

January/February 2007

The Value Examiner

A PROFESSIONAL DEVELOPMENT JOURNAL *for the* CONSULTING DISCIPLINES



ENTERPRISE

PERSONAL

GOODWILL
ATTRIBUTES

Goodwill Attributes: Assessing Utility

by David N. Wood, CPA/ABV, CVA

The purpose of this article is to assist valuers using the multi-attribute utility model (MUM) to allocate enterprise and personal goodwill by assessing the utility of each attribute identified. Whether you use MUM or another allocation approach, the article will help you understand how the attributes of a business¹ affect your efforts to allocate goodwill between enterprise and personal.

Details on how MUM works can be found in the sidebar, “MUM’s the Word” (page 28). Note that MUM has been accepted in the Appellate Court of Illinois (5th District), in a case where its validity and acceptance were challenged.²

This article will focus on MUM’s steps three and four: defining the attributes and as-

sessing their utility. MUM divides attributes into those that tend to indicate either enterprise or personal goodwill, and then uses the relative weights to challenge, confirm, and communicate the valuator’s opinion.

A common method of allocating enterprise and personal goodwill involves a generic “point-scoring” system. All too often a report using such a system contains a general discussion of various personal and enterprise attributes, often focusing on just a few; then a conclusion is presented without much in the way of analysis or explanation. On the witness stand, it sounds like this. “That is my opinion based on my experience as a CPA and business valuator.”

Some valuers prefer to duck the allocation of enterprise and personal goodwill and assign all personal or all enterprise, believing that they can defend the “zero proposition” easier than concluding that the goodwill actually consists of both. While a zero conclusion for either enterprise or

personal goodwill occurs in many cases, it seems that in most cases goodwill includes both enterprise and personal elements.

Whether the valuator uses MUM or a point-scoring method, or even the “duck” method, the report should contain a complete discussion of the attributes of enterprise and personal goodwill and how the valuator arrived at the opinion.

Enterprise and Personal Goodwill Defined

Goodwill, a concept based in old English law dating from the early 1800s, is “that intangible asset arising as a result of name, reputation, customer loyalty, location, products, and similar factors....”³

In the early 1900’s in the United States, Justice Cardozo captured the essence that goodwill was the tendency for customers to return to the same location or company because of its name.

I define the two elements of goodwill, personal and enterprise, as follows:

Personal goodwill is the value of earnings or cash flow directly attributable to the individual's characteristics or attributes. Personal goodwill, sometimes referred to as professional goodwill, is a function of the earnings from repeat business that will patronize the individual as opposed to the business, new consumers who will seek out the individual, and new referrals that will be made to the individual.

Enterprise goodwill is the value of earnings or cash flow directly attributable to the enterprise's characteristics or attributes. Enterprise goodwill, sometimes referred to as practice goodwill, is a function of the earnings from repeat business that will patronize the business as opposed to the individual, new consumers who will seek out the business, and new referrals that will be made to the business.

Goodwill Attributes

The word attribute describes a characteristic or a tendency toward a result. Used as a noun, attribute is a quality, property, or characteristic. Used as a transitive verb, attribute ascribes a feature taking on the qualities of causation. In the valuation assignment of determining enterprise goodwill and personal goodwill, the valuator uses the word attribute in both ways – by examining the qualities of the various attributes and by determining their causation on the allocation between the two. Thus, attributes

are properties we need to define, and they are causations we need to understand.

Most valutors approach the problem of allocation by dividing the attributes into enterprise and personal. MUM takes this approach one step further. Each attribute is placed into one of three categories: personal, business, and industry. I believe that classifying the attributes in this manner helps the valuator establish the importance and existence of the attributes, as well as the causation of the attributes to both types of goodwill—enterprise and personal.

Personal Attributes

Personal attributes are those that specifically and directly relate to the goodwill subject, i.e., the person for whom the goodwill allocation is being performed, e.g., physician, architect, accountant, etc. Personal attributes reflect the efforts by the goodwill subject, or they are inherent in the individual, such as age and health.

