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Course Work

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COURSE NAME: BADWILL

Student´s profile

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At times, we can see a few public outcries directed to companies in some countries in the whole wide world. Besides, there are companies which face some financial distress due to the lack of foreign exchange, as it is the case of Refriango Company_ In Luanda-Angola_ which back in the year 2015 was about to have its doors closed, due to the lack of open finance lines from the side of our local comercial banks (https://novojornal.co.ao/economia/interior/refriango-ameaca-paralisar-1895.html); should not the owners of the referred company handle this situation, they would be obliged to sell it at a lower price compared to its fair market net value; sort of event which from the accounting perspective is called BadWill.

Well, public outcries and lack of financial lines are not the only serious issues or challenges a company could deal with. For example, a huge debt or even bankruptcy could lead companies to BadWill; i.e., those companies facing these challenges could be sold at less fair market value.

From the economic perspective, Badwill refers to negative perceptions, attitudes, or emotions directed towards a company or organization. When a company's actions, policies, or products are perceived as harmful, unethical, or immoral, it can lead to public backlash, boycotts, and reputational damage.

Here are some examples of companies that have faced *public outcry* due to badwill.

1. Volkswagen - In 2015, Volkswagen was caught cheating on *emissions tests* for diesel engines, leading to a scandal that rocked the automotive industry. The company had installed software in its cars that allowed them to pass *emissions tests*, even though they were emitting up to 40 times the legal limit of pollutants.

The scandal led to billions of dollars in fines, recalls of millions of vehicles, and *a significant hit* to the company's reputation.

2. United Airlines - In 2017, United Airlines faced *a public relations disaster* when a passenger was violently dragged off an overbooked flight. The incident was captured on video and went viral, sparking outrage around the world. The airline's initial response was widely criticized, and the incident led to calls for boycotts and *a significant drop* in the company's stock price.

3. BP - In 2010, BP faced a massive oil spill in the Gulf of Mexico, which became one of the worst environmental disasters in history. The company's response was criticized for being slow and inadequate, and the spill led to widespread damage to the environment and *local communities*. BP faced billions of dollars in fines and *compensation claims*, as well as *a significant hit* to its reputation.

4. Nestle - Nestle has faced *public outcry* for its use of child labor in *its cocoa supply chain*. The company has been accused of exploiting children in *Ivory Coast*, where it sources much of its cocoa. Nestle has faced lawsuits and boycotts over the issue, and has been criticized for not doing enough to address the problem.

5. Uber - Uber has faced *public outcry* over its treatment of drivers and allegations of sexual harassment and discrimination within the company. The company has also faced criticism for its aggressive business practices and disregard for *local regulations*. Uber has faced lawsuits, boycotts, and *a significant hit* to its reputation as a result.

When faced with public outcry due to badwill, companies have several options. They can deny the allegations, apologize and make amends, or take steps to address the underlying issues. Ultimately, the best option will depend on the specific circumstances and the severity of the situation. However, it is clear that ignoring public outcry is not a viable option, as it can lead to *significant reputational* *damage* and *financial losses*. Companies must be proactive in addressing badwill and taking steps to rebuild trust with their stakeholders.

Nevertheless, BadWill can actually provide significant benefits to the acquiring company and on the other hand provide losses to the asset selling companies.

We can see below, a few companies that have leveraged negative goodwill to their advantage:

2. Case Study 1: Google's Acquisition of *Motorola Mobility*

In 2012, Google acquired Motorola Mobility, a leading manufacturer of smartphones and other mobile devices, for a price significantly below its net assets' fair value. This resulted in negative goodwill of $4.5 billion for Google. By acquiring Motorola Mobility at a bargain price, Google not only gained access to valuable patents and intellectual property but also expanded its presence in *the mobile device market*. This strategic move allowed Google to strengthen *its Android ecosystem* and compete more effectively against rivals such as Apple.

3. Case Study 2: Berkshire Hathaway's Acquisition of *Burlington Northern Santa Fe*

In 2010, Berkshire Hathaway, led by legendary investor Warren Buffett, acquired Burlington Northern Santa Fe (BNSF), one of the largest railroad companies in the United States. The acquisition was completed at a price significantly lower than the fair value of BNSF's net assets, resulting in negative goodwill of $1.8 billion. By acquiring BNSF at a bargain price, Berkshire Hathaway gained control over a critical transportation infrastructure, positioning itself to benefit from the long-term growth in freight transportation. This case study showcases how negative goodwill can provide a competitive advantage and long-term value for *the acquiring company*.

4. Tips for Identifying Opportunities for Negative Goodwill

While negative goodwill may not be a common occurrence, it is worth exploring *potential opportunities* for acquiring companies at *a bargain price*. Here are some tips for identifying such opportunities:

A) Distressed Companies: Look for companies that are facing financial distress or *operational challenges*. These companies may be more willing to sell their assets at *a discounted price*, resulting in potential negative goodwill.

B) Market Downturns: During economic downturns or market corrections, the valuations of companies may decline below *their net asset values*. This presents an opportunity to acquire companies at *a bargain price* and generate negative goodwill.

C) Special Situations: Keep an eye out for *special situations* such as mergers and acquisitions, divestitures, or bankruptcies. These events can create opportunities for acquiring companies at a price below *the fair value* of their net assets.

Negative goodwill, though often overlooked, can be a hidden source of value for acquiring companies. The case studies of Google and Berkshire Hathaway demonstrate how strategic acquisitions at a bargain price can lead to long-term benefits and competitive advantages. By identifying opportunities for negative goodwill and leveraging them effectively, companies can unlock *hidden value* and position themselves for success in today's dynamic business landscape.

