



# **Current Practice in Brand Valuation**

**A Gee Bulletin**

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## **1. Intangible assets: Driving corporate value in the 21<sup>st</sup> century**

In the late 1980s, many investment analysts and fund managers based investment decisions on traditional measures of financial health, which were principally earnings per share, dividend yield and balance sheet asset values. Such measures can fundamentally misstate corporate value.

The main impetus for an acknowledgement of the value of brands, and other intangible assets, came from the corporate raiders and asset strippers of the 1980s who targeted brand rich companies and paid significantly more than their net asset value. This resulted in huge 'goodwill' values that had to be recognised. Alarm bells rang in the boardrooms of many under-performing branded goods companies, as directors realised there was a clear need for a method of accounting for brands, which would recognise their true value in the balance sheet, and avoid arbitrary write-offs, which damaged investor perceptions.

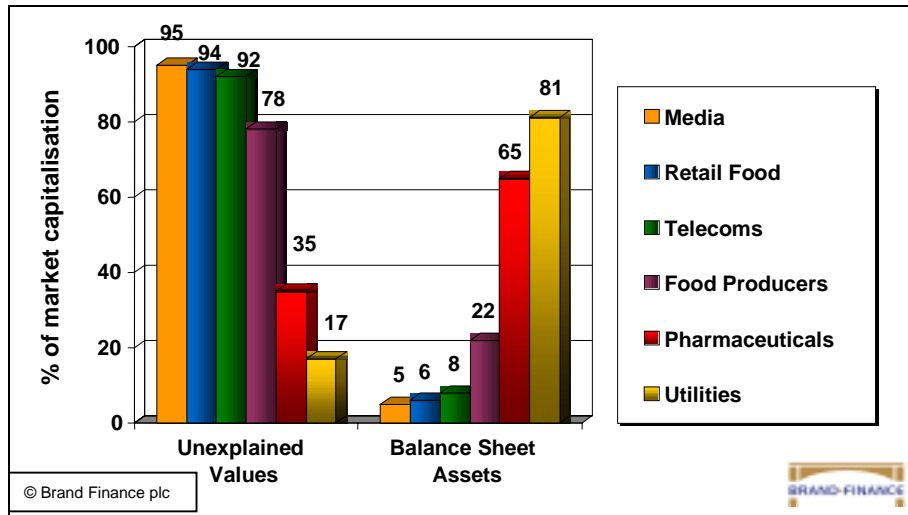
A realisation that the full value of brand owning companies was neither explicitly shown in the accounts, nor always reflected in stock market values, led to a reappraisal of the importance of intangible assets in general, and brands in particular. This in turn raised the question of how such assets should be valued and disclosed. Although the accounting profession has only partially adapted to a world in which intangible assets are the main drivers of value, business leaders and investors have been quicker off the mark.

There is currently a global merger and acquisition boom in progress. Brands have played a significant role in this activity. In 1999, Mannesmann, for example, agreed to pay nearly £20 billion for a mobile phone brand that had only been in existence for five years. Within a year, Orange had been sold to France Telecom for £31 billion. In its home market, Orange boasts higher customer acquisition, retention and usage rates than its rivals – all key factors of a successful brand. Orange has achieved that magic ingredient which positions it as a lifestyle brand. It has already been licensed into new geographies and is tipped to move into other product categories.

Instances such as this bring the value of specific brands into the public domain, but the bulk of intangible asset value remains 'off balance sheet'. A recent research study carried out by Brand Finance indicates that brands and other intangible assets now contribute the bulk of shareholder value in many sectors. This UK based study reviewed the annual reports of 344 of the FTSE 350 companies with year-ends up to and including 31<sup>st</sup> December 1998.

It seems bizarre that 72% of the value of the companies surveyed was not reflected in published balance sheets. This percentage varies considerably by sector highlighting the varied importance of intangible assets between sectors.

Gap between FTSE 350's market capitalization and net asset value at 31/12/98

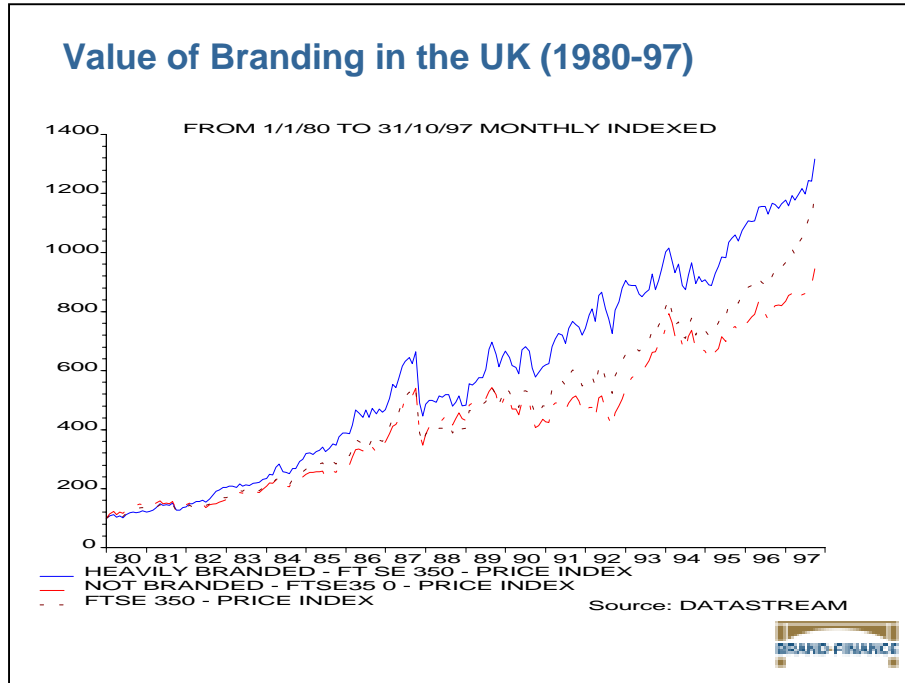


Brands form a significant part of this 'unexplained value'. Other intangibles such as patents, customer lists, licenses, know-how and major contracts also play a role. Patents, for instance, are a major component of value in the pharmaceuticals sector.

