‘Understanding the Financial Value of Brands’

A report prepared for and published in conjunction with the

European Association of Advertising Agencies

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Brand Finance

Brand Finance 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.

Services designed to maximise value in marketing and branding include brand audits, brand equity research, brand performance forecasting, brand valuation, brand portfolio review, budget allocation strategy, agency remuneration, accounts payable and production cost audit, 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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David Haigh read English at Bristol University before qualifying as a Chartered Accountant with Price Waterhouse in London. He worked in international financial management then moved into the marketing services sector, firstly as Financial Director of The Creative Business and then as Financial Director of WCRS & Partners.

He left to set up a financial marketing consultancy, which was later acquired by Publicis, the pan European marketing services group, where he worked as a director for 5 years. He moved to Interbrand as director of brand valuation in its London-based global brand valuation practice, leaving in 1996 to launch Brand Finance.

David is a fellow of the UK Chartered Institute of marketing and was a judge for the 1998 IPA Advertising Effectiveness Awards judging panel.

He is author of 'Strategic Control of Marketing Finance (FT/Pitman Publishing 1994), 'Brand Valuation - a review of current practice' (IPA, 1996) and 'Brand Valuation' (FT - Retail and Consumer Publishing, 1998).

The Development of Brand Valuation

Introduction

Brand valuation first rose to prominence in the late eighties. A decade later, brands now often represent a significant proportion of total shareholder's equity. Yet financial people have been slow to recognise this vital new class of asset.

Despite the fact that a number of powerful brands have been in existence for more than a century, many accountants were slow to grasp the fact that brands can be built, purchased and valued in a similar fashion to property, machinery and the other tangible assets around which businesses have traditionally been built.

Although it is apparent that advertising and marketing expenditure influence customer buying behaviour long after specific campaign periods, it was not considered sensible by the accountancy profession to carry forward any part of the cost to be matched against future revenues. The year-end valuation of intangible assets was considered to be too uncertain to attribute carrying values. The capitalisation of brands being regarded as an imprudent reinstatement of expenses previously written off to the profit and loss account.

In instances where a company was acquired for a consideration in excess of its tangible asset value, the excess was lumped under the heading of 'goodwill'. The accounting treatment of goodwill varied between and within countries. In the UK acquisition goodwill was either written off immediately on acquisition or very rapidly amortised. Consequently many companies failed to reflect the true value of brands in their balance sheets. Companies had never reflected organically grown brands in their balance sheets and acquirers tended to write them off.

In essence, the value of intangible assets on balance sheets was effectively ignored. Without a reporting requirement, little time was spent calculating 'theoretical' brand values.

It was assumed that analysts and professional investors would be shrewd enough to appreciate the underlying value of a company's brand portfolio and would consequently reflect this in its share price. This proved to be a false assumption - the hidden value of brands was not always spotted by the market.

In the late eighties many investment analysts and fund managers were still basing investment decisions on traditional measures of financial health, principally earnings per share, dividend yield and balance sheet asset values. Such measures can fundamentally misstate corporate value. Most financial analysts now value companies on the basis of free cash flows discounted back to a net present value, a technique which avoids the distortions caused by historical accounting conventions.

The impact of corporate raiders

The main impetus for brand valuation came from the corporate raiders and asset strippers of the eighties who targeted brand rich companies and ended up with huge goodwill values, which needed to be accounted for. Alarm bells rank in the boardrooms of many under-performing branded goods companies as their directors realised that 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.

Examples of goodwill payments in the eighties		
Acquirer	**Vendor**	**Goodwill as % of price paid**
Nestle	Rowntree	83
Grand Met	Pillsbury	88
Cadbury Schweppes	Trebor	75
United Biscuits	Verkade	66

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 how intangible assets in general, and brands in particular, should be valued and disclosed.

RHM - the first brand valuation

The watershed came with the Goodman Fielder Wattie bid for Ranks Hovis McDougall in 1988. In its defence document, RHM played heavily on the power of its various brands and the fact that GFW's bid was an attempt to get them on the cheap. The RHM defence document stated that:

"RHM owns a number of strong brands, many of which are market leaders, which are valuable in their own right, but which the stock market tends consistently to undervalue. These valuable assets are not included in the balance sheet, but they have helped RHM build profits in the past and provide a sound base for future growth."

After fighting off GFW, and in case there was any doubt about the arguments put forward in the heat of the bid battle, RHM's 1988 accounts incorporated the first independently prepared balance sheet valuation of a brand portfolio. A figure of £678 million was included under intangible assets, being the valuation of both internally generated and externally acquired brands.

The RHM action provoked much argument within the accountancy profession. It also led to a wider debate which significantly raised awareness of the brand valuation issue, not only in finance departments but in marketing departments and at Board level.

Most marketing people found the argument among financial people about the rights and wrongs of brand valuation extremely puzzling. Surely it was obvious that legally

protectable and saleable brands, often developed over decades, with vast marketing resources behind them, had an inherent value?

RHM was ultimately taken over by Tomkins Plc for a value analysts widely regarded as being a full price, having succeeded in avoiding being snapped up on the cheap.

Internally generated brands

That RHM included both internally and externally generated brands on the balance sheet would appear to some observers to have been consistent and sensible treatment. However, most accountants were horrified by the prospect.

The capitalisation of internally generated brands represents the resurrection of costs already written-off to the profit and loss account. This means that there is scope for creative accounting.

At least with externally acquired brands a known sum has been paid to a third party which exceeds the value of the identifiable, tangible assets. In the old days the difference between tangible asset values and the amount paid was referred to simply as 'goodwill' and was held to relate to an indeterminate mix of intangibles, including brands.

But as the brands debate took off, and as methodologies were developed to quantify brand values, goodwill began to be split up into its component parts, one of the most significant being brands. It became clear that there was a 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.

Current accounting treatment of intangible assets

The resulting debate within the accountancy profession has resulted in gradual improvements in the accounting treatment of intangible assets.

In the UK, where the debate began, the situation has been clarified by Financial Reporting Standard 10, which required that from December 1998 acquired brands must be carried as intangible assets and amortised over their 'useful lives'. There is a 'rebuttable presumption' that the useful economic life of individual intangible assets cannot exceed 20 years from the date of acquisition. The 20 year presumption can be rebutted where the useful economic life of the brand can be demonstrated to be greater than 20 years and where the asset is capable of reliable measurement. Regular impairment reviews should be carried out to ensure that intangible assets are not carried at above their recoverable amounts. Capitalisation of internally generated brands is not permitted. FRS 10 requires that brands should be valued independently and recommends that discounted cashflow methods should be used for valuation purposes.

Meanwhile, International Accounting Standard 38 was published in September 1998; its effective date being July 1999. This incorporates very similar requirements regarding the capitalisation of acquired brands, and includes a rebuttable presumption that the useful life of an intangible asset is 20 or less. Where the presumption is rebutted it is forbidden to opt for an infinite life. The recommended approach to valuation is very similar to the UK standard. IAS 38 requires that costs of creating internally generated brands should be treated as expenses when they are incurred.

In summary, it is now widely accepted, by the world's accounting standards setters, that while internally generated brands should not appear in balance sheets externally acquired brands should always be identified, valued and recognised as corporate assets. It is also widely recognised that 'goodwill' is not an amorphous accounting 'difference' but a sum covering a range of identifiable and separable assets. The supporters 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. Not a formal part of the profit and loss account but a more detailed note to shareholders of all intangible assets.

Uses of brand valuation

Although much attention has focused on the accountancy debate, brand valuations have become an accepted technique in a wide range of applications, including:

- Tax planning
- Securitised borrowing
- Litigation support
- Internal marketing management
- Licensing and franchising
- Mergers and acquisition planning
- Marketing budget allocation
- Portfolio review

These uses are illustrated in section 3 of this report.

Brand Valuation Methodology

Summary of Methods

A number of methods can be used to value brands:

- Cost based valuations

It is possible to value a brand on the basis of what it actually cost to create or what it might theoretically cost to recreate. However, such costs may bear little similarity to the current value of a brand.

- Market based valuations

When information of market transactions involving comparable brands is available it is possible to estimate one brand's value by comparison to another brand. However, the fact that such data is scarce and that brands are unique makes this an unsatisfactory primary method of valuing a brand. However, market comparisons can be useful in testing a primary valuation.

- 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.

- Economic use method

This method considers the economic value of a brand to the current owner in its current use. As this is the most widely used method of brand valuation it is discussed in more detail.

Economic use method

Just as analysts now value shares on the basis of sustainable cash-flows from the business, putting a value on that cash stream, the 'economic use' brand valuation process is essentially a cash-flow valuation.

The focus is on the return earned as a result of owning the brand - the brand's net contribution to the business, both now and in the future. This can be measured by estimating the increase in gross profit attributable to selling a branded rather than an unbranded product or service. However, brand valuations are more commonly based on net, 'fully absorbed' profits by identifying the excess net earnings attributable to ownership of the brand.

Initially such valuations were based on a **multiple of historical brand earnings**, a method used by 'Financial World', a US financial magazine, which produced an annual estimate of brand values for many years.

However, what we really want to know is the value of future earnings stemming from the brand's pact with its consumers. It is therefore increasingly common for 'economic use' valuations to be based on the **discounted value of future brand earnings.**

The idea is to take the stream of expected cash flows, arising at different times in the future, and calculate their value to an investor now through a Discounted Cash Flow (DCF) calculation. The translation of future cash flows into current values is achieved by identifying a discount rate, which takes account of the risks inherent in the predicted cash flow. A highly risky cash flow, for example the cash flow on sales of Nintendo games, would be discounted much more heavily than the cash flow from a less risky brand, for example Lego bricks. The former is highly volatile and a sensible investor would mark down the value of the future cash flows, while the latter is likely to be highly reliable.

Using the DCF approach the brand valuer discounts estimated future brand earnings, at an appropriate discount rate, to arrive at a Net Present Value (NPV) - the brand value.

Such valuations draw on internal information, supplemented by external market research. They do not consider the value of the brand in use by a different owner or any 'hope value' based on new uses of the brand.

Theoretically, the economic use approach should use pure cash flows from future brand sales. However, it is more straightforward to use an adjusted profit and loss account figure as an approximation of pure cash flow. This has the benefit of simplicity.

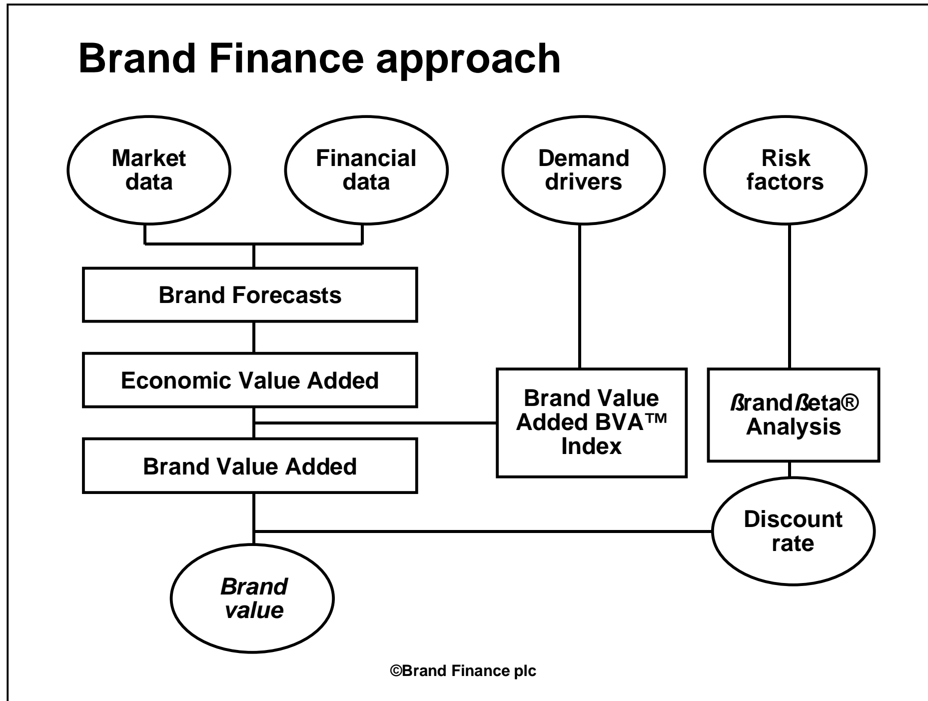
The approach uses the future earnings stream attributable to a brand after making a fair charge for the tangible assets employed (both maintenance and financing costs). The result is earnings attributable to the intangible assets as a whole. A charge is also normally made for tax at a notional rate. The resulting 'excess' earnings are discounted back to a Net Present Value (NPV) representing the current value of the brand in question.

Typically, such brand valuations are based on 5 to 10 year earnings forecasts prepared on an annual basis. In addition, an 'annuity' is calculated on the final year's earnings on the assumption that the brand continues beyond the forecast period, effectively in perpetuity. As brand rights can be owned in perpetuity and many brands have been around for over 50 years this is not an unreasonable assumption in many instances.

A brand valuation typically comprises four elements:-

- Market analysis (to understand market and competitive conditions)
- Brand financial analysis (to identify branded business earnings)
- Driver analysis (to determine what proportion of business earnings are attributable to the brand - Brand Value Added BVA™).
- Brand risk analysis (to assess the security of the brand franchise both with customers and with end-consumers - the ßrandßeta™)

The process can be flow-charted as follows:



The steps in a Brand Valuation

A wide range of information is gathered about the brand, its performance and its history from a number of different sources. Data is collected by a mixture of desk research, questionnaires and face to face interviews. It is then analysed to assess the brand in various terms beginning with the financial data.

Calculating Economic Value Added

Once a brand's background and its revenues, costs and capital employed have been established it is possible to produce a 5-10 year cash flow forecast that can be assessed for reasonableness. Clear definition of the Economic Value Added in the branded business is essential for valuation purposes.

The earnings used to arrive at Economic Value Added must be the fully absorbed earnings of the brand after the allocation of central overhead costs.

- *Elimination of private label production*

The earnings used in the discounted cash-flow calculation must relate only to the brand being valued and not to other unbranded goods which may be produced in parallel with the brand, but which are not sold under the brand name.

