

THE ROLE OF GOODWILL AS A KEY FACTOR IN BUILDING THE DEVELOPMENT OF A SMALL BUSINESS

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Purpose: The aim of this article was to present the analytical results of an evaluation of the English-language research literature on the important concept of goodwill as building blocks for the intangible aspects of corporate value added. The study took into account the results of research published in the English-language literature and the preliminary results of the author's own research on accounting offices. The topic was taken up by the Author due to the lack of sufficient analyses concerning the quantitative significance of the goodwill concept and its specific role in the creation of company value.

Design/methodology/approach: The listed research results provide a basis for conducting in-depth analyses in the undertaken scope concerning the determination of the essence of individual factors creating the company's value. At present, in both Polish and English-language literature, there are no specific results relating to the quantitative assessment of the essence of goodwill. It is necessary to clarify the differences in its role in various aspects concerning the functioning of the liberal professions and to indicate the role of trust in the area of this concept, which constitutes its key element and points to the essence of the role of intangible factors boiling down to the value of capital and the human potential of an individual.

Findings: The research carried out showed that the value of goodwill in relation to the three selected professions varies. With regard to the value of law practices, the key element is the role of the practitioner. With regard to accountancy firms, the key element also shaping the value of each practice is the ability to generate income, taking into account aspects related to the partner's transition in and out of the partnership and the experience of the employer running the practice. In the case of medical services, it is not possible to assign a uniform goodwill value to a single business given its diversity and the type of services offered.

Originality/value: The topic addressed is new on the quantitative side. At present, the author has carried out a preliminary survey of accounting offices. In addition, the English-language literature presented has made it possible to prepare a key summary to assess their value. The topic fills an important research gap.

Keywords: małe przedsiębiorstwo, goodwill, wolne zawody, zaufanie, wartości niematerialne.

Category of the paper: Scientific paper.

1. Introduction

The application of Rules-of-Thumb shows the development of the relationship between the market value of a business in practice and the specific business parameters of the companies being valued. Despite the fact that the adopted multiplier methods are in practice simplified methods of determining the value of a business, in theory they provide many difficulties related to their actual valuation. In practice, we now know of many multipliers involving the determination of a company's value using multiplier methods. While the application of these methods is important from the perspective of enterprise valuation, it also provides an opportunity not only to determine the value of the actual purchase price of an enterprise, but also to value it rationally. In the practice of business valuation - this is not only a financial possibility but also the only way to determine the price of a small and specific business. The value of each business is estimated as the sum of the net assets and the value of the goodwill. When analysing issues related to factors shaping the market value of small businesses in Poland, attention should also be paid to the issue of trust influencing the advantage of a specific business over its competitors. The market value assessed by consumers, indicating the position of a particular business and its owner at the same time, becomes crucial.

These valuations combine both economic, financial and governance issues, indicating the high interdisciplinary nature of the Rules-of-Thumb. On the one hand, goodwill is the identification and determination of the impact of defined financial and non-financial factors on the market value of a company, while on the other hand, it is the impact of factors determining the growth of trust in the entrepreneur and the evaluation of segments determining the choice of services by specific often regular customers.

Goodwill is a combination of quantitative as well as qualitative aspects. For the assessment of the level of goodwill aimed at all professions, the following evaluation criteria are established:

- the area of financial internal factors (investment in working capital, investment in fixed assets, financing of activities from own financial resources, financing of activities from external sources, level of operating costs of activities carried out, operating profit margin, tangible fixed assets held)
- the area of external financial factors (structure of achieved revenues, convenient forms and principles of payment for services, high income of customers in the region where the services are provided, level of service prices, prices of materials, tax strategies),
- the area of internal factors on the market and marketing (easy way to reach clients, convenient hours when services are provided, certificates held, licences held, ownership of premises where services are provided, length of cooperation with clients, type of cooperation - individual and corporate clients, good relations with clients, low staff turnover,

- the area of external factors on the market and marketing (whisper marketing, age distribution of clients, size of the enterprise, owned trademark, favourable legal-administrative regulations, access to natural resources, labour market, low level of market saturation, length of enterprise on the market)
- the area of management-related factors (innovative technologies and solutions used, software used, good relations with employees, work schedule in force, clear and comprehensible procedures adopted and established, independence in decision-making, involvement of employees in deciding on the future of the company, effective logistics),
- the area of factors covering human capital and potential (creativity, practical experience of the freelancer, education and qualifications of the freelancer, titles and degrees of the professional, additional qualifications, specialisations of the freelancer, interpersonal skills including ease of establishing contacts, managerial skills in managing people and organising working time).