Brands will be major drivers of corporate value in the 21<sup>st</sup> century. Investors and business leaders have recognised this. Financial managers and planners are increasingly using brand valuation models to facilitate business planning. They should go one step further. Investors need and want greater disclosure of brand values and marketing performance. Financial managers should play a lead role in ensuring that such information is adequately communicated to investors, rather than waiting for statutory disclosure requirements to catch up with reality.

## 2. Brand economics: How brands add value

As illustrated by the following chart, heavily branded companies have a history of outperforming the UK market.



A similar performance gap between heavily branded companies and the market index is apparent in the US.

How do brands add value? In economic terms, the answer is simple. They impact on both the demand and supply curves.

On the demand side, brands enable a product to achieve a higher price at a given sales volume. Strong brands can also increase sales volumes and churn rates. Price and volume impacts are in some instances achieved at the same time. An example, taken from the Economist, is of the GEO Prizm and Toyota Corolla in the US. These vehicles are virtually identical, coming off the same production line and having similar levels of distribution and service levels. However, the Corolla trades at an 8% premium and sells double the volumes.

Brands also establish more stable demand, through their relationship with consumers. They establish barriers to entry. The relationship with consumers is due to both functional and emotional attributes. On the functional side, brands ensure recognition and further aid the purchase decision through a guarantee of quality. From an emotional perspective, they satisfy aspirational and self-expression requirements. This is most evident in luxury and fashion sectors.

A further benefit of branding, which has increased in importance in recent years, is the ability to transfer the equity or values associated with a brand into new product

categories. In order for brand stretching to be effective, it is necessary that the core values of the brand are image, rather than product, based.

Whilst there are numerous examples of successful brands that have achieved significant price premiums or higher volumes, the impact of branding on the supply curve is often ignored. Brands tend to shift the supply curve downwards due to the following reasons:

- Greater trade and consumer recognition and loyalty. This results in lower sales conversion costs and more favorable supplier terms.
- Lower staff acquisition and retention costs.
- Lower cost of capital.
- Economies of scale achieved through higher volumes.

There is an increasing body of research supporting the fact that successful brands add corporate value. There are, of course, examples of successful brands that have fallen from grace and branding initiatives that have failed. The challenge is to identify how your brand impacts on the business model, and to monitor whether marketing strategies are successful in adding value to the brand.

### 3. Brand valuation methodology

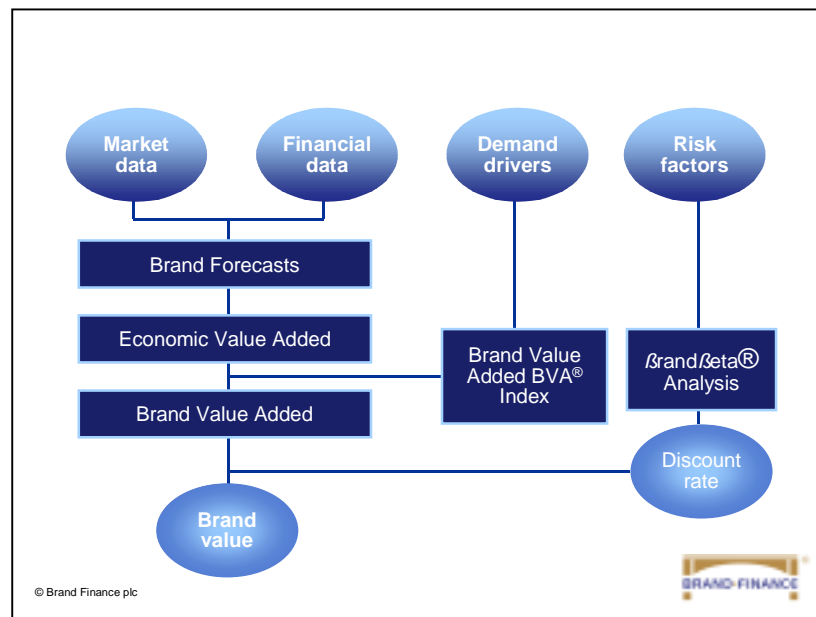
A number of methods can be used to value brands. Cost based brand valuations are rarely used, as the cost of creating a brand tends to have little similarity to its current value. Market based comparisons, on the other hand, are unsatisfactory as a primary method of valuing a brand because comparative data is scarce and brands are unique. However, where available, market comparisons are useful for testing primary valuations.

A more commonly used approach is the royalty relief method. This is based on the assumption that if a brand has to be licensed from a third party brand owner, a royalty rate on turnover will be charged for the privilege of using the brand. By owning the brand such royalties are avoided. The royalty relief method involves estimating likely future sales and then applying an appropriate royalty rate to arrive at the income attributable to brand royalties in future years. The stream of notional brand royalty is discounted back to a net present value – the brand value.

Although the royalty relief method is technically sound, it provides little understanding of how and where the brand is creating value. It might therefore be an appropriate method of valuing a brand for balance sheet or tax purposes, but will be of limited use to a marketing director wishing to leverage the value of a brand.

The economic use method integrates consumer research and competitive analysis with the brand's forecast earnings. As such, it provides a foundation for brand management in addition to determining the value of the brand by market segment. As this method is of most interest to marketers, and is the most widely used method of brand valuation, it is discussed in more detail.