- *Remuneration of capital employed*

To avoid overvaluation of the brand it is necessary to make a fair charge for the value of the tangible assets employed in the business; for example, the distribution system, the manufacturing plant and the stock. Until a fair return has been made on the fixed assets and working capital tied up in the business, it cannot be said that the brand is adding value to the business.

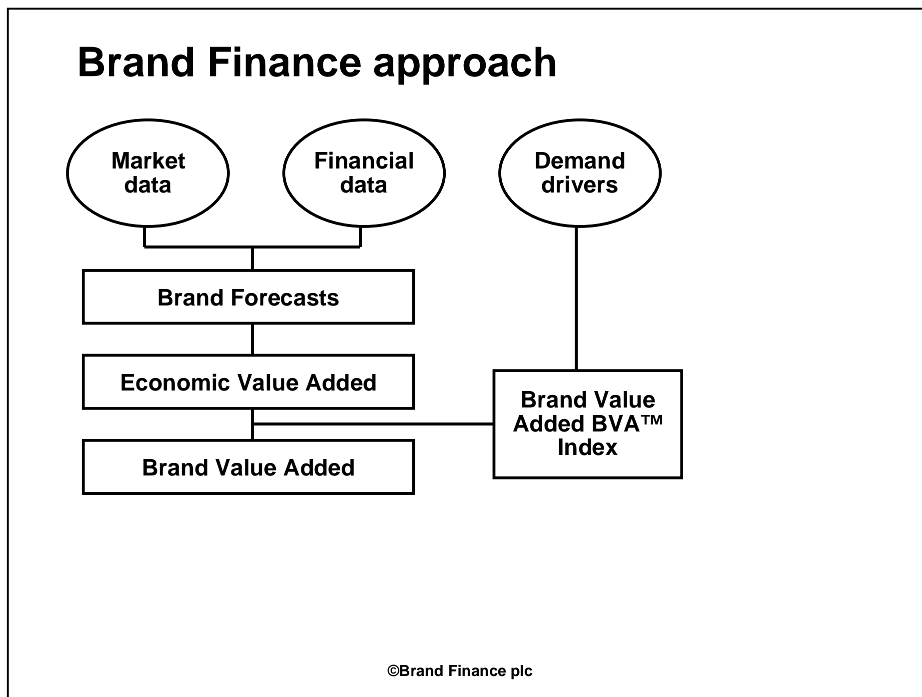
- *Taxation*

The discount rate is always applied to post-tax earnings.

The result of this analysis is a thorough assessment of the historic and prospective Residual Earnings attributable to all the intangible assets employed in the branded business. The next step is to establish what proportion of the total Residual Earnings relate to the brand as opposed to other intangible assets.

Calculating Brand Value Added (BVA™)

Different businesses rely in varying degrees on branding to stimulate demand and support price. By identifying what it is that drives demand in the specific market it is possible to estimate the contribution made to the business by the brand. This is typically achieved using a form of trade off analysis.



This is known as the Brand Value Added BVA™ Analysis. The exercise provides a systematised way in which to approach the question and produces reliable conclusions, particularly where it is supported by large sample customer trade off or conjoint analysis. Large sample customer research 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 (BVA™). 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.

By applying the Brand Value Added BVA™ Index to Economic Value Added in the branded business Brand Value Added can be estimated.

Assessing Brand Risk

A brand value reflects not only the potential of a brand to generate income, but also the likelihood that the brand will do so. It is therefore necessary to determine an appropriate discount rate which takes into account economic, market and brand risks.

The Brand Finance valuation team has developed an approach to discount rate determination grounded in investment theory. This approach, which was designed to be transparent, objective and reproducible, is known as *ß*rand*ß*eta® Analysis.

ßrandßeta® analysis

- **Composite rate analysis**
  - ***Risk free borrowing rate***
  - ***Equity risk premium for the market***
  - ***Weighting for sector risk***
- **ßrandßeta® based on**
  - ***stability, scale and growth of the brand***
  - ***comparative review of competitor brands***

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The starting point is the risk free borrowing rate for the geographic market in which the valuation is being completed.

This is adjusted to incorporate an equity risk premium. These are available for most stock markets and reflect the expected returns for equity investors in those markets.

The resulting composite discount rate is then adjusted for the risk inherent in the specific sector in which the brand being valued operates.

Finally, the average market sector risk rate is either increased or decreased by reference to the specific risk profile of the individual brand to be valued.

ßrandßeta® Analysis - the final part in the process - considers 10 objectively verifiable key indicators of brand performance. All brands in the market are scored relative to one another to arrive at the relevant ßrandßeta® for the brand being valued. The scores determine the extent to which the brand specific discount rate should be above or below the average for the industrial sector and geographic market in which the brand operates.

The ßrandßeta® Analysis scoring template is as follows:

Example ßrandßeta® Scoring Proforma

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Attribute	Score
Time in market	(0-10)
Distribution	(0-10)
Market share	(0-10)
Market position	(0-10)
Sales growth rate	(0-10)
Price premium	(0-10)
Elasticity of price	(0-10)
Marketing spend/support	(0-10)
Advertising awareness	(0-10)
Brand awareness	(0-10)
TOTAL	(0-100)

Having scored all brands in a given market against the 10 objectively verifiable criteria Brand Ratings are determined. These are effectively credit ratings for brands, and just as traditional credit rating drive the rates at which banks will lend to corporations, the ßrandßeta® Ratings determine the required rate of return implicit in the brand valuation. ßrandßeta® ratings drive the discount rates used.

An average brand, achieving a ßrandßeta® score of 50 will attract the average composite discount rate for that sector in that geographic market. A brand scoring 100 is theoretically risk free and is discounted at a risk free rate. In practice, few if any, brands are likely to attract such a rating.

A score of 0 attracts the highest discount rate, with a doubling of the equity risk premium. Again this is an unlikely scenario and is likely to apply only to brands in imminent danger of exiting the market.

The following chart summarises the ßrandßeta® scores, the associated brand 'credit ratings' and the process for calculating discount rates.

Brand Ratings

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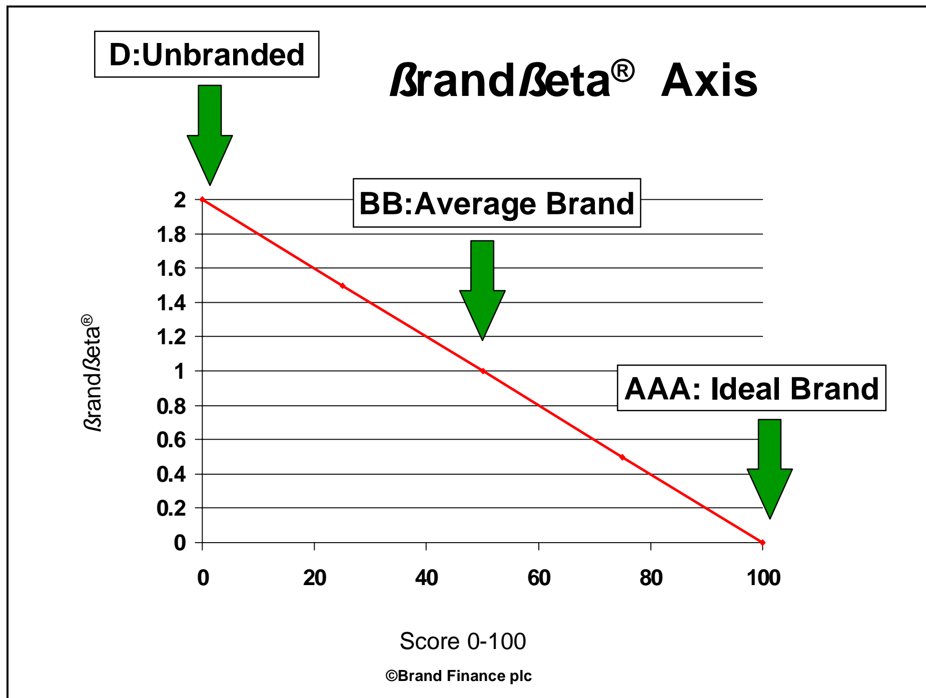
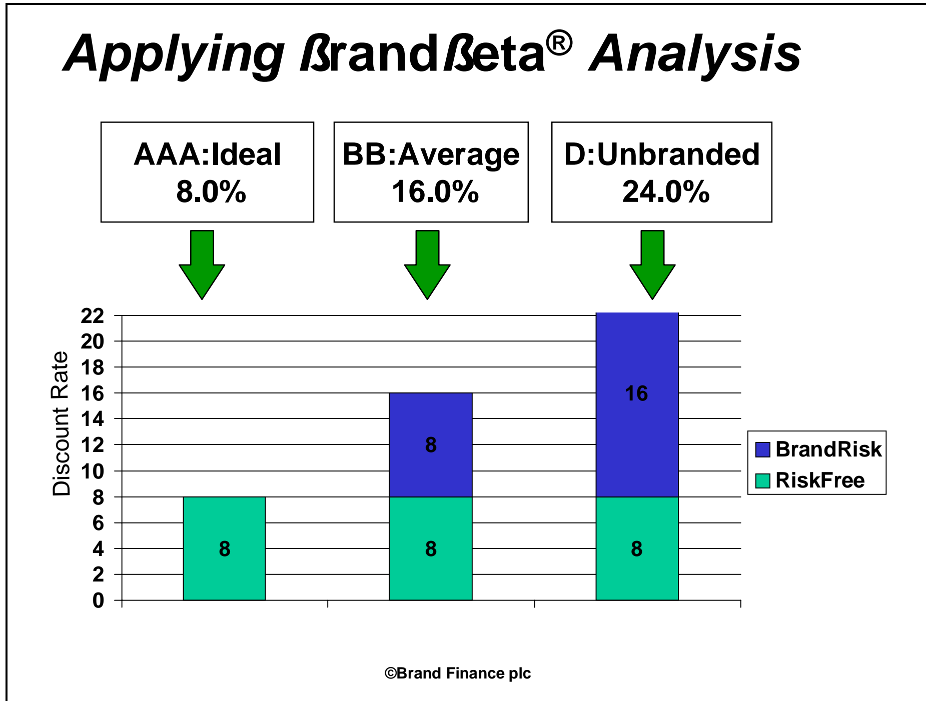
ßrandßeta® Score	***Rating***	***ßrandßeta® Score***	***Rating***
91-100	**AAA**	**41-50**	**B**
81-90	**AA**	**31-40**	**CCC**
71-80	**A**	**21-30**	**CC**
61-70	**BBB**	**11-20**	**C**
51-60	**BB**	**0-10**	**D**





Brand Valuation

Armed with forecast Brand Value Added (BVA®) for the brand, and with a robustly and transparently determined discount rate, brand value is calculated by applying the appropriate discount rate to the expected future brand cash flows.

It will be seen in the following simplified example that we begin with operating earnings calculated in the conventional way.

Capital employed in the operation of the brand is determined and a full charge is made against operating earnings for the finance required to support the brand. The charge for capital employed is normally at a risk free borrowing rate on the principle that the capital is included at its realisable market value and that no risk is involved in ownership of the capital.

Having made the financing charge we are left with Economic Value Added in the branded business. It is this surplus, after rewarding all factors of production including capital, that can be realistically attributed to the intangible assets at work in the business - including the brand.

The total value of the Economic Value Added from the business can and usually is used to calculate the branded business value. One subset of this total value is the brand value alone

Using the process described above we calculate a Brand Value Added (BVA®) percentage which is carried down into the brand valuation calculation.

Example valuation - Discounted Future Earnings method

Brand Valuation template

	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 @ 5%	12.5	13.0	13.8	14.5	15.5	16.3
Economic Value Added	62.5	65.0	68.8	72.5	77.5	81.3
BVA Index @ 75%	46.9	48.8	51.6	54.4	58.1	60.9
Tax Rate	*33%*	*33%*	*33%*	*33%*	*33%*	*33%*
Tax	15.5	16.1	17.0	17.9	19.2	20.1
Post tax BVA	31.4	**32.7**	**34.5**	**36.4**	**38.9**	**40.8**
Discount Rate	*15%*					
Discount Factor	1.0	1.15	1.32	1.52	1.75	2.01
Discounted Cash-flow	31.4	**28.4**	**26.1**	**24.0**	**22.3**	**20.3**
Value to year 5	**152.4**					
Annuity	**135.3**					
Growth *0%*						
Brand Value	**287.8**					

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It will be noted that in addition to the specific valuation of the first 5 years of discounted cash flows we also include an 'annuity'. This is a mathematical summation of all the future earnings beyond the initial valuation period and reflects the fact that brand earnings can and frequently do continue effectively in perpetuity.

Segmentation and Aggregation of Brand Values

Brands only have value in the context of specific market places. In one market the brand may add a great deal of value, in another it may add very little. Consequently brand valuations are normally segmented by discrete market and then aggregated back to total value. In some markets the brand may even be destroying shareholder value and this should be aggregated into the total valuation as part of the overall segmentation.

Such segmentation brings brand valuation down to the level at which markets and businesses actually operate. It allows a better understanding of where brand value is really being added and from a management point of view allows for modelling of how overall brand value might be increased at aggregate level. It is this which takes brand valuation from the realms of financial reporting into the area of better business management.

Applications of Brand Valuation

In the last ten years brand valuation techniques have become accepted in a wide range of applications. The extent and range of these uses demonstrates to what extent brand valuation has become an important technique for strategic decision making about brands and businesses.

Balance sheet reporting

Current accounting practice is outlined earlier in this document. It is clear that the trend will be for companies to disclose more brand value information than the required minimum. Corporate analysts have realised the value of marketing generally and brands in particular. Of the 157 London analysts interviewed for the Brand Finance Report 1999, 75% wanted more information on marketing and advertising investments from the companies they followed, and 71% wanted more information about brand values.

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 forecast 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.

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.

Marketing budget 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.

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.

Internal marketing management

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

Mergers and acquisition planning

Brand valuation techniques now play a significant role in mergers and acquisitions 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.

External investor relations

As major companies like Diageo have stated that building a portfolio of world class brands is one of its central objectives, so the banking sector 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.

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.

Securitised borrowing

As brands have increasingly become recognised 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 and 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.

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.

