

BRAND VALUATION

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Abstract:

Tangible assets (manufacturing assets, land, buildings and financial assets) have always been regarded as the main source of business value. However, market conditions in the last quarter of the twentieth century showed that a company's value is not made up of its tangibles alone. The importance of intangibles, primarily the brand, but also patents, technology and employees has been recognized in the market, which lead to a dramatic shift in the market value of some companies relative to their book value. In spite of the fact that a company's market value (shareholder value) has increased, brand contribution and its specific value remained unclear and were not specifically quantified. Current accounting standards continue to deal mainly with tangibles to determine a company's value. Brand is rarely explicitly and adequately valued and it appears very rarely on financial statements. Even when it does appear, the numbers do not have a universally recognized economic and market foundation.

In recent years, an increasing number of companies, agencies, and institutions have been trying to find an adequate brand valuation model. Currently, various models that provide more or less reliable data on brand value are in use. Standardized and dependable brand valuation system is necessary to establish reliably the real value of a company that owns it.

Key words: brand, brand valuation, brand value

BRAND VALUE

For some companies, the brand is the most important asset they have. The following statement by John Stuart (former CEO of Quaker, 1900) illustrates the value of brand "If this business were split up, I would give you the land and bricks and mortar, and I would take the brands and trademarks, and I would fare better than

you.”¹ Having a brand like Google, Coca-Cola or Mercedes Benz almost guarantees business success. Large brand owners have always been aware of value and importance of their brands and have deliberately created a series of brand characteristics that they presented to their buyers. The purchasing of brand is no longer merely an acquisition of a product; it also includes an intrinsic experience of a consumer and even reflects a certain lifestyle. Even non-profit organizations have started embracing the brand as a key asset for obtaining donations, sponsorships and volunteers. When recently the author was involved in a panel debate about ‘Brands: Heroes or villains’, it was interesting that when asked which was her favourite brand, one of the panellists, who was speaking on behalf of the anti-globalisation movement, replied ‘The Red Cross’.²

A successful brand has loyal consumers, which ultimately reflects on sales value and brand owner’s market value. A continuous increase in the gap between companies’ book values and their market value has brought to the recognition that the value of intangibles can be quantified. This gap has become particularly evident in the late 1980s when companies were bought at much higher premiums than their book value.

The total brand value includes two aspects: economic value and social value.

The economic value of brand

The economic value of brand in a company’s shareholder value is most visible when companies are being bought or sold. In 1989, Philip Morris paid \$12.9 billion for Kraft, six times its net asset value.³

Several studies have tried to estimate the contribution that brands make to shareholder value. The 2003 study by Interbrand (see Table 1)⁴ concluded that on average brands account for more than one-third of shareholder value.






¹ Source: <http://www.brandchannel.com/images/papers/EditorialBrands.pdf>; p. 1, accessed on 01 May 2007

² Source: <http://www.brandchannel.com/images/papers/EditorialBrands.pdf>; p. 2, accessed on 01 May 2007

³ Source: <http://www.thephelpsgroup.com/whitepaperBrandStockEquity.asp>, p. 1, accessed on 26 May 2007

⁴ Source: prepared by authors based on information downloaded from <http://int2.cof.org/conferences/presentations/2004corporatesummit/lindemann.pdf>; p. 13, accessed on 03 May 2007

Table 1 *The contribution of brand to the shareholder value of parent company*

COMPANY	Company's Value (US\$bn)	Brand contribution to shareholder value (%)	Brand value (US\$bn)
	110,2	64%	70,5
Microsoft	283,5	23%	65,2
IBM	140,0	37%	51,8
	282,0	15%	42,3
intel	163,7	19%	31,1
NOKIA	70,0	42%	29,4
	42,4	66%	28,0
	26,8	92%	24,7
Marlboro	88,8	25%	22,2
 Mercedes-Benz	35,1	61%	21,4

The social value of brand

In the world of growing social responsibility (towards environment or people), brand values have also come under public scrutiny. "Social responsibility is the key factor that helps companies with accessibility to capital at the international market because research has shown that 86% of institutional investors in Europe believe that management of society- and environment-related risks has a positive effect on the company's long-term market value."⁵

