New International Standard on Brand Valuation

"IS 10668 gives brand valuation analysis the institutional credibility which it previously lacked. It professionalises brand management."

David Haigh, CEO, Brand Finance plc

In 2007 the International Organization for Standardization ('ISO'), a worldwide federation of national standard setting bodies, set up a task force to draft an International Standard ('IS') on monetary brand valuation.

After 3 years of discussion and deliberation IS 10668 – Monetary Brand Valuation – will be released in Autumn 2010. This sets out the principles which should be adopted when valuing any brand.

The new IS applies to brand valuations commissioned for all purposes, including:

• Accounting and financial reporting
• Insolvency and liquidation
• Tax planning and compliance
• Litigation support and dispute resolution
• Corporate finance and fundraising
• Licensing and joint venture negotiation
• Internal management information and reporting
• Strategic planning and brand management

The last of these applications includes:

• Brand and marketing budget determination
• Brand portfolio review
• Brand architecture analysis
• Brand extension planning

Under IS 10668 the brand valuer must declare the purpose of the valuation as this affects the premise or basis of value, the valuation assumptions used and the ultimate valuation opinion, all of which need to be transparent to a user of the final brand valuation report.

Requirements of an ISO compliant brand valuation?

IS 10668 is a 'meta standard' which succinctly specifies the principles to be followed and the types of work to be conducted in any brand valuation. It is a summary of existing best practice and intentionally avoids detailed methodological work steps and requirements.

As such IS 10668 applies to all proprietary and non-proprietary brand valuation approaches and methodologies that have been developed over the years, so long as they follow the fundamental principles specified in the meta standard.

IS 10668 specifies that when conducting a brand valuation the brand valuer must conduct 3 types of analysis before passing an opinion on the brand's value.

These are Legal, Behavioural and Financial analysis. All 3 types of analysis are required to arrive at a thorough brand valuation opinion. This requirement applies to valuations of existing brands, new brands and brand extensions.

Module 1 Legal analysis

The first requirement is to define what is meant by 'brand' and which intangible assets should be included in the brand valuation opinion.

IS 10668 begins by defining Trademarks in conventional terms but it also refers to other Intangible Assets ('IA') including Intellectual Property Rights ('IPR') which are often included in broader definitions of 'brand'.

International Financial Reporting Standard ('IFRS') 3, specifies how all acquired assets should be defined, valued and accounted for post-acquisition. It refers to 5 specific IA types which can be separated from residual Goodwill arising on acquisition.

These are: technological, customer, contractual, artistic and marketing related IA.

IS 10668 mirrors this classification by defining brands as marketing related IA, including trademarks and other associated IPR. This refers inter alia to design rights, domain names, copyrights and other marketing related IA and IPR which may be included in a broader definition of 'brand'.

The brand valuer must precisely determine the bundle of IA and IPR included in the definition of 'brand' subject to valuation. He may include names, terms, signs, symbols, logos, designs, domains or other related IPR intended to identify goods and services and which create distinctive images and associations in the minds of stakeholders, generating economic benefits for the branded business.

The brand valuer is required to assess the legal protection afforded to the brand by identifying each of the legal rights that protect it, the legal owner of each relevant legal right and the legal parameters influencing negatively or positively the value of the brand.

It is vital that the brand valuation includes an assessment of the legal protection afforded to the brand in each geographical jurisdiction and product or service registration category. These legal rights vary between legal systems and need to be carefully considered when forming the brand valuation opinion. For example, the legal rights protecting brands exist at a national (UK), supra-national (EU) and global (WIPO) level and have different characteristics.

Extensive due diligence and risk analysis is required in the Legal analysis module of an IS 10668 compliant brand valuation. It should be noted that the Legal analysis must be segmented by type of IPR, territory and business category.

The brand valuation opinion may be affected positively or negatively by the distinctiveness, scope of use or registration (territory and business category), extent of use, notoriety of the brand, risk of cancellation, priority, dilution and the ability of the brand owner to enforce such legal rights.

Module 2 Behavioural analysis

The second requirement when valuing brands under IS 10668 is a thorough behavioural analysis. The brand valuer must understand and form an opinion on likely stakeholder behaviour in each of the geographical, product and customer segments in which the subject brand operates.

To do this it is necessary to understand:

- market size and trends - determined by conducting a critical review of predicted trends in distribution channels, customer demographics, market volumes, values and margins.

- contribution of brand to the purchase decision - determining the monetary brand contribution in the geographical, product and customer segments under review.

- attitude of all stakeholder groups to the brand - to assess the long term demand for the brand, any risks to the branded business and the appropriate cost of capital.

- all economic benefits conferred on the branded business by the brand – to assess the sustainability of future revenues and profits.

