Brand Valuation

By Jan Lindemann

Editor's comment: Brand valuation has proved to be one of the most popular topics since it was first covered in Pool. This new feature discusses the current situation and shows how brand valuation is undertaken as well as some of the benefits from undertaking such an approach.

Introduction

The brand is a very special asset and in many businesses it is the most important asset. This is due to the far-reaching economic impact that brands have on enterprise. Brands influence the choice of customers, employees, investors and government authorities. In a world of abundant choices such influence is crucial for commercial success and creation of shareholder value. Even non-profit organisations have started embracing the brand as a key asset for obtaining donations, sponsorships and volunteers.

Brands have also demonstrated a unique durability and sustained competitive advantage unmatched by any other corporate asset. The world's most valuable brand, Coca-Cola, is more than 118 years old and many leading brands are older than 60 years. This is almost three times the average life span of a corporation. Many brands have survived a string of different corporate owners. The combination of durability and commercial impact make brands a key corporate asset equally for consumer and b2b focused businesses.

Several studies have tried to estimate the contribution that brands make to shareholder value. The most comprehensive of these is Interbrand's study of "The Best Global Brands" which concluded that on average brands account for more than a third of shareholder value. In many cases brands account for more than 70% of shareholder value.

Approaches to Brand Valuation

Financial values have been attached to brands and to other intangible assets as long as valuations have been performed either implicitly or explicitly. Every business valuation would by definition include all business assets such as brands. However, it was only in the late 1980s that valuation approaches were established that could fairly claim to understand and assess the specific value of brands. Whilst the idea of separating and valuing a brand was previously regarded by many with some suspicion, it is today a widely accepted and endorsed concept by both financial and marketing constituencies. Demands from accounting standards, transfer pricing and licensing agreements, mergers & acquisitions and value based management have made brand valuation a key component of today's businesses.

A wide range of approaches have been developed and used to assess the performance and value of brands. They used to fall into two categories, research based brand equity evaluations or purely financially driven approaches.

Approaches that are either only driven by brand equity measures or only by financial measures lack either the financial or the marketing component to provide a complete and robust assessment of the economic value of brands. The 'economic' use approach combines brand equity and financial measure into an integrated model that provides a financial value for brands that complies with the principles of current corporate finance theory and makes the value of brands comparable to the value of all other business assets. This approach is today the most widely accepted and recommended brand valuation method. The economic use method assesses the value of the brand by identifying the brand's future earnings and discounting these to a net present value using a discount rate that reflects the risk of those earnings being realised. The economic use approach was developed by Interbrand in 1988 and has become the most widely recognised and accepted methodology. It has been used in more than 3,500 brand valuations worldwide. The economic use approach is based on fundamental marketing and financial principles.

The marketing principle refers to the commercial function that brands perform within businesses. Firstly brands help to generate customer demand; customers can be individual consumers as well as corporate customers depending on the nature of the business and the purchase situation. Customer demand translates into revenues through purchase volume, price and frequency. Secondly, brands secure customer demand for the long term through re-purchase and loyalty.

The financial principle refers to the net present value of future expected earnings. Contemporary corporate finance theory suggests that discounted cash flow (DCF) and net present value (NPV) of future earnings are the appropriate concepts for assessing the financial value of any type of asset. Today, even tangible assets that have traditionally been valued on a cost or comparables basis are professionally valued according to DCF. The net present value calculation was initially based on discounted cash flows (DCF) but refers today equally to economic profit models which many companies use for their financial forecasting. In net present value terms DCF and economic profit result by definition in the same value.

To capture the complex value creation of a brand the following five valuation steps brand should be performed:

1. Market Segmentation – Brands influence customer choice, however, their influence differs depending on the market it operates in. The brand's markets are split into non-overlapping and homogenous groups of consumers according to applicable criteria such as product or service, distribution channels, consumption patterns, purchase sophistication, geography, existing and new customers, etc. The brand is valued in each segment and the sum of the segment valuations constitutes the total value of the brand.

2. Financial Analysis - Identify and forecast revenues and 'Earnings from Intangibles' generated by the brand for each of the distinct segments determined in step 1. Intangible earnings are defined as Branded revenues less operating costs, applicable taxes and a charge for the capital employed. The concept is similar to the notion of economic profit.

3. Demand Analysis - Assess the role that the brand plays in driving demand for products and services in the markets in which it operates, and hence to determine what proportion of Intangible Earnings are attributable to the brand measured by an indicator referred to as the 'Role of Branding Index'. This is calculated by firstly identifying the various drivers of demand for the branded business, then determining the degree to which each driver is directly influenced by the brand. The Role of Branding represents the percentage of Intangible Earnings that are generated by the brand. Brand Earnings are derived by multiplying the Role of Branding by Intangible Earnings.

4. Competitive Benchmarking – Determine the competitive strengths and weaknesses of the brand to derive the specific Brand Discount Rate that reflects the risk profile of its expected future earnings (this is measured by an indicator referred to as the 'Brand Strength Score'. This comprises extensive competitive benchmarking , and a structured evaluation of the brand's market, stability, leadership position, growth trend, support, geographic footprint and legal protectability.