A brand that has social value ensures success on the market. For individuals, the social value of brand lies in the consumer surplus, freedom of choice and possibility to express preference and personality by buying a certain brand. Branded companies invest more in research and development, which in turn leads to a continuous process of product improvement and development. "A study by the European Brands Association revealed that less-branded businesses launch fewer products, invest significantly less in development and have fewer product advantages than their branded

⁵ Source: <http://www.hup.hr/default.asp?ru=349&gl=200507050000005&sid=&jezik=1>, accessed on 27 May 2007

counterparts. Almost half of the non-branded sample spent nothing on product R&D compared with less than a quarter of the branded sample. And while 26 percent of non-branded producers never introduced significant new products, this figure was far lower at 7 percent for the branded set.”⁶

In terms of ethical behaviour, brand owners are leading the way all over the world in adopting ethical business practices thus expanding the influence and social value of the brand considerably beyond the framework of the company that owns the brand.

APPROACHES TO BRAND VALUATION

For those concerned with accounting, management, mergers and acquisitions brand valuation plays a key role in business today. Although financial values have to some extent always been attached to brands and to other intangible assets, it was only in the late 1980s that valuation approaches were established that helped understand and assess the value of brands.

Unlike other assets such as stocks, bonds, commodities and real estate, there is no active market in brands that would provide comparable values. So a number of brand evaluation approaches have been developed over the last two decades. Basic approaches fall into three categories: research-based, financially driven and economic.⁷

Research-based approaches

Research-based approaches use consumer research to assess the performance of brands. Research approaches do not put a financial value on brands; instead, they measure consumer

behaviour and attitudes that have an impact on the economic performance of brands. Although the sophistication and complexity of such models may vary, they all try to explain and measure consumers’ perceptions that influence purchase behaviour. They include a wide range of perceptive measures. Through different methods of statistical modelling, these measures are arranged either in hierarchic order, to show degrees of relationship towards the brand (from awareness to preference and purchase). The disadvantage of the research-based techniques is that they do not differentiate between the effects of the brand on consumers and the effects of other factors such as research, development and design. They therefore do not provide a

⁶ Source: http://www.brandchannel.com/images/papers/financial_value.pdf, p. 5, accessed on 02 May 2007

⁷ Source: http://www.brandchannel.com/images/papers/financial_value.pdf, p. 5, accessed on 02 May 2007

clear link between the specific marketing indicators and the financial performance of the brand. A brand can perform strongly according to these indicators but still fail to create financial and shareholder value.

Factors that have impact on the success of the brand in the eyes of consumers are crucial for assessing the financial value of brands. However, unless they are integrated into economic models, they are insufficient for assessing the economic value of brands.

Financially driven approaches

In contrast to research-based approaches, financially driven approaches do not research consumer behaviour but are based on financial performance of a certain brand. Financially-driven approaches include⁸:

- **Cost-based approaches** - define the value of a brand as the aggregation of all historic costs incurred while bringing the brand to its current state: that is, the development costs, marketing costs, advertising and other communication costs, and so on. Cost-based approaches fail because there is no direct correlation between the financial investment made and the value added by a brand. Financial investment is an important component in building brand value, provided it is effectively targeted.
- **Comparables** - This approach is used to arrive at a value for a brand by observing and valuing comparables of different brands. Defining a comparable is difficult as by definition they should be differentiated and thus not comparable. Comparables can provide an interesting cross-check; however, they should never be relied on solely for valuing brands.
- **Premium price** – premium price is the price paid by a buyer for improved quality of the product guaranteed by the certificate and not for product appearance. In this method, the price (premium price) is calculated as the net present value of future price premiums that a branded product would command over an unbranded or generic equivalent. However, the primary purpose of many brands is not necessarily to obtain a price premium but rather to secure the highest level of future demand. This method is flawed because there are rarely generic equivalents to which the premium price of a branded product can be compared. Today, almost everything is branded, and in some cases store brands can be as strong as producer brands charging the same or similar prices. The price difference between a brand and competing

⁸ Source: http://www.brandchannel.com/images/papers/financial_value.pdf, p. 5, accessed on 02 May 2007

products can be an indicator of its strength, but it does not represent the only and most important value contribution a brand makes to the underlying business.

