

Measuring and Valuing Brand Equity

Including:
Canada's Most Valuable Brands

A report prepared by Brand Finance in collaboration with the
Institute of Communications and Advertising

Sponsored by Canadian Business

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**CANADIAN
BUSINESS**

Foreword

Interest in the subject of brands as business assets has increased dramatically since we first published this report in May 2000. The over-supply of goods and services in the Canadian market has heightened the importance of the role that strong brands play in creating customer preference and providing a basis for ongoing customer loyalty.

As a result, brands are recognised as significant business assets. Yet marketing is still generally regarded as an expense rather than an investment.

One reason for this paradox is that marketers have struggled to define a credible way of measuring the long-term value that marketing adds to a business. Measurement of the return on marketing investment has typically focused on the short-term uplift on sales as a result of a new campaign, rather than on the creation of a business asset.

The challenge to the marketing profession is to demonstrate that brands are business assets capable of generating superior economic returns for their owners, and worthy of multi-year investment commitments. To do so, marketers need to show that they have a robust approach for measuring the quality of their brand assets, and for quantifying the contribution that the brand asset makes to shareholder value.

This is the challenge that we address in this report.

The ICA and Brand Finance hope that this report will promote a lively and well-informed debate about the contribution of brands to enhanced business performance.

We hope you enjoy the report and welcome your feedback (feedback@brandfinance.com).



Rupert Brendon
President & CEO
Institute for Communications and Advertising

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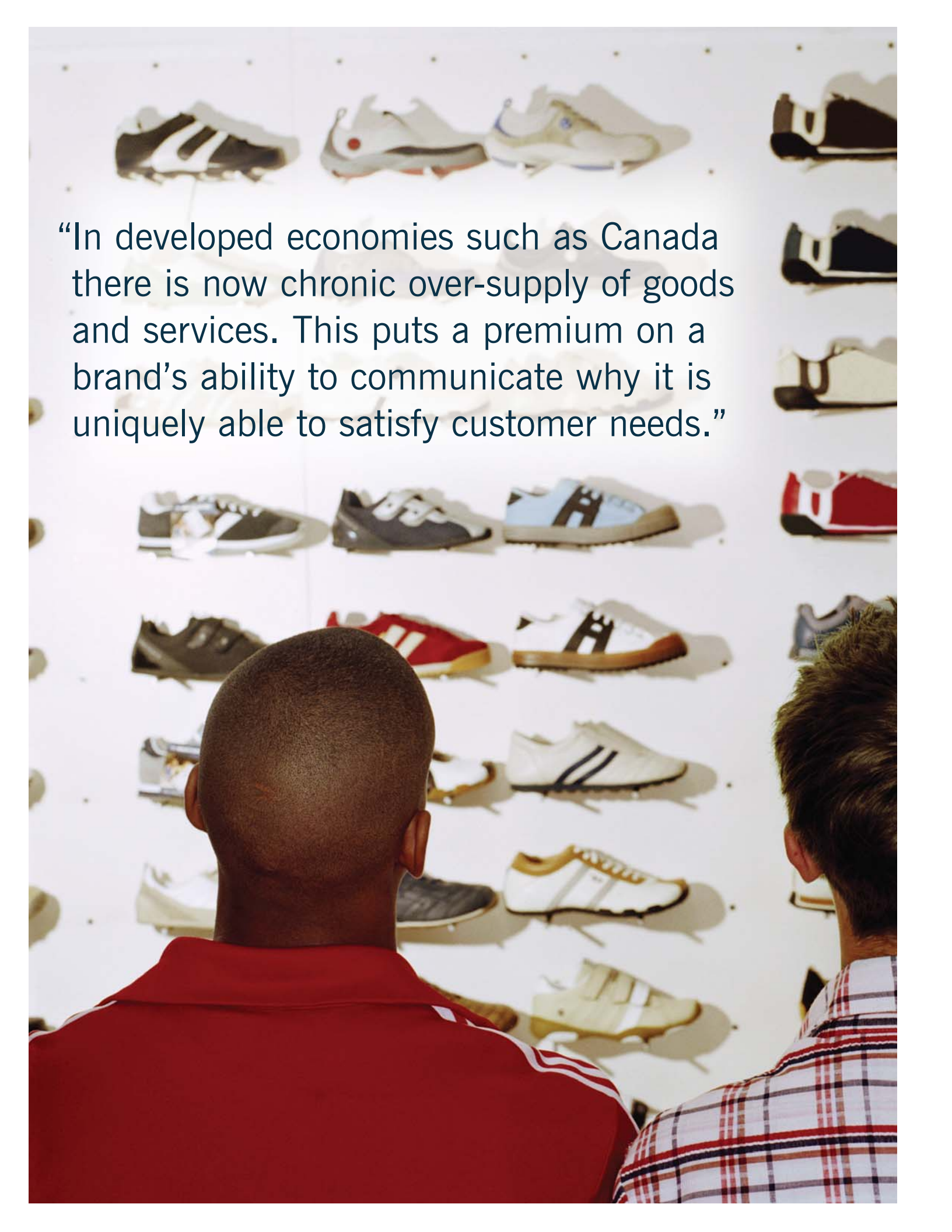
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“In developed economies such as Canada there is now chronic over-supply of goods and services. This puts a premium on a brand’s ability to communicate why it is uniquely able to satisfy customer needs.”

The Business Context for Brands

Peter Drucker, the renowned business author, wrote “Business has two basic functions: marketing and innovation. Marketing and innovation produce results; all the rest are costs.” In his habitually prescient way (he made this comment in 1954), Peter Drucker identified that the creation of customer value – through invention or through brands – is the only sustainable foundation for business.

This comment has never been more true than it is today. In developed economies such as Canada there is now chronic over-supply of goods and services. This puts a premium on a brand’s ability to communicate why it is uniquely able to satisfy customer needs.