Fair Trading investigations

Brand valuation techniques have been used as evidence in fair trading investigations where it has been held that high market share is the result of unfair trading. In such situations brand valuation techniques have been useful as a way of explaining to non-marketing audiences the role of brands, and the importance their value has for the companies which spend so much acquiring and maintaining them.

Tax planning

In the past many companies had allowed their affiliates to use their brand names for little or no charge, but as the realisation 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.

Advertising Agency performance evaluation

Just as a significant minority of marketing directors believe that part of their rewards should be linked to long-term brand values some clients also believe that advertising agencies should be rewarded, at least in part, according to the value they add to the brands they serve, rather than on the number of awards they win or the amounts they spend in the media

Whether a single measure of brand value will ever become the benchmark for management and agency performance it is no exaggeration to suggest that brand valuation has become an important technique for strategic decision making. Its growing importance mirrors the growing importance of brands to the companies, which own them.

How can advertising agencies contribute to the brand valuation process?

The brand valuation process requires

a. Market understanding
b. Brand knowledge
c. Understanding of data relationships
d. Detailed financial analysis

To a greater or lesser degree it is quite natural for advertising agencies to be involved in all of these stages.

a. Market Understanding

It is a prerequisite of sound account planning that the planner on a particular brand should have all the latest market trend data available in the agency information library or from proprietary sources. Some agencies commission their own market studies to better understand the markets in which their clients operate. This could represent a vital information source for any brand valuer.

It should be understood that the key requirement in a brand valuation is large amounts of data about the brand, both internal and external. While this is often available from different departments of the client, data gathering is usually the single most difficult stage in a brand valuation. It can be time consuming, incomplete and fraught with frustration. Brand valuations are often conducted for particular short term reasons and under time and cost pressure.

Any agency, acting in its rightful role as 'brand guardian' can facilitate and simplify the process by ensuring easy access to all relevant information for the valuation. This should not simply be an administrative service to the client or the professional valuer but should form the bedrock of a better client understanding.

b. Brand Knowledge

Although a lot of detailed and robust numerical analysis is involved, brand valuation is of necessity a judgemental process. Brand valuation provides information about asset values at a point in time and a perspective on how value might be enhanced over time.

A detailed understanding of the brand and its business potential is therefore vital to the process. Who is better able to interpret and assess what particular brands are capable of than the agency that may have lived with and built the brand for longer than the average brand manager or even marketing director.

Brand valuers may be able to pick up key information on the brand very quickly but it is unlikely that their accumulated knowledge will beat an experienced advertising agency planner's knowledge about his or her brand. Such knowledge and opinions are often vital in completing a robust valuation. In practice agency planners already participate in valuations because clients often source much of the detailed data from the agency and then pass it on to the brand valuer.

Undoubtedly this informal approach can be made more formal in many cases. One example of the value agencies can bring is in the debate about which brand equity tracking technique to use and what the results tell us about the future potential of the brand. This debate is outlined in greater detail in the following chapter 'Brand Valuation versus Brand Evaluation'.

c. Understanding data relationships

If the valuer is to estimate likely future sales of the brand it is vital to understand historical data relationships. This may be based on observation, market research, correlation or regression. Studies may be conducted by the valuer or by the client but could equally be conducted by the agency. In fact, there is already an increasing tendency for agencies to conduct econometric modelling exercises for clients (particularly for media agencies). 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

d. Detailed Financial Analysis

The financial director of the agency can often help to inform an understanding of complex client financial data. Certainly all agencies should have a reasonable understanding of the underlying financial case behind its clients business.

In future, agencies will increasingly be involved in brand valuation, providing information and interpreting results.

Brand Equity: Brand Valuation versus Brand Evaluation

Introduction

> "Brand equity is a phrase of great interest and currency to the modern marketing community, but it is also one often used imprecisely. Many regard equity as a synonym for image, value, character, or personality - another metaphor for the perception, substance and worth of brands. In fact, equity in the context of brands is essentially a financial concept. It is the bottom line – the specific dollar worth of a product or service, beyond its physical and delivery costs, that is realised because of the impact of its branding."[1]

Middleton and Dalla Costa

The last phrase in this extract from Middleton's and Dalla Costa's work – "the impact of (its) branding" – is at the core of Brand Valuation. Reliable brand valuations depend upon understanding and predicting the relationship between two distinct elements of Brand Equity. These elements can be described as:

i.) the marketing measures (the impact of branding)
ii.) the financial measures (the physical and delivery costs)

The 'Brand Equity' Debate

One of the greatest challenges facing marketing and finance directors is identifying, measuring and managing the elements of 'brand equity' data which, if properly understood, could be used to better manage brand health and value. If only connections, can be made between apparently unconnected data it becomes possible to solve all manner of fundamental marketing problems.

Crack the code and it should be possible to spend marketing budgets more efficiently and grow healthier brands in the process. It should be possible to identify which consumer groups to target, which markets to enter or withdraw from, how far brands can be extended and what the optimal marketing mix should be.

In crude financial terms it should be possible to spend less yet still add corporate value. Which explains why, in these times of marketing accountability, financial analysts, brand consultants and market researchers are looking for the answer to the 'brand equity' conundrum. The optimists and pragmatists argue that the answer is there to be found in the data, if only we can use enough intelligence and computer processing power. The pessimists and theorists argue that there is no discernible pattern in the data.

Unfortunately, finding the answer is hindered by a lack of agreement about what a 'brand equity' actually is, which are the most important 'brand equity' measures and what are the most likely causal relationships between them.

[1] Advertising Works, Allan C. Middleton and John Dalla Costa

In a recent paper entitled "The business value of brands", Paul Feldwick, Executive Planning Director of BMP DDB Needham in the UK, highlights the difficulty of finding any single, integrated measure of 'brand equity.'

"The word 'equity' has been borrowed from finance, and its popularity reflects a general realisation that a brand can be an asset. The reason I personally dislike it is that it is used, in practice, to refer to descriptive aspects of a brand, its symbols or consumer imagery; and because of its financial origin, it frequently implies, the financial valuation of a brand. This is dangerous, because it suggests to the unwary that all these things are essentially the same.

Most companies, if you push them into a statement of their overall business objective, will come up with something like 'long term profitable growth.' In other words, their owners and stockholders are not just interested in this year's profits, but in a secure expectation that those profits will continue, and grow, for a number of years to come. An established and successful brand name is one of the best mechanisms for delivering this long term profit stream. Sales that are not associated with a strong brand (e.g. supplying a retailer's own brand) are relatively vulnerable to competitors, to innovation, to price wars. But a strong relationship between the brand and its end consumers is not so easily disrupted, although eventually it can be eroded.

That is why brand names are often bought and sold for considerable sums of money – prices which reflect, not the tangible assets of the brand, the bricks and mortar and machinery, which are usually pretty small, but the expectation of continuing the brand's level of sales into the foreseeable future. The prospect is associated with the brand name and its meaning to the public.

It is not, of course, guaranteed. A brand name is not necessarily an annuity and those who imagine it is often come unstuck. No brand is so strong that it cannot be seriously challenged by environmental change or by determined competition, and even the best brand can be destroyed extremely rapidly by inspired mismanagement. But within certain limits it is a sound bet that a brand's sales will continue well into the future, and this is why brand names are worth money.

We should recognise at the outset, then, that there is no single dimension on which we could all agree to define 'brand strength.' What we can do is understand the nature of a brand's relationship with its public on a number of different dimensions, and on these dimensions we can quantify trends and compare it with other brands in its own category, and in some cases with brands in other categories. We can, if we wish, create a single measure to represent our overall estimation of brand strength, but this will necessarily be a somewhat artificial and arbitrary concept, like indices of 'standard of living' or 'national prosperity' used by economists – such a measure might have its uses but we should not forget its limitations."

Defining 'Brand Equity'

Feldwick therefore rejects the term 'brand equity' as a catchall phrase which is frequently used to describe three quite different aspects of brand performance:

i.) The first aspect covers the images, associations and beliefs consumers have about particular brands.

For example, a brand may be 'young', 'green' or 'exciting'. Feldwick refers to this as 'brand description.' Because these associations and beliefs vary from consumer group to consumer group it is unlikely that simple measures and comparisons will ever be appropriate. However, they provide vital information for brand planning and may be connected with more numerical performance measures.

A great deal of 'brand equity modeling' has been done in the US charting the relationship between brand associations and quantifiable brand performance. Advertising agencies have an interest in demonstrating the relationship between image shift and brand performance.

ii.) The second aspect is the measurement of consumer loyalty to particular brands.

This may be measured in terms of price elasticity, demand volume, purchase frequency, attitudes or awareness. Feldwick refers to this as 'brand strength.' There are many different ways of tracking 'brand strength.' Econometric modeling of empirical data, experimental trade-off analysis and 'Share of Category Requirements' analysis are just a few of the techniques available. Research into quality perceptions and category saliency are just two examples of attitudinal and awareness measures.

'Brand strength' comparisons can be made between brands but a number of different measures need to be considered side-by-side rather than identifying one single measure.

iii.) The third aspect of brand measurement is financial evaluation of brands as separable assets – referred to by Feldwick as 'brand value.'

In his view, while it may be necessary to value brands for financial transactions and for the balance sheet, such valuations are only one way of measuring the long-term health of brands.

Because brand valuations are based on estimates of future profits and depend on assumptions made about ownership, usage and cost structures...'there is no such thing as an absolute value for a brand.'

Measuring Brand Strength

Feldwick suggests there are three broad categories of measuring brand strength:

a) Brand Strength based on observation of how the brand is currently performing in the marketplace;

Discussions of 'brand strength' or 'equity' sometimes suggest that these are abstract values, somehow quite separate from the brand's actual sales in the marketplace. Certainly we are assuming there are aspects of the brand's 'strength' that may not be apparent just by looking at its marketplace performance. But this should not blind us to the fact that the most obvious evidence of a brand's relationship with its public is normally to be found in its sales. A brand that is struggling in the marketplace can only be said to be 'strong' in specific and limited ways, if at all.

This is underlined by the fact that most forms of financial brand valuation, whether for sales or balance sheet purposes, start by looking at the brand's current sales and profit.

In one sense it is always true to say that a big, successful brand is a strong brand. But only in the tautological sense that we have made size and success our definition of strength. And this does not really help very much in addressing the management needs we explained earlier. What we are interested in is interpreting sales data so that it may tell us something extra about the brand's strength in a way that is not merely tautological.

The main possibility here is to define brand strength as the strength of consumer demand for our brand, relative to its competitors. 'Demand' and 'sales' will normally march in step, but not necessarily. In other words, we need to make some allowance for factors that might be influencing aspects of sales without actually improving consumer demand. The most important ones are price and distribution.

b) Brand Strength based on attempts to access the relevant beliefs, associations and attitudes that are in consumers' minds:

Our original explanation of the whole branding phenomenon put great emphasis on the meanings and associations that a brand can create in the mind of the consumer. So the obvious place to anatomise the strength of a brand should be the consumer's mind.

David Aaker of the University of California, Berkley, visualises each brand name as a box in the consumers brain, in which are stored away all the bits of information and associations to do with that brand. The whole box is then in turn stored with positive or negative feelings. This is as good an image as any, although like all metaphors for how the mind works it is likely to be too simplistic and therefore runs the risk of sometimes being misleading. It will serve however to introduce some basic categories of information that we can try to gather about what goes on in the consumers mind:

i. Awareness – whether there is a box for our brand there at all, or whether it is easy to find.

ii. Associations and beliefs – what's in the box? This is a big area in itself with many dimensions to it.

iii. Attitude – how the consumers feel about a brand, positive, negative, indifferent.

Each of these areas can be interpreted to tell us more about an aspect of a brand's 'strength.' You could say a brand is strong because many people have heard of it or spontaneously think of it; you could certainly say it is strong if many people express great loyalty or affection for it, in their words and actions. In between, a brand can be called strong if it is strongly associated with imagery or functional benefits that we interpret as desirable for consumers.

c) <u>Brand Strength based on attempts to estimate the brand's future performance and profit streams, and thus put a financial value on the brand as a corporate asset</u>:

There is, perhaps, a thin line between asking someone to rate a brand on 'quality' and asking them to express a degree of personal preference for it, but this represents a shift from the respondent's perception of the brand to one about their relationship with the brand.

Ultimately the bottom-line relevance of all the perceptual material described in the preceding section is that it somehow translates into consumer behaviour – it leads to them buying the brand, staying with the brand, perhaps paying more for the brand. It is possible to observe the results of this behaviour directly in the form of sales, but this alone still begs a question highly relevant to the original issue of brand strength; they may be buying our brand today, but how likely are they to go on buying it tomorrow? Are they simply buying out of habit and inertia, or so they actively value it and feel close to it? How easy would it be for a competitor to take away our sales?

What is being asked for here is a measure of the consumer's overall attraction to the brand. This is also commonly called 'loyalty', though as we shall see this can be defined in different ways. (It is worth thinking about what the word loyalty meant, before it was borrowed by marketing people. A 'loyal' follower of the King was not just one who fought on his side, but one who would resist bribes or threats to betray

him or run away. A 'loyal' football supporter goes to every game, home or away. A 'loyal' friend stands by you when others find a reason to desert you.) Or we could describe what we are looking for here as the consumer's 'attitude' to the brand, in the original and proper (dictionary) sense of the word:

'A mental and neural state of readiness, organised through experience, exerting a directive or dynamic influence upon the individual's response to all objects and situations with which it is related.'

Getting from Theory to Practice

It is easy to understand Feldwick's reservations about finding a simple connection between the different aspects of 'brand equity.' It is also easy to understand his reservations about the crudeness of turning complex and subtle brand measures into one financial number using brand valuation techniques.

However, in the real world we are only interested in brands and 'brand equity' to find persuasive connections which will allow reliable business valuations to be arrived at and sensible business decisions to be made

This is why such a huge effort is being made to find statistical relationships between the types of data we have been considering even if the relationships found are only persuasive rather than definitive. And despite the obvious problems with volatility and separability, brand valuation seems to provide the most practical framework for expressing the effect of those statistical connections back into the language of business and finance.