2. Research findings to date

The research conducted to date indicates the great importance of intangible factors in shaping the value of an organisation, the market value of which is determined by the level of human capital, both in relation to the owner and subordinates. The role of human capital acquires particular importance in the case of companies employing people in the so-called liberal professions. 'From the point of view of the usefulness of human capital for the organisation, two possibilities for increasing the return on capital are distinguished by raising the level of skills of individual employees and by managing human capital effectively in a broader sense (Maciąg, 2011). In turn, B. Pfau and I. Key, on the basis of their research among 750 large companies, found that human capital is a leading indicator of corporate financial performance, and that investing in employee development provides shareholders with three times the returns compared to other companies.

Human capital, which is one of the areas assessed during the implementation of research tasks, is one of the most important factors determining the future economic results of an organization. According to research conducted by B. Hansson, the basic organizational factors influencing the value of human capital on the example of management staff are leadership (communication, efficiency, qualifications, organizational values, charisma skills), commitment (time management skills, working conditions), knowledge (creativity, inventiveness, access to knowledge), efficiency (good working conditions, delegation of authority, motivation) and development (innovations, improvement, training) (Hansson, 2009). As it results from the research, human capital should be treated as one of the factors building the reputation of a small enterprise and at the same time creating its added value in economic

terms. "The essence of reputation is the value of the organization for the environment in which it operates, the assessment of its previous activities in terms of the goals it has formulated. From the perspective of the company's ability to maintain its development on the market, reputation is shaped mainly by intangible assets, which include: credibility, responsibility and trust" (Maciąg, 2013).

According to H. Keh and Y. Xie, 'a good reputation among stakeholders can influence delaying effects related to competitors' activities, obtaining higher selling prices in uncertain markets, attracting better quality investment capital or raising more capital from the stock market, maintaining high employee morale, obtaining better efficiency from business activities"(Keh, Xie, 2009). The impact of reputation on a company's financial health has been the subject of research for many years. In 2000, based on their research, R. Dunbar and J. Schwalbach found both the existence of an impact of financial performance on reputation and the impact of reputation on financial performance (Dunabr, Schwalbach, 2000). R.A. Srivastav, T.H. McInish, R.A. Wood A.J. Capraro have shown that for companies with better reputations, investors subjectively assess the risk of an investment as significantly lower and therefore approve of a lower rate of return (Srivastav, McInish, Wood, Capraro, 1997). Research conducted indicates that intangible factors, including reputation is increasingly becoming a determinant of investment decisions (Helm, 2007).

Thus, as can be seen from the research conducted so far, corporate reputation reflects a company's ability to meet the needs and demands of different stakeholder groups. It is an element of a company's intangible assets and influences its value measured in financial terms. As practice indicates, the valuation of a small business boils down to the assessment of resources of a financial, tangible and intangible nature. A specific group are intangible resources, which are not always fully reflected in the balance sheet. One of the elements determining the value of intangible factors shaping a company's goodwill is trust. This trust has a pragmatic value. Trust is the associated loyalty and truthfulness that represents real, practical economic value that increases the efficiency of the system and allows more goods to be produced (Arrow, 1974). In the practice of small business, it is assumed that it is the quality of capital and human potential that builds relationships and enhances trust at the enterprise-client level.

3. Multiplier methods from the perspective of assessing the intangible value of an enterprise

The entire value of an enterprise and, at the same time, its valuation possibilities are based on the application of multiplier methods. These methods are used in the case of determining the value of partnerships and thus freelancers. According to Article 88 of the Companies Act,

partners in a partnership may be: Group I (advocate, legal adviser, notary, tax adviser), Group II (patent agent, sworn translator, property expert), Group III (accountant, chartered accountant, insurance broker, stockbroker, investment adviser), Group IV (architect, construction engineer), Group V (nurse, midwife, physiotherapist, laboratory diagnostician), Group VI (doctors), Group VII (dentist, veterinarian), Group VIII (pharmacists). The division of the groups was taken into account on the basis of the degree of connection between the different professions, taking also into account the needs of the individual clients and the level of trust required.