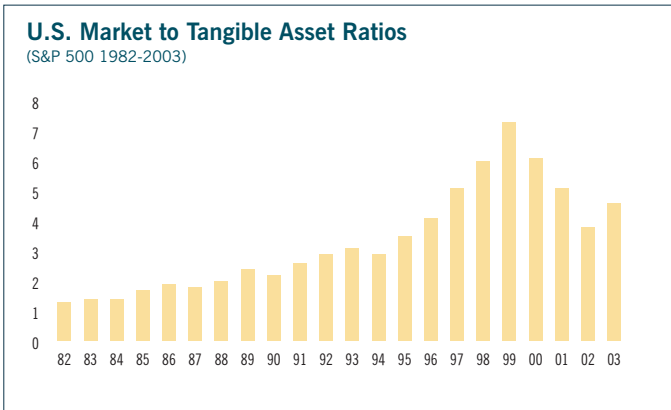
Excess supply has resulted in an overwhelming proliferation of choice for consumers. In Canada, there are well over 100 possible variations of cell phone calling plans to choose from, over 2,500 mutual funds to consider investing in, 200 varieties of potato chips to consider, and whole grocery aisles devoted to shampoo and conditioner.

Not only has the range of choice and services multiplied, but the average quality of those goods and services has improved enormously. For example, the adoption of Six Sigma and Total Quality Management (TQM) has raised the quality of cars to such an extent that J.D. Power’s 1998 survey in the U.S. commented – for the first time ever – that “there are no bad cars out there.” Quality has become commoditised.

This abundance of choice can be confusing for consumers, especially as the perceived differences between the products and services have narrowed. Paul Goldberger, the cultural correspondent of the *New York Times*, neatly encapsulated this phenomenon when he remarked that “while everything may be better, it is also increasingly the same.”

More goods, all of higher quality, chasing limited customer dollars creates an environment in which the sources of value creation have moved increasingly from tangible assets (such as plant and machinery) to intangible ones (such as brands, patents, customer databases and skilled workforce).

This is an environment in which the scarce resources are not factories and goods, but rather talented people, good ideas and differentiated brands.

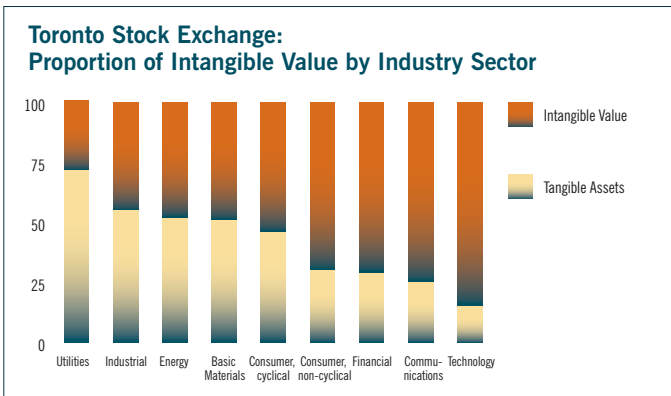


Source: Bloomberg, 2003 year end data

Reflecting this shift in the sources of value creation, the market-to-tangible-asset ratio for the S&P 500 (the broad-based index of the 500 largest companies in the U.S.) has risen from 1.3 in the early 1980s to 4.6 as at July 2004.

What this means is that the tangible assets recorded on the balance sheets of these 500 companies that used to account for over 75% of their stock market value in the early 1980s now explain less than 22% of the market value of these companies.

Investors recognize that the productive resources of these companies are increasingly represented by assets that do not appear in the financial statements – patents, supply chain systems, distribution rights, skilled workers and brands. Within the S&P 500, there is only one industry sector – utilities – in which tangible assets represent more than 50% of market value.



Source: Bloomberg, 2003 data

The migration of value to intangible assets is less dramatic in Canada, reflecting the importance of capital-intensive industries such as oil and gas, mining and forestry in the Canadian economy. The market-to-tangible-asset ratio for the Toronto Stock Exchange index stood at 2.4 at the end of July 2004, meaning that tangible assets represented around 41% of the value that investors were placing on these businesses.

The ratio of tangible assets to market value varies greatly across industry sectors in Canada. Tangible assets represent around 70% of the market value of utilities, around 55% of the market value of industrial, energy and basic materials companies and around 30% of the value of communications and non-cyclical consumer companies. As expected, technology companies have the lowest percentage of tangible assets to market value – less than 20%.

The importance of understanding the intangible assets that now account for the majority of business value has been reinforced by recent changes in the accounting standards for business acquisitions.

The Canadian Institute of Chartered Accountants was a leading contributor to the work of the International Accounting Standards Board that resulted in a new reporting standard for “business combinations.”

International Financial Reporting Standard 3 (IFRS 3) – which came into force at the end of March 2004 – provides for a single international accounting treatment for acquisitions. Adopting the precedent set by the U.S. Financial Accounting Standard 141 of June 2001, IFRS 3 requires that “goodwill” be specifically allocated to the intangible assets acquired.

The goal of FAS 141 and IFRS 3 is to require companies to be transparent about the nature and scale of the assets that they are acquiring. It is no longer permissible to report a single “goodwill” figure representing the excess of the purchase price over the tangible assets acquired. Goodwill must be allocated to five classes of intangible asset – technology-based assets (such as patents), contract-based assets (such as leases and licensing agreements), artistic assets (such as plays and films), customer-based assets (such as customer lists), and marketing-related assets (such as trademarks and brands).

The combination of the increasing economic significance of brands and this reform to accounting standards has heightened the importance of a well-informed discussion of the value that brands deliver to business. The goal of this report is to contribute to this discussion by providing an overview of the methodologies for measuring brand equity from the customer perspective, and for measuring how this customer equity translates into superior business value.

To provide momentum to this discussion, Brand Finance has created a list of Canada’s most valuable brands. To our knowledge, this is the first time that such a list has been produced for Canadian companies.

Canada's Most Valuable Brands

The table opposite shows the 25 most valuable Canadian brands based on their global sales.

The valuation was performed by Brand Finance using the “relief from royalty” approach. This is an intuitively simple approach that assumes that a company does not own its own brand and calculates how much it would need to pay to license it from a third party. The present value of that stream of (hypothetical) royalty payments represents the value of the brand.