Brand valuations will only ever be credible if they are based on reliable forecasts, and reliable forecasts must be informed with statistical valid historical data relationships. When accompanied by sensitivity analysis they indicate the most likely parameters of a brand's performance. When forecasts are backed up with robust evidence, using for example, econometrics modeling data or correlation analysis, valuations become a credible addition to management decision-making.

In recognition of this, the use of market research tracking data to link 'soft' marketing measures with 'hard' financial measures is one of the fastest growing areas of market research.

Brand Equity Tracking Data

Marketing research tracking is an approach that monitors consumer perception of brands via sample based surveys.

In Europe, as in the U.S., there are three main sources of the 'brand equity' research:

i) custom design studies, offered by research supplier firms;
ii) advertising agencies, many of which have invested in the development and execution of 'brand equity' research;
iii) proprietary system, developed specifically for the purpose of measuring brand equity, by suppliers with a particular commitment to this field of research.

A custom design study may indeed be a viable option in some circumstances. The unique focus and approach prevents us from providing examples in this presentation – indeed, descriptions are often unavailable due to the confidentiality of buyer-supplier agreement.

Advertising agencies' knowledge and systems are generally not openly marketed, but rather, restricted to current clients or advertisers somehow linked to an agency. Although this applies to research conducted by Young & Rubicam, extensive description of their research has been made available for general review. A summary description of Y&R's Brand Asset Valuator research illustrates the contribution being made by advertising agencies.

Proprietary systems are represented by:

- **Brand Dynamics™** (Millward Brown)
- **EquiTrend™** (Total Research)
- **Brand Equity Ten** (David Aaker)

It should be noted that the following descriptions were provided by the agency, research firms or individuals concerned and are not the opinions of either Brand Finance or the EAAA. They are included as a showcase of Brand Equity approaches.

Young & Rubicam: BrandAsset™ Valuator (BAV)

Y&R decided upon a knowledge acquisition strategy that would enable the firm and its operating companies to provide clients with the best brand-leverage opportunities. As part of the implementation of the strategy, the largest worldwide surveys of consumer brand perceptions were undertaken in the Summer of 1993 and Spring of 1998.

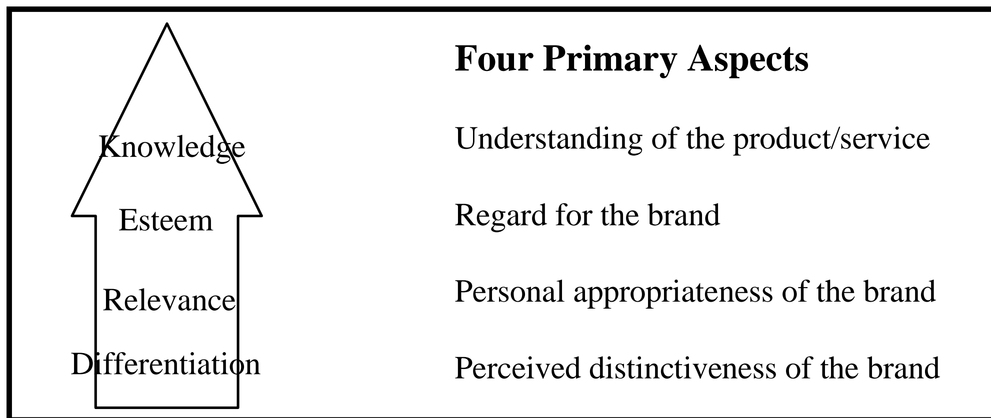
HOW BRANDS ARE BUILT

The process of building brands, BAV demonstrates, is reflected through a progression of four primary measures:

- Differentiation
- Relevance
- Esteem
- Knowledge

These measures are used in BAV to evaluate current brand performance, to identify core issues for the brands, as well as to evaluate brand potential.

Brands can be evaluated by these individual measures. But more important, the relationships between the pillars show the true picture of a brand's health, its intrinsic value, its muscular capacity to carry a premium price and its ability to fend off competitors.



DIFFERENTIATION IS FIRST

The starting point for all brands is Differentiation. It defines the brand and distinguishes it from all others. Differentiation is how brands are born.

As a brand matures, BAV finds that Differentiation often declines. It doesn't have to happen. Even after reaching maturity, with good management, a brand can perpetuate its Differentiation. A low level of Differentiation is a clear warning that a brand is fading.

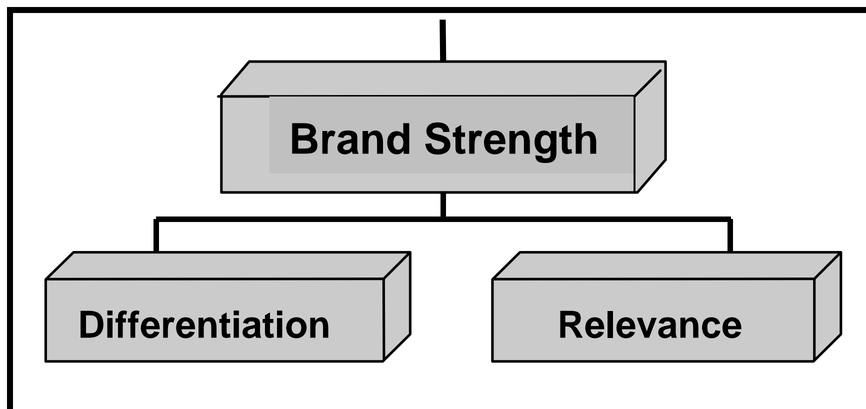
RELEVANCE COMES NEXT

Differentiation is only the first step in building a brand. The next step is Relevance. If a brand isn't relevant, or personally appropriate to consumers, it isn't going to attract and keep them - certainly not in any great numbers.

BAV shows that there is a distinct correlation between Relevance and market penetration. Relevance drives franchise size.

BRAND STRENGTH

A brand's Relevance and Differentiation viewed in relationship represent Brand Strength, which is a strong indicator of future performance.



Relevant Differentiation - remaining both relevant and differentiated - is the central challenge of every brand. It is critical for all brands all over the world.

THE BASIS OF ESTEEM

BAV's third primary measure is Esteem - how much consumers like a brand, hold it in high regard. In the progression of building a brand, it follows Differentiation and Relevance. It's the consumer's response to a marketer's brand - building activity.

Esteem is related to two factors:
Perceptions of quality and popularity and the proportions of these factors differ by country and culture.

BAV tracks the ways in which brands gain Esteem, that helps us consider how to manage consumer perceptions. Through BAV, we can identify opportunities for leveraging a brand's Esteem.

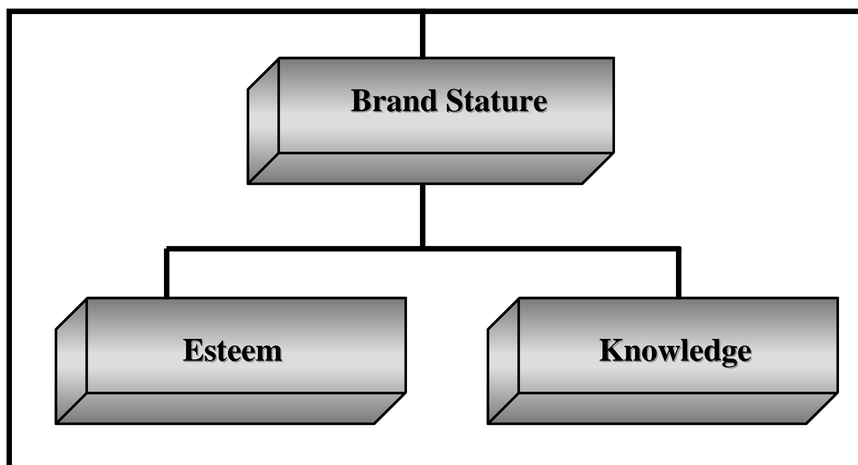
KNOWLEDGE IS THE SUCCESSFUL OUTCOME

If a brand has established its Relevant Differentiation and consumers come to hold it in high Esteem, Brand Knowledge is the outcome and represents the successful culmination of building a brand. Knowledge is not a consequence of media weight alone. Spending money against a weak idea will not buy knowledge. It has to be achieved.

BRAND STATURE

As Brand Strength was found between Relevance and Differentiation, Brand Stature is discovered in the combination of Esteem and Knowledge.

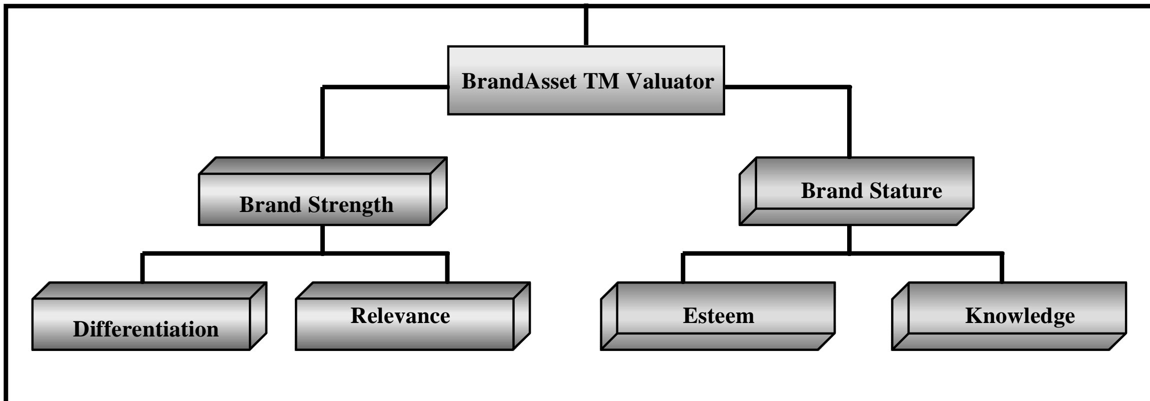
Brand Stature indicates brand status and scope - the consumers response to brand. As such, it reflects current brand performance and is a strong strategic indicator. For example, Esteem rises before Knowledge for a growing brand. If the data shows the opposite relationship, a problem has been identified.



RELATIONSHIPS TELL THE STORY

By plotting all four measures - Differentiation, Relevance, Esteem and Knowledge - BAV serves as an exceptional diagnostic tool for building and managing brands.

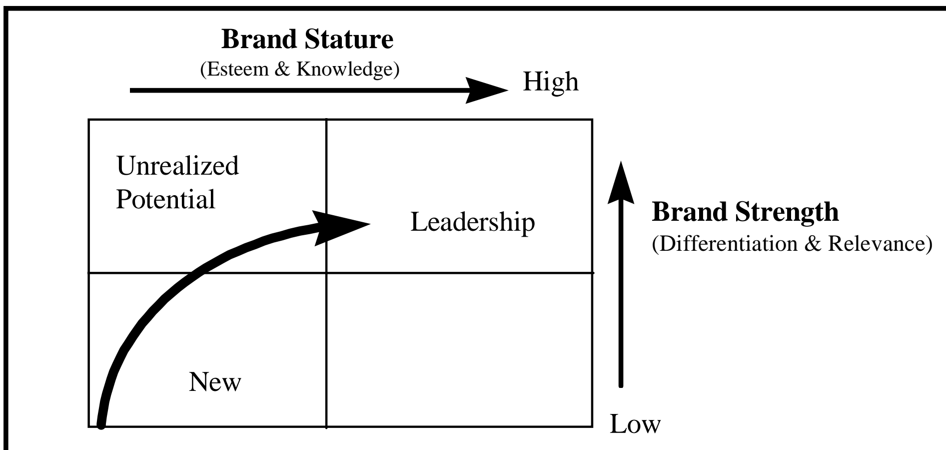
BAV's Power Grid sets the strategic process in gear by showing the strengths and weaknesses of a brand. It identifies the strategic direction to maximise brand strength and helps clarify the role of elements in the marketing mix.



THE POWER GRID

On the vertical axis, we plot each Brand's Strength - its level of Relevant Differentiation. Along the horizontal axis, we plot each brand's current Stature - its Esteem and Knowledge levels.

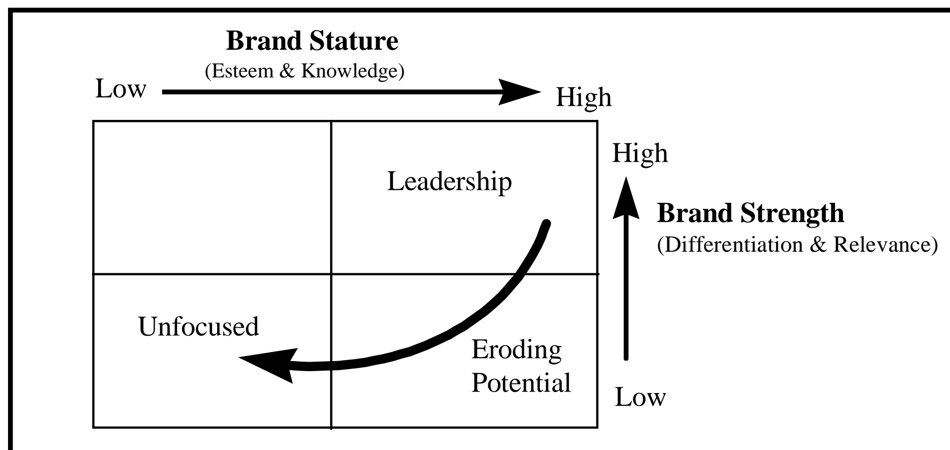
Brands begin life in the lower left corner, where they first establish their Differentiation, their reason for being. Most of the movement here is upward. The process of growth starts with Differentiation, then Relevance, while the brand is not yet held in Esteem or is not widely known.



Enough Strength boosts the brand into the upper left quadrant. This quadrant represents the potential for a brand. Strength is still building and the challenge here is to translate this Strength into Stature for the brand.

Brands can stay in the upper left quadrant, establishing themselves as successful niche players. Or from this position, a brand can launch its attack. From a marketer's standpoint, it is also an area of yet unrealized potential. Current brand leaders need to recognize the brands in this quadrant as their emerging competition.
The upper right area is populated by the brand leaders. The strongest brands are here, those with megabrand potential and, in many cases, the megabrands themselves. A key finding of BAV is revealed in the Power Grid. Both older and relatively younger brands are found in this upper right quadrant. The implication is tremendous - brands can hold a position of power, virtually forever, if managed properly.

