Don't Waste Time with Brand Valuation

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There is widespread acceptance among senior management that strong brands represent significant assets of a business. With high levels of competition and excess capacity in virtually every industry, strong brands enable companies to differentiate themselves and to provide a basis for ongoing customer loyalty.

At the same time, there is a widespread but erroneous assumption that brands need to be valued. The publication of tables of brand values in magazines such as *BusinessWeek*, *Forbes*, and a number of marketing publications has raised the profile of brand valuation but unfortunately has done so without clarifying its purpose.

It is an obvious point but one that bears repeating — the mere act of valuing an asset, whether financial, tangible, or intangible, does nothing to improve its quality. Most companies do not need an answer to the question "What is the value of my brand?" except for the specific purpose of accounting for goodwill after an acquisition. Rather they need an answer to the question "How — and by how much — does my brand contribute to the overall success of my business?" It is this insight into the sources of customer value and the economic cost of delivering that value that will enable them to run more successful businesses. Brand value on its own provides nothing more than bragging rights at corporate cocktail parties.

In light of this, we suggest that companies should begin from the position that they do not need to value their brand(s) unless they have compelling answers to the following:

- What commercial objective will be served by a brand valuation?
- What is the asset we will be measuring if we do a brand valuation?

What Commercial Objective Will Be Served by a Brand Valuation?

In our experience, there are three basic reasons why a brand valuation may be justified:

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

Accounting purposes

Since March 31, 2004, gone are the significant differences that previously had separated international and U.S. rules on accounting for business acquisitions. Both U.S. and international rules (respectively Financial Accounting Standard 141 in the United States and International Financial Reporting Standard 3 from the International Accounting Standard Board) require that all identifiable intangible assets of the acquired business be recorded at fair value. This ends the previous practice of treating the excess of the purchase price over the net tangible assets acquired as a single goodwill figure.

Now there is a requirement that this single goodwill figure will be broken down into a number of specific intangible assets, leaving only a small residual amount of unidentified

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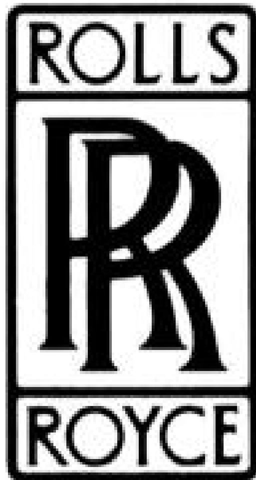
goodwill. The types of intangible assets that are now to be expressly recognized include technology-based assets, such as patents; contract-based assets, such as leases and licensing agreements; artistic assets, such as plays and films; customer-based assets, such as customer lists; and marketing-related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

If you acquired a number of brands as a result of an acquisition, U.S. and international rules now require you to report a value for these brands on your balance sheet. A recent example is the acquisition of the Miller Brewing Co. by South African Breweries. The Miller brands represent $4.5 billion of the $6.5 billion of intangible assets that appear on the SAB Miller balance sheet for 2003.



Transactional purposes
The second circumstance in which a brand valuation may be justified is to inform the terms of a prospective transaction. The transaction may be internal or external.

The two most common types of internal transactions involving brands are securitization or tax planning. Securitization involves raising funds against the security of future revenues, such as the $55 million that David Bowie raised in 1997. The "Bowie bonds" were backed by the future royalties anticipated on his pre-1990 records. Despite a lot of discussion, brands have rarely been used as the collateral in asset-backed securities.

Brand-based tax planning is, by contrast, a relatively common practice. Companies transfer the ownership of their brand and other intellectual property assets to a central holding company. The central IP holding company then charges a royalty for the use of these assets to the operating companies, enabling a portion of the profits of these operating companies to be shielded from local taxes. Obviously, the fiscal authorities require demonstration of the value of the brand asset that provides the basis for these royalty payments.

External transactions involving brands usually take the form of acquisitions of branded companies or of licensing of brands from third parties. In each case, commercial due diligence is required to verify the economic value of the asset being acquired or licensed and to inform the discussion over the deal terms. In the case of acquisitions, the knowledge that accounting rules now require allocation of the purchase price between the different types of assets acquired has heightened the significance of the preacquisition due diligence process.

Management of the brand

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The third commercial purpose that can be served by a brand valuation is the one that offers both the most opportunity for value enhancement and the greatest danger of wasted effort and expense.