5. Brand Value Calculation - Brand Value is the net present value (NPV) of the forecast Brand Earnings, discounted by the Brand Discount Rate. The NPV calculation comprises both the forecast period and the period beyond, reflecting the ability of brands to continue gener-

ating future earnings.

Applications

Since its creation in 1988 the range of applications of brand valuation has continually widened. Today brand valuation finds application in most strategic marketing and financial decisions. The applications fall into two main categories: strategic brand management and financial transactions. Brand valuations for strategic brand management focuses mainly on internal audiences by providing tools and processes to manage and increase the economic value of brands. Brand valuations for financial transactions provide brand values to facilitate a variety of brand related transactions with outside parties.

Strategic Brand Management

Recognition of the economic value of brands has increased the demand for effective management of the brand asset. In the pursuit of increasing shareholder value companies are keen to establish procedures for the management of brands that are aligned with those for other business assets, as well as for the company as a whole. The main ones are the following:

- Optimise business investments by making the brand asset comparable to other intangible and tangible company assets. Resource allocation between the different asset types follows the same economic criteria and rationale, i.e. capital allocation and return requirements.

- Measure the return on brand investments based on brand value to provide robust ROI metrics. Brand management and marketing service providers can be measured against clearly identified performance targets related to the value of the brand asset.

- Optimise brand investment by prioritising them by brand, customer segment, geographic market, product or service, distribution channel, etc. Brand investments can be optimised for cost and impact resulting in an overall higher return on brand investments.

- License the brand to subsidiary companies to make them accountable for its management and use. An asset that has to be paid for is managed differently than an asset that is free.

- Turn the marketing department from a cost into a profit centre by connecting brand investments and brand returns (royalties from the use of the brand by subsidiaries). The relationship between investments in and returns from the brand becomes transparent and manageable. Remuneration and career development of marketing staff can be linked to and measured by brand value development.

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Allocating marketing expenditures according to the benefit each business unit derives from the brand asset.

- Optimise and organise the use of different brands in the business (eg corporate, product, subsidiary brands) according to their respective economic value contribution.

- Assess Co-branding initiatives according to their economic benefits and risks to the value of the company's brand. Decide on the appropriate branding after a merger according to a clear economic rationale.

- Manage brand migration more successfully by understanding and quantifying the economic risk of loosing one brand and potential of another brand to capture and increase the value creation of branding within the business.

- Establish brand value scorecards based on the understanding of the drivers of brand value that provide focused and actionable measures for optimal brand performance.

- Manage a portfolio of brands across a variety of markets based on brand valuation. Brand performance and brand investments can be assessed on an equally comparable basis to enhance the overall return from the brand portfolio.

- Communicate where appropriate the economic value creation of the brand to capital markets to support share prices and obtain funding.

There is substantial depth in the way brand valuation helps companies managing and achieving better returns on the use and application of their brand asset.

Financial Transactions

Brands constitute a key asset in a variety of financial transactions.

Key financial applications brand valuation is used for are the following:

- Assessing fair transfer prices for the use of brands to subsidiary companies. Brand royalties can be repatriated as income to corporate headquarters in a tax effective way. Brands can be licensed to international subsidiaries and in the US also to subsidiaries in different states.

- Determining fair and robust brand royalty rates for optimal exploitation of the brand asset through licensing the brand to third parties.

- Capitalising brand assets on the balance sheet according to US GAAP, IAS and many country specific accounting standards. Brand valuation is used for both the initial valuation as well as the periodical impairment tests for the derived values.

- Assess and negotiate fair and robust sell or purchase value for brand assets in Mergers & Acquisitions as well as clear identification of the value that brands add to a transaction. In many transactions brand valuation has identified additional value that has significantly enhanced the final sell or purchase price.

- Determine the value contribution of brands to joint ventures for determining profit share, investment requirements and shareholding in the venture.

- Use brands for securitisation of debt facilities in which the rights for the economic exploitations of brands serve as collateral.

Many financial transactions can be enhanced by recognising the economic value of brands.

Biography of Jan Lindemann, Interbrand

Jan is Managing Director of Interbrand's global brand valuation practice. He has extensive experience in advising on brands, marketing and financial issues in all major industries and countries. Jan's clients include AXA, ANA, Bank of America, BP Amoco, Continental Teves, easyJet, Fujitsu, General Electric, Gucci, Japan Tobacco, Harrods, Heineken, IBM, Nestlé, Omnicom, L'Oréal, Orange, Prada, Tata Sons, Texas Instruments, Samsung, Swissair, Wells Fargo and Zurich Re. He is a frequent lecturer, commentator and broadcaster on brand related issues.

Jan's work has been widely published and includes the survey of "The Best Global Brands" published in co-operation with BusinessWeek. Prior to joining Interbrand Jan worked as Mergers & Acquisitions advisor for The Chase Manhattan Bank. His clients included food and multinational companies.

Jan holds a masters degree in history, philosophy and political science from the Free University of Berlin, Germany and a masters degree in international economics and international politics from The School of Advanced International Studies (SAIS) of The Johns Hopkins University, Washington, D.C., USA. Jan is registered with the Securities and Futures Authority (SFA) in the UK.

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