Analysis of the liberal professions has shown that they cannot be assigned to a specific group, so for the purpose of this analysis groups of professions have been created, taking into account a similar range. Currently used multiplier methods refer only to certain liberal professions enjoying the highest level of trust, taking into account customer feedback and value for the owner. To date, individual valuation mechanisms have not been identified for specific industries. The valuation standards used to date include commonly used professions such as the legal, medical and accounting professions. No less, all the considerations undertaken relate only to discussion taking into account the specifics of these professions.

In practice, taking into account all liberal professions each has different valuation mechanisms, assuming the influence of various factors (both tangible and intangible) on their value. In the Polish and Anglo-Saxon literature, there is a well-established consideration of the applicable standards taken into account in valuation by multiplier methods, which in effect include a qualitative analysis of the experience accumulated to date. As indicated in the applicable definitions, 'The methodology requires that gross revenues are averaged over the last 5 years to compensate for any unusual increases or decreases in the revenue stream. Gross revenues for that year are then multiplied by a factor. The factor or multiplier varies depending on the industry and even geographical location. Some accounting firms are valued at 1.0 to 1.5 times annual gross revenues, while medical practices may be valued at 0.4 to 1.0 (40 to 100 per cent) of annual gross revenues' (Brown, 2020) The literature indicates that a standard for law firms has not yet been developed, no less as the available data indicates that the value of the multiplier can be determined based on the data conditioning it. Among other authors, it is indicated that an analysis of aspects such as:

- the market in which the local practice operates (a factor similar to other small businesses),
- stability of clients (similar factor to other sectors),
- sources of reference for all factors identical in all sectors),
- type of client relationships,
- the ability of lawyers in the firm to maintain the business (factor not included in the situation of sole practitioners),
- the payment arrangements for law firm services (fixed amount, one-off),

- the degree of concentration of income (variation from year to year - we take 5 years into account for the analysis),
- the level of profitability of the practice in relation to competitors (differentiation in relation to other practices),
- the size of the law firm (level of employment, stability of employment, scope of services),
- stability of counterparties (partners)-level of stability of employment.

Central to the valuation of small business practices is the position and independence of the owner.

The factors adopted for valuation taking into account the high level of autonomy of the owner and the lack of dependence on the performance of others leads to a professional valuation of the profession by taking into account the following values usually taken into account, among others: the age and health of the professional, the possibility of obtaining lucrative contracts in advance, the reputation of the professional in the environment in which he or she operates (in terms of knowledge and skills, the extent of the professional's professional success, the nature and duration of the professional practice taking into account the way the business is conducted in the form of a partner in a partnership or professional corporation (Trugman, 2018). The idea of professionalism is that clients, when choosing an attorney, come to a professional, not to the firm itself. Related to this are skills, knowledge, reputation and personality. In the case of legal services, changing the place of service does not have the effect of reducing the number of clients. Revenue-generating opportunities are attributed directly to the practitioner, including the legal profession.

In lawyers' assessments, goodwill in the case of a goodwill valuation is primarily intrinsic value, so it comes down to the value of the owner, regardless of its marketability. Despite the determination of intrinsic value, the sale of such services is not possible given the strictly professional nature of the business and the economic nature of its non-transferability. It is currently difficult to establish a reasonable remuneration. Also, in subsequent cases decided by the Courts, age, experience, education, expertise, the effort of locating the practice - and therefore the high individualism of the activity performed - have all proved relevant in determining the value of the practice (Fishman, Pratt, Morrison, 2013). The court stated that the value of this type of practice cannot be equated solely with its economic value because it is primarily intangible factors that determine its value. Therefore, the ultimate value of a practice lies in the assessment of its consumers. From an economic perspective, the question of continuity of value is crucial. Taking into account Polish regulations on the division of assets, it is assumed that an enterprise is an organised set of intangible and tangible components designed to conduct business activity.