The Brand Finance methodology has been used by leading brand owners across the world and will be used to illustrate a marketing orientated valuation. A snap shot of this valuation framework is provided below:



The focus is on the return earned as a result of owning the brand – the brand's contribution to the business, both now and in the future. This framework is based on a discounted cash flow (DCF) analysis of forecast financial performance, segmented into relevant components of value.

The DCF approach is consistent with the approach to valuation used by financial analysts to value equities and by accountants to test for impairment of fixed assets (both tangible and intangible) as required by new international accounting standards.

For some purposes, market based valuation or the royalty relief method of valuation may be possible. However, DCF valuation is the most widely accepted approach to brand valuation and provides a greater depth of understanding of the dynamics of the brand.

While brand valuations can be based on a multiple of historical earnings, it is clear that past performance is no guarantee of future performance and that investors base value judgements on expected future returns rather than actual historical returns. However, historical results are crucial for accurate valuation mainly because they provide information and data relationships, which help to more accurately forecast the future.

Valuations based on projected earnings are therefore our preferred approach with the caveat that forecasts must be credible. Where forecasts are credible, the valuation results are both robust and actionable.

A brand valuation study typically consists of four work streams:

- Financial forecasts.
- Brand Value Added BVA<sup>®</sup> - analysis of the brand's contribution to demand.
- BrandBeta<sup>®</sup> analysis - determination of the risk attached to future earnings.
- Valuation and sensitivity analysis.

The BVA<sup>®</sup> section of the analysis can be extended to incorporate a study of causal relationships within the business model. This facilitates the development of a dynamic brand valuation model, as discussed in section 3.6.

Prior to commencing these studies, it is necessary to decide on the most appropriate level of segmentation.

### **3.1 Segmentation**

In applying the valuation framework, one of the first and most critical tasks is to determine the nature of the segmentation for valuation purposes. It is then important to identify how internal financial and marketing data, and external market and competitor data, can be obtained in a way which fits with the chosen segmentation.

The principles behind effective segmentation for brand valuation purposes are as follows:

- Homogeneous geographic, product and customer groupings to ensure that the valuations are relevant to defined target markets.
- Clearly definable set of discrete competitors in each segment to ensure that apples are compared with apples.

- Availability of market research data to match the chosen segmentation.
- Availability of volumetric and value data for competitor brands to match the chosen segmentation.

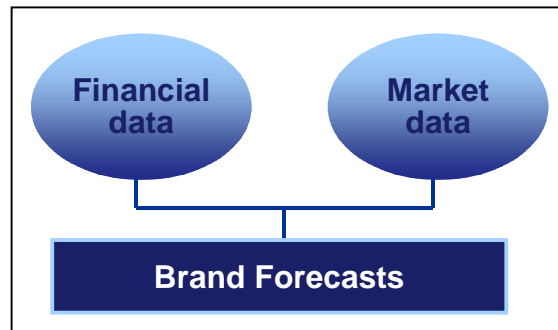
There is little point in choosing a valuation segmentation based on an aggregation of product or customer groupings which obscures important underlying differences.

Equally, there is little point in choosing a particular detailed segmentation against which it is impossible to obtain volumetric or value data to the appropriate level of detail. Without these it may be hard, if not impossible, to estimate relative market shares and to compare performance and forecasts against competitors.

Much of the success of a brand valuation lies in the selection and planning of the relevant segmentation and the sourcing of suitable data.

### 3.2 Financial Forecasts

Typically, explicit forecasts for periods of 3-5 years are used for the basis of such valuations and should be identical to internal management planning forecasts.



An important part of the brand valuation process involves ensuring that forecasts are credible.

#### Forecast revenues

##### *Macro-Economic Review*

It is necessary to conduct extensive due diligence on each of the markets in which the brand operates to ensure the valuation takes into account all the macro-economic factors likely to affect the level of demand for the brand. These could be technological, structural, legislative, cultural or competitive.

The brand valuation exercise needs to consider the likely trends for both volume and value for the market as a whole and for the brand being valued. This often involves detailed discussion between the brand valuation team and internal competitor analysis, corporate strategy, market research and marketing departments.

### *Micro-Economic Review*

If the valuer is to estimate likely future sales of the brand, it is vital to understand the historical data relationships that have affected the performance of the brand in each of its markets.

This may be based on observation, market research, correlation or regression. This can involve econometric modeling or some other form of statistical analysis of past performance to show how certain causal variables have affected revenues.

This is of vital assistance in building the business case or cases on which brand valuations are based. Such analysis gives credibility to the underlying assumptions. It creates the framework within which dynamic and option valuations can be based.

One of the key issues in terms of branding is to understand the causal relationship between total marketing spend, pricing and sales results. It is equally important to understand the relative effect of different media on the overall level of sales.

The task of the brand valuation team is therefore to ensure that brand and marketing factors are being accounted for properly in the modeling and analysis taking place, and that results are used to obtain the most appropriate forecast sales values.

In the same way that it may be desirable to use econometric analysis of past influences on sales, it may also be appropriate to use projective price elasticity research to predict the effect of price on sales.

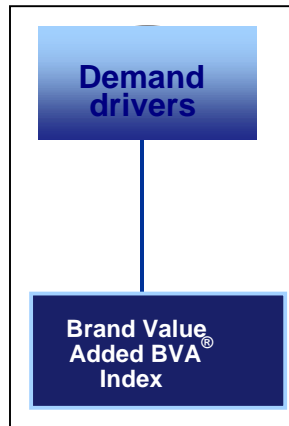
Price elasticity modeling of this type is typically based on large sample quantitative research and is used to improve the accuracy of future sales forecasts. To the extent that this is not already being done, we recommend that this should be considered as an input to the brand valuation process to help refine forecast earnings.