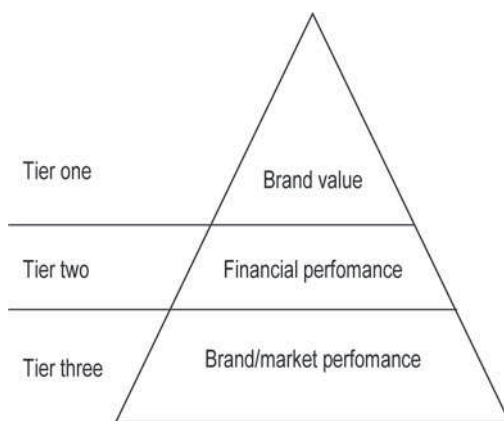
The above-mentioned research-based and financially driven approaches are essentially one-dimensional. Research-based approaches lack financial component, while financially driven approaches lack marketing component to provide a complete and robust assessment of the economic value of brands.

Economic use approach

The economic use approach provides the multidimensionality to brand valuation as it combines brand equity with financial measures. Companies such as Interbrand and MillwardBrown compile a list of most valuable brands each year which is based on economic principles and replies to the fundamental question: how much more valuable is the business because it owns certain brands. This brand valuation includes both a marketing measure that reflects the security and growth prospects of the brand and a financial measure that reflects the earnings potential of the brand.

The total brand value comprises several tiers which when put together resemble a pyramid (Figure 1)⁹.

Figure 1. *Brand valuation pyramid tiers*

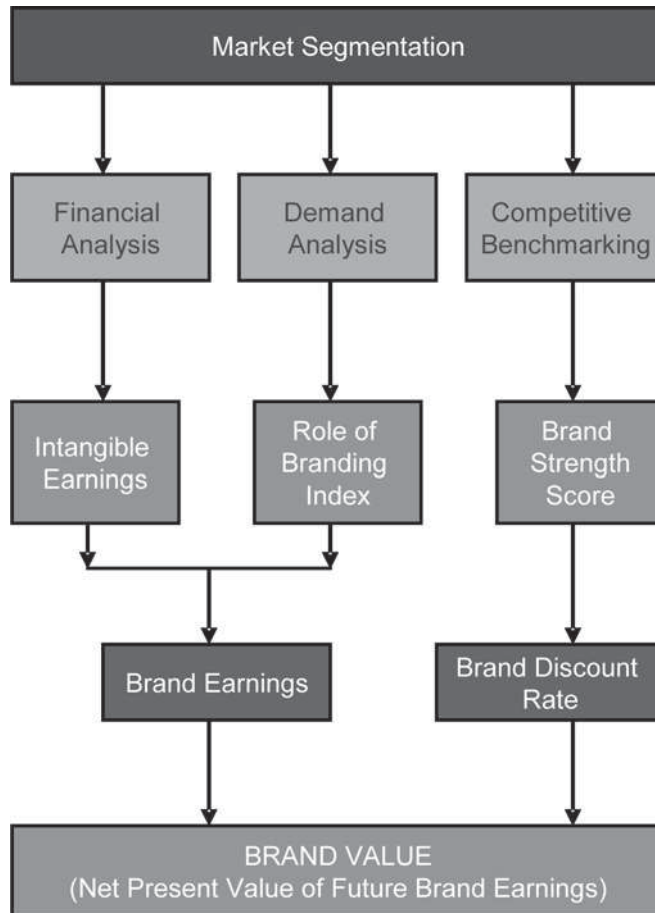


Brand value is often identified with its most visibly attractive elements, but that is just the first tier (the top of the pyramid) of the overall brand value. Tier two contains financial measures such as brand's profitability, income, and tax, while tier three contains measures of brand strength and market conditions.

⁹ Source: prepared by authors based on model downloaded from <http://www.poolonline.com/archive/issue36/iss36fea3.html>, accessed on 10 May 2007

Given this concept of economic worth, the value of a brand reflects not only what earnings it is capable of generating in the future, but also the likelihood of those earnings actually being realized. Interbrand's brand valuation model is shown in Figure 2¹⁰.