Finally, the bottom right quadrant is the trouble spot for brands, and an indicator of eroding potential. These brands have failed to maintain their Relevant Differentiation, their core Strength. If unattended long enough, their stature will begin to fall and the franchise decline.



BAV points out the wisdom of looking at brands in the entire brand landscape, which will lead us to consider new possibilities for the brand, rather than risking the dangers of a narrow vision of the category. The overreaching truth here is that, properly managed brands can exist eternally. And BAV gives us the diagnostic framework to help our clients build, leverage and maintain the power of their brands.

Millward Brown: BrandDynamics™

BrandDynamics™ measures and explains a brand's **consumer equity -** consumers' predisposition towards a brand as distinct from other factors that contribute to the brand's financial equity (eg distribution strengths, production efficiencies, patents etc). BrandDynamics™ provides both consumer equity measurement and the diagnostic understanding to inform tactical and strategic decision-making. BrandDynamics™ is built on over 20 years of continuous brand health tracking research and 18 months of R&D investment. Key measures are **validated against sales**.

Launched in 1996, customised BrandDynamics™ studies have been completed over 1300 brands in 15 categories across 19 countries. In 1998 one single study looked at 8-10 brands in each of 50 categories in 7 countries around the world - providing a data base on over 3500 brands by markets.

How does BrandDynamics™ work?

For each brand the system has two key components - Consumer Value, which is a measure of the sales value of **each** respondent to the brand, and the Brand Pyramid which is a systematic way of diagnosing the factors driving that value. Both are derived from a proprietary set of questions asked within a short survey interview among a random sample of category users.

Consumer Value

This is a research-based measure, built on 4 key components:

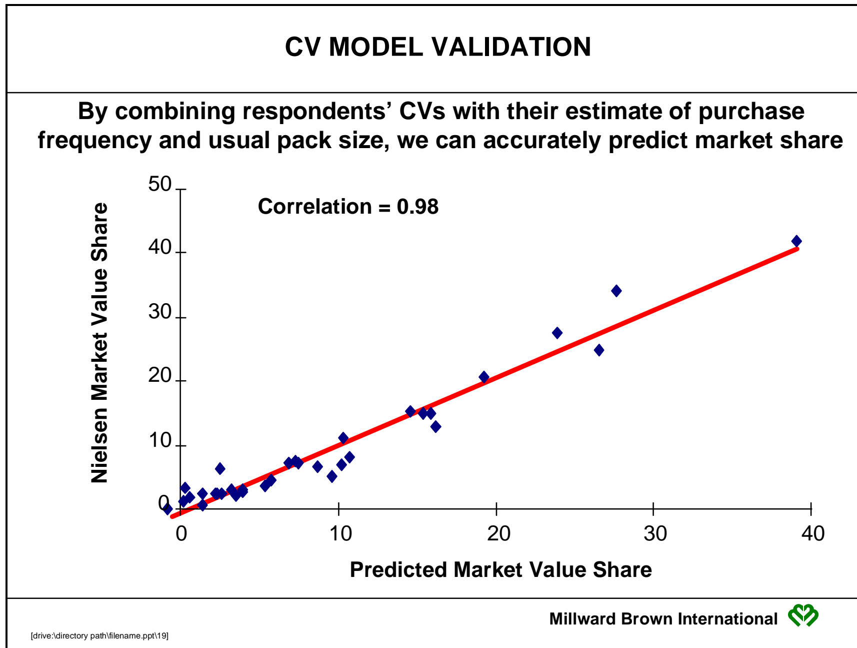
- The consumer's predisposition toward the brand - their likelihood of purchasing that brand next, share of requirements (for packaged goods)

- The size of the brand - big brands achieve more sales for any given level of consideration (i.e. consumers' consideration 'underestimates' actual purchasing of big brands)

- The type of consumer - Are they more attitudinally disposed to brands, or do they see the category as a commodity where price is the key issue?

- The brand's relative price (i.e. consumers' consideration 'overestimates' actual purchasing of expensive brands)

These four factors can be combined together in a model to predict the likelihood of **each** consumer buying the brand - a respondent level prediction of brand loyalty. Then category expenditure data is added to provide consumer value - which is strongly correlated with value market share.



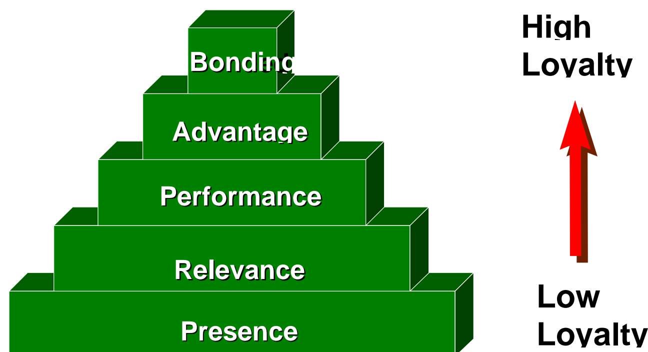
For categories where sales data are unreliable or unobtainable, Consumer Value is of significance in its own right as a valid indicator of sales. Some clients place more faith in consumer value than market share, which can be distorted by promotions.

Brand Pyramid

The importance of having a validated, respondent-based measure is to explain why some consumers are more valuable than others. This is done via five equity building blocks which form a Brand Pyramid. Consumers at each level of the Brand Pyramid can be targeted via advertising and other marketing activity. **BrandDynamics™** provides specific and practical diagnostics-driven marketing guidance.

BrandDynamics™ PYRAMID

The Brand Pyramid is the framework for defining how consumers relate to brands



[c:\andy aequity 7] Millward Brown International

Presence
The first step is to stimulate active knowledge of the brand - Presence. By active knowledge we mean unaidedly aware, have tried brand, or an endorsement of the brand on key image dimensions which show they have an understanding of what the brand promises.

Relevance.
To get to the next level the consumer has to feel that the brand could meet their needs - and do so at an acceptable price for them. Relevance can be thought of as a hurdle that the consumer has to pass over before a stronger relationship with the brand can be developed.

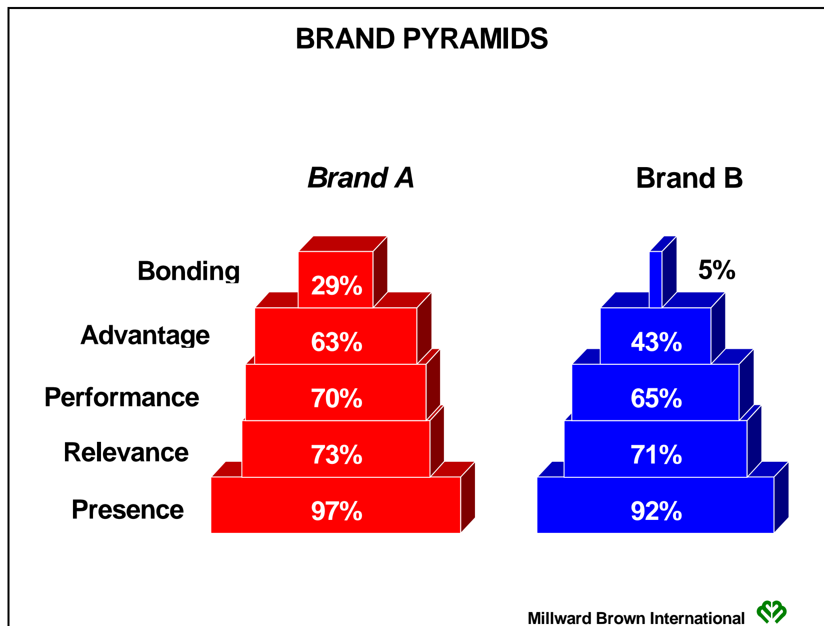
Product Performance
The brand does not have to be better than its competitors. But it does have to offer an acceptable level of product delivery. If a brand has a genuinely superior product **and** consumers are aware of this, then this will form a brand advantage.

Advantage
Many brands may be acceptable, but for the brand to be more valuable to the consumer it needs some form of 'perceived advantage'. This can be a direct extension of some unique aspect of the product delivery, however in many categories brands have little genuine product differentiation. For these brands, softer aspects such as saliency, emotional appeal, personality and popularity can provide the advantage.

Bonding
The more the consumer feels that the brand is the only one that offers key advantages within their repertoire, the greater the bond between the consumer and the brand, and the more loyal they are likely to be.

Using BrandDynamics™ to inform Strategic Decision-Making

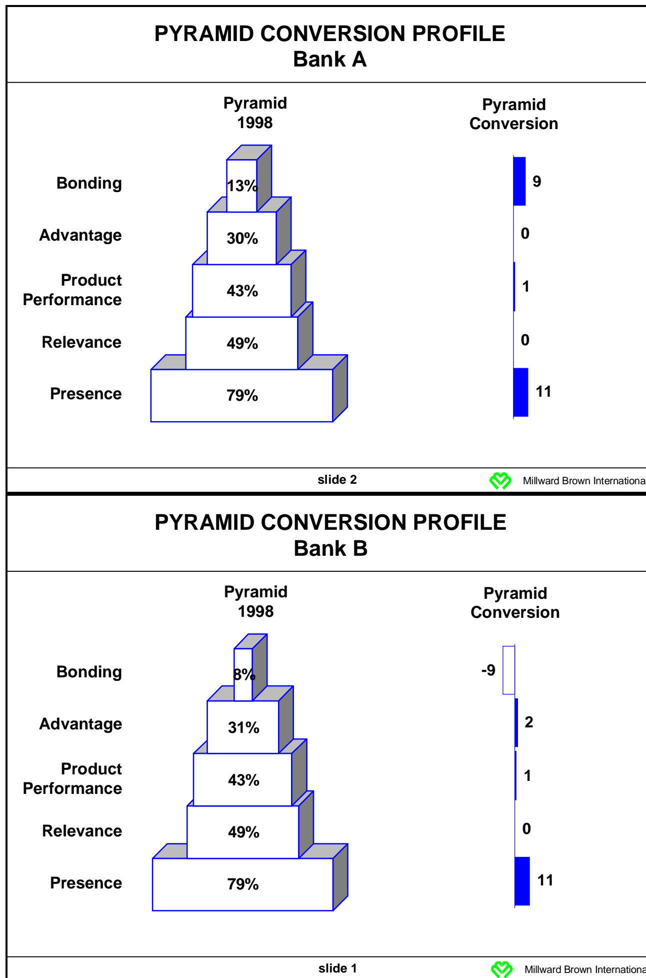
The pyramid is the starting point for the analysis of the brand's strengths and weaknesses. For example, we can see below that Brand A has a similar level of presence, relevance and product acceptability as Brand B, but has higher advantage and much higher bonding.



This is a useful finding, BUT as with most marketing data relating to brands, we have to remove the brand size effects to uncover the brand's core strengths and weaknesses. We do this via a profiling technique at the category level. This technique produces a strength and weakness analysis for each brand by comparing the conversion from each level up the pyramid with the other brands in the category.

This is the start point for understanding the strategic options available to the brand and it is a key input to measuring BRAND STRENGTH (described shortly).

While the overall pyramids for these two banks look quite similar, the conversion profiles reveal stark differences - both of which reflect their recent communications programs. Bank A has communicated its appreciation for its core customer's business and how it is working to make banking easier for them. Bank A enjoys higher levels of Bonding.



Bank B concentrated its communication on overall bank visibility leaving itself with fewer Bonded customers - current customers felt neglected by the communications. Is this important? Bank B has a much higher rate of past to present customers than Bank A; it has been much less successful in keeping its customers.

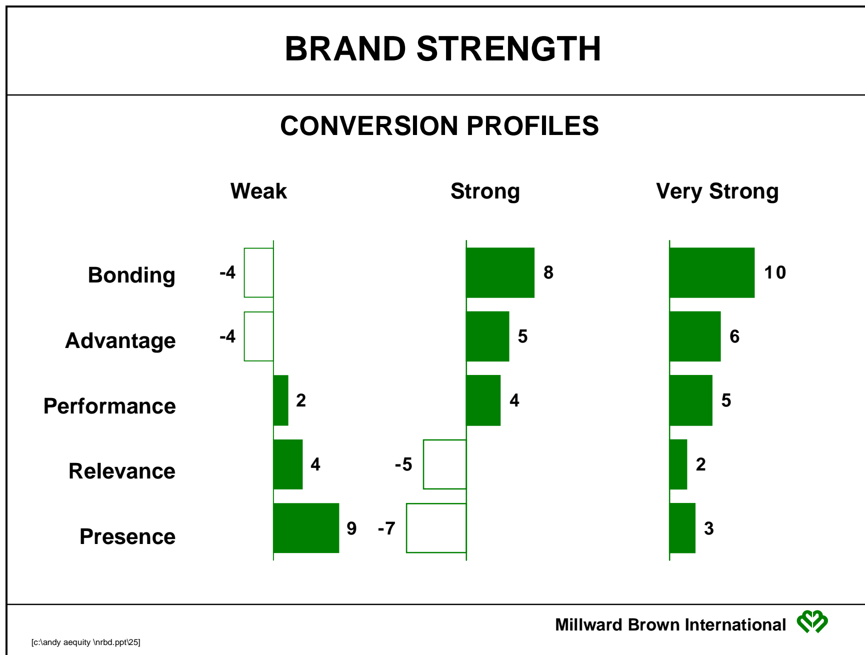
Source of Revenue

Does position in the Pyramid matter? Certainly. As might be expected, Bonded consumers typically generate a disproportionate share of the brand's revenue. In the example Brand A's revenue comes primarily from Bonded and Advantage groups.