The Importance Utility. How does one determine if a particular attribute is important in the valuation process? This is assessing the importance utility for the valuator using MUM. A fundamental question is, "What is the impact on earnings of the specific attribute?" The greater the impact, the greater the importance of the attribute.

For personal attributes, I first examine whether the attribute is important to the personal success of the goodwill subject in the business. Generally, if the personal attributes contribute significantly to the goodwill subject's earnings, then I would consider the attribute at least moderately important. However, not all abilities, skills, and work habits are

necessary to one's success. Consider the following example.

Cosmetic surgeons must have terrific skills in order to perform face-lifts. However, recently a new treatment—Botox injections given three or four times a year—has created an enormous revenue-producing capacity for the cosmetic surgeon's practice. Regardless of what the surgeon may tell you, the Botox treatment does not require the same high-skill set as a face lift. Thus, it is important for the valuator to examine the personal attributes with a view to the earnings, particularly recurring earnings.

Second, I look to the requirements or expectations of the industry to determine the importance of the attribute. In your own valuation business, think how essential credentials and training have become. Generally, if the industry requires the attribute, the valuator should consider the attribute at least moderately important. If the attribute significantly contributes to the personal success of the goodwill subject and the industry requires such skills sets, it would likely require a most important weight.

The Existence Utility. After you determine the importance of the attribute, then you must find a way to assess the presence of each attribute. To a large extent, this effort depends on your intuition and research into the business and the industry. Sometimes the importance of the attribute is obvious, sometimes not.

Throughout the attribute assessment, you must ask this question: "Does the presence of this attribute add to the earnings of the business?" The greater the impact on earnings, the greater the presence of the attribute.

1. Goodwill allocations often have significant impact on marital valuations involving professional and service businesses.

However, the courts in most jurisdictions do not limit such determinations of personal goodwill to professional practices and service businesses. In this article, I refer to the target of the valuation as the business instead of the more limiting term practice.

2. In re Marriage of Alexander, Appellate Court of Illinois (5th District) No. 5-05-019, September, 2006. www.state.il.us/court/Opinions/AppellateCourt/2006/.

3. International Glossary of Business Valuation Terms (AICPA).

Ability, Skills, and Judgment Attribute. This attribute focuses on the “doing” by the goodwill subject, the ability to perform at a level to generate sufficient earnings to establish goodwill. The goodwill subject’s education, training, and demonstrated ability will almost always be an important attribute, although, as the above Botox example demonstrates, the valuator should not put this down as most important without giving it some consideration. Does the ability of the goodwill subject directly affect the value of the goodwill?

Does the industry require certain skills as a prerequisite to entry; advanced skills to progress; master skills to excel? In our industry, generally the CPA with some training will gain access to the valuation business, but it requires much training and experience to qualify for various credentials and progress to more an advanced level; and a great deal more training and experience to excel and gain wide recognition.

Specialization of skills is an issue separate and apart from ability—after all, a general practitioner may have extraordinary skills, though not highly specialized skills. Specialized skills are generally correlated with personal goodwill, but it is not clear that a specialized skill is a direct cause of personal goodwill. Specialized skills are probably more of a factor in assessing the ability, skills, and judgment attribute, as well as others, as opposed to being a separate attribute.

If the goodwill subject’s ability drives earnings, and the industry regards these skills as necessary, then the attribute would likely be considered at least moderately important, and probably most important.

The most direct way to determine the presence of the attribute is to examine the education and training, degrees, special designations, and certifications of the goodwill subject. However, not all abilities

come from education, training, and experience. The successful funeral director often has more people skills than mortician skills.

What skills drive the earnings? Very often the skill will be something that sets the successful person apart from the pack. Don’t forget to determine if those same skills are lacking. The valuator must know what drives earnings down as well as up.