Figure 2. *Interbrand's brand valuation model*



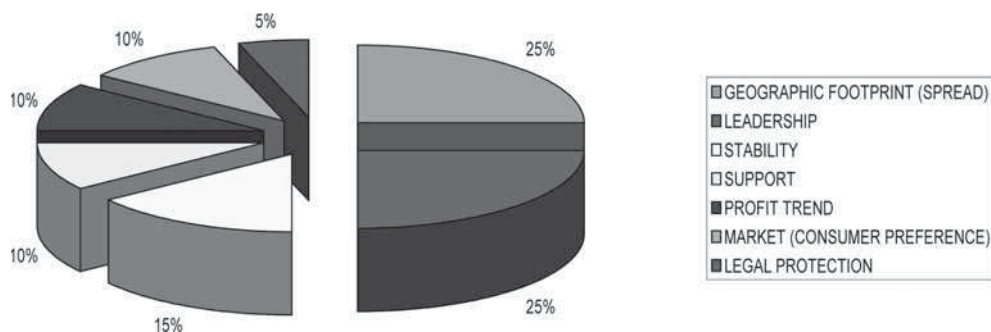
Undeniably, brands influence customer choice; however, that influence varies depending on the market in which the brand operates. This is why market is split into segments, i.e., brand consumers are divided into non-overlapping and homogeneous groups of consumers according to criteria such as consumption patterns, purchase

¹⁰ Source: <http://int2.cof.org/conferences/presentations/2004corporatesummit/lindemann.pdf>, p. 23, accessed on 03 May 2007

behaviour, geography, etc. The brand is valued in each segment according to the following elements:

- **Financial analysis** – includes identification and forecast of revenues and earnings from intangibles for each of the distinct segments
- **Demand/market analysis** – assesses the role that the brand plays in driving demand for products and services in the markets in which it operates and determines what proportion of intangible earnings is attributable to the brand (measured by an indicator referred to as the *role of branding index*). The role of branding index represents the percentage of intangible earnings that are generated by the brand. Brand earnings are calculated by multiplying the role of branding index by intangible earnings. This is done by first identifying the various drivers of demand for the branded products, then determining the degree to which each driver is directly influenced by the brand. For some brands (perfume industry, clothing industry) the role of branding index is very high because consumer's subjective opinion plays an important role, while it is less prominent for others. Besides the brand itself, the consumer's choice is also affected by some other factors (we buy Microsoft not only because of the brand but also because of the fact that 80% of softwares are based on their products).
- **Brand earnings** – calculated by multiplying the role of branding index by intangible earnings
- **Competitive benchmarking** - looks at the competitive strengths and weaknesses of the brand as well as the likelihood of expected future earnings (this indicator is referred to as the *brand strength score*). Brand strength comprises seven components as shown in Figure 3.