We used the “relief from royalty” methodology for two reasons – first, it is the valuation methodology that is favoured by the tax authorities and the courts because it calculates brand values by reference to documented, third-party transactions; and second, because it can be performed on the basis of publicly available financial information.

Note that only brands that belong to Canadian companies were eligible for inclusion in the list. This means that certain iconic “Canadian” brands are excluded because they are no longer Canadian-owned – these include Tim Hortons (owned since 1995 by Wendy’s International), Labatt (acquired in 1995 by Interbrew – now InBev) and Future Shop (now owned by Best Buy).

Royal Bank Notches up Another “First”

The most valuable Canadian brand by a clear margin is Royal Bank of Canada. Its pre-eminent position with a brand value of just over \$4.4 billion reflects both the strength of its brand and the overall size of its business (it is in the top 10 of Canadian businesses by almost any measure – revenue, profits, number of employees, number of retail outlets, market capitalisation).

Bell Canada takes second position with a brand value of \$3.0 billion. Its ubiquity in the marketplace and recent efforts to improve its customer value proposition through bundled offerings makes it a force to be reckoned with.

Loblaws’ brand value of just under \$3.0 billion secures third position, and by far the most impressive performance of any of the grocery or retailing brands. Loblaws continues to derive benefit from its early recognition of the potential for store brands, and its ongoing development of the President’s Choice brand.

The next five places go to financial services companies, underscoring the importance of the financial services sector in the Canadian economy. As at the end of 2003, financial services represented just under 40% of the market capitalisation of the Toronto Stock Exchange (the next most valuable sector was energy, which represented under 20% of market capitalisation).

The two remaining slots in the top 10 are secured by two contrasting bellwethers of the Canadian business landscape – Canadian Tire and Bombardier. Despite their contrasting exposures (one to the domestic consumer market, the other to the international business market) and their massive difference in size (Bombardier’s revenues are over three times those of Canadian Tire), their brand values compute to be almost identical.

Canada's 25 Most Valuable Brands All figures are in C\$ millions

Company	Brand Value	Market Value	2003 Revenue
1. Royal Bank of Canada	4,418	41,526	24,829
2. Bell Canada	3,036	38,094	19,056
3. Loblaws	2,957	22,742	25,220
4. TD Bank	2,650	31,595	15,665
5. CIBC	2,592	25,507	17,122
6. Scotiabank	2,195	39,329	17,261
7. Bank of Montreal	1,761	28,287	13,147
8. Sun Life	1,367	22,673	22,056
9. Canadian Tire	1,358	5,232	6,553
10. Bombardier	1,322	12,417	21,321
11. Telus	1,238	17,073	7,146
12. Esso	1,221	25,455	19,094
13. Sears Canada	1,194	2,493	6,223
14. Molson	1,081	5,267	2,526
15. Rogers	1,015	12,205	4,847
16. McCain Foods	1,009	NA	6,469
17. Petro-Canada	979	19,229	12,209
18. Manulife	941	46,672	16,656
19. Zellers	893	NA	4,625
20. Sobeys	834	2,652	11,047
21. Shoppers Drug Mart	822	8,523	4,415
22. Great-West Lifeco	768	23,552	13,429
23. Nortel Networks	747	21,400	13,743
24. Air Canada	730	NA	8,727
25. Alimentation Couche-Tard	672	3,296	5,872

Source: Brand Finance, CIBC World Markets, Bloomberg data

Market value data as at November 4, 2004. Market value is defined as the market value of equity for banks and insurers, and as the market value of equity plus long-term debt for non-financial companies.

Market value information is not available for Air Canada (shares suspended), McCain Foods (privately held) and Zellers (a unit within the Hudson's Bay Company)

Key assumptions include:

- a common gearing of 40% for all companies
- a tax rate of 36.1%

The other 6 brands with a value of over \$1 billion are mostly from consumer industries. At over 40%, Molson enjoys the highest brand value to revenue ratio of all the brands on the list, underscoring the importance of brand in driving consumer preference in beer. McCain Foods (which has the distinction of being the only privately owned brand to qualify for the list) illustrates this point in relation to food, as do Rogers and Telus in relation to the consumer communications space.

The importance of retail presence is evident in the brands that make up the rest of the list. In addition to the traditional retailers (such as Sobeys, Shoppers Drug Mart, Alimentation Couche-Tard and the department stores – Sears Canada and Zellers), there is another set of retailers who often are overlooked – Esso, Petro-Canada and Shell (the latter falls just outside the top 25).

The fuel retailers have some of the largest retail networks in the country. To be precise, they own three of the four largest retail networks in Canada. As the table below shows, they have almost twice the number of “stores” as the major banks and grocers, and nearly three times the number of the specialist retailers such as Shoppers Drug Mart. To put it in perspective, Shell has more retail locations than Canadian Tire, Shoppers Drug Mart, Zellers, The Bay, Wal-Mart and Sears combined.

Largest Retail Networks in Canada By number of retail stores, 2003

Company	Retail Stores	Company	Retail Stores
Shell	2,440	Loblaws	1,105
Tim Hortons	2,100	CIBC	1,100
Esso	2,000	TD Bank	1,090
Petro-Canada	2,000	Ultramar	1,050
Alimentation Couche-Tard	1,710	ARAMARK	1,000
Sobeys	1,660	Bank of Montreal	1,000
Subway	1,650	Scotiabank	960
Compass	1,600	RadioShack	830
Royal Bank	1,300	KFC	816
McDonald's	1,270	Shoppers Drug Mart	750

Source: ICA Marketing Handbook 2004, websites and annual reports

Despite the company's current financial woes, Air Canada's brand remains a powerful asset of the business and earns a place in the top 25. In common with certain of the retailers (Sears Canada and Hudson's Bay), we attribute a value to the brand that exceeds the current equity value of the business. If these companies are able to improve the underlying efficiency of their business models, we believe that the strength of their brands will have a multiplicative impact on their market capitalisation.

The list of Canada's 25 most valuable brands demonstrates that brand value is concentrated in certain sectors. A review of the largest advertisers in Canada over the past three years gives a good sense of the sectors in which brand and communications are seen to provide the greatest leverage to business performance. Auto companies and dealers represent 10 of the top 25 advertisers. Consumer products occupy 7 of the 25 places (including the top slot), communications companies take 4 places, and retailers account for 3 places.