Work Habits. Work habits can encompass many things and should be interpreted broadly. Think of work habits as personal efficiency and dedication to the work ethic. Long hours usually outweigh efficiency. My personal physician is known as the “six million dollar man” because of the tremendous fees brought to his hospital. However, he would hardly be described as efficient, with papers piled on every flat surface of his office.

A workaholic has certain habits that most of us can recognize. Some know how to stop and smell the roses, others only know how to work. A physician I know works extraordinarily hard, never says no to a new patient, works long hours at the office and hospital, and is on call. His office is running at maximum performance: He uses lab technicians, nurses, and even an ultrasound technician. The office is well organized and his waiting room is full, as is his well-organized appointment calendar. This is an example of a physician with strong work habits that result in more revenues.

Age and Health. MUM permits only increases in the amount of personal goodwill from personal attributes. In other words, there is no negative rating for importance or existence. Perhaps this is most apparent for the age and health attribute. Age and health are significant because they help determine the longevity of the goodwill subject’s impact on earnings. Underlying all value is the time frame for

cash flow or earnings. Older and less healthy could mean a shorter and more uncertain stream of future earnings, and thus a lesser personal goodwill allocation.

Young and healthy should contribute to personal goodwill. However, given two healthy goodwill subjects, one age 35 and one age 50, there would likely be little or no difference in the personal goodwill impact for this attribute. In this case, younger would not necessarily increase the overall value of the personal goodwill. Discounting earnings would likely be unaffected if the goodwill subject’s life expectancy is long, because other factors keep the time frame shorter. Most discount periods would be 10 years or less. Because of this, age and health would likely be moderately important, or even less important.

Business Attributes

Business attributes are the result of decisions made by management that affect the organization, operations, finances, and the business’s image. The decisions may be made by the goodwill subject or by other management who may be supervised by the goodwill subject. Who makes the decisions does not affect the goodwill allocation. The goodwill subject making decisions that improve enterprise attributes does not increase personal goodwill—it increases enterprise goodwill!

To determine the importance utility I ask the fundamental question, “Do the business attributes successfully contribute to the earnings of the enterprise?” Specifically, does the attribute actually contribute to the earnings of the business, such that without the attribute, the earnings would be less? It is a good idea to return to this fundamental question throughout your assessment of the importance of an attribute.

As with personal attributes, the industry’s expectations or requirements influence the importance of a

business attribute. Take a pharmacy as an example. It should have a drive-up window. Nearly all pharmacies have gone to this marketing strategy in this age of fast food and ultra-convenience. If the business needs and the expectations of the industry are high, the business attribute would likely be most important.

Determining the presence of business attributes, like personal attributes, is a matter of intuition, research, and observation, and can vary significantly from valuation to valuation. In this case, a good location and well designed layout of the parking lot and drive-up would give a high presence to this enterprise attribute.

Enterprise: Location. The multiple locations attribute and the business location attribute, although separate and distinct, can be discussed together. Multiple locations should not necessarily lead one to assume a strong indication of enterprise goodwill. You must assess how the locations are being used. If a goodwill subject uses two offices as a way to expand his market reach, but only one office is providing service at a time, i.e., when the physician is present, then the multiple offices would have less impact. However, if a physician were using one office for his practice, but had satellite offices that provided limited service through physician's assistants, then enterprise goodwill would arguably increase.

The business location is important if location is important in the industry and it is a primary factor in customers' decision to return. Many medical offices and pharmacies are located near hospitals and clinics. A specialty formalwear dress shop or retail shoe store need locations with good visibility. A property management company most often would need an office convenient for its employees, but not necessarily a high-profile location. Look at the industry to determine how important

the location is, and whether a good location means increased earnings.

It is not too difficult to determine the existence of multiple locations, although a visit to each will often reveal how the business uses the locations to increase earnings. Determining and showing that a location is a good one is more difficult. I have used the Department of Transportation to get drive-by statistics. Aerial photography, generally available in the county assessor's office, can give the top-down view to show location. Another great source is Google Map and Google Earth, which can show satellite images with street overlays. I have used this to pinpoint outdoor advertising sign locations.

