Valuation of Goodwill

- Practical approach with examples and illustrations.

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Concept of Goodwill

- Goodwill = Value of reputation + Customer loyalty.
- It cannot be seen but adds to earning capacity.

Why Value Goodwill?

- • At the time of partnership changes
- • For mergers and acquisitions
- • For settling disputes
- • For balance sheet presentation

Method 1: Average Profit

- Formula: Goodwill = Average Profit × Years' Purchase
- Example: Avg. profit = 50,000; Years' Purchase = 3 → Goodwill = 1,50,000

Method 2: Super Profit

- Formula: Goodwill = (Actual Profit – Normal Profit) × Years' Purchase
- Example: Actual = 60,000; Normal = 40,000; Yrs = 3 → Goodwill = 60,000

Method 3: Capitalization

- Formula: Goodwill = Capitalized Value – Net Assets
- Example: Avg. Profit = 50,000; NRR = 10%; Net Assets = 4,00,000
- Capitalized Value = 5,00,000 → Goodwill = 1,00,000

Comparison of Methods

- Average: Simple, based on past profits
- Super Profit: Considers abnormal earning power
- Capitalization: Based on overall business worth

Conclusion

- Goodwill valuation ensures fair settlement.
- Choice of method depends on purpose and circumstances.