Figure 3. *Brand strength components*¹¹

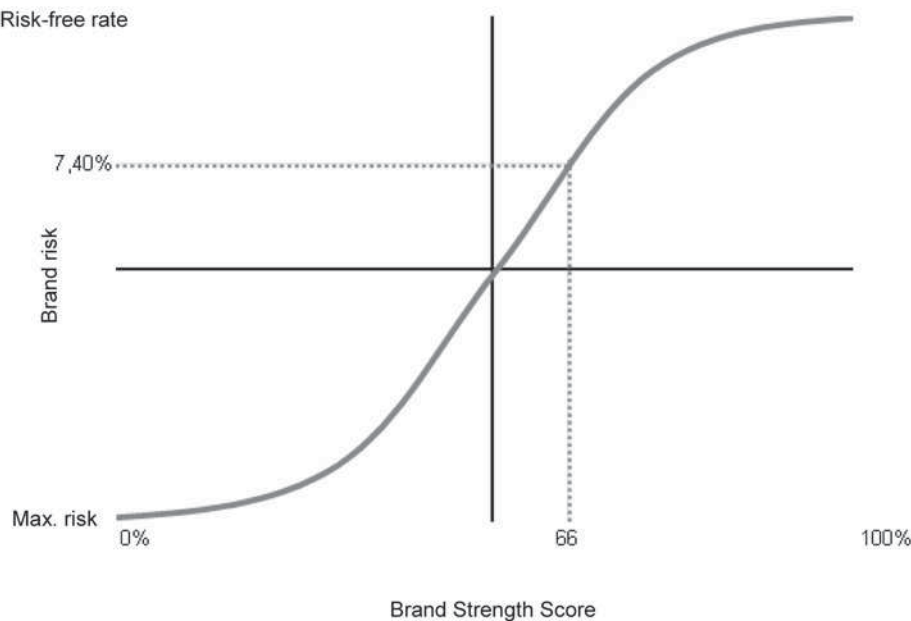


¹¹ Source: prepared by authors based on information downloaded from http://www.buildingbrands.com/didyouknow/11_brand_valuation.php, accessed on 10 May 2007

Brands that have proven international acceptance (wider geographic footprint) are inherently stronger than regional brands or national brands, as they are less susceptible to competitive attack and therefore are more stable assets. Leadership position and stability usually result in strong market share and bigger influence on the market. Long-term profit trend enables development and improvement of brand thus satisfying buyers’ needs. Brands with developed and focused support reach consumers much easier. Although consumer preference towards a certain brand is a subjective category, some brands (food) depend on consumer preference less than others (perfumes, clothing) because the consumption need for these products is not susceptible to sudden changes. Securing legal protection for the brand (copyright, trademark) is also an important component of brand strength in international circumstances.

The Brand Strength Score, which measures the competitive strength of the brand in the market, is transformed into a discount rate using an S-curve (Figure 4)¹².

Figure 4. *S-curve – Transformation of brand strength into discount rate*



Discount rate is used to calculate the net present value of the brand (see Table 2). To calculate the net present value of the brand we need the discount rate which

¹² Source: http://www.interbrand.ch/e/pdf/IBZL_Brand_Valuation_e.pdf, p. 3, accessed on 08 May 2007

represents the risk profile of future brand earnings. Discount rate is determined by two factors: present value of cash flow and risk profile of brand's future earnings. Discount rate is a risk rate one has to take into account when calculating the future earnings. For instance, the 5-year discount rate for Coca-Cola brand is lower than for Fanta brand because Coca-Cola is a much stronger brand than Fanta and as such it is likely to reach values closer to the expected earnings. This means that an ideal brand would be risk-free.

- **Brand value calculation** – Brand value is the net present value of the forecast brand earnings, discounted by the brand discount rate. The net present value calculation comprises both the forecast period and the period beyond, reflecting the ability of brands to continue generating future earnings. An example of a hypothetical valuation of a brand in one market segment is shown in Table 2.

Table 2 *Sample brand valuation calculation*¹³

		2007	2008	2009	2010	2011
FINANCIAL ANALYSIS	Market (units)	150.000	153.000	156.366	161.057	167.499
	Market growth rate		2%	2%	3%	4%
	Market share (volume)	15%	17%	19%	21%	23%
	Volume	22.500	26.010	29.710	33.822	38.525
	Price	10,00	10,00	10,25	10,50	10,75
	Price change		3,00%	2,50%	2,00%	2,00%
	Branded Revenues	225.000	267.903	312.136	362.233	422.425
	Cost of sales	40%	90.000	107.161	124.854	144.893
	Gross margin		135.000	160.742	217.340	253.455
	Marketing costs	30%	40.500	48.223	56.184	65.202
	Depreciation	1,25%	1.688	2.009	2.717	3.168
	Other overheads	8,50%	11.475	13.663	15.919	18.474
	Central cost allocation	2%	2.700	3.215	3.746	4.347
	EBITA (Earnings Before Interest, Tax and Ammortization)		78.638	93.632	109.091	126.601
	Applicable taxes	35%	27.523	32.771	38.182	44.310
	NOPAT (Net Operating Profit After Tax)		51.114	60.861	70.909	82.290
	Capital employed		78.525	93.498	108.935	126.419
	Working capital		67.532	80.408	93.684	108.721
	Net PPE		10.994	13.090	15.251	17.699
	Capital charge	8%	6.282	7.480	8.715	10.114
	Intangible earnings		44.832	53.381	62.195	72.177
DEMAND ANALYSIS	Role of Branding Index	70%				
	Brand Earnings		31.383	37.367	43.536	50.524
COMPETITIVE BENCHMARKING	Brand Strength Score	66				
	Brand Discount Rate	7,40%				
	Discounted Brand Earnings		29.220	32.395	37.744	41.232
BRAND VALUE	NPV (Net Present Value) of Discounted Brand Earnings (Years 1–5)	2,50%	178.564			
	Brand Value (beyond Year 5)		786.342			
	Brand value		964.906			