Enterprise: Systems and Organization. The systems and organization attribute refers to all of the decisions made by management that help the business perform. Without such systems in place, the business functions in chaos and inefficiency. An efficient, well defined and well maintained set of systems make up a strong organization. This attribute is a good indicator of enterprise value, even if the goodwill subject is the one who created the systems. The issue is not who created it, but whether the systems drive the earnings.

Even in a highly personalized business, a set of systems that make the business profitable, efficient, and transferable can generate enterprise goodwill. For most businesses, effective systems and organization is sought after, and nearly all industries have an expectation of such systems. Thus, it would be likely that the systems and organization attribute would be weighted at least moderately important.

Determining the presence of systems requires broad thinking. Systems would include computer systems, templates and forms, customer lists and databases, collections systems, internal audit controls, financial reporting systems—literally

every system in place. You cannot evaluate each and every system, but must be sufficiently familiar with the business's systems to assess them in their totality.

Sometime asset efficiency can give clues to systems. Are collections better than most as a result of a well designed billing system? Are inventory levels maintained at low levels, but still sufficient to avoid back orders? Are there forms used by employees to avoid errors or time spent recreating solutions for tasks? Are reminder cards sent to customers regarding future appointments, such as pet owners for their pets' annual vaccinations? Is there a Web presence—and does the website content help to increase revenues, or is it just "tombstone" information?

I get a call from my dentist's appointment system reminding me of my semiannual checkup five days before the appointment. Such systems are invaluable for keeping professionals busy and profitable.

Enterprise and Personal: Reputation. Business reputation is the customer's perception about all aspects of the product or service, including price, customer support, quality, and satisfaction. If the reputation is based on the goodwill subject, then the characteristic is personal. However, it is common for a customer to associate a business with an individual, when, in fact, it is the business reputation that they are counting on.

The business reputation is based on many more things than just the reputation of one person, such as the reputation of other professionals and staff, the quality of the product or service, convenience, and price. Even when there is a strong case for personal reputation, it often operates in conjunction with the business reputation. For example, a patient often has a strong connection to both the dentist (personal) and the dental hygienist (business).

Personal reputation is the customer's perception about the goodwill subject's ability, skills, and judgment. Whether the goodwill subject has these qualities may be entirely different from whether he is perceived by customers to have these qualities. It is difficult to measure the perceptions of others, but it can be done.

Consider the ophthalmologic surgeon. The surgery aspect of the service may strongly suggest that personal reputation is at play. But a surgery patient may also become a regular patient for annual eye examinations, performed by other members of the practice. One could reasonably make the case that the patient came to the practice for the surgery, but stays with the practice for other reasons, including the reputation of the business.

Determining a business's reputation can be tricky. Management's opinion is probably biased. Consider checking with others in the community, even the competition, if appropriate. If the competition says the business has a good reputation, your research may be nearly complete.

Does the company maintain a complaint file (some businesses are required to do so)? How are complaints dealt with? Have there been lawsuits alleging poor service or a defective product? Has the business won any awards? Quality service and sales are often recognized by vendors, industry organizations, and communities, and may be hanging on the wall right in front of you during your field visit.

Assessing the personal reputation attribute is similar to assessing the abilities, skills, and judgment attribute, except that the focus is more on the recognition of the abilities. Indicators of significant personal reputation include, awards recognizing one's abilities, a high position with a highly rated medical institute, holding a teaching position in addition to one's tax practice, and bylined articles published. People

often look at these accomplishments when selecting a professional.

As with each of the attributes, you must attempt to connect the business and personal attributes to the earnings. If the business or personal reputation is strongly connected to earnings, then these attributes would likely be at least moderately important.