BadWill is an accounting practice…

From the perspective of accounting, it is when a company is sold, as stated above, at a less fair market value due to serious financial distress. Thus, favoring the potential buyers.

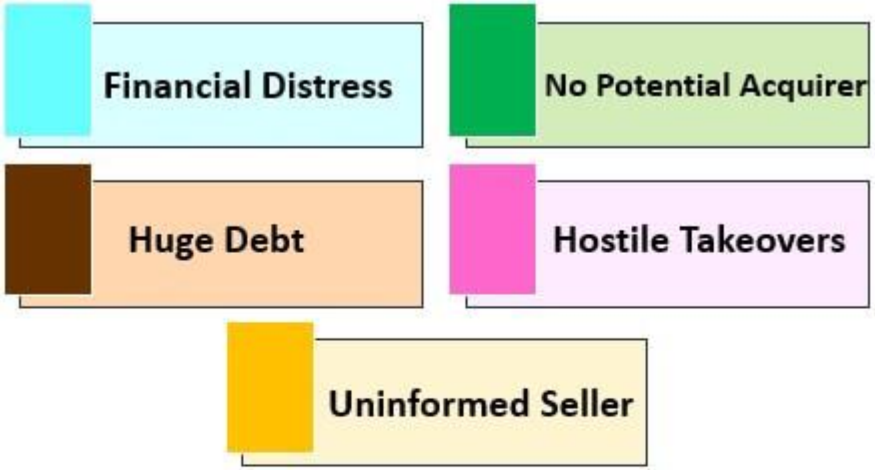
Badwill

JOURNAL				
Date	**Particulars**	**Folio**	**Debit**	**Credit**
xx	Value of all the Assets Acquired		$0.00	
	To Bank			$0.00
	To Extraordinary Gain on Bargain Purchase			$0.00
	(Brief narration of the transaction)			

JOURNAL				
Date	**Particulars**	**Folio**	**Debit**	**Credit**
xx	Net-Assets Acquired		$650.00	
	To Bank			$500.00
	To Extraordinary Gain on Bargain Purchase			$150.00
	ABC Inc. acquired XYZ Inc.			

Causes of Badwill

There are several reasons companies sell their assets or business for the sale consideration amount that is way less than the fair market value of the assets, such as:



- **Financial** Distress: If a company is in distress and reporting losses in past years consistently or has negative Free Cash Flows consistently in the past years, the chances are the company's valuation may fall below the market value of its assets.
- **Huge Debt**: If there is a significant level of leverage in a company with no consistent positive cash flows to meet the financial obligations, it can lead to the sale of the entity's assets for a lower value than its market price.
- **No Potential Acquirer**: If a company wants to sell its business or a division but faces difficulties finding the buyer, this may cause the target company to accept the lower sale consideration.
- **Hostile Takeovers**: **Hostile takeovers** refer to the acquisition of the target company by the acquirer without the consent of its Board of Directors. These takeovers occur in a forced way, either by filing a lawsuit, making a **tender offer** to the target company's shareholders, or gaining ownership in the open market.

Hostile takeovers are the opposite of **friendly takeovers** wherein both the acquirer and seller mutually agree to the acquisition of the business, thus, sometimes closing the deal with low sale consideration value resulting in the bad will.

- **Uninformed Seller**: Sometimes, the seller isn't aware of the potential growth and market value of its business and accepts the lower valuation of its business due to the lack of awareness.

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- If the fair value of the assets acquired is more than the consideration price paid for the acquisition of the assets, the resulting difference is termed **Negative Goodwill**.
- In the books of accounts of the acquirer, the value of Negative Goodwill is allocated to reduce the cost of **non-current assets** acquired to zero.

- After reducing the cost of non-current assets to zero, the remaining value of badwill is recognized as an **Extra-Ordinary Gain** in Income Statement.

Journal Entries of Badwill

The acquiring company can recognize the negative goodwill as “Extraordinary gain” or “Bargain Purchase Gain” by following Journal Entry:

Journal

Date	Particulars	Folio	Debit	Credit
XXX	Value of all the Assets Acquired		$0.00	
	To Bank			$0.00
	To Extraordinary Gain on Bargain Purchase			$0.00

(Brief narration of the transaction)

Example

Let us say ABC Inc. acquired the entire business of XYZ Inc. for a consideration value of US $ 500 million. On the date of acquisition, the fair market value of XYZ Inc.'s net assets (including **Property, plants, and**

Equipment and other current assets minus non-current liabilities and current liabilities) was US $ 650 million.

As the fair market value of the net assets of XYZ Inc. is more than the consideration value paid by ABC Inc., the transaction can be termed as Bargain Purchase with the Badwill amounting to US $ 150 million. (US $ 500 million minus the US $ 650 million)

ABC Inc. can recognize the value of negative goodwill of US $ 150 by recording the following journal entry:

Journal

Date	Particulars	Folio	Debit	Credit
XXX	Net-Assets Acquired		$650.00	

Date	Particulars	Folio	Debit	Credit
	To Bank			$500.00
	To Extraordinary Gain on Bargain Purchase			$150.00

(ABC Inc. acquired XYZ Inc.)

Conclusion

Badwill occurs when the acquiring company acquires the net assets of the target company for a considerable price that is lower than the fair value of the company’s assets. These transactions occur when the target company is in financial distress or has a significant debt with no positive, consistent **cash flows** to meet the financial obligation or through a hostile takeover.

Importantly, a company-related purchase process can also be carried out through the opposite event for BadWill; which is when a company is sold at a higher value compared to its fair market net value. This latter, of course, favors the selling party of the deal.

References

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