### Forecast costs

It is necessary to understand fully the basis on which forecast costs have been determined. The brand valuation team will need to confirm that the basis of cost allocation is sensible between each of the geographic, product or customer segments on a current and forecast basis.

The same principle applies to the allocation of capital to different segments and the resulting charges for capital made against the segmented brand earnings streams to arrive at forecast Economic Value Added. Economic Value Added is the starting point for the brand valuation. A proportion of the identified Economic Value Added is ultimately attributed to the brand in the brand valuation calculation.

### 3.3 Calculating Brand Value Added BVA®



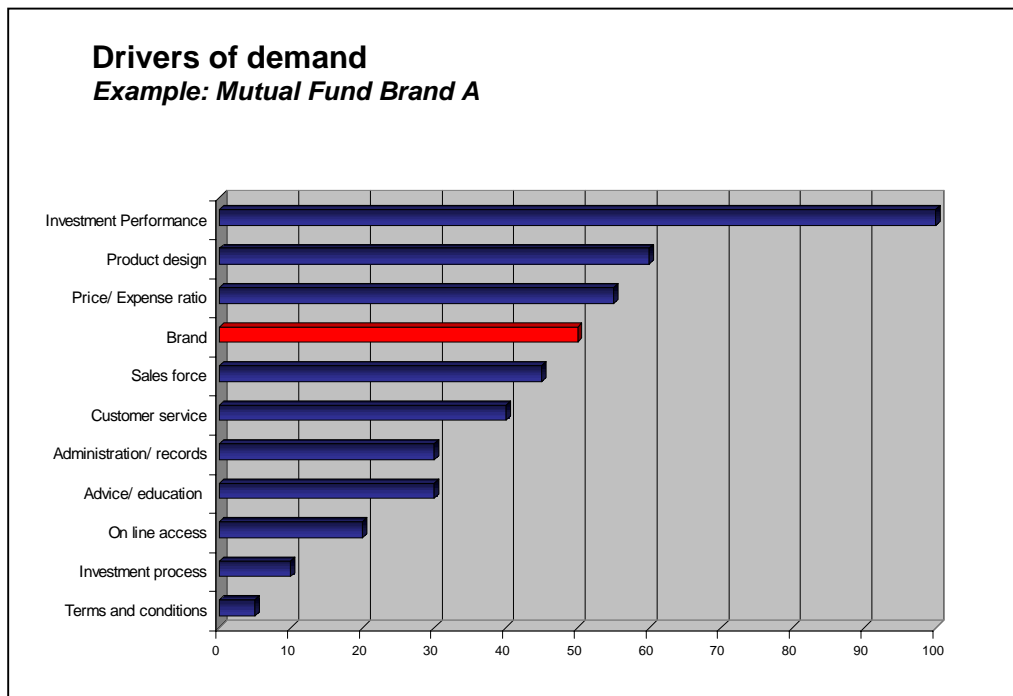
This is the heart of any valuation, as it determines the proportion of total Economic Value Added to be included in the brand valuation.

Having selected an appropriate segmentation and populated it with comparative volumetric, value and market research data, we next need to identify, for each of the competitor brands under review, the extent to which the brand contributes to demand. We do this with 'trade-off analysis', which is based on quantitative market research.

It is usual to first identify the key drivers of demand by reference to existing qualitative and quantitative research or by means of management discussions. It is possible to reasonably estimate the relative importance of different factors in determining demand by means of detailed management workshops.

However, it is preferable to eliminate the inherent subjectivity of this approach by using large sample customer based research and trade-off analysis. It is ultimately more robust for justifying a financial valuation and more useful as a barometer of the relative importance of different factors which drive sales demand. It is therefore more useable as a line management decision-making tool rather than simply a valuation technique.

A top-level illustration of the output of this approach follows. This indicates the contribution of the brand to the purchase decision in a US mutual funds business.

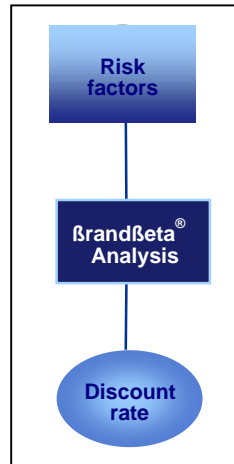


Trade-off analysis of this type can be conducted at a number of levels to identify the importance of the brand to the purchase decision from:

- one brand to another,
- one time period to another,
- one target audience sub-segment to another and
- one product class to another.

It is an invaluable, statistically robust means of attributing income to the brand in a brand valuation. In addition, it can be used for tracking the changing importance of different drivers in given markets, for planning resource allocation behind different drivers of demand and for tracking the effect such resource allocations may have on the profile of factors affecting demand for the brand. It can also be used to assist in anticipating future demand.

### 3.4 Assessing Brand Risk



The final step in the brand valuation is to determine the appropriate discount rate to use in the DCF analysis. At Brand Finance, we have developed an approach to discount rate determination, which is a transparent adaptation of the Capital Asset Pricing Model. We build up the appropriate discount rate from first principles as follows:

$$\text{Discount rate} = \beta_{\text{BrandBeta}}^{\text{®}} \text{ adjusted cost of equity} \times (\text{proportion of equity funding}) \\ + \text{cost of debt} \times (\text{proportion of debt funding})$$

$$\beta_{\text{BrandBeta}}^{\text{®}} \text{ adjusted cost of equity} = \text{risk free rate} + (\text{equity risk premium} \\ \times \text{sector beta} \times \beta_{\text{BrandBeta}}^{\text{®}})$$

The 10-year risk free borrowing rate in the geographic market under review is the starting point. The equity risk premium is the medium term excess return of the equity market over the risk free rate. This can be obtained from investment data providers and a number of risk evaluation services. So too can the sector beta which is used to determine an average implied discount rate for all brands in the sector under review.