Enterprise and Personal: Staffing. Staffing describes all the employees of the business other than the goodwill subject. Usually employees in place would be associated with enterprise goodwill. However, it is possible that staffing can indicate personal goodwill, such as when personal reputation is the reason the employee sought the position. This might occur with a professional who has a national reputation for excellent training. Essentially, the question is whether the staff would have sought the position if the goodwill subject had not been involved in the business.

Consider the importance of the staff to the earnings, and their contribution to keeping business returning. Is the business labor-intensive? Is there close contact between the staff and the customer? Is the contact of a personal or confidential nature? Is there a high level of training required? Does the work require special physical strengths? These are many of the same characteristics used to assess personal goodwill of the goodwill subject.

Clerical, secretarial, and office administrators are generally less important, primarily because they normally could be replaced more easily and may have less contact with customers, although certainly there are exceptions.

There are no hard and fast rules in making this determination. Generally, I believe that enterprise staff is likely to be more important than personal staff. They are separate attributes and require separate analysis.

One last thought about staffing: Multiple service providers, such as

multiple accounting partners, are sometimes listed as a separate attribute. Since staffing includes all employees other than the goodwill subject, it seems that evaluating the impact of multiple service providers can easily be accomplished within the context of the staff attribute. If the multiple service provider's attribute is listed in addition to the staffing attribute, take care not to double-count the impact.

Enterprise and Personal: Name. There is probably no more misunderstood attribute than the personalized name attribute. Judges and attorneys often leap to the conclusion that if someone's name is on the business, then all the goodwill must be personal. This is false. If it were true, those businesses with personal names would sell for much less. I know of no evidence to support such a claim.

Many businesses with the founders' names are sold and simply carry on with the personal names. Others buyers acquire the name and change it. The question you must address is, "Would the customers abandon the business solely because it changed its name?" Not very likely. Methinks Shakespeare was right—it is "still a rose."

Barring unusual circumstances, I would normally consider the naming attributes to be of moderate importance or less. As for their presence, there are certainly different levels of the attribute for the personal and business name. A very personalized name, such as Dr. I. C. Yue, Inc., might have an above average or strong presence for the personal name attribute and a weak presence for the business name attribute; while the Yue Eye Institute might be a moderate or below average presence for the personal name and a moderate or above average presence for enterprise goodwill.

Enterprise and Personal: Marketing and Branding. Marketing and branding tend to be

thought of as indicators of enterprise more than personal goodwill. However, when the marketing focus is the goodwill subject rather than the business, the marketing drives the personal goodwill higher. In St. Louis, there is an ophthalmologic surgeon who has a large and very successful clinic. I am sure that there is a large amount of goodwill and that there is a significant element of enterprise goodwill associated with it. However, the marketing of the clinic is extremely personal; print media advertisements with endorsements of local celebrities, business persons, and sports figures all standing next to Dr. P. In this case, the marketing focuses on the doctor, and therefore it adds to the personal goodwill.

Consider whether the marketing and branding contribute to the success of the business. Is marketing being done by the competition? Is it customary for businesses in the goodwill subject's industry to have active marketing campaigns? Even when it is not customary, is the business doing an exceptional job of marketing the business?

Determining that a business has a marketing plan is much easier than determining how effective the plan is at increasing earnings. The marketing plan will differ by industry, so you should perform industry research and determine what type of marketing is typical, and then assess how well the business is meeting this task.

Industry Attributes

Industry attributes are defined by the industry, as opposed to some action taken by the goodwill subject or decisions made by the business. For example, the first attribute, closeness of contact, is generally a function of the industry. Dentists have close contact, radiologists do not. Sometimes the goodwill subject's style is more personal, with an emphasis on contact; I consider this to be a work habit, however.

In determining the importance utility of industry attributes, I consider the requirements, expectations, and nature of the industry. As with personal and business attributes, you should understand the connection between the industry attribute and the returning business.