Canada's 25 Largest Advertisers By average annual spend on broadcast media, 2001 to 2003

Company	2001–2003 Annual Average (\$ millions)	Company	2001–2003 Annual Average (\$ millions)
Procter & Gamble	133	Sony	59
General Motors	104	Wendy's/Tim Hortons	58
Bell Canada	100	Chevrolet Oldsmobile (dealers)	57
Chrysler Dodge Jeep (dealers)	96	Labatt	54
The Bay/Zellers	87	Walt Disney	54
Ford	82	L'Oreal	52
Rogers Communications	80	Daimler Chrysler	52
CanWest Communications	73	Best Buy/Future Shop	52
General Motors (dealers)	72	Telus	51
Sears Canada	66	Molson	50
Chrysler (dealers)	62	Ford (dealers)	50
Toyota	61	Unilever	45
Pontiac Buick Cadillac (dealers)	60		

Source: Nielsen Media Research

Commentary on Canada's most valuable brands would be incomplete without reference to a number of the most valuable companies in Canada whose brands do not make it into the list of the top 25 most valuable brands. These companies include Thomson, EnCana, Alcan and Research In Motion, all of which enjoy market capitalisations of over \$20 billion. These are excellently managed businesses that operate in sectors where the contribution of brand to the overall performance of the company is relatively small. For these companies, it is other forms of intangible asset (such as technology and quality of management) that explain the sizeable difference between their market value and their tangible assets.

When Is Brand Valuation Necessary?

Tables of brand values such as the one in this report and in magazines like *BusinessWeek* and *Forbes* have helped to raise awareness of the economic significance of brands, but have also created a mistaken impression that brands always need to be valued.

It is an obvious point but one that bears repeating here – the mere act of valuing an asset (whether financial, tangible or intangible) does nothing to improve its quality. The key question for management purposes is not “How much is my brand worth?” but rather “How important is branding to the overall success of my business?” Brand is one component of the overall strategy. The focus should be on maximising the value of the strategy (increasing the “size of the pie”), not on valuing the individual components of the strategy (the “slices of the pie”).

However, there are three circumstances in which a brand valuation may be necessary or desirable:

1. It is required for accounting purposes.
2. It will inform the terms of a prospective transaction.
3. It will enhance the management of the brand.

Accounting Purposes

As noted earlier, both U.S. and international accounting standards (Financial Accounting Standard 141 and International Financial Reporting Standard 3) now require that the “goodwill” in an acquisition (the excess of the purchase price over the value of the tangible assets acquired) be allocated to the intangible assets that the company is acquiring.

This means that brand valuations are now a part of the commercial due diligence performed before an acquisition.

Transactional Purposes

The second circumstance in which a brand valuation may be desirable is to inform the terms of a prospective transaction.

The transactions are generally of four types – securitisation, tax-planning, licensing and acquisitions.

Securitisation involves raising funds against the security of future revenues. A noteworthy example was the \$55 million loan raised by David Bowie in 1997 through the issues of “Bowie bonds” backed by the future royalties on his pre-1990 recordings.

Despite a lot of discussion, brands have rarely been used as the collateral for asset-backed securities.

Brand-based tax planning is, by contrast, a relatively common practice. It involves transferring the ownership of the trademark (and, usually, other forms of intellectual property) to a central holding company that then charges a royalty for the use of these assets to the operating companies.

As we discuss in the final section of this report, this type of structure not only enhances the management of these intangible assets but also enables a portion of the profits of the operating companies to be shielded from local taxes. Obviously, the fiscal authorities require demonstration of the value of the brand asset that provides the basis for these royalty payments.

Brand licensing also requires an understanding of the economic benefit provided by the brand in order to establish an appropriate royalty rate. A similar logic applies to the acquisitions of branded companies when the brand represents a major asset in the transaction.

It is worth remarking that all the applications of brand valuation mentioned so far are for **purposes other than marketing**, and are commissioned by departments other than marketing – finance, legal and business development. This fact comes as a surprise to business managers who assume that brand valuation is the territory of the marketing department.

Management of the Brand

This is the application of brand valuation that is most frequently discussed in the media, although it represents a minority of the brand valuations conducted in any given year.

Unlike the technical and financial applications of brand valuation discussed so far, brand valuations for brand management purposes are not generally subject to external review. The motive is to enhance the effectiveness of brand strategy, and document its contribution to the overall success of the business.

These types of brand valuation appear to offer the greatest prospect for value enhancement for the business overall – but also the greatest danger of wasted effort and expense.

The danger arises from two sources – first, that without the discipline of third-party validation, the brand valuation initiative degenerates into an exercise in budget justification by the marketing department; and second, that the valuation exercise founders on the lack of clarity about the definition of the asset being valued.

Brand valuations for technical and financial purposes focus on a narrow definition of brand as the bundle of legally enforceable intellectual property rights that the brand owner has established (specifically, the trademark and associated goodwill). Brand valuations conducted for marketing purposes invariably want to use a much wider definition of the brand – one that is based in an understanding of the sources of customer value, rather than intellectual property rights.

Generally what marketers mean by brand is whatever is involved in creating the brand experience for customers. So, for example, a valuation of the Guinness brand would include a larger bundle of intellectual property rights such as the trademarks, domain names, product design rights, trade dress, packaging, copyrights in associated colours, sounds, descriptors, logotypes, advertising visuals, and written copy, plus a large element of “associated goodwill.” In addition, it would include the recipe and production process, perhaps even the widget technology behind the “draught Guinness in a can.”

In services businesses, definition of what constitutes the brand becomes even more complex. The absence of a physical product means that the brand experience is strongly affected by customer service issues and the overall reputation of the business. In this case, what is being valued is often the entire contribution of “branded-ness” to the success of the business.