These kinds of financial assessments are based on companies' annual reports on turnover and earnings contained in their business records.

¹³ Source: prepared by authors based on model downloaded from http://www.brandchannel.com/images/papers/financial_value.pdf, p. 8, accessed on 02 May 2007

APPLICATIONS OF BRAND VALUATION SYSTEM

Brand valuation systems are now used in majority of strategic marketing financial decisions. There are two main categories of applications:¹⁴

- Strategic brand management – brand valuation for the purpose of internal analyses by providing tools and processes which enable the increase of economic value of brands.
- Financial transactions – brand valuation helps with transactions with external partners.

Strategic brand management

Recognition of the economic value of brands has increased the demand for effective management of the brand asset. In the pursuit of increasing shareholder value, companies establish procedures for the management of brands that are aligned with those for other business assets, as well as for the company as a whole. Economic value creation becomes the focus of brand management. Reliable brand valuation represents an economic rationale for branding business decisions. Brand valuation can be used for the following:¹⁵

- *Making decisions on business investments* – If the brand asset appears comparable to other company assets (intangible and tangible), resource allocation between the different asset types can follow the same economic criteria and rationale (for example, capital allocation and return requirements).
- *Measuring the return on brand investments* - Brand management and marketing service providers can be measured against performance targets related to the value of the brand asset.
- *Making decisions on licensing the brand to subsidiary companies* - By licensing, subsidiaries will be accountable for the brand's management and use, because management is more rigorous than one that is free.
- *Awarding and promoting of employees* – according to the growth of brand value.
 - *Organizing and optimizing the use of different brands* (for example, corporate, product, subsidiary brand) according to their respective economic value contribution.

¹⁴ Source: http://www.brandchannel.com/images/papers/financial_value.pdf, p. 9, accessed on 02 May 2007

¹⁵ Source: http://www.brandchannel.com/images/papers/financial_value.pdf, p. 10-11, accessed on 02 May 2007

- *Assessing co-branding initiatives* according to their economic benefits and risks to the value of the company's brand.

Financial transactions

The financial uses of brand valuation include the following:¹⁶

- *Assessing fair transfer prices* for the use of brands in subsidiaries;
- *Determining brand royalty rates* to be returned to the parent company. A brand can be licensed to an international subsidiary and a subsidiary in the country of origin under different conditions.
- *Capitalizing brand assets on the balance sheet* according to accounting standards.
- *Determining a price for brand assets in mergers, acquisitions or sale of company* (identifying the value that brands add to a transaction).
- *Using brands for securitization of debt facilities* in which the rights for the economic exploitations of brands are used as collateral.

ACCOUNTING FOR BRAND VALUE ON THE BALANCE SHEET

"The Coca-Cola Company had a market cap (\$50.28 per share times 2.32 billion shares) of \$117 billion on April 10, 2007. The book value of its assets was \$30 billion. The book value of its intangible assets was \$5 billion. Subtract Coke's intangibles from total assets and assume the remaining \$25 billion book value of tangible assets is a fair approximation of their replacement cost. This puts the market value of the company's intangibles at around \$92 billion, or 79% of its market cap. Notice that the book value of Coke's intangibles (that \$5 billion) is just 6% of their market value. Interbrand calculated the 2006 intangible value of the Coca-Cola brand at \$67 billion. The remaining \$25 billion represents the intangible value of the company's other brands. Coca-Cola has more than 400 brands in over 200 countries."¹⁷