This sector specific discount rate is finessed to take account of the relative strength of different brands in the given market. We call this  $\beta_{\text{BrandBeta}}^{\text{®}}$  analysis and base it on 10 key criteria for which data is usually available and which, in our view, represent the best indicators of risk.

The generic list of  $\beta_{\text{BrandBeta}}^{\text{®}}$  attributes used by Brand Finance is shown below. It must be stressed that these are evaluated in each instance to ensure the most appropriate grouping of risk measures for a specific sector is identified.

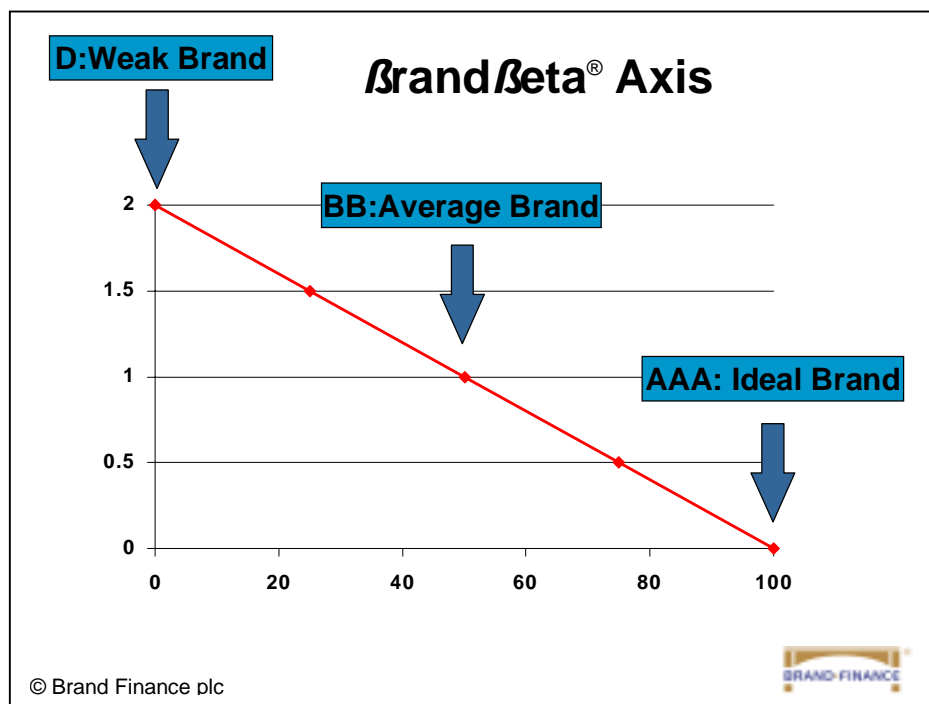
A standard  $\beta$ rand $\beta$ eta<sup>®</sup> scoring template:

Attribute	Score
Time in the market	0 -10
Distribution	0 -10
Market share	0 -10
Market position	0 -10
Sales growth rate	0 -10
Price premium	0 -10
Price elasticity	0 -10
Marketing spend	0 -10
Advertising awareness	0 -10
Brand awareness	0 -10
<b>Total</b>	<b>0 - 100</b>

Careful planning will be required to define which competitors need to be monitored and evaluated and in which sectors. There may also be a need to change the competitor set over time if the focus of the business shifts into new areas.

A score of 50 implies that the brand offers average investment risk in the sector under review and therefore attracts a  $\beta$ rand $\beta$ eta<sup>®</sup> of 1. This means that the discount rate used in the valuation will be the average composite rate for the sector.

A score of 100 implies a theoretically risk free brand which would be discounted at the risk free rate. A score of 0 implies a particularly weak brand, which doubles the equity risk premium.



The review of data for the *BrandBeta*<sup>®</sup> analysis provides invaluable insights into the competitive position of the brand in its market and acts as a useful focus for a balanced scorecard for the brand.

Where available perceived quality of brands is a strong alternative to simple 'brand awareness' in the *BrandBeta*<sup>®</sup> scorecard. The scorecard is data driven and transparent and produces supportable discount rates.

### 3.5 Point-in-time valuation

The result of the foregoing analysis is a Branded Business Value for each segment identified. The Branded Business Value expresses the full net present value of the intangible earnings in each segment. In addition, we produce a detailed competitive review with risk scoring and a robust estimate of the contribution the brand makes in each segment. This is used to drive a value for the brand alone within the total value of the branded business.

We typically also produce a sensitivity analysis indicating the impact on value of altering certain key assumptions.

An important philosophy behind a brand valuation exercise is that the model should become a simple and comprehensible rallying point for the whole brand team, not a sophisticated model for the initiated only.