It is vital to clarify from the outset the definition of the asset being valued in a brand valuation. In our experience, it is useful to think in terms of three definitions of brand:

- 1. A logo and associated visual elements.** This definition focuses on the legally protectable visual elements used to differentiate and stimulate demand for one company’s products and services over another. The main legal elements covered by this definition include trade names, trademarks and trade symbols.
- 2. A larger bundle of trademark and associated intellectual property rights** such as domain names, product design rights, trade dress, packaging, and copyrights in associated colours, smells, sounds, descriptors, advertising visuals and other associated goodwill.
- 3. A holistic company or organisational brand.** A combination of the legal rights together with the culture, people and programs of an organisation all provide a basis for differentiation and value creation within that organisation.

A valuation based on the first definition represents a *trademark valuation*. A valuation based on the second definition represents a *brand valuation*. A valuation based on the third definition represents a *branded business valuation*.

In our experience, brand valuations for marketing purposes are most insightful when they focus on branded business valuation. This maintains the focus on the question “Where – and by how much – does the brand enhance the performance of the overall business?” and ensures that the brand valuation exercise provides insight into the value dynamics of the overall business.

The next section profiles the main methodologies used in brand valuation.

Valuing Brand Equity

Value is a function of three primary variables – profitability, growth and risk. Businesses are valued on the basis of the future cash flow they are expected to generate. Therefore investors care about the level of cash flow (profitability), the prospects for increasing cash flow (growth), and the volatility of cash flows (risk).

If marketing professionals want to capture the attention of their finance colleagues, they need to express the impact of brands in terms of these three variables.

This is less daunting than it sounds, because marketers have known for years that brands create preference (the basis for profitability), permission (the basis for growth), and loyalty (the basis for stable revenues and profits). What is required is a methodology for quantifying the impact of brands in terms of the profit, growth and risk of the overall business.

This can be achieved by the creation of a robust financial model that allows for the impact of the brand to be accurately modelled and measured. By observing the impact on business value of changes in those variables on which the brand has some degree of influence, the sources and scale of the value contribution of the brand can be identified.

This knowledge allows for an informed management decision about the scale of the marketing investment that is required/justified to achieve this brand equity.

Measurement of the incremental contribution of an asset to the performance of the business is known as the “economic use” basis for valuation (in contrast to “historical cost” or “replacement cost” approaches generally used for accounting purposes). The two most common economic use methodologies are the “relief from royalty” approach and the “earnings split” approach.

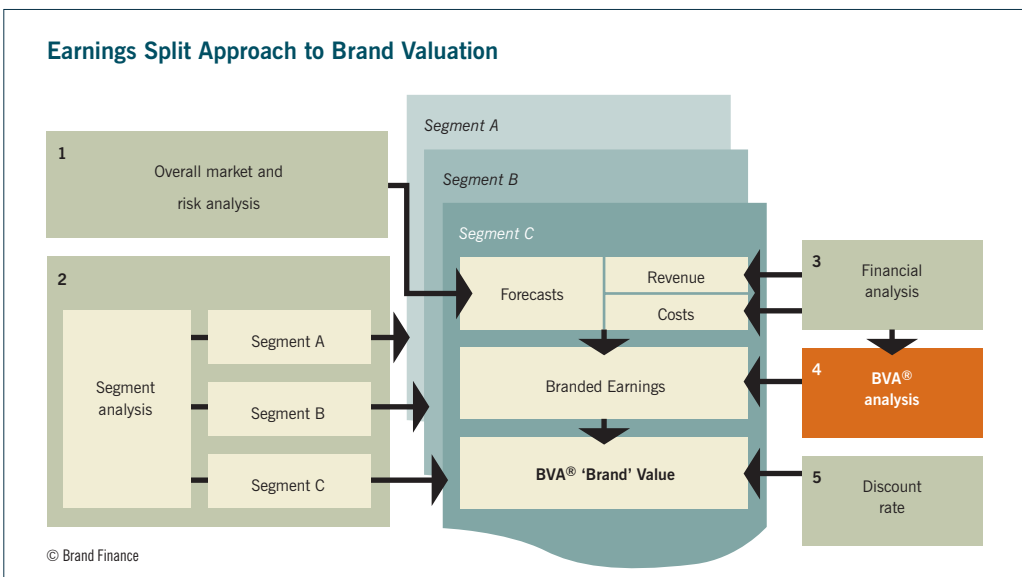
As discussed above, the “relief from royalty” approach imagines that a business does not own its trademarks but licenses them from another business at a market rate. Under this method, brand value is the net present value of the royalty payments made.

Under the “earnings split” approach, the earnings above a break-even economic return on the tangible assets of the business are attributed to the intangible assets of the business. These “excess earnings” are then split between the various classes of intangible assets (hence the term “earnings split”).

The “earnings split” approach is the approach used for most valuations for marketing purposes. It involves decomposing the business into a number of segments, allowing for the significance of brand-related issues in each segment to be accurately captured in the valuation model.

There are five major steps in this process:

1. **Market and Competitive Context.** This initial step focuses on identifying the overall dynamics of the market and the strength of competition.
2. **Business Segmentation.** Because the influence of brand-related factors varies by lines of business, customer segment and product type, this step divides the business into a number of discrete segments based on the scale of the role played by the brand.
3. **Financial Forecasts.** This involves generating projections for the future earnings of each of the segments defined in the previous step.
4. **Role of the Brand (Brand Value Added – BVA®).** This involves identifying the drivers of purchase decisions in each of the segments and the degree of the impact exerted by the brand. The composite brand score across all the drivers of the purchase decision provides the proportion of total branded business earnings that is attributed specifically to the brand.
5. **Risk Analysis (BrandBeta®).** This involves the assessment of the strength of the brand's franchise with both trade customers and end consumers to establish the security of future brand earnings. The resulting discount rate is used to discount the stream of earnings attributable to the brand.



An “earnings split” approach has three major benefits. First, it is conducted on the basis of a segmentation that makes sense from a customer perspective (rather than an internal financial perspective). It allows for the potential sources of value to be modelled on both the “direct” and “indirect” audiences for the brand.

“Direct” audiences are those for which a direct connection can be made between a change of behaviour and the financial performance of the business. Note that, in addition to customers, “direct” audiences include staff, suppliers, staff and the providers of debt/equity capital.