Consider the repeating revenue stream attribute. It is the nature of accounting firms to have repeat business. This attribute in an accounting firm might be considered most important, while in an architectural firm, whose business is less likely to be repeated, would likely give repeating revenue stream a lesser weight.

Personal: Closeness of Contact. Politicians have known from the very first elections that "pressing the flesh" helps to get votes. For much the same reason, the more contact and the more direct the contact, the more likely the subject will enjoy personal goodwill from the beneficiary of that contact.

The importance of closeness of contact is a function of the industry. In the case of the radiologist, where the

work often involves no more than examining x-ray film or other images, the closeness of the contact may be of little importance. A general practitioner often has numerous or annual appointments with each patient, which would be considered normal and important in their relationship. Some cases are more intuitive than others, but you should try to determine what the customary practice is for the business. If closeness of contact is important and customary in the industry, then it is likely that it would be at least moderately important.

Personal: Important Personal Nature Attributes.

Not all kinds of contact are equal when it comes to building goodwill. However, the closeness of the contact should not be confused with the importance or nature of the contact. Two eye doctors spending roughly the same amount of time with a patient could easily have different levels of goodwill resulting from the contact. The eye doctor who places a sharp instrument into the center of your eye during surgery has a different connection than the eye doctor who puts a puff of air on your eye during your annual exam.

Generally, significant close contact in combination with important personal service would tend to create more personal goodwill than either of the two attributes separately.

Enterprise or Personal: Referrals. "Inbound referrals" to a goodwill subject often indicate a high level of respect for his or her abilities. Referrals are usually personal in nature, made to a particular individual, increasing personal goodwill. However, referrals can certainly be made to a business, supporting a greater enterprise allocation.

Referrals are a direct source of business, and therefore directly impact the earnings of the business. Often the industry will show you the importance of this attribute. Keep in mind that referrals can come from customers or from others, such as general practitioners recommending a specialist. Referrals from general practitioners probably represents a stronger impact on earnings than referrals from customers when non-customer referrals are a strong source of earnings.

"Outbound referrals," such as a general practitioner dentist to an oral surgeon, may indicate a collateral relationship; it would not seem to have great value to most buyers, since outbound referrals do not likely mean increased earnings. The problem with using a collateral relationship is the absence of causation.

Enterprise: Repeating Revenue Stream. Repeat business is at the heart of goodwill. Business can return because of enterprise or personal attributes. However, some businesses are inherently more likely to have repeat business by the very nature of their industry. Thus, this attribute is not concerned with the reason for the repeating business—for example, a great location or a consummate professional. The attribute deals with the specific nature of the revenue stream. Dentists, veterinarians, tax accountants, eye doctors, OB/GYNs,

internists, and many non-surgical medical specialists all have one thing in common: The customer keeps coming back on a regular or nearly regular basis.

This is a powerful element of enterprise goodwill. If the repeating income stream is likely to continue with a new owner, then a significant portion of the goodwill is enterprise-related. If the nature of the industry includes a repeating income stream, then it is likely that such an attribute would be at least moderately important.

If the business is taking full advantage of the repeating income stream, then the existence would be strong. One veterinarian sends out postcards reminding pet owners that their pet needs an annual vaccination, and then follows up by having a staff person make reminder phone calls to set up appointments for any pet not vaccinated within 60 days. This is an excellent system in an industry that enables the professional to take advantage of the repeating income stream. Another veterinarian chooses not to send out the reminders, or does not have the staff or systems in place. Which has a greater percentage of enterprise goodwill? The industrious veterinarian with the efficient reminder system, of course.

Enterprise: Intellectual Property. Copyrights, patents, trademarks, processes, and other intellectual property are intangible rights conferred on the business by law or contract. You may place values on the specific intangible rights separate and apart from the value of goodwill. However, it is not unusual for a valuator to include in the value of goodwill the unspecified value of the intangible rights. This is especially true when (a) the value of those rights is small in relation to the value of the business and the value of the goodwill, or (b) the realities of time, budget, and methodology limit the valuator. Whatever the approach, you must synthesize the weighting of this attribute with the determination of a separate value.