It includes in particular: signs identifying the business or its separate parts, ownership of immovable or movable property, including equipment, materials, goods and wares and they rights in rem in immovable or movable property, rights arising from contracts of lease and hire

of immovable or movable property and rights to use immovable or movable property arising from other legal relationships, receivables, rights in securities and cash, concessions licences and permits, patents and other copyrights and property related rights, business secrets, books and documents relating to the conduct of the business not extending beyond the period of the business.

All assets must be valued at the date of distribution of the estate, so the issue of continuity of value is not taken into account. All subsequent gains are not taken into account at the time of distribution. This approach distinguishes Polish laws from US solutions. Legal professions are considered to be most attributable to the position and reputation of the owner. The valuation of a law practice is particularly complicated because of the type of business and its structure, attributed to the reputation and skills of the owner.

‘While in many cases the personal efforts of the individual owner are analysed, in few cases is the applicability of an appropriate methodology for valuing the personal efforts and the business itself considered’ (Hitchner, 2006). In practice, the value of an enterprise carried out by a freelancer is nothing more than the reputation, prestige, brand, repute or image of the enterprise therefore the non-financial aspects affecting its economic value. A company's reputation is an attribute that increases the value of a company over and above the carrying value of its physical assets and has a strong impact on the company's market position. Another author takes the view that the individual value of a professional practice can be defined as the reputation of a company, the main purpose of which is to express the value of the company's market position.

In relation to business reputation, it is an economic term in which reputation is the overall result of a company's long-term presence in the market and which includes the impact of the costs of marketing activities and also other activities and opportunities that can lead to the creation of a better overall awareness of the company and its activities (Palazzo, Foroudi, 2021).

The long-term presence of the company in the market is characterised by the value of the medical practice, which relates more to the work and opinions of doctors. The value is less attributed to the person of the owner. Most professional practices are run by individuals associated with the practice being valued. As with law firms in relation to medical practices, the valued intangible assets include several key issues that affect the value of a medical practice, such as the reputation of the doctors, the location of the practice, the loyalty and number of high-paying patients, and the management systems in place (Hekman, 2008).

A greater role is attributed to external factors from the perspective of company value creation. With regard to the value of medical practices, examples of factors that can be classified as key factors include: local competition, partners and key employees, medical equipment, planned investments (share of existing investments in the company's assets, structure of achieved revenues). In the case of health care, the criterion of trust relates to several levels, including a person who has already had contact and experience with a health care professional, a person who believes in the effectiveness of a health care system that is trustworthy.

Ideally, it should be based on the care as well as the attitude of health care professionals towards the patient. With regard to medicine, we distinguish between several types of multipliers due to the size of the practice and the loyalty as well as the treatment process of the patient. With regard to patients using the specialist on a continuous basis for a longer period of time, the goodwill value is higher.

In relation to the final aspects, from specialist, in a continuous manner, the value of the goodwill is higher. In practice, the upper limits of the multipliers for assessing the goodwill, apply to those practitioners whose key intangible assets are loyal members. The higher the value of the intangibles, the lower the goodwill. From the other perspective, we have those values, whose contact with the patient is ad hoc and resulting from his temporary needs, e.g. surgery or other fields not related to pathological changes. In the case of such groups of patients, the multiplier is relatively low. No less likely is the existence of a problem. Because there are many complications as the so-called ad hoc has many patients, which can be, because the value of goodwill has an impact on other people associated with the doctor. You can even use practices that can be applied in the case of many schemes, and thus obtain different values of the goodwill. To a large extent, the value of the goodwill is connected with the role of the professional in relation to the values of the accounting office. In the case of accounting offices, its greater value, not only the intangible aspects, but also elements of the element of the activity. Office access height usually comes from two sources.

As in the case of the medical industry, these are regular clients with whom the office has signed an agreement for accounting and tax services and serves large companies, as well as occasional users of the office's services for often one-off needs. It should be noted that accounting offices are currently focused on serving regular clients, who to the greatest extent determine revenues from regular contracts with clients. Signed contracts with clients have shown that the goodwill of this type of enterprise is set high, taking into account other forms of activity. The pilot studies conducted have initially shown which intangible and tangible factors shape the value of the office to the greatest extent and determine the amount of goodwill. The value of an accounting office is estimated at a level closer to other classic types of enterprises. The value of an accounting office, regardless of its size, is influenced by the sum of net assets and goodwill values, as well as the deducted value of liabilities shown on the valuation date.