Example valuation sheets for both Branded Business Value and Brand Value are as follows:

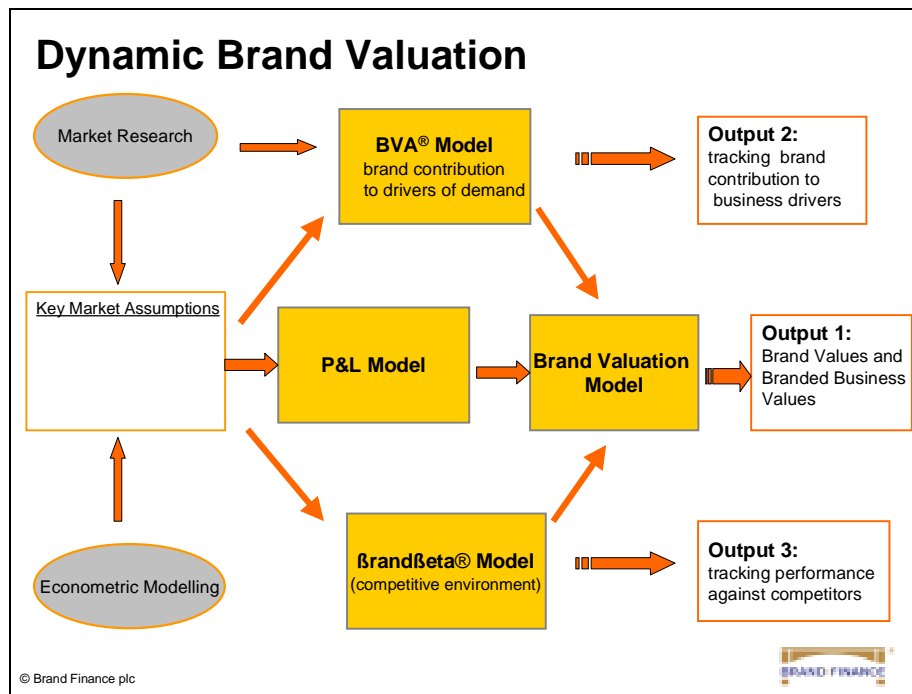
<b><i>Branded Business Value (Segmented)</i></b>							
		<b>Year 0</b>	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
<b>Net Sales</b>		500	<b>520</b>	<b>550</b>	<b>580</b>	<b>620</b>	<b>650</b>
<b>Operating Earnings</b>		75.0	78.0	82.5	87.0	93.0	97.5
<b>Tangible Capital employed</b>		250	260	275	290	310	325
<b>Charge for Capital @ 15%</b>		37.5	39.0	41.3	43.5	46.5	48.8
<b>Earnings</b>		37.5	39.0	41.3	43.5	46.5	48.8
<b>Tax Rate</b>		33%	33%	33%	33%	33%	33%
<b>Tax</b>		12.4	12.9	13.6	14.4	15.3	16.1
<b>Post tax Earnings</b>		25.1	<b>26.1</b>	<b>27.6</b>	<b>29.1</b>	<b>31.2</b>	<b>32.7</b>
<b>Discount Rate</b>		15%					
<b>Discount Factor</b>		1.0	1.15	1.32	1.52	1.75	2.01
<b>Discounted Cash-flow</b>			<b>22.7</b>	<b>20.9</b>	<b>19.2</b>	<b>17.8</b>	<b>16.2</b>
<b>Value to year 5</b>			<b>96.8</b>				
<b>Annuity</b>			<b>108.3</b>				
<b>Growth</b>	0%						
<b>Enterprise Value</b>			<b>205.1</b>				

## Brand Value (Segmented)

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Net Sales	500	520	550	580	620	650
Operating Earnings	75.0	78.0	82.5	87.0	93.0	97.5
Tangible Capital employed	250	260	275	290	310	325
Charge for Capital @ 15%	37.5	39.0	41.3	43.5	46.5	48.8
Earnings	37.5	39.0	41.3	43.5	46.5	48.8
Brand Value Added @ 25%	9.4	9.8	10.3	10.9	11.6	12.2
Tax Rate	33%	33%	33%	33%	33%	33%
Tax	3.1	3.2	3.4	3.6	3.8	4.0
Post tax BVA	6.3	6.5	6.9	7.3	7.8	8.2
Discount Rate	15%					
Discount Factor	1.0	1.15	1.32	1.52	1.75	2.01
Discounted Cash-flow		5.7	5.2	4.8	4.5	4.1
Value to year 5	24.2					
Annuity	27.1					
Growth	0%					
Brand Value	51.3					

### 3.6 Dynamic brand evaluation

A dynamic valuation process can be expressed pictorially as follows:



The point-in-time valuation methodology discussed thus far provides a robust brand valuation model drawing directly on financial, analytical and market research activities, which either are or should be in place already. In a sense, it merely brings together existing measures and processes in a coherent way.

It is therefore a suitable way of producing valuations on a periodic basis by and for internal management. In our experience, it is often preferable to create a static valuation model, then increase the sophistication of the model and introduce a scenario planning capacity.

The section of this bulletin entitled 'Brand economics' discussed how brands can result in price premiums, increased volumes, reduced churn rates and cost savings. It concluded by stating that the challenge is to identify these relationships and to track whether marketing strategies are successful in adding value to the brand.

The purpose of a dynamic brand valuation model is to incorporate causal relationships. The model is then used to carry out scenario planning in order to select the most appropriate strategy, and then to track the impact of the selected strategy.

Such a model can be used for considering and comparing the level of marketing investment behind the brand in different segments. It can be used for flexing key assumptions on the basis of hypotheses and testing the value impact of changes to brand activities. It will show where brand and corporate value is being created and destroyed together with the intermediate measures that cause the growth or decline.

Econometric modeling and Brand Value Added (BVA<sup>®</sup>) research are used to identify historic and predictive cause and effect relationships between marketing inputs and sales volumes. Both these and market assumptions can be built into a dynamic brand evaluation model in such a way that the likely impact of marketing actions on short term profitability and long term value can be established. One of the key differences between a static and dynamic valuation model is the extent of consumer research that is used.

Such a tool sounds like the marketing Holy Grail. However, it must be remembered that the predictive ability of the model will only be as good as the research that has been used to determine the causal relationships between consumers and the brand. Even in the absence of ideal research, we have found that the process of estimating cause and effect relationships and assessing the sensitivity of the business model to changes in these assumptions to be an extremely useful process.