The brand valuer needs to research brand value drivers, including an evaluation of relevant stakeholders' perceptions of the brand in comparison with competitor brands. Measures commonly used to understand brand strength include awareness, perceptual attributes, knowledge, attitude and loyalty. The brand valuer needs to assess the brand's strength in order to estimate future sales volumes, revenues and risks.

Module 3 Financial analysis

The third requirement when valuing brands under IS 10668 is a thorough financial analysis.

IS 10668 specifies three alternative brand valuation approaches - the Market, Cost and Income Approaches. The purpose of the brand valuation, the premise or basis of value and the characteristics of the subject brand dictate which primary approach should be used to calculate its value.

Market approach

The market approach measures value by reference to what other purchasers in the market have paid for similar assets to those being valued. The application of a market approach results in an estimate of the price expected to be realized if the brand were to be sold in the open market. Data on the price paid for comparable brands is collected and adjustments are made to compensate for differences between those brands and the brand under review.

As brands are unique and it is often hard to find relevant comparables this is not a widely used approach.

Cost approach

The cost approach measures value by reference to the cost invested in creating, replacing or reproducing the brand. This approach is based on the premise that a prudent investor would not pay more for a brand than the cost to recreate, replace or reproduce an asset of similar utility.

As the value of brands seldom equates to the costs invested creating them (or hypothetically replacing or reproducing them) this is not a widely used approach.

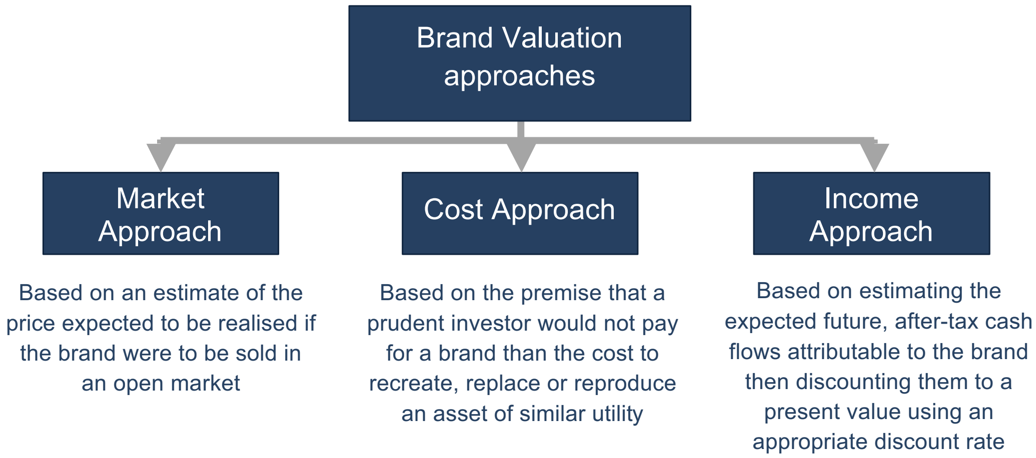
Income approach

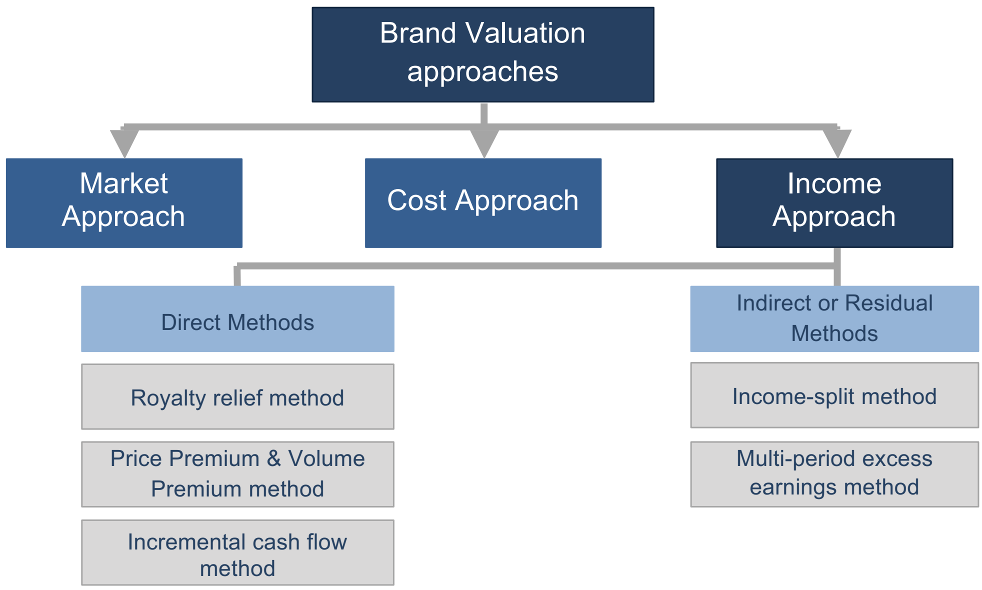
The income approach measures value by reference to the economic benefits expected to be received over the remaining useful economic life of the brand. This involves estimating the expected future, after-tax cash flows attributable to the brand then discounting them to a present value using an appropriate discount rate.

