sales revenues and high market value are not only a consequence of high company value and therefore it is worth additionally using, for example, the "brand importance index" when making choices by the consumer. This is the estimated (percentage) impact of the brand on the sales volume or price premium on products. This should be supported by consumer surveys. However, this is very costly and that is why here we only want to obtain the opinion of the companies themselves (question 10 of the questionnaire);

d) using a weighted average to determine the final value of the company.

Below are presented the 20 most valuable Polish brands in 2021.

Table 2.
Most valuable Polish brands in 2021

No	Brand	Brand value assessment in PLN million	Sector	Source of data
1	PKO ORLEN	9 869,0	Oil & Gas	*
2	Jeronimo Martins Polska S.A. (Biedronka)	7 267,7	Retail	*
3	PGNiG SA	6 026,6	Oil & Gas	*
4	PGE	5 224,6	Energetical	***
5	Grupa Lotos SA GK	3 322,8	Oil & Gas	*
6	GK PZU	3 322,0	Finance/banking	***
7	KGHM	3 115,1	Mining	***
8	GK Tauron	2 166,0	Power engineering	***
9	Lotto	1 599,3	Other	*
10	PKO Bank Polski	1 504,6	Finance/banking	*/***
11	Asseco Poland SA GK	1 475,7	IT	*
12	Energa	1 445,2	Power engineering	***
13	Grupa Azoty SA GK	1 410,6	Chemical	*
14	Bank Pekao SA GK	1 292,1	Finance/banking	*
15	Inter Cars SA GK	1 120,2	Automobiles	*
16	Żabka	1 067,5	Retail	**
17	PLAY	1 000,8	Telecommunication	***
18	Grupa Warta	964,9	Finance/banking	*
19	Dino	948,9	Retail	**
20	Budimex	926,4	Construction	***

The following data sources were used for calculations: *questionnaire, **GFK, ***annual reports posted on the websites of individual companies, ****financial statements included in the National Court Register, *****other information (internet, stock exchange quotes.

Source: own calculations according to own methodology.

6. Summary

The research results on the valuation of a company's brand presented above are of a subjective (expert) nature. They are the result of the author's own valuation model and the assumptions made by the author. These types of analyzes are currently very difficult due to the enormous instability in the global economy and the resulting, among others, high variability of financial results.

The research conducted on the valuation of a company's brand leads to several key methodological conclusions:

- there is no single brand valuation method that could be considered as a method allowing for an objective valuation,
- the above, quite commonly accepted conclusion leads to the conclusion that it is better to use several methods,
- the selection of brand valuation methods is subjective (expert) in nature, which leads to different valuations of the same brands by different researchers,
- when using several valuation methods, the subjective share of a given method in the final result has a very significant impact on the final result.

Enterprises that are monopolies pose a specific valuation problem, especially when the main shareholder is the State Treasury. This includes, among others: enterprises in positions 1, 2 and 4. Monopolies usually have better results than other enterprises because they use monopoly rents. If the main shareholder is the State Treasury, there is a serious risk that such enterprises will be treated in a privileged manner.

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