## 4. Applications of brand valuation

During the last five years, brand valuation has become a mainstream business tool used in the following applications:

<b>4.1 Financially focused</b> <ul style="list-style-type: none"><li>▪ Balance Sheet reporting</li><li>▪ Mergers and acquisitions</li><li>▪ Tax planning</li><li>▪ Securitised borrowing</li><li>▪ Licensing and franchising</li><li>▪ Investor relations</li><li>▪ Litigation support</li></ul>	<b>4.2 Strategically orientated</b> <ul style="list-style-type: none"><li>▪ Brand portfolio reviews</li><li>▪ Marketing budget determination</li><li>▪ Resource allocation</li><li>▪ Brand performance tracking</li><li>▪ New product development</li><li>▪ Internal communications</li></ul>
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### 4.1 Financially focused brand valuations

#### Balance Sheet reporting

Since the 23<sup>rd</sup> December 1998, all companies in the UK have been obliged to account for purchased goodwill and intangible assets under the Accounting Standard Board's new directive, Financial Reporting Standard 10 (FRS 10).

Under the previous accounting standard, Statement of Standard Accounting Practice 22 (SSAP 22), companies had much greater latitude in the accounting treatments adopted. Under SSAP 22, financial directors could capitalise, amortise or eliminate purchased goodwill against reserves as they saw fit. Most opted for the latter with the exception of major branded companies where the amounts involved were highly material.

FRS 10 now requires capitalisation of purchased goodwill and acquired intangibles – including licenses, franchises, publishing titles, patents and brands. Capitalised values must be amortised over the 'expected useful lives' of the intangible assets in question. In exceptional circumstances, amortisation is not necessary if assets can be demonstrated to have indefinite useful lives, subject to annual impairment reviews described in FRS 11.

It seems clear that FRS 10 and IAS 38, while raising the profile of intangible assets, do not really answer the main problem with published accounts, which is their failure to reflect true intangible asset values. There is a debate in progress about how accounts might reflect such value. We will continue to monitor the nature of intangible asset reporting. It seems that the conservative accounting standard setters will never be persuaded to include real values in accounts and that a new form of reporting will need to develop side by side with traditional historical cost accounts. Brand Finance expects to be heavily involved in the development of this new reporting culture into the new millennium.

There is nothing to prevent companies including additional information in their Annual Reports and this seems likely to happen. The Operating and Financial Review and Notes to the Accounts are almost certain to include far more information on such matters in future, whether or not internally generated and revalued assets appear on the face of the Balance Sheet.

The areas where it seems clear that far more information will be provided in future include:

- Segmentation of results by brand, region and consumer group.
- Qualitative and quantitative analysis of marketing investment.
- Revaluation of brands, both acquired and internally generated.
- Long as well as short-term forecasts of performance.

There is increasing pressure for companies to show 5 or even 10-year forecasts in their reports to analysts. Some commentators are now arguing for 'value reporting' which would incorporate historic and prospective information of both a quantitative and qualitative nature.

There will also be increasing pressure for companies to go beyond the minimum statutory reporting requirements with regard to brand value and brand performance. Companies have the choice of being reluctant followers of this pressure, or adopting a more pro-active and confident approach to marketing disclosure. Ironically, the marketing, brand and advertising information wanted by analysts can often be obtained from other sources, such as independent research companies and competitive trade intelligence. Yet companies are reluctant to pre-digest and explain such information for investors.

If the Board appreciates the value of its brand portfolio and is confident that its marketing strategy will deliver increased value, this information should be disclosed to analysts and investors. If it is not disclosed, the market will base its valuation of the company on incomplete information, or analysts will 'fly kites' based on rumor rather than fact.

### Mergers and acquisitions

Brand valuation techniques now play a significant role in merger and acquisition activity. Potential acquirers of branded goods companies, and their investors and bankers, increasingly use brand valuations to provide comfort that the price being paid for a company can be substantiated by reference to the value of specific intangible assets, as well as the tangible assets being acquired.

Conversely, an independent brand valuation performed as part of the defence strategy on behalf of a target company can help to convince the investment banking community that an aggressive bid is undervalued.

### Tax planning

In the past, many companies had allowed their affiliates to use their brand names for little or no charge, but as the realization has grown of the profit generating powers of brands, companies have increasingly taken to charging royalties for their use. This has alerted tax authorities around the world, with many now asking companies to charge their subsidiary operations for the use of their brands.

### Securitised borrowing

As brands have increasingly become recognized as assets, the opportunity to use them to back specific borrowing lines has increased, especially in the United States where companies as significant as Disney have borrowed major sums against their brand. A new market is opening up for the insurance of brand assets with a number of major insurers creating products tied to the capital value of brands. If such risk-oriented insurance products take hold, there is likely to be an increase in securitised loans, because lenders will know that preferential rates will be underwritten by catastrophe risk insurance.

### Licensing and franchising

Where companies allow associates to use brand names or are involved in the external licensing or franchising of their brands, brand valuation allows a realistic set of charges to be created. These charges reflect the value of the asset being licensed. The ultimate effect of recharging for the use of a brand name is exactly the same as charging for the use of central research facilities or shared production facilities.

### Investor relations

In the case of a listed food manufacturer, a brand valuation was conducted in order to communicate the value of the company's main brand to analysts and investors. Management commissioned the study, as they believed the shares were undervalued and the company vulnerable to takeover.

As major companies like Diageo have stated that building a portfolio of world class brands is one of its central objectives, so the investment community has become more concerned that a company's brand strength is reflected in its share value. Brand valuations can be used in this context as a means of providing hard numbers in what is currently a soft argument.

