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Towards an understanding of the phases of goodwill accounting in four Western capitalist countries: From stakeholder model to shareholder model

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Abstract

The objective of this paper is to illustrate that the change in shareholders' attitude towards firms (from stakeholder model to shareholder model) influences the accounting treatments of goodwill. Our study is based on four countries (Great Britain, the United States, Germany, and France) and covers more than a century, starting in 1880. We explain that all these countries have gone through four identified phases of goodwill accounting, classified as (1) "static" (immediate or rapid expensing), (2) "weakened static" (write-off against equity), (3) "dynamic" (recognition with amortization over a long period) and (4) "actuarial" (recognition without amortization but with impairment if necessary). We contribute several new features to the existing literature on goodwill: our study (1) is international and comparative, (2) spans more than a century, (3) uses the stakeholder/shareholder models to explain the evolution in goodwill treatment in the four countries studied. More precisely, it relates a balance sheet theory, which distinguishes four phases in accounting treatment for goodwill, to the shift from a stakeholder model to a shareholder model, which leads to the preference for short-term rather than long-term profit, (4) contributes to the debate on whether accounting rules simply reflect or arguably help to produce the general trend towards the shareholder model, (5) demonstrates a "one-way" evolution of goodwill treatment in the four countries studied, towards the actuarial phase.

Introduction

In positive accounting literature, the "stakeholder model" and "shareholder model" concepts have been emphasized (Ball, Kothari, & Robin, 2000, p. 243) to explain certain properties of accounting earnings (timeliness, conservatism).

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The stakeholder model (usually related to code-law countries) is a highly concentrated shareholding model where shareholders are mainly the founder families, the state, the bank or even employees and are actively involved in management of the company. The shareholder model (usually related to common-law countries) is not used as a legal term, but refers to a specific corporate governance model where ownership is dispersed and shareholders are separate from management. This literature offers us an interesting framework for analysing how the changes in actors' forms of calculation impact accounting regulations (Robson, 1993).

Taking the accounting treatment for goodwill as an emblematic illustration, this article sets out to show that the direct associations between the stakeholder model and code-law countries, on the one hand, and between the shareholder model and common-law countries, on the other hand, are open to debate. Based on a social and historical study of four countries which have played a major role in the Western world economy during the 20th century, Great Britain, the United States, Germany and France, we show that rather than corresponding to a clear dichotomy between common-law and code-law countries, these two models of corporate governance relate to a gradual shift: the stakeholder model was present in all four countries, and has evolved over time into the shareholder model. More precisely, we demonstrate that the four countries studied have a common starting point (stakeholder model), a time when shareholders were mainly insiders actively involved in management; and from that point, due to the capital markets' current importance, all of them have made their way to the common destination of professionalization of management and investors (shareholder model), but by different routes and at different paces.

Leake (1914, p. 81) pointed out that the "word 'Goodwill' has been in commercial use for centuries" and cited a reference from the year 1571. Without looking so far back, our study still covers a period of more than a century, starting from the 1880s. Hughes (1982, p. 24) tells us that "accounting literature on goodwill appeared in ... periodicals or newspapers, such as *The Accountant* [which] started in 1874".

Our paper concentrates on "acquired goodwill": acquired either individually (goodwill purchased when buying assets other than by buying shares in a company [non-consolidation goodwill]) or in a business combination (goodwill purchased by a group when buying shares in a company [consolidation goodwill]) (Nobes & Norton, 1996, p. 180). Internally generated goodwill is not covered, as it involves specific issues in addition to those relating to acquired goodwill (see Jennings & Thompson, 1996).

Many articles observe a wide diversity in both the regulations and treatments applied in practice to goodwill (Arnold, Eggington, Kirkham, Macve, & Peasnell, 1994; Catlett & Olson, 1968; Cooper, 2007; Hughes, 1982). In the United States, Walker (1938a) provides tables showing prevailing practices and the diversity in the treatment of goodwill in the balance sheet.

It is always difficult to divide prevailing accounting treatment into clearly dated phases. For this study, we decided to take a time of fundamental change as the start of a phase. That change generally concerns accounting regulations: newly issued standards or exposure drafts that would later lead to the final standard constitute our primary sources. However, for the early stages (late 19th century and early 20th century) before formal accounting regulation of goodwill, our sources are court rulings and discussion papers written by leading scholars of the period ("doctrine"). We determine the phases on the basis of these elements.

In this article, we relate the stakeholder/shareholder models to a "balance sheet theory", developed by continental European scholars such as Schmalenbach (1908) with his concept of the "dynamic (vs. static) balance sheet". We extend these concepts to identify four phases in accounting treatment for goodwill. All the countries examined went through an initial phase that can be classified as "static": the idea was that the balance sheet should relate to the "end" of the firm, with items measured on the basis of liquidation value. This phase is marked by great reluctance to see goodwill as a true asset. In principle, this "unsightly, unwieldy and 'un-valuable' asset", to borrow Dicksee's expression (1897, p. 47), was to