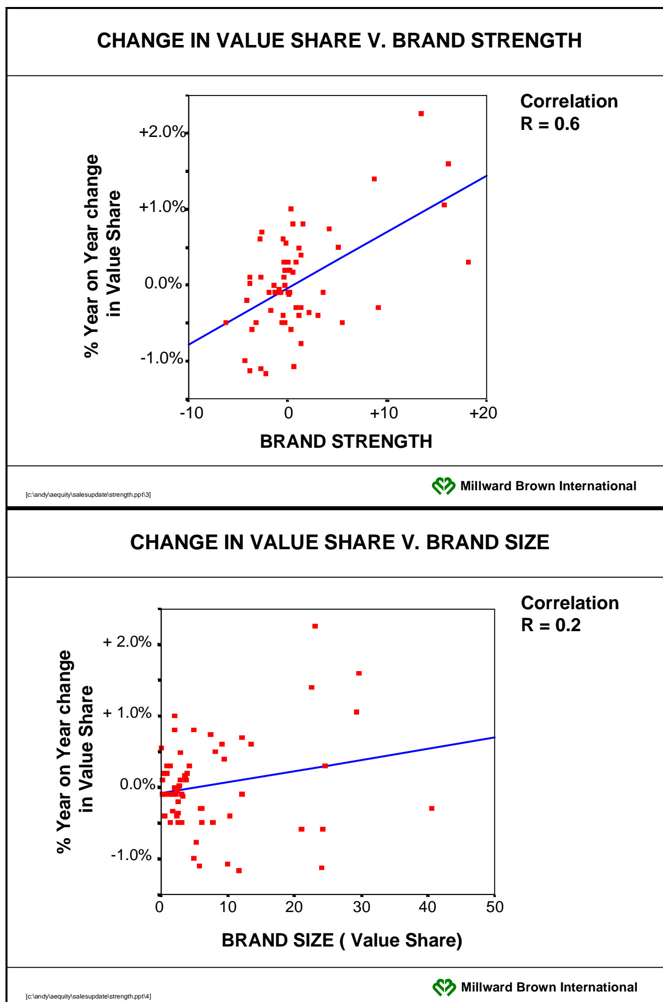
Brand Strength

Future revenue is an important component of a brand's equity; it demonstrates how a brand's market share is underpinned by the consumer's predisposition toward certain brands. While Consumer Value tells us about the worth of the brand now, it is not a measure of market share robustness, i.e. brand strength. However, a brand's conversion profile does provide a measure of its relative strengths and weaknesses.

Based on the results from the initial BrandDynamics™ studies, three main types of pyramid profiles were observed. These are shown below. The profile on the left shows the brand to have relatively high presence and relevance, but relatively low advantage and bonding. In contrast, the middle profile shows the brand to be low at presence and relevance - but once past these hurdles to have a relatively high conversion to performance, advantage and bonding. The third profile is one where the brand is positive all the way up the pyramid (with the possible exception of relevance) - particularly at performance, advantage and bonding.



This pattern is significant because brands with the left-handed profile tend to be brands which have been declining, brands in the middle tend to be new (and hence gaining share) or niche (often able to command a premium), and those with right-hand profile tend to be brand leaders. It makes intuitive sense that brands with relative strength toward the top of the pyramid, and hence a stronger relationship with their consumers, would over time fare better in the market place. And indeed when we score this profile with a higher weighting (ie based on the consumer loyalty of respondents at each level) to the pyramid levels toward the top, we find that it does have a clear correlation with share change. A correlation which does not exist for brand size.



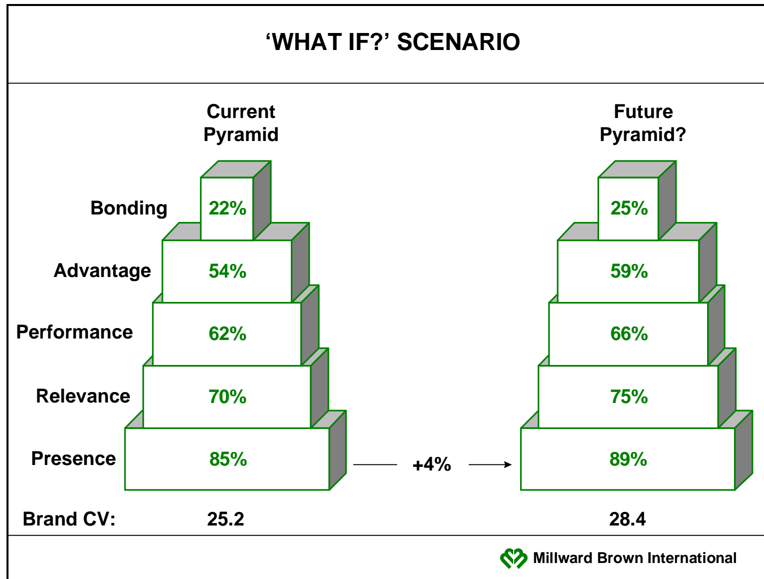
In summary, the BrandDynamics™ conversion profile provides the basis for a consumer-based measure of brand strength. This measure can be shown to have a positive correlation with changes in future value share. This provides clear evidence that brands which consumers feel to have either rational, but more often emotional or saliency based, advantages in the category are likely to be worth more to their owners in the future than ones which are bought purely on the basis of availability. This provides continued evidence for the value of long-term brand-building activity.

'What if' Scenarios

One of the key tools for strategic decision-making is being able to play 'What if' scenarios. Over the past six months MBI have been developing a sophisticated micro model based on the raw inputs to the Brand Pyramid. This model allows the user to examine the impact of changing each of the equity building blocks such as trial, saliency or emotional appeal. For each change the model will estimate the expected change in the Brand Pyramid, Consumer Value (and by extension underlying brand share), brand strength.

One of the key features of this system is that the model uses the relationships in the data for your brand, rather than assuming that it is like all the other brands in the category.

The following chart shows the effects of a 4% increase in Presence and how the pyramid levels change as well as the increase in CV (which in turn would be equivalent to share increase).



Based on this kind of "what if" analysis and detailed diagnostics to guide marketing investments, clients have been able to successfully grow market share, as predicted. We are starting to use BrandDynamics™ to look at mergers and to provide marketing budget guidelines. With these kind of metrics, effectively managing brand equity is becoming possible.

Summary

BrandDynamics™ provides both a validated measurement of consumer equity and the diagnostic understanding to inform tactical and strategic decision-making. And, it does this in a way that is readily accessible to senior marketing professionals.

EquiTrend™ (Total Research)

Total Research's "EquiTrend™" brand equity tracking survey is based on a small set of questions designed to gauge consumers' opinion of a wide range of consumer brands. The 1998 UK EquiTrend™ survey involved 1,000 respondents who gave their opinion on 120 brands across 24 product and service categories.

How does EquiTrend™ work?

The EquiTrend™ method is based on measuring three facets of brand equity.

The first of these is **Salience,** or brand knowledge as it is more frequently referred to now and is specifically a measure of the overall quality of a brand. It is more insightful than awareness, in that it says "I know of the brand and it has communicated a message to me about its quality, whether that is good or bad". It is a derived measure arising from the quality perceptions question.

Perceived Quality is measured on a scale which grades consumer reactions to quality on an 11 point scale. The top score grades a brand as "outstanding", the lowest as "unacceptable".

Finally, **User Satisfaction** focuses on the opinion of consumers who buy the brand most. It is possible for a brand to be a long way down the list in overall perceived quality, but high in user satisfaction, which measures a particular user group.

EquiTrend™ is an ongoing study of brand equity. In the US there have been more than twenty waves of research dating back to 1989. The model is designed to help companies build brand equity.

Total Research feels that its model provides great sensitivity, and points out that the results have been stable year on year.

A process called TRBC (Total Research Bias Correction) enhances and refines the data collected to make it 50% more accurate and predictive of market behaviour. No other brand equity measurement approach uses the TRBC process. A great deal of market research "information" is actually scale bias treated as fact. Scale bias can have a tangible effect on results. For example, on a scale of 0 – 10, a response of 7 from one individual may express the same truth as a response of 10 from another.

On the international stage the Japanese are very disinclined to use the extremes of a scale and therefore express their views within a narrow band of the scale; the Italians tend to use the top end of scales and the Scandinavians are relatively "mean" scorers. Middle aged people tend to be more "mean" in their scoring than younger and older people, and females tend to score higher than men. The extent of the difference is often significant.

A survey of frequent business travellers across Europe, conducted by Total Research, showed that response bias accounted for as much as 1.2 points on a ten point scale when comparing results in Scandinavia (0.69 points lower than the European average) and Italy (0.47 points higher than European average). The implications of this are

significant in that, at worse, "raw" data can be misleading, and at best, comparisons within the data cannot be reliably interpreted as true differences of opinion. The TRBC technique enhances the value of the information through removing bias from raw data by taking into account the different levels of critical awareness of individual respondents, their age and gender.

Since EquiTrend™ has been carried out regularly since 1989, it is possible to understand the current performance of brands and also how brand equity changes over the years.

By observing the way that consumers judge hundreds of properties, it is possible to model their judgement process and create segments of people who have a similar way of judging brands and defining brand quality. These are "psychographic" segments enhance the ability of brand owners to distinguish the reasons why certain people approve of certain brands and dislike others, and offer clear cut direction for improvement in brand equity.

A predictive tool

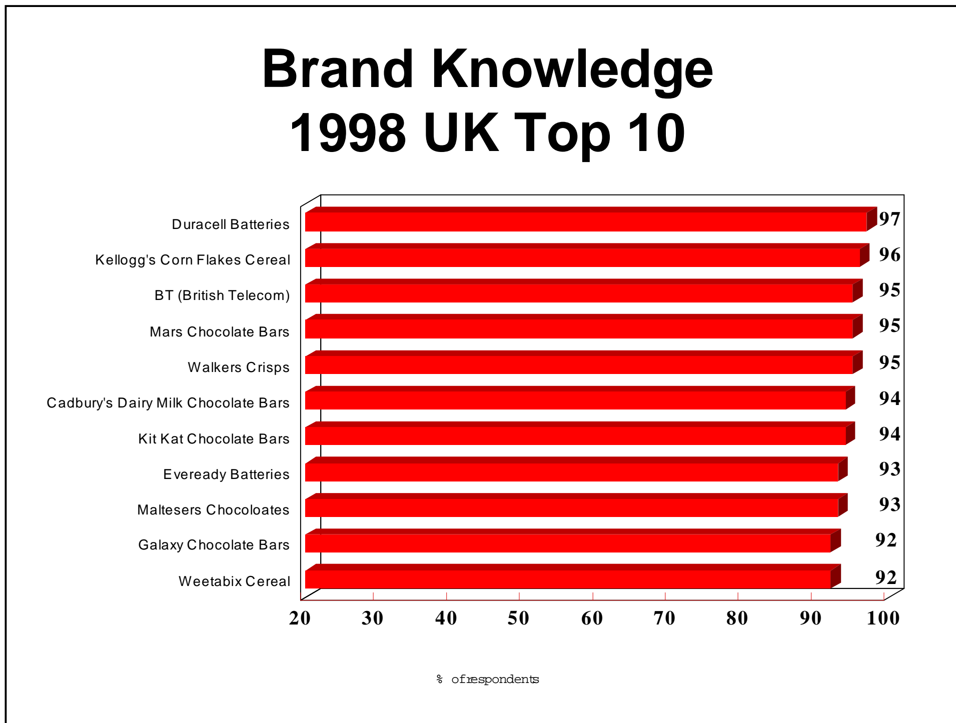
Longitudinal studies suggest that the EquiTrend™ overall quality measure is both predictive of brand loyalty (people with higher perceived quality tend to stay with a brand) and acquisition of new users (high perceived quality for a non-user is predictive of future usage).

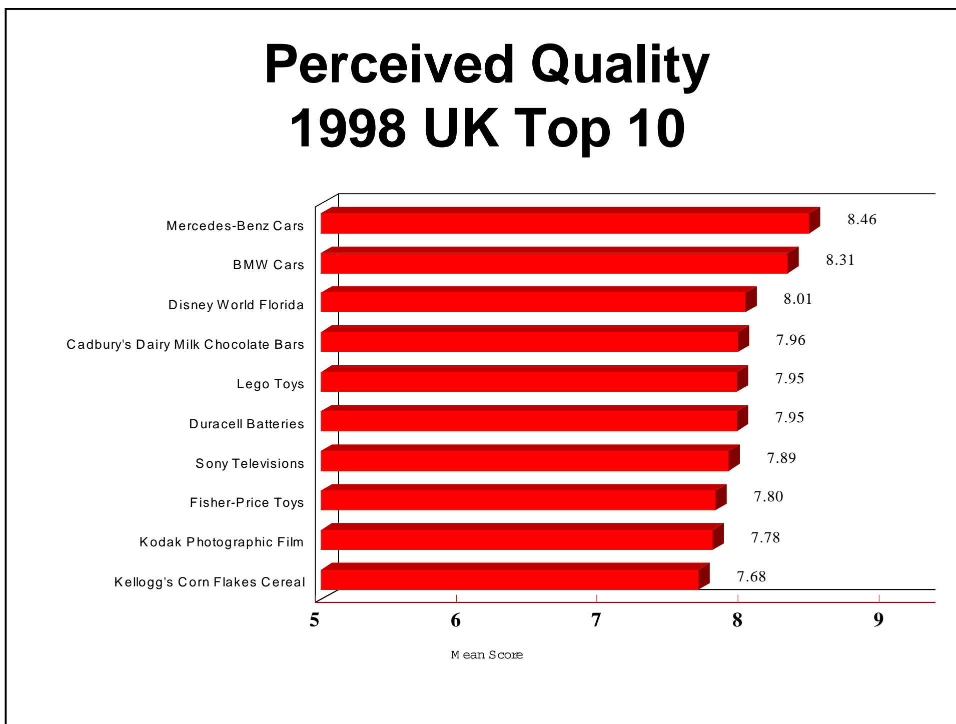
David Aaker of the University of California, Berkeley has also documented a strong relationship between changes in EquiTrend™ measurements and changes in corporate stock returns. For every wave of the twenty-plus waves of EquiTrend™, there has been a correlation between wave-to-wave changes in flagship brand perceived quality and concurrent changes in corporate stock prices. Academics at the Kellogg Graduate School of Management are now trying to tie changes in EquiTrend™ scores to changes in corporate earnings.

Improving brand equity

EquiTrend™ has a set of twenty-four brand personality scales that are very effective at diagnosing why a brand's equity is good, bad, or indifferent. These provide clear guidance on specifically how a brand's equity can be improved.

Total Research publishes an annual league table of brand performance. Perceived quality is acknowledged as the "core measurement" for these results.