A similar situation to that involving the Coca-Cola Company, where balance sheets showed only a part of the market value of intangible assets, has been in the focus of attention since the 1980s. The wave of brand acquisitions and mergers on the world market resulted in large amounts of goodwill that most accounting standards could not deal with in a traditional way. Transactions involving premiums

¹⁶ Source: http://www.brandchannel.com/images/papers/financial_value.pdf, p. 10, accessed on 02 May 2007

¹⁷ Source: http://www.customersandcapital.com/book/2007/04/cocacolas_other.html, accessed on 26 May 2007

much above the book value of tangible assets that were paid in those years sparked the debate about accounting for intangibles on the balance sheet.

In countries such as the UK, France, Australia and New Zealand it was, and still is, possible to recognize the value of intangible assets (*goodwill and brand*) and to put these on the balance sheet of the company. This helped to resolve the problem of goodwill. The recognition of brands as intangible assets made use of a grey area of accounting, especially in the UK and France. Companies were neither encouraged to include brands on the balance sheet nor were they prevented from doing so.

In 1989, the London stock market confirmed the concept of brand valuation allowing the value of intangibles to be included into the balance sheet during the takeover process.¹⁸ This proved to be a driving force and a series of leading branded companies started to recognize the value of brand as an intangible asset on their balance sheets.

The UK, Australia and New Zealand have been leading the way by allowing brand value to appear on the balance sheet. Their example provided guidelines on how to deal with brand value. "In 1999, the UK Accounting Standards Board introduced FRS 10 and 11 on the treatment of acquired goodwill on the balance sheet. The International Accounting Standards Board followed suit with IAS 38. And in spring 2002, the US Accounting Standards Board introduced FASB 141 and 142 dealing with the same issues (recognizing goodwill on the balance sheet). There are indications that most accounting standards will eventually convert to the US model. This is because most international companies that wish to raise funds in the US capital markets or have operations in the United States will be required to adhere to US Generally Accepted Accounting Principles (GAAP)."

The principal stipulations of all new accounting standards are that acquired goodwill needs to be capitalized on the balance sheet and amortized according to its useful life. However, it is unrealistic to expect that intangible assets such as brands that can claim infinite life will be subjected to amortization.

While some companies have already started including brand value into their financial statements (insufficiently, because the values do not reflect the actual market value – the mentioned example of Coca-Cola), there are still many which do not do that (McDonalds brand does not appear on the company's balance sheet although it is estimated to account for about 92 percent of the firm's stock market value - see Table 1).

¹⁸ Source: http://www.interbrand.ch/e/pdf/IBZL_Brand_Valuation_e.pdf, p. 3, accessed on 08 May 2007

The biggest problem is the quality of brand valuations for balance sheet recognition. Companies use different methods of brand valuation, some of which are less sophisticated and produce questionable values. The debate about bringing financial reporting more in line with the reality of long-term corporate value is likely to continue, but if there is greater consistency in brand-valuation approaches corporate asset values will become more transparent.

CONCLUSION

Growing global competition and ever shorter periods of supremacy of products with inbuilt *latest* technology, the contribution of brand to its owners will keep on increasing. Brand is just one of several factors that provide stable competitive advantage.

Despite the commercial importance of brands, their management still lags behind that of their tangible counterparts. A number of techniques have been developed for managing production, that measure and analyse every detail of the manufacturing process using sophisticated computer systems. A similar situation is found in financial controlling. But, strangely, this cannot be said for the management of the brand asset. Although many brand measures are available, few can link the brand to long-term financial value creation. Brand investments and their results are not followed in detail nearly as much as investments in other assets.

As the importance of intangibles to companies increases, managers will inevitably need to install more value-based brand management systems that can align the management of the brand asset with that of other corporate assets and provide more reliable indicators on contribution of brand to the overall business performance. For that purpose, it is necessary to amend accounting standards because the current standards are inadequate for observing and analysis of intangible assets.

As the need for brand valuation is constantly increasing from both the management and the market, the first and most important step is the development of a unique economic use approach to brand valuation. Such a system may well become the most important management tool in the future.

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