Transferability of Goodwill

This is a difficult subject. In the past, I have treated ease or difficulty of transferability as an attribute of enterprise or personal goodwill. However, it does not seem to add much to the analysis, since personal goodwill is difficult to transfer and enterprise goodwill is relatively easy to transfer. In the final version of MUM, I decided to exclude it as an attribute. Of course, you are welcome to use it if you find it useful.

If you decide to use transferability as an attribute, it is the ease or difficulty you are assessing, not the ultimate ability to be transferred. For an asset to have value to a willing buyer, the asset must be transferable.

Thus, for enterprise goodwill to have value, it must be transferable. But wait a minute—is that not also true for personal goodwill? Of course it is. So personal goodwill, at least the portion of it that would have value to a buyer, must also be transferable.

Take the case of two physicians, a general practitioner and a highly specialized one. A valuator could easily conclude that the GP has the greater enterprise goodwill percentage. If the practices and financial statements are generally similar, would it be fair to conclude that each would have a similar total fair market value, but with the GP getting a larger percentage share of goodwill allocated to the enterprise?

At first blush the answer might seem logical. But consider the transferability of goodwill. It is nearly certain that the GP's practice will have a greater overall value than the specialist's. Due to the MUM allocations of goodwill and the issue of transferability, the GP's practice will have more enterprise goodwill as a percentage, but also a greater overall value. Thus a MUM allocation of goodwill must be a part of a valuation that starts with a solid value of the enterprise. In short, you cannot allocate goodwill if it does not exist or is not transferable. **VE**

S I D E B A R

MUM's the Word

How the Multi-attribute Utility Model Works

By David N. Wood, CPA/ABV, CVA

The multi-attribute utility model (MUM) has been used extensively in fields such as economics, politics, and science for making decisions based on subjective and imprecise information. As used in valuations, MUM is an allocation model for distinguishing enterprise goodwill from personal goodwill. It assists valuers in marital dissolution cases in jurisdictions that require separation of goodwill into the two components, enterprise and personal. MUM was first described in 2004 in the *American Journal of Family Law*.¹ The model has been accepted in the only appellate court to review

the method, in a case where its validity and acceptance under Frye were directly challenged.²

Many subjective judgments and decisions are made in every valuation. The valuator uses methodologies that bring more objectivity and consistency to these judgments and decisions, and provide results that are better understood and more meaningful to those who depend on the valuations. MUM is one such methodology. It is sophisticated enough to be useful in various scientific disciplines, yet relatively simple to use.

MUM provides a seven-step guide that can offer a reasonable support against evidentiary challenges. The steps are as follows:

1. Define an Objective

Determine the value of the two elements of goodwill, personal and enterprise, from the total goodwill, such that a reasonable, well founded basis can be communicated as the support for the opinion of value.

2. Establish the Alternatives

The alternatives define the possible outcomes in which MUM will result. The alternatives are selected as a range of percentages of personal goodwill. The outcome for each range is a specific personal goodwill percentage within the range. Enterprise goodwill is the reciprocal percentage. Table 1 shows five alternatives and the resulting percentage values.

Table 1: Establish the Alternatives

Five Alternative Ranges			
	From	To	Outcome
1	0%	20%	10%
2	20%	40%	30%
3	40%	60%	50%
4	60%	80%	70%
5	80%	100%	90%

3. Define the Attributes

Divide the attributes into the two categories, personal attributes and enterprise attributes. (See the main article, "Goodwill Attributes: Assessing Utility," page 20.)

4. Determine the Attribute's Importance and Existence Utilities

The importance utility is an assessment of how important the attribute is in making an allocation between enterprise and personal goodwill. MUM presumes that an attribute selected has some merit and, thus, has a weight greater than zero. An example of importance utility weights are shown in Table 2.