“Indirect” audiences are those whose impact on the overall value of the business may be significant, but hard to measure accurately. “Indirect” audiences might include government departments, sector consultants, trade bodies, environmental activists, community-based pressure groups and so on.

Second, it requires the relationship between marketing actions and customer behaviour to be made explicit, allowing these to be tested and refined. This discipline makes it clear which marketing metrics need to be monitored closely and merit inclusion on the balanced scorecard or dashboard of the business (the subject of the final section of this report).

Third, by understanding the role that the brand plays in influencing not just the customer purchase decision but also the behaviours of a wider set of audiences, the valuation model provides an insightful representation of the dynamics of the business. This ensures that the focus remains on how the brand can contribute to a more successful business, and prevents the brand valuation being seen as a simple budget justification exercise.

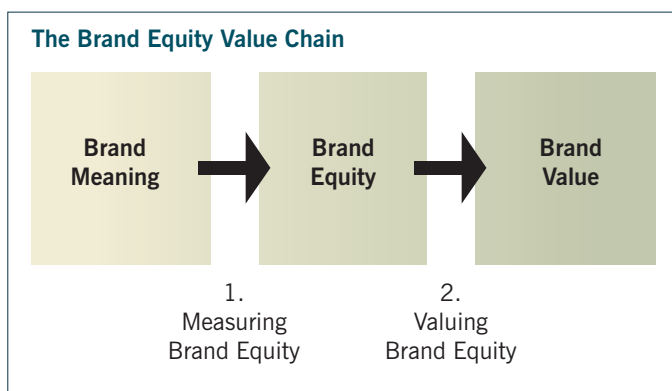
The “earnings split” approach ensures that the focus of the analysis remains external – brand equity only exists to the extent that some utility is created in the minds of the audiences of the brand. The essential companion to brand valuation is therefore brand equity measurement.

Brand valuation measures the value impact of the customer, staff and supplier utility provided by the brand. Brand equity measurement analyses the sources of that utility, most typically among customers.

Measurement of the nature and scale of brand equity is the subject of the next section.

Measuring Brand Equity

It is interesting to know the financial value of a brand. But, from a management point of view, it is much more useful to know what causes the value of a brand to go up or down. Such knowledge is the foundation for effective business and marketing strategy.



Brand equity measurement is the discipline that investigates how the meaning of a brand (the various images, memories and other associations that it triggers in the minds of customers) translates into utility as perceived by those customers. It is this utility (brand equity) that represents the basis for the financial value of the brand (see the chart opposite).

It is first worth clarifying what brand equity means. If brand equity is to be reliably linked to the creation of shareholder value, then it must capture the potential of the brand to sustain premium margins or deliver above-average growth. Brand equity must be an indicator of where a brand is going, not just its current position.

This means that the traditional metrics of market research – awareness, familiarity and quality – are often poor measures of brand equity. They do a good job of benchmarking the scale of a brand's presence. But they do a poor job of measuring a brand's potential.

A brand's potential is based on the extent to which it is perceived to offer a unique set of benefits. This concept is perhaps most closely captured in the notion of "relevant differentiation." This measures the ability of a brand to communicate a unique and valuable set of benefits to its customers.

In the paragraphs below we outline three reputable methodologies for brand equity measurement that are available in the Canadian market, each of which helps to identify which brands are delivering in terms of "relevant differentiation." Fuller information on each methodology can be found on the respective websites of the individual companies (a contact from each company is listed on the final page of this report).

Equity*Builder™

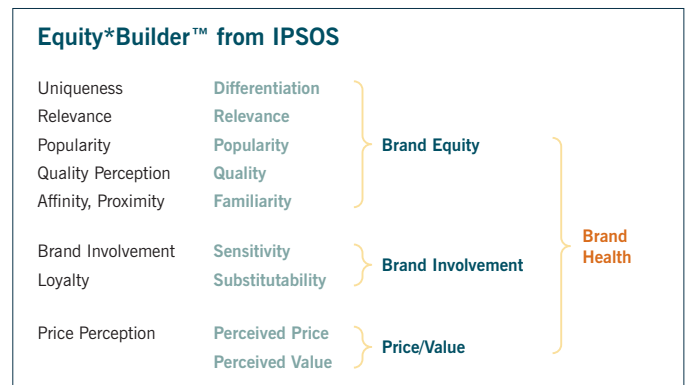
Equity*Builder™ is the brand equity measurement methodology developed by the Ipsos Group, one of the world's leading market research firms with offices in 30 countries. Ipsos-Reid is Canada's largest provider of market research and has offices in eight cities in Canada.

Equity*Builder™ delivers an overall brand health score based on three components – a brand's attitudinal equity, the level of customer involvement with the category, and price/value perceptions.

As shown in the diagram below, the score on each of these three components is based on a number of individual elements – for example, attitudinal equity is the composite of a brand's familiarity, perceived uniqueness, relevance, popularity and quality.

This understanding of the attitudinal equity of the brand can be supplemented by Ipsos' Brand*Builder™ approach that incorporates data on customer behaviour. This allows the customer base of the brand to be divided into four key segments – core, prospects, vulnerables and long-term prospects.

Based on their survey of 200 brands, Ipsos found a 0.75 correlation between the Equity*Builder™ measure of brand health and the in-market performance (measured by market share and profit trends) of the brands.

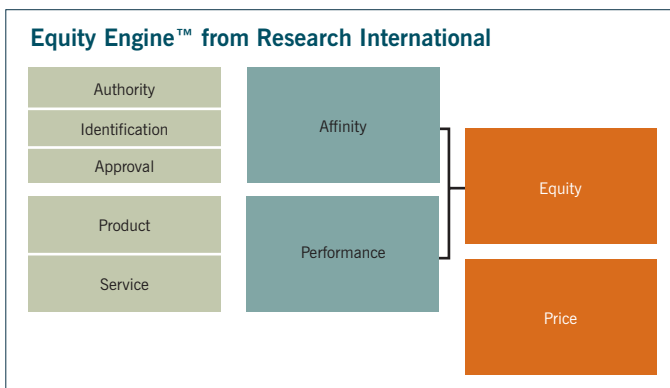


Equity Engine™

Equity Engine™ is the brand equity measurement methodology developed by Research International, a qualitative and quantitative market research firm with operations in 50 countries. The Canadian subsidiary of Research International is in Toronto.