Brand Knowledge
1998 UK Top 10
Duracell Batteries
Kellogg's Corn Flakes Cereal
BT (British Telecom)
Mars Chocolate Bars
Walkers Crisps
Cadbury's Dairy Milk Chocolate Bars
Kit Kat Chocolate Bars
Eveready Batteries
Maltesers Chocoloates
Galaxy Chocolate Bars
Weetabix Cereal
97
96
95
95
95
94
94
93
93
92
92
20
30
40
50
60
70
80
90
100
% of respondents


Perceived Quality
1998 UK Top 10
Mercedes-Benz Cars
BMW Cars
Disney World Florida
Cadbury's Dairy Milk Chocolate Bars
Lego Toys
Duracell Batteries
Sony Televisions
Fisher-Price Toys
Kodak Photographic Film
Kellogg's Corn Flakes Cereal
8.46
8.31
8.01
7.96
7.95
7.95
7.89
7.80
7.78
7.68
5
6
7
8
9
Mean Score

Summary

Total Research feels that "EquiTrend™ combines uniquely accurate, sensitive, and valid information on brand equity with strategic analytical power not ordinarily found in a syndicated piece of research. It is for companies that want to know what their brand equity really is and want to know how to understand and improve that equity. EquiTrend™ allows this by avoiding insensitive scale scores loaded with research biases and artefacts."

In "Building Strong Brands" David Aaker has the following to say of Equitrend™

"EquiTrend™, developed by Total Research, provides a nice contrast to the Young & Rubicam Brand Asset™ Valuator. Much more parsimonious, EquiTrend™ is based on a small set of simple yet powerful questions. Although limited in scope compared to the Y&R study, EquiTrend™ has developed data over time that greatly enhance its ability to make judgements about the dynamics of brand equity and its effects. Its annual survey of 2,000 respondents started with 133 US brands, and by 1995 covered over 700 brands in 100 categories."

The Brand Equity Ten (David Aaker)

David Aaker, Marketing Professor at the University of California, Berkeley, advocates a flexible approach to brand equity evaluation, which he calls the **Brand Equity Ten**.

He identifies what he believes to be the 10 key aspects of brand performance, which illustrate the components of brand strength. He recommends that brands should be scored against the following template:

Loyalty Measures

1. Price Premium
Measuring the additional price that consumers are prepared to pay for a brand. For example, a structured questionnaire may be used to establish the relationship between cost and stated consumer preference for a number of similar goods. Or empirical evidence may be available to demonstrate from historical data the actual relationship.

2. Satisfaction/ Loyalty
Researching the customer's level of satisfaction with a brand and the level of price sensitivity allows the market to be segmented into "loyal users, price chasers and those in between."

Perceived Quality/ Leadership Measures

3. Perceived Quality
Statistical models can be used to correlate perceived quality and financial measures such as returns on investment and stock return. The changes in perceived quality scores can be measured across a variety of different sectors, allowing a comparison of relative brand health.

4. Leadership/ Popularity
Leadership scales attempt to measure whether the brand is "a category leader, is growing more popular or is respected for innovation".

Associations/ Differentiation Measures

5. Perceived value
This measures whether a brand represents value for money and whether consumers have a reason to choose one brand over its competitors. In the latter sense it is a similar measure to perceived quality.

6. Brand Personality
This is a particularly important factor where there are apparently only minor functional differences between different brands in a market. Brand personality "says something" about the consumers of different brands. The soft drinks market is an example of this. There may be little discernible difference in taste between Pepsi and Coca Cola, so the marketing functions in each company concentrate their efforts upon differentiating the products through image.

7. Organisational Associations

Brand strength often goes beyond the product brand to the corporate brand which underlies it. For example, companies might seek to gauge how consumers react over time to statements such as:

- This brand is made by an organisation I would trust.
- I admire the brand X organisation.
- I would be proud (or pleased) to do business with the brand X.

Awareness Measures

8. Brand Awareness

A simple measure of the distinctiveness of a brand's personality and the effectiveness of its advertising and communication campaigns. Loyalty and purchase build from this platform. Performance relative to competitor brands is a key indicator of brand health.

Market Behaviour Measures

9. Market share

Measuring a brand via market share can be a clear indicator of consumers' perceptions and satisfaction with that brand. A falling market share is usually a good indicator that the brand is slipping in the consumers' estimations, although distinctions clearly need to be made between volume and value share.

10. Market Price and Distribution Coverage

Brand strength can be measured by distribution percentage. Unlike market share these measures are easier to define and are less subject to short term blips that may be caused by price promotions. Measures like the percentage of shops stocking the brand, and the brands accessibility to the percentage of consumers, are often used to judge a brand's performance.

Aaker's recommended approach to brand equity evaluation, outlined in more detail in his recent book *'Building Strong Brands' (The Free Press)*, focuses principally on consumer-oriented measures of brand strength, although it also looks at market oriented measures.

He recommends that brand owners seeking to evaluate the historical and future performance of their brands should adopt a flexible and pragmatic approach to brand equity evaluation.

He acknowledges the difficulty of defining one simple, single score or measure of Brand Strength. He is not prescriptive about the weightings or scores which should be applied to each attribute but recommends that brand management should tailor the general approach to its own specific circumstances.

Aaker is persuasive in his advocacy of the **Brand Equity Ten** and it is hard not to endorse his mixture of attitudinal, behavioural and market measures of brand equity.

A balanced approach

As we have seen there are many different proprietary approaches and systems for measuring 'brand strength' and 'brand equity'. We have considered a handful in detail but there are numerous other, less well known approaches. Their validity is to a great extent dependent upon the nature, complexity and structure of the market, whether it is a Consumer or Business to Business market and whether the product or service is a frequent or an infrequent purchase.

In 'fast moving consumer goods' markets consumers tend to have a repertoire of brands, which are often almost interchangeable and the 'share of requirements' for a particular brand may vary for a whole range of relatively unpredictable reasons. By contrast, in many financial or 'durable goods' markets purchase frequency is very low and inertia is a massive influence on sales.

With many of these studies the number of respondents limits segmentation of the sample results while timing of the research can affect the validity of the conclusions.

Therefore, there is no one brand equity tracking model which is a "world beater" in all categories. Before approaching the consultant involved, the client should consider a number of factors.

- Why the final information is required
- The level of detail of the information required
- The timescale in which the information is required
- Whether static or rolling data is required
- The amount that they are prepared to spend on the report
- The level of reliance they are prepared to place on the results

The key to success of the models described is arguably to marry simplicity and user-friendly results with a detailed and intensive information gathering engine. Category segmentation is a key. The ideal model inevitably analyses a brand's strength by segment i.e. by geography, by lifestyle, by personality or by organisational associations.

Paul Feldwick and David Aaker are right in saying that there is no simple measure of 'brand equity'. There are several measures which, taken together, inform management decision-making. What major companies are beginning to realise is that all of the various measures need to be gathered, reviewed and prioritised in a structured brand audit and considered as a whole in the brand evaluation process. Data needs to be statistically analysed to find persuasive if not definitive relationships, which can be tested empirically.

Amongst these measures there is a place for the consumer-oriented approaches like Y&R's Brand Asset™ Valuator or Total Research's EquiTrend™. There is also a place for the type of financial analysis and framework pioneered for balance sheet valuations.

Techniques have been developed and refined to produce robust brand valuations. There remains a need for credible disclosure of assumptions used, and for detailed accounting disclosure when valuing for financial reporting purposes. However, to a large extent the accounting debate has masked the other uses brand valuation techniques can be employed for, such as brand building.

Inevitably there have to be strong commercial reasons for the development and use of brand valuation methods. More importantly clients seem to agree and many are building monitoring and forecasting systems incorporating brand equity measures and brand valuation techniques.

The search for a perfect solution goes on.

Appendix 1

Brand Valuation Case Studies

1. <u>DALGETY PLC AND FELIX CAT FOOD</u>
Using brand valuation techniques for balance sheet reporting

When Dalgety acquired the European Petfood business of Quaker Oats, it paid £465m for net assets with a combined value of £116m. It was clear that the difference between these amounts was split between goodwill and the value of the Felix brand of cat food. To reflect the true substance of the acquisition it was Dalgety's intention to carry the brand value as an intangible asset on its balance sheet.

"How can we value the brand?" was the question the board was faced with. In 1995 the publication of the Accounting Standard Board's Financial Reporting Standard 10 was a long way off and the debate on carrying intangibles in company balance sheets raged on. This left Delgaty's senior financial staff with the initial obstacle of collating information that would provide a starting point for the valuation process.

Database and library facilities provided one source of information. Dalgety used other sets of company accounts that included brands on their balance sheets in order to establish a potentially suitable wording for the accounting policies. At the time these included Grand Metropolitan and Cadbury Schweppes. Dalgety also turned to its auditors for advice on the subject.

Interestingly a straight Net Present Value method of valuation was rejected in favour of a multiple method. It was not the board's aim to include future cash-flows in the valuation, a method they felt would reflect Dalgety's ambitions and intentions for the brand. The company's main concern was simply to include a valuation, which was as near as possible to the historical cost of the brand at the date of purchase. The Net Present Value method, however, was employed in impairment testing, management feeling that NPV represented a "net residual value" and would therefore fit with the requirement to show assets at the lower of cost and net realisable value on the balance sheet.

Owing to practical factors such as time constraints and materiality, the decision was taken to value only the significant brands in Dalgety's portfolio. Many of the brands that had been purchased in previous years were acquired at costs so eroded by inflation that capitalising them was not regarded as a worthwhile exercise.

A significant influence on Dalgety's thinking was what it felt was the need to keep things as simple as possible. A Net Present Value calculation was performed as a reasonableness test to ensure that the initial value ascribed to the brand was realistic. The danger of producing an overvalued brand in the first year was the potentially damaging effect on profit that would be caused by corrective impairment reviews in subsequent years.

Producing a valuation for the balance sheet represented only half of the battle. To include Dalgety's assumptions and valuations in the year end accounts meant

convincing the auditors that the "truth and fairness" of those accounts was not compromised.

In order to achieve this Dalgety provided the auditors with information on its non-capitalised brands. The company included in the notes to the accounts that a brand could be disposed of separately. Evidence was also produced for the auditors concerning the valuation of the brand carried on the balance sheet.

The valuation issue had been a thorny one for Dalgety to tackle as the process was fraught with a number of difficulties. A key problem was the allocation of overheads to particular brands, especially as individual brands were not manufactured at exclusive sites. Similarly, the structure of the impairment tests and the underlying assumptions behind them had to be considered carefully with Dalgety's intentions for the future development of the brand borne in mind.

An impairment test only requires an intangible asset to be written down in value when it is assumed that the value of that asset has fallen during the financial period. As the asset is written down the company suffers bares the cost in its profit and loss account.

It was the practical rather than the theoretical issue, which posed problems for Dalgety. The source for the impairment test numbers was the extraction of brand cash-flows out of the strategic plan. These figures where then traced back into the board-approved plan documents. A clear audit trail would also provide the external auditors with sufficient evidence to test the figures calculated.

Ultimately Dalgety saw the impairment review as the greatest risk associated with capitalising a brand. The effects on profit of an impairment review for any company can be dramatic, especially if the brand carried is subject to volatile movements in valuation.

Once an accounting policy is suggested it is very difficult to deviate from that treatment, which is a problem when considering the purchase of new brands. Dalgety felt that what was a suitable policy for Felix may not necessarily have been the best policy for a future brand acquisition.

On the positive side, the capitalisation of brands dramatically improved balance sheet gearing. The June 1996 accounts revealed that the inclusion of the brand reduced gearing from 100% to 67%. In terms of increasing stakeholder awareness the move was a success.

2. CADBURY SCHWEPPES

Using brand valuation for internal communications

Back in the acquisition hungry days of the late 1980's Cadbury Schweppes, the confectionery and beverages group, was a major player. In 1989 alone the group made twelve separate acquisitions for a gross outlay of £718m.

This impacted on the group in several ways. Firstly, Cadbury Schweppes succeeded in increasing its sphere of influence in the world of branded goods by extending its portfolio in a frenzy of take-over activity. Secondly, the group balance sheet was heavily effected by the substantial cash outlay this level of activity naturally involved.

Without capitalisation of intangibles, the Cadbury Schweppes balance sheet at the end of the financial year in 1989 would have shown shareholders funds of £340m to £350m compared with borrowings of £440m to £450m. To less sophisticated users this was the balance sheet of an organisation in financial difficulty not the reflection of a group embarking upon a programme of rapid expansion.

The board at Cadbury was now faced with a problem that was caused by financial reporting conventions rather than by commercial reality. Accounting standards dictated that the excess amount paid by the acquiring company over and above the net assets of the vendor company would be written off against shareholders funds in the group accounts. Essentially, the group balance sheet would contract rather than expand after the group's acquisitions.

The immediate write-off of goodwill was misunderstood by many shareholders and had the potential to restrict the group's activities in the future. Stock Exchange Class tests required shareholder approval for ever-smaller deals and there remained the danger that shareholders would hold the group back simply because they did not fully appreciate the true balance sheet position.

There was also the possibility that the frightening level of gearing on the group balance sheet would lead to lower credit ratings and problems with debt covenants. It would be no surprise if lenders, who were faced group borrowing figures far in excess of shareholders funds, would blanch at the thought of offering further debt.

The now defunct Accounting Standards Committee (ASC) had published draft regulations in February 1989 on how companies were to treat brand values and other forms of goodwill on their balance sheets. The A.S.C. proposed regulations, which required the immediate write-off of goodwill or its amortisation over a period of twenty years.

Cadbury's solution to its gearing problem was to capitalise the brands acquired since 1985. This was perceived by many observers as a direct challenge to the A.S.C. and a shot across the bows of the new standards setting board which was to be introduced in the Summer of 1989. Instead of amortising the brands over a period of twenty years Cadbury Schweppes stated its intention of retaining its acquired brands on the balance sheet and only depreciating them when it was apparent that those brands had suffered a diminution in value.

Sir Graham Day, the then chairman of Cadbury Schweppes, said at a news conference that the company was not "trying to go head to head" with the accountancy profession, but had decided "to recognise changing stock exchange considerations" in Cadbury's share price. To the board, the fact that the portfolio of brands was reflected in the group's market capitalisation, but not in the balance sheet seemed a contradiction.