Under the income approach, risks that are not already reflected in future cash flows must be considered in the discount rate. The discount rate used for discounting future expected cash flows attributable to a brand is usually derived from the Weighted Average Cost of Capital ('WACC') of the business.

As the value of brands stems from their ability to generate higher profits for either their existing or potential new owners this is the most widely accepted and used brand valuation approach.

When conducting a brand valuation using the income approach various methods are suggested by IS 10668 to determine future cash flows.





Royalty Relief method

This is the most widely used method used to determine brand cash flows. This method assumes that the brand is not owned by the branded business but is licensed in from a third party. The value is deemed to be the present value of the royalty payments saved by virtue of owning the brand.

The royalty rate applied in the valuation is determined after an in-depth analysis of available data from licensing arrangements for comparable brands and an appropriate split of brand earnings between licensor and licensee, using behavioural and business analysis.

The Royalty Relief method is widely used because it is grounded in commercial reality and can be benchmarked against real world transactions.

Price Premium and Volume Premium methods

The Price Premium method estimates the value of a brand by reference to the price premium it commands over unbranded, weakly branded or generic products or services. In practice it is often difficult to identify unbranded comparators. To identify the full impact on demand created by a brand the Price Premium method is typically used in conjunction with the Volume Premium method.

The Volume Premium method estimates the value of a brand by reference to the volume premium that it generates. Additional cash flows generated through a volume premium are determined by reference to an analysis of relative market shares. The additional cash flow generated by an above average brand is deemed to be the cash flow related to its 'excess' market share. In determining relevant volume premiums the valuer has to consider other factors which may explain a dominant market share. For example, legislation which establishes a monopoly position for one brand.

Taken together the Price Premium and Volume Premium methods provide a useful insight into the value a brand adds to revenue drivers in the business model. Other methods go further to explain the value impact of brands on revenue and cost drivers.

Income-split method

The income-split method starts with net operating profits and deducts a charge for total tangible capital employed in the branded business, to arrive at 'economic profits' attributable to total intangible capital employed. Behavioural analysis is then used to identify the percentage contribution of brand to these intangible economic profits. The same analysis can be used to determine the percentage contribution of other intangible assets such as patents or technology. The value of the brand is deemed to be the present value of the percentage of future intangible economic profits attributable to the brand.

Multi-period excess earnings method

The multi-period excess earnings method is similar to the income-split method. However, in this case the brand valuer first values each tangible and intangible asset employed in the branded business (other than the brand). He uses a variety of valuation approaches and methods depending on what is considered most appropriate to each specific asset.

Having arrived at the value of all other tangible and intangible assets employed in the branded business a charge is then made against earnings for each of these assets, leaving residual earnings attributable to the brand alone. The brand value is deemed to be the present value of all such residual earnings over the remaining useful economic life of the brand.

Incremental cash flow method

The incremental cash flow method identifies all cash flows generated by the brand in a business, by comparison with comparable businesses with no such brand. Cash flows are generated through both increased revenues and reduced costs.

This is a more detailed and complex approach which tends not to be used in technical brand valuations but is extremely useful for strategic, commercial purposes. For example, when Virgin negotiates a new brand license with a new licensee, the incremental value added to the licensee's business form's the starting point for the negotiation.

Application of brand valuations

IS 10668 was developed to provide a consistent framework for the valuation of local, national and international brands both large and small. The primary concern was to create an approach to brand valuation which was transparent, reconcilable and repeatable. In the wake of the standard's launch it is expected that many companies will either value their brands for the first time or revalue them compliant with the standard.

Brand Valuations and Brand Strategy?

Common commercial applications of brand valuation are brand portfolio and brand architecture reviews.

Brand Portfolio reviews consider whether the right number of brands and sub-brands are in the portfolio. Brand Architecture reviews considers whether individual brands are too fragmented and extended.

In both these cases, brand valuation analysis can help to evaluate the most effective value adding strategy. Brand valuation can help companies rationalise and rebuild their brand portfolios and trim their brand architecture to best address current market conditions.

Brand Dashboards

Having determined an ideal brand portfolio and architecture at a point in time it is recommended to create a long term brand dashboard to monitor changes in brand equity and value so that swift corrective action can be taken if necessary.

CONCLUSION

IS 10668 gives brand valuation analysis the institutional credibility which it previously lacked. It professionalises brand management. As evidence of this SAM Group which produces the Dow Jones Sustainability Index, intends to upweight businesses in the DJSI if they adopt ISO 10668 principles. This is based on the view that businesses which manage their brands systematically are likely to be more sustainable long term.