Equity Engine™ measures customers' perceptions of the brand on three dimensions – Functional Performance, Affinity (or Emotional Performance) and Price. The drivers of Functional Performance are those category and product-specific attributes that determine what is a credible offering in the category. Affinity captures the emotional and intangible attributes that customers associate with the brand. These include Identification (the closeness customers feel to the brand), Approval (the status the brand enjoys among a wider social context of family, friends and colleagues) and Authority (the reputation of the brand).

As shown in the diagram below, Functional Performance and Affinity together determine brand equity. The purchase decision can then be expressed in terms of the percentage to which it is based on price considerations or on considerations of brand equity.



At heart, Equity Engine™ is a powerful conjoint methodology that establishes the price premium that a brand's equity will support while still maintaining a "good value for money" rating from customers.

BrandDynamics™

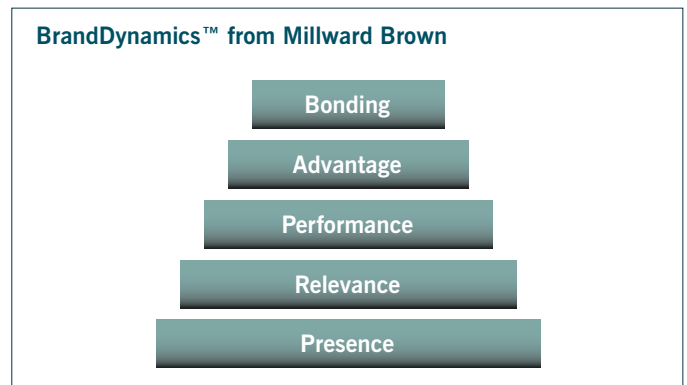
BrandDynamics™ is the brand equity measurement system developed by Millward Brown, a market research consultancy that is part of The Kantar Group, the information and consultancy division of WPP. Millward Brown has offices in 35 countries. The Canadian subsidiary is Millward Brown Goldfarb, based in Toronto.

BrandDynamics™ provides a framework for segmenting a company's customer base according to their degree of attachment to the brand. The model divides customers into five levels of attachment – Presence, Relevance, Performance, Advantage and Bonding. “Presence” customers have only a basic awareness of the brand while “Bonded” customers are intensely loyal, allocating a high proportion of their category expenditure to the brand and often acting as advocates of the brand.

It is a powerful methodology for mapping the loyalty distribution of a brand's customer base and the dimensions on which to focus in order to be able to migrate customers to higher levels of loyalty.

The related BrandSignature™ service provides an analysis of a brand relative to a defined set of competitors, permitting companies to see how their customer profile compares to the peer set average and their relative performance in migrating customers to higher levels of attachment.

The loyalty profile of a brand can be expressed as a single Brand Voltage™ number that indicates the brand's success in migrating customers up the pyramid. This number is significant because it is a strong predictor of a brand's potential to grow.



The Accounting Treatment of Brands

The increasing economic importance of intangible assets has provoked a lively debate within the accountancy profession about the circumstances under which these assets can be recognised in a company's report and accounts.

The Canadian Institute of Chartered Accountants has been a leading contributor to the work of the International Accounting Standards Board that culminated in the adoption of International Financial Reporting Standard 3 (IFRS 3) on March 31, 2004.

IFRS 3 eliminates the significant differences that had previously existed between the national rules on accounting for acquisitions. It brings international practice into line with U.S. practice in this area (as enshrined in Financial Accounting Standard 141). The most important elements of the change are:

- All identifiable intangible assets of the acquired business must be recorded at fair value – meaning that the acquisition price must be allocated to the assets acquired
- Goodwill and certain other intangibles can be declared to have an indefinite economic life
- Impairment testing is required for all forms of intangible asset at least once a year or whenever there is an indication of impairment

The types of intangible assets that are now to be expressly recognised include technology-based assets (such as patents), contract-based assets (such as leases and licensing agreements), artistic assets (such as plays and films), customer-based assets (such as customer lists), and marketing-related assets (such as trademarks and brands).

In summary, there is now broad-based consensus among the world's accounting standards setters that internally generated brands should not appear in balance sheets and that externally acquired brands should always be identified, valued and recognized as corporate assets. It is also widely recognised that "goodwill" is not an amorphous accounting "plug number" but a figure that encompasses a range of identifiable and separable assets.

Looking ahead, the proponents of brand valuation argue that the next logical step would be for the inclusion of a statement of brand values and equity, including both acquired and internally generated brands, as a separate part of the annual financial statements. The statement of brand values would not be a formal part of the profit and loss account but would appear in a more detailed note to shareholders covering the full range of intangible assets.

Conclusions

It is now widely acknowledged that brands are significant assets of a business. Increased appreciation of the economic significance of brands brings with it the expectation of greater marketing accountability.

Many business managers – and a fair proportion of marketing professionals themselves – are frustrated about the lack of a framework for measuring and managing brand equity in a way that links directly the metrics that CEOs care about.

One of the challenges is that the traditional metrics used by marketers (such as awareness and perceived quality) no longer appear to be reliable indicators of the potential for value creation. This has led to the marginalisation of the marketing function – a trend succinctly expressed by Don Lehmann, Professor of Marketing at the Graduate School of Business at Columbia in New York, when he observed:

“When marketing people talk about what they do, the variables they cite are not the ones the CEO cares about. Customer awareness, customer satisfaction and market share are metrics, and they are nice to know about. But the CEO is more concerned with shareholder value, market capitalisation, return on assets and return on investment. In marketing, people don’t talk that way.”