The pilot study carried out showed that in relation to accounting offices, the key factor shaping the value of a small enterprise is the stability of clients, segmentation of revenues and local competition. Most of the companies had been operating on the market for over 15 years, which allowed them to accumulate goodwill. Most of the companies were sole proprietorships. Despite the fact that accounting firms have relatively stable goodwill considering their level of revenues, they are usually small companies. Research shows that in terms of the factors creating their value, the share of assets physically creating the value of the enterprise is small. To a large extent, these are companies; the type of business conducted is also of little importance

considering its size, which indicates a high demand for this type of service. In terms of the essence of goodwill, the respondents were asked about the value of capital and human potential from the perspective of shaping the economic value of the enterprise. The practical experience of a person performing a freelance profession, creativity and interpersonal skills had the greatest impact on the value of the concept of goodwill. To a lesser extent, the managerial skills and qualifications of a person performing a freelance profession were of lesser importance. This thesis confirms much earlier assumptions according to which in the case of persons practicing the accounting profession, practical experience is more important than the qualifications held and constitutes the main goodwill value (Maciąg, 2013).

The conducted research confirmed the importance of goodwill understood on the one hand as the value of intangible factors in the role of owned assets and on the other hand showed how important its role is in shaping the value of the company. Taking into account only three professions performed, it can be seen that its role is very diverse considering the size of its share in shaping assets and depends to a large extent on the competence and trust in the person conducting this type of activity. It should be noted that only one profession in the form of legal practice had the greatest impact on creating the value of the company. The remaining professions to a greater extent reflected a value similar to other companies, including other more general professions. A key element also shaping the value of each practice is the ability to generate income, taking into account aspects related to the transfer and departure of a partner from the Company.

4. Conclusions from the conducted research

In practice, in the valuation of an enterprise, we encounter two types of enterprise value. One aspect is the external value established by the adopted methods, and on the other hand, we are dealing with the valuation of goodwill, which is an element of intangible value, in that it is the result of trust in the owner. Intangible value is also an internal element, i.e. related to the professional, assigned to non-financial elements. At present, too many studies focus only on mathematical elements that can be calculated relatively easily. At present, in Poland, there are no regulated uniform valuation standards in relation to specialist industries, which are the subject of many analyses and valuations. The very approach to the concept of "trust" in relation to the valuation of enterprises is an element proving the role of intangible assets. Although the approach to valuation using the goodwill method is known in the subject literature, there are currently no methods enabling its valuation in the case of specialist practices represented by freelancers.

In the context of Polish realities, there are no developed Polish multipliers that take into account intangible assets related to Polish economic realities and reflect the value of goodwill taking into account its global dimension. Currently prepared indicators do not include research results containing the specific role of intangible factors in shaping the value of an enterprise. In relation to selected categories of freelance professions, for example in relation to legal professions, the adopted valuation methods are based on common, often qualitative findings without referring to the specificity of a specific undertaking. It should be noted that the valuation of an enterprise is not only a quantitative aspect but also a qualitative one, which can be determined using appropriate research methods. Currently, all previously developed multipliers also based on intangible elements (knowledge, human capital) refer to the results of American research based on transaction values, having no major impact on the Polish market. Taking into account the value of intangible assets, it should be remembered that in the field of similar professions, the same valuation pattern cannot be used because all valued practices have different criteria related to determining the factors shaping the value of goodwill.

5. Summary

The main objective of the prepared article was to highlight the factors determining the value of businesses run by freelancers. The key aspect was to analyze the value of each practice from the perspective of the issue of trust in the professional and increasing the value of intangible factors.

The achievements of English-language literature and the results of own research relating to the specifics of running accounting offices were assessed. The conducted research showed that not all businesses run by freelancers have the same level of trust and not all activities can be treated in a uniform way. The greatest increase in trust in shaping intangible assets was observed in law firms, while it was least visible in relation to accounting offices, where the key factor was the experience, not the education of the person providing the services.

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