### Litigation support

Brand valuation techniques have frequently been used in legal cases to defend the brand value, whether it is against the illicit use of a brand name or, in the event of receivership, against the under valuation of assets by insolvency practitioners.

## 4.2 Strategically orientated brand evaluations

A particular trend has been the increasing use of brand valuations as a tool to aid marketing management. The focus here is to increase the effectiveness of the marketing effort and aid brand management. A prime benefit in this regard is the fact that a brand valuation model is linked to the company's business model and provides a financial measure that is understood throughout the organization and by investors.

A well-constructed brand valuation pulls together market research, competitive data and forecasts of future financial performance. This increases the understanding of the brand's value and its contribution to demand in each segment and identifies opportunities for leveraging the brand. A dynamic brand valuation model can be used for scenario planning purposes.

The ability to place a financial value on a brand within each key market segment is not the only output of a valuation study:

- Research into the drivers of demand yields information that aids a range of decisions, including portfolio planning and product positioning. It can help define the focus of the advertising message.
- An identification of causal relationships within the business model facilitates an increase in advertising effectiveness.
- The competitive benchmarking study that forms part of an assessment of the risk attached to future earnings provides a gauge of the brand's strength, in relation to competitors, from segment to segment.

Some examples of internally focused brand valuations that Brand Finance has carried out during the last two years are shown below.

### Brand portfolio reviews

Portfolio reviews have a tendency to become clouded by emotional and subjective factors. The overriding consideration should be the identification of the portfolio that maximises shareholder value. Once this has been determined, strategic implications can be considered. A brand valuation model will allow the profit and value implications of all options to be considered.

The first example illustrates the use of a brand valuation to help resolve a specific issue. The impetus for the project had been the acquisition by a global financial services company of a number of new brands. This had resulted in a cluttered portfolio, which required rationalization. The brand valuation was segmented by product and customer for all of the group's brands in the UK, Europe, Australia, Hong Kong and the US. The project formed the framework to inform brand rationalization and brand architecture decisions.

### Marketing budget determination

A global insurance company provides an example of a valuation initially carried out for a specific purpose, but that has now been repeated. In this instance, brand valuation and competitor benchmarking techniques were combined to determine the optimal global advertising investment behind the client's corporate brand. The results were used by senior management to set corporate advertising levels. Periodic repetition of the exercise has been used by management to understand and monitor the effect of brand investment decisions on corporate brand value.

### Resource allocation

As brand valuation has become a widespread measure of management performance, so it can produce relevant quantitative data that provides common ground for marketing and finance departments. This assists in budgeting decisions and provides a movement away from a reliance on short-term variables or intuition to a more systematic basis for decision making.

In the case of a retail bank, a brand evaluation project was carried out in order to assess the contribution of the brand in the corporate, as opposed to the consumer, market segment. The study was also segmented by major product groups. Consumer research was commissioned to quantify the drivers of demand. The study impacted on the allocation of marketing resources between market segments and was applied to measure the effectiveness of marketing investment.

Understanding brand values can also be useful in managing portfolios of brands. For example, when allocating advertising budgets between brands, launching new brands, setting discount policies or extending brands to new territories.

### Brand performance tracking

Brand valuations are increasingly being used as a management tool. Strategic use of brand valuation techniques is becoming more prevalent in many blue-chip organizations, allowing senior management to compare the success of different brand strategies and the relative performance of particular marketing teams.

A major tobacco company illustrates the use of a brand valuation model on an ongoing basis. The corporate marketing finance team commissioned the constructing of a brand evaluation model to monitor the performance of key client and competitor brands in local markets and at a global level. The brand valuation has been placed on the company's intranet and is supported by a manual which clarifies what information is required to be inputted into the model and how the results can be used. The model is kept up to date by operating companies in sixty countries. The data produced by the model informs local decision making as well as group planning.

Many organizations suffer from a surplus rather than a lack of market and consumer information. Unfortunately, much of this is gathered and stored in isolation. The old functional boundaries of a bygone era still prevent the effective flow and integration of information. Even if brand tracking data makes it onto the intranet or a shared directory, it tends to remain in 'research speak' and tends not to be used by financial and strategic planners.

#### New product development

There has been a trend to stretch brands into new categories and geographies during the last few years. Such actions can have significant value implications – both positive and negative.

The development of a financial model that incorporates an understanding of the brand's impact on volumes and price aids such decision-making. This needs to be informed by predictive research into the brand's contribution in the new areas of activity. Some assumptions are likely to be necessary in developing an NPD evaluation model. Sensitivity analysis will determine which are the crucial assumptions within the model.

#### Internal communications

Brand valuations are growing as an internal measure having been used as a means of explaining performance and as a means of motivating management. Similarly, the use of internal royalty rates based on brand values makes it clear to domestic, associated and foreign operations the value of the corporate assets, which they are using. This enhances the growing demand for marketing accountability.

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Brand Finance plc is a specialist consultancy dedicated to the better understanding of marketing finances. It is entirely independent and offers a highly professional approach to marketing accountability and brand valuation. Brand Finance has developed transparent and accessible brand valuation methodologies grounded in leading-edge marketing and investment practice.

Brand Finance offers consulting services designed to maximise value in marketing and branding. These services include brand valuation, brand audits, brand equity research, brand performance forecasting, brand portfolio review, marketing budget allocation strategy, and advice on related information technology and training.

Brand Finance works for a wide range of blue-chip clients conducting national and international brand valuation and strategy assignments. Sectors covered include food, confectionery, alcoholic drinks, automotive, telecommunications, oil, banking and insurance, chemicals, and leisure / retail.

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