The goal of this report has been to suggest ways in which this gap can be narrowed. Specific suggestions include:

- Acknowledging that brand equity is an intermediary step towards the larger goal of creating a more successful business
- Accepting the need to express the impact of brands in terms of profitability, growth and risk
- Defining brand equity in a way that captures the potential of a brand to create future cash flow (for example, by replacing metrics such as awareness with measures of brand salience – such as relevant differentiation)
- Resisting the temptation to narrow the focus to brand valuation when the focus should be on the overall value dynamics of the business

As these suggestions indicate, it is absolutely necessary for marketers to become more financially literate. It also means abandoning the old “4Ps of marketing” mindset and its outdated assumption that all the elements of the marketing mix can be controlled in favour of a more dynamic concept of marketing. Most importantly, it involves developing a mental model for how marketing actions impact business results, not just customer attitudes.

Marketing Dashboards or Scorecards

One technique for expressing this “mental map” is the creation of a brand dashboard. The goal of a marketing dashboard is to express in a simple, easily grasped format the key indicators of marketing performance. Techniques vary – at Brand Finance, we favour an approach that includes indicators of performance at four levels: marketing actions, customer attitudes, customer behaviours and market performance.

The important thing is that the dashboard should communicate an understanding of – or at least a hypothesis about – the customer decision process, and of the company’s own cost structure. Only by making explicit the key drivers of business success can an informed management decision be made about how much to invest in marketing.

This requires a fundamental change of mindset for many marketing agencies. Instead of seeing the world from the perspective of their specific medium (advertising, direct mail, web marketing, public relations or whatever), this requires seeing the world from the perspective of the target audience.

Marketing Return on Investment

ROMI or mROI is currently a hot topic and rightfully so. The increasing availability of tracking data across a range of media and the ability to cross-tab data from different sources has created a fertile environment for new measurement techniques and progress towards the goal of greater marketing accountability.

However, marketers need to be mindful of the experience of CRM. While there has been considerable success in delivering enhanced efficiency of customer **transaction** management, the goal of improved customer **relationship** management remains elusive. Marketing ROI tools will make a strong contribution to enhancing the efficiency of marketing investments but may well fail to deliver the same level of benefit as regards the effectiveness of marketing investments.

The creation of measurement tools that capture the return on marketing investment over a relatively brief time horizon (generally up to 18 months) does not answer the requirement for a longer-term approach that sees brand equity as a key resource of the business. There is still a need to develop a resource-based view of business that expresses its value in terms of a number of tangible and intangible assets.

The most accessible of these approaches attempt to identify and understand the nature of the assets that account for the excess of a company’s market value over the value of its net tangible assets. These assets can take a variety of forms – intellectual (such as patents); business process assets (unique ways of organising the business); market position assets (such as quotas or landing rights); and relationship assets (such as brands).

Centralised Ownership and Management of Intellectual Property

This asset-based approach is gaining significant traction in the finance, accounting and legal departments, in part because of the new rules on accounting for intangible assets post-acquisition.

An increasing number of companies are adopting a more sophisticated approach to the management of their brands, patents and other forms of Intellectual Property (IP). This generally takes the form of the creation of a specific group holding company that assumes ownership of the Intellectual Property assets of the group and charges a royalty to the group operating companies for their use.

This approach offers three main forms of benefit – enhancement of the management of these assets; the opportunity for tax planning; and behavioural change on the part of all those that are involved in the financing, development or use of the brand. In our experience, the centralised model for holding – and charging for – Intellectual Property assets almost always results in:

- Greater appreciation of the value of IP assets among users, resulting in more effective management of the IP
- Greater visibility of true economic performance, leading to better resource allocation across lines of business
- Significant reduction in the internal negotiations associated with service fee levels
- A benchmark for licensing deals with third parties based on the internal arrangements in place
- Scope for reduction in overall corporate tax burden
- Creation of a central budget for investment in IP, funded by royalty payments from the lines of business

Marketing – Reclaiming a Seat at the Table

The fact that the finance, accounting and legal departments are already embarked on this path increases the urgency for marketers to claim their place at the table.

Marketing has a unique perspective to offer. It is the only discipline that sees the business from the perspective of the customer and sees brand in its full context – as the vehicle for customer meaning and not just some piece of Intellectual Property.

The key thing for marketers is to engage in the debate, accepting that the language they will need to use is that of shareholder value.

The ICA and Brand Finance hope that this report provides a useful start to this process.

We welcome your comments (feedback@brandfinance.com).

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David is a qualified Chartered Accountant, a Fellow of the Institute of Chartered Accountants in England and Wales, a Fellow of the UK Chartered Institute of Marketing, a Member of the Institute of Public Relations, the UK Academy of Expert Witnesses, the Licensing Executive Society, and the Society of Share and Business Valuers.

Prior to founding Brand Finance in 1996, David held a variety of positions in marketing services firms including Managing Director of Publicis Dialogue, Finance Director of the advertising agency WCRS & Partners, and Director of the brand valuation practice at Interbrand.

He is the author of four books on the contribution of marketing to corporate performance and a frequent speaker at business schools and conferences.

Jonathan Knowles is the Managing Director of Brand Finance (Canada), and of Brand Finance (USA) Inc.

Jonathan has extensive experience of both the marketing and financial dimensions of brand strategy, having spent six years with the value-based management consultancies Stern Stewart & Co. and Marakon Associates, and six years with Wolff Olins, Europe's leading corporate identity and brand consultancy.

Jonathan began his career in banking with the Bank of England and also enjoyed a brief period as the CMO of an internet infrastructure business.

He is the principal contributor to the book *Brands: Visions and Values*, the author of over twenty articles on the role of brands in business strategy and a regular speaker at business schools and conferences.

Brand Finance is a specialist consultancy focused on the management and valuation of brands and of branded businesses. Since 1996, Brand Finance has performed over 250 brand valuations with an aggregate value of over C\$150 billion. The valuations have been in support of a variety of business needs – technical valuations for accounting, tax and legal purposes; valuations in support of commercial transactions (acquisitions, divestitures, licensing and joint ventures); and valuations as part of a wider mandate to deliver value-based marketing strategy and tracking.

Brand Finance is headquartered in London and has offices in Toronto, New York, São Paulo, Barcelona, Bangalore, Singapore, Hong Kong and Sydney.

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