In contrast to the technical and financial applications of brand valuation outlined here, in this case, the purpose of the valuation is purely to improve marketing's effectiveness. In theory its goal is to measure the extent to which brands enhance the underlying business performance and valuation of the company. In practice, the valuation model often gets subverted and used for defending marketing budgets.

The second major source of danger is that a brand valuation for marketing purposes requires greater thought about the nature of the asset being valued. Brand valuations for technical and financial purposes generally focus on a narrow definition of brand as the bundle of legally enforceable intellectual property rights that the brand owner has established. These center on the trademark itself but frequently also encompass the associated goodwill that the brand enjoys among its customers.

The specific details of the extent of the assets covered in the acquisition of a branded company were powerfully illustrated by Volkswagen's acquisition of Rolls Royce Motors for $667 million in 1988. The acquisition included all of the physical assets of the production of Rolls Royce and Bentley automobiles. But BMW, in a separate transaction, acquired the rights to use the Rolls Royce trademark in automobiles for $62 million.

Where a brand valuation is being contemplated for marketing purposes, considerable emphasis should be placed on determining the nature of the asset being valued.

What Is the Asset We Will Be Measuring If We Do a Brand Valuation?

In our experience there are three distinct definitions of the asset, all of which are sometimes referred to as the brand.

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A logo and associated visual elements. This is the most specific definition of brand, focusing on the legally protectable, visual, and verbal elements that are used to differentiate one company's products and services from another's and to stimulate demand for those products and services. The main legal elements covered by this definition are trade names, trademarks, and trade symbols.

However, in order to add value, trademarks and trade symbols need to carry "associated goodwill" in the minds of customers based on the experience or reputation of high-quality products and good service.

A valuation based on this definition of brand is more properly called a trademark valuation.

A larger bundle of trademark and associated intellectual property rights. Under this definition, "brand" is extended to encompass a larger bundle of intellectual property rights such as domain names, product design rights, trade dress, packaging, copyrights in associated colors, smells, sounds, descriptors, logotypes, advertising visuals, and written copy.

Some commentators have interpreted the intellectual property rights included in the definition of brand to encompass tangible as well as intangible property rights (for example, to include the recipe and production process in the case of Guinness). This more holistic view is consistent with the opinion that brand is a much broader and deeper experience than the logo and associated visual elements.

This is the definition of brand that is generally intended when talking about a brand valuation in a marketing context.

A holistic company or organizational brand. The debate as to which intellectual property rights should be incorporated into the definition of "brand" often leads to the view that brand refers to the whole organization within which the specific logo and associated visual elements plus the larger bundle of "visual and marketing intangibles" and the "associated goodwill" are deployed.

A combination of all these legal rights, together with the culture, people, and programs of an organization, all provide a basis for differentiation and value creation by that organization. Taken as a whole, they represent a specific value proposition and foundation for strong customer, supplier, and staff relationships. This definition of brand serves as the basis for a branded business valuation.

This broader perspective on the business is of significant value to those with strategic planning responsibilities. It illuminates the principal value drivers of the business and identifies how brand perceptions and preferences affect consumer purchase behavior and enrich staff and supplier relationships. As such, it makes a substantive contribution to understanding the sources and scale of a company's competitive position. It quantifies the size of the asset that the brand represents and — perhaps more important — identifies ways in which the value can be enhanced.

Going for Substance over Style

It comes as a surprise to many business professionals that the majority of brand valuations are performed for purposes other than marketing. But, as we have outlined here, there is a demonstrated commercial purpose for brand valuation in the context of accounting, tax planning, and commercial due diligence. Brand valuation for marketing purposes suffers from some muddled thinking.

Most senior marketers embrace the idea of value-based brand strategy and see brand valuation as a means to this end (and a basis for a compelling presentation to the C-suite). We applaud this goal but still advise caution before valuable resources are committed to a brand-valuation exercise. The process of valuing intangible assets such as human capital or brands is fraught with issues of definition, methodology, and measurement, with the result that the exercise frequently fails to deliver the expected benefits. For this reason, we recommend that significant thought be given to the

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interrelated issues of the commercial goal that will be supported by the brand valuation and the definition of "brand" to be used in the valuation.

Doing so will avoid some of the most frequent issues that arise due to the need to reconcile the economic, management reporting, and accounting perspectives on brand. It will also clarify whether the goal of value-based brand strategy and management might not be better served by devoting resources to better understanding the sources of customer value and the relative strength of a brand's equity rather than to brand valuation.

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