Table 2: Determine the Attribute's Importance Utility

MUM Importance Utility Weights	
	Weight
Least Important	1
Moderately Important	3
Most Important	5

To determining the existence utility, you assess the presence of the specific attribute. An important attribute would not have as much impact on goodwill if the attribute exists only in small quantities. Each attribute is assessed to determine its existence, and then is weighted accordingly. An example of existence utility weights are shown in Table 3.

Table 3: Determine the Attribute's Importance Utility

MUM Existence Utility Weights	
	Weight
Weak Presence	0
Below Average	1
Moderate Presence	2
Above Average	3
Strong Presence	4

1. "An Allocation Model for Distinguishing Enterprise Goodwill from Personal Goodwill," by David Wood, American Journal of Family Law, Fall, 2004. The author will be happy to forward a PDF copy of this article upon request (david@woodvaluation.com).
 2. In re Marriage of Alexander, Appellate Court of Illinois (5th District) No. 5-05-019, September, 2006. www.state.il.us /court/Opinions/AppellateCourt/2006/.

5. Aggregate the Results

Divide the attributes into the two groups, enterprise and personal. Then multiply the importance utility by the existence utility to determine the attribute's multiplicative utility. Establish the respective percentages of each attribute for personal and enterprise goodwill. Table 4 shows the attributes (partial) and the computed utilities for a business with significant personal goodwill.

Table 4: Aggregate the Result

Personal Goodwill Attributes	Importance Utility	Existence Utility	Multiplicative Utility	Percent
Ability, Skill and Judgment	15	3	45	25.4%
Work Habits	3	3	9	5.1%
Age and Health	1	2	2	1.1%
⋮	⋮	⋮	⋮	⋮
Closeness of Contact	5	2	10	5.6%
Important Personal Nature	5	3	15	8.5%
Total Personal Utilities	44	28		
Total Multiplicative (PGA) Utility			136	76.8%
Enterprise Goodwill Attributes	Importance Utility	Existence Utility	Multiplicative Utility	Percent
Enterprise Staff	3	1	3	1.7%
Business Reputation	3	0	0	0.0%
Business Name	5	0	0	0.0%
⋮	⋮	⋮	⋮	⋮
Marketing and Branding	3	1	3	1.7%
Repeating Revenue Stream	5	4	20	11.3%
Total Enterprise Utilities	35	11		
Total Multiplicative (EGA) Utility			41	23.2%
Total Multiplicative Utility (TMU)			177	100.0%

6. Fit the Results to the Alternative and Analyze the Outcomes

Fit the personal goodwill attributes utility and the enterprise goodwill attributes utility outcome percentages (see Table 4) into an alternatives table such as Table 1. The outcome is expressed as a percentage of personal goodwill. The difference between total goodwill and personal goodwill is the enterprise goodwill. In Table 4, the resulting outcome is 70 percent personal goodwill. Review and analyze the outcome using sensitivity analysis on the attributes to challenge and confirm the assessments.

7. Express an Opinion

Assessing the attribute's utilities and fitting the outcomes to the alternatives provides the basis for the opinion of the allocation between personal and enterprise goodwill. This opinion may be expressed as an opinion of value or as an estimate of value. **VE**



David N. Wood, CPA/ABV, CVA, is the principal of Wood Forensic/Valuation Services in Mount Vernon, Illinois (www.woodvaluation.com).

Continued from Page 4...

“Herman Kelting, AVA, is an engineer with the Internal Revenue Service, with academic training in industrial engineering, accounting, and real estate and urban land economics. His work experience includes business valuations and related discounts, allocation of purchase cost, and the valuation of intangible assets. The opinions expressed herein are those of the author, and do not necessarily reflect the position of the IRS.”

Also in the November/December issue, we published the wrong photo for Mark Kohn, CPA/ABV, CVA, CFE, author of “Goodwill of the Superstar within the Excess Earnings Methodology” (page 7). The correct photo is shown here. We apologize to the authors for the errors. **VE**