In a move backed by the group's auditors the acquired brands were valued at £307m. The decision was welcomed by the financial directors of a number of blue chip companies, including Guinness, who had been amongst the first wave of firms to capitalise their brands.

Cadbury Schweppes used a number of criteria when analysing the suitability of its brands for capitalisation. Only significant brands acquired since 1985 that generated identifiable cash flows and that could be separated from the company's other assets were capitalised. Legal protection through a trademark was also an important factor. It was decided that capitalisation would be restricted to house names rather than including individual products.

In March 1988 Cadbury Schweppes had stated that it would not follow the likes of Grand Metropolitan, United Biscuits and Reckitt and Colman who had already started to include brands on their balance sheets. After a year in which they had added the likes of Trebor and Bassett to their portfolio, Cadbury Schweppes clearly felt that the potential effect of these acquisitions on its balance sheet and financial flexibility was too damaging to ignore.

The capitalisation of the Cadbury Schweppes brands not only posed a further challenge to the Accounting Standards Committee's recommendations, it also helped to improve the group's balance sheet and significantly reduce its level of gearing.

Excluding the £307m intangible asset, Cadbury's debt to equity ratio would have been in excess of 100%. Adding the brands back produced a more manageable 62.4%. The company had largely achieved its key objective.

Having included acquired brands in its balance sheet Cadbury has subsequently developed its internal use of brand valuation. All brands are now regularly valued using discounted cash flow analysis to report to the management of those brands whether they are creating or destroying shareholder value. Similar information is being used for investor relations purposes. This is a good example of how brand valuation is adopted for one reason but then extends on into other areas of internal management and external communication.

3. FAZER
Using brand valuation techniques for marketing budget allocation

Fazer is a large Finnish confectionery company with a wide portfolio of brands. As the trade barriers between Finland and the EU were brought down in the wake of Finland's entry into the EU it became clear that Fazer's portfolio of brands would need to be reviewed to compete in the new era of pan-european competition.

The review was needed to identify 'strategic' and 'tactical' brands and to identify which geographical markets offered the best potential value enhancement for the total Fazer portfolio.

Over a number of years Fazer consistently applied brand valuation methodologies to its portfolio to help identify which brands should be invested in most heavily, which allowed to continue and which might more profitably be discontinued. On the international stage Fazer wanted a consistent benchmark for deciding which European markets offered the greatest potential.

The brand valuation process was built into a brand value management information system, which was used as the basis for negotiation between sales, marketing and financial personnel and as an input to the strategic planning process.

4. GRAND METROPOLITAN/ DIAGEO
Using brand valuation techniques for internal marketing management

Until its merger with Guinness to form Diageo, Grand Met had a portfolio of brands including names as prominent as Smirnoff, Baileys, Haagen-Dazs, Green Giant and Burger King.

In 1988 Grand Met had shocked the financial world by including its acquired brands as intangible assets on its balance sheet. Being so rich in name brands it was little surprise that senior management appreciated their importance to the long term health of the organisation and wished to reflect this in the company accounts. The 1988 balance sheet included brands with a cost of £608m.

To the board of Grand Met the fact that a series of expensive and high profile acquisitions might not have been included in the accounts seemed an absurd contradiction and would have left the company perilously undervalued.

An anomaly remained. Only acquired brands were included on the balance sheet despite the obvious value to Grand Met of their internally generated brands. Similarly, early valuations were based on historical earnings multiples, a method not currently seen as accurately reflecting the true worth of a brand.

The difficulty of attempting to value brands purely for financial purposes illustrates the problems that management face for internal reporting and assessing the relative health of a portfolio of brands. For internal purposes an absolute balance sheet valuation is of little use.

Grand Met's response to this problem and evidence of a real bridge being built between marketing and finance functions was the introduction of its "brand equity monitor". The purpose of this was not to place a historical value on a brand, but to give management an idea of the performance of brands. The factors measured could not be measured in purely profit and loss terms and the monitor included both economic, consumer and perceptual measures of performance, which together formed a subtle and responsive mechanism for tracking both brand health, and if necessary financial brand value.

The process has been extended from its early beginnings and Diageo now monitors a number of key financial and marketing drivers to establish the level of brand equity. These drivers focus management's attention on gaining customer awareness, loyalty, market share and the brand's ability to charge a price premium. It is this premium which communicates the value of a brand to the company's stakeholders.

There are a number of checks used by Diageo staff to assess the trends in brand equity. A sample of these measures includes awareness, advertising spend, market penetration and share of display.

Management is able to gauge the relative health of brands from a flow of consistent and reliable data. The fact that the vast majority of this data will never be included in the company accounts is irrelevant, it provides instead a degree of strategic and operational control over the group's most valuable assets.

However, the catalyst for these developments was the need to adequately reflect, from solely a financial reporting perspective, the value of brands.

5. CORSODYL AND SMITHKLINE BEECHAM

Using brand valuation techniques for mergers and acquisitions

One example of this phenomenon was the acquisition of Corsodyl by SKB. In this case a higher price was paid than might have been suggested by a normal valuation because Corsodyl was a unique brand, with a tremendous heritage, the gold standard for mouth infections, recommended by both doctors and dentists. Corsodyl integrated perfectly with the rest of the SKB oral hygiene range, creating the platform for merchandising other dental products on the same trade sales calls as the popular Corsodyl brand.

Not only was it possible to estimate a value of the Corsodyl brand on existing products in existing markets. It was also possible to estimate the value of line extensions and favourable portfolio effects of other SKB oral hygiene brands.

Very similar arguments applied at a consumer level with the acquisition of Rowntree confectionery brands like KitKat by Nestlé. In that case huge 'option' value lay in new applications in both confectionery and in related areas such as ice creams.

6. BURMAH CASTROL

Using brand valuation techniques for external investor relations

On 9th February 1996 Burmah Castrol's share price leapt 51p to a record 1039p high. The reason for this was a document entitled "Barbarians at the Gates of Swindon", a circular produced by the company's broker Merrill Lynch.

During the 1970's the price of Castrol's stock had plummeted to the equivalent of 40p per share. The Wiltshire based company had survived that crisis and continued to trade successfully.

However, the analysts at Merrill Lynch were concerned that the Burmah Castrol share price did not reflect the true value of the company. Although there did not appear to be any predators at the time, the relatively low value of the company would have made it an attractive target for a corporate raid.

Merrill Lynch estimated that the break-up value of the organisation was in the region of £20 per share. The analysts believed that the share price did not reflect the true earning potential of the Castrol brand of lubricant nor the company's growth into emerging markets. Cadbury Schweppes' recent acquisitions of the well known American brands Dr Pepper and A&W provided the basis for Merrill's estimates.

While acknowledging that the confectionery industry and the petrochemicals industry were not directly comparable, the analysts applied similar multiples to those applied in the Cadbury deals. The critical factor was that Castrol was regarded as an internationally recognised premium brand.

Castrol was valued at around twelve times its then predicted profit figure of £220m. Merrill also believed that the industrial lubricants arm was worth £400m, the fuels side £180m and Foseco speciality chemicals £400m. These estimates were described by Merrill as conservative.

"We believe," said the report "that the market has missed the underlying strength of the Foseco and printing inks business and missed the significant restructuring of these businesses that has been an ongoing feature in the last few years."

As well as ensuring that the value of Burmah Castrol's shares rocketed immediately after publication, the content of Merrill's circular raised questions about the ability of the market to ensure that the "real" value of a public limited company is reflected in its share price.

Merrill's arguments appeared valid when days after the publication of the report Burmah Castrol's Indian subsidiary posted a 12% improvement in its 1995 profits. Shares in Burmah Castrol rose 28p in one day. Burmah's success in the emerging markets eased any worries that there may have been about the company's dependence on mature markets like the United States and Europe.

At the time lubricants represented one of the few areas in downstream businesses that was successful. Castrol, as one of the top rated brand names, was able to exploit this. The argument of the conservative wing of the accountancy profession, who opposed the carrying of subjective intangible values on company balance sheets, was that the internal and external information available to markets would allow company valuations to settle at a realistic level on the stock exchange.

This line of thought appeared to be challenged by Merrill's findings. Clearly the bank disagreed with the view that the market was sophisticated enough to reflect the future earning potential of a company in its share price.

The market's key weakness was that it assumed that Burmah Castrol was just another oil major. The report quoted a Burmah Castrol company director who, when asked whether his organisation was a motor oil company or a chemicals company, answered as follows,

"Neither….Burmah Castrol's key strength is in international marketing of specialised products, with a strong technology input, tailored to meet specific country needs."

The market was attempting to compare Burmah's stock against companies with which it shared few similarities. By divulging additional information in its report Merrill Lynch had given the market a nudge.

7. ICI

Using brand valuation for licensing and franchising

In 1995 Imperial Chemical Industries began a brand valuation of its "housemark", the ICI roundel, the motivating factor being financial.

The worldwide ICI businesses paid the trademarks department an annual fee in return for protecting and enforcing "their" trademarks. Additionally, each business had to pay a proportional amount to protect the umbrella housemarks (the ICI roundel and letters).

As budgetary pressure increased in the worldwide businesses, there was a desire to cut costs by relying less on internal departments including the central trademarks department. At the same time, the finance department at ICI was examining a number of ways of governing international cash flows to offset the credit balance on its Advance Corporation Tax account.

Brand valuation was seen as a means of solving these problems. As Caroline Davis of ICI explains,

"If we could put in place a royalty stream back to Plc based on licensing the ICI Roundel to user companies worldwide, this would provide a steady flow of income into the trademark budget centre. This would also result in tax benefits to the ICI group."

The positive effects of the brand name on shareholder value would also be given a numerical significance. Charles Miller Smith, ICI's CEO, was convinced that the ICI

roundel was one of the group's greatest assets. It was hoped that the study would tell ICI whether it was maximising the potential value of its brand.
The study was completed in 1996. It ensured a greater understanding of the company's brand and closer links between the trademarks department and the finance and marketing departments. Tax savings were also achieved.

The separate businesses, initially sceptical, came to appreciate the value of the study and even commissioned their own. The study helped to raise the profile of branding throughout the company and highlight some of the problems ICI faced.

By the Summer of 1997 ICI had definite plans on how to take the process forward. An internal branding/marketing conference was planned to bring the information together and the tax aspects of the study were to be analysed on an ongoing basis.

8. WALT DISNEY CORPORATION
Using brand valuation for securitised borrowing

The entertainment industry is one particularly well suited to the use of brands as security on debt and this has been demonstrated by the Walt Disney Corporation on more than one occasion.

Disney has a range of characters and products that are instantly recognisable across the world. That the Disney brand was not carried as an absolute figure on the balance sheet did not dissuade management from exploiting its inherent value by using the Disney name as a means of raising new streams of finance.

Tokyo Disneyland is owned and operated by Oriental Land Co, a Japanese organisation that pays royalties to Disney.

In a transaction arranged by Citicorp Investment Bank and the Long-Term Credit Bank of Japan, Disney ensured that its future earnings from the Tokyo park would not be effected by fluctuations in the dollar-yen exchange rate. Disney monetised a substantial portion of the park's expected future royalties. Bonds were issued that were securitised against the park's performance over a period of twenty years.

The deal was structured so that investors would bare any shortfall in the projected royalty streams while surplus amounts would be received in their entirety by Disney. Disney could not lose.

The total net proceeds of the issue of the bonds were approximately US$725m in what was widely described at the time (1988) as the "deal of the decade". The markets had demonstrated unshakeable faith in the Walt Disney brand. In the event park attendance soared above the agreed limits. Disney had achieved this without any loss of control over its business.

Given the success of its previous effort it was no surprise that Disney returned to the markets in 1992. A $400m bond was launched through Citibank and Lehman Brothers which offered investors a return linked to the profits of a pool of future movies.

The seven year unsecured notes were rated as a safe bet by the market who, once again, demonstrated their appreciation of the power of the Disney brand by ensuring that it was well taken up.

One Japanese banker even ventured the opinion that Mickey Mouse was a lower risk than the US government.

9. POCKLINGTON FOODS (GAINERS INC)

Using brand valuation techniques for litigation support

This recent case in Canada highlights the use of brand valuation as a part of expert testimony in court cases.

The food company had run into trading difficulties and was unable to meet the terms and conditions of its borrowing facilities. The Alberta Government foreclosed on the business and operated it until it was sold to a third party. However, the price achieved for the company assets and brands did not cover the outstanding loans and the Government sued the former owner of the company to recover the balance.

Far from agreeing to pay up, the former owner argued that in terms of the financing agreement in place between himself and the Government, the Government was obliged to pay him the 'value' of the shares of the company. He argued that the company was worth more than the government had sold it for because the sales price did not adequately reflect assets such as trademarks, customer lists, brand names and shelf space. He felt that the 'true' value of the company exceeded the liabilities. The former owner took legal action and a protracted legal action ensued with expert brand valuations being used as evidence for both sides in the case.

In the lawsuit, the former owner said the company was worth about $136-million, while the province put its debts at about $116-million.

In February 1998, an Alberta judge ruled against the claim by the former company owner that the value of the company was $20-million more than it's liabilities, and that the Government should pay him the surplus value. He found that the plant was worth more than the $77-million that the province valued it at, but that there still wasn't enough of an intangible asset base to overcome the $114-million actually judged to be owed.

In his final ruling, the judge said the company was actually worth about $95-million, and its debts were about $114-million.

10. NESCAFE

Using brand valuation techniques in fair trading investigations

A great deal of expert witness evidence was used when Nescafé was subject to a Monopolies and Mergers Commission enquiry into the soluble coffee market. Its lawyers ultimately demonstrated that the reason for Nescafé's high market share was less to do with unfair trade practices and more to do with strong brands heavily and consistently advertised.

11. MAJOR U.S. COURIER COMPANY

Using brand valuation techniques for tax planning

In the US one large organisation was recently hit with a retrospective tax charge for imputed royalties not levied on its foreign affiliates. In the opposite direction, several international companies have been accused of charging excess brand royalties to their US affiliates as a way of expatriating profits earned in the US. The net result is that more and more international organisations are actively planning the most effective domicile for their brand portfolios and are planning their tax affairs with branded royalty streams in mind.

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Barbarians at the Gates of Swindon
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