CHAPTER 13

Valuing Brands

The real monetary value of brands

Throughout this book we have referred to `brand values'. They can be critically important or small inconsequential things but above all they are the things which give the brand its worth and differentiate it. Through these brand values a product or service is enhanced beyond its functional purpose. In this context the brand provides the consumer with more value and this is why they are prepared to pay a premium to acquire it.

Various studies have been carried out in consumer markets to determine the premium that people will pay for brands over and above a base line. Assessing the value of intangibles by asking consumers to separate out the brand and place a monetary value on it is difficult because they do not do this in the real world. The purchase decision is taken in the round.

We now want to consider the value of brands in another context - that of their monetary worth if sold on the open market and how this value can be estimated even when disposal is not anticipated. At the onset of this discussion is it important to draw a distinction between individual brands owned by a company (eg Kit-Kat) and a brand which is also a company name (such as JCB). In principle the approach is the same in both cases but whether any valuation of a corporate brand name is realistic is more uncertain.

Goodwill and the value of brands

When a company is sold, it seeks to obtain a value over and beyond that of its tangible assets. Historically this has been referred to as `goodwill' and was taken to mean the value of the loyalty of the firm's customers. This is an interesting concept as we have seen that loyalty is an important component of branding so already it is clear that there is a strong link between goodwill and brands. After all, a *good* brand is one which customers insist on by name and for which they are prepared to pay a premium. This loyalty would have a value if the brand was ever sold.

Accountants are now refining their views of goodwill and accept that it extends beyond loyalty. On these grounds goodwill is taken to include other intangibles which enable a company to earn `super profits' or those profits over and above what could be expected from the tangible assets of the company alone. This concept of goodwill is important as it signifies that it is an asset, namely something which an organisation controls and which will provide future benefits. The asset of goodwill can be realised by the sale of a company but its very existence implies that it can also be assessed at any time and given an internal valuation - this view departs from the traditional approach which crystallised goodwill only at the time of sale.

Firms have a collection of intangible assets in the form of people (key personnel such as a skilled workforce, managers, scientists), special company procedures (such as ISO 9000 or other quality systems), distribution agreements (which keep the product in and the competition out) and patents (which give a product protection over a finite number of years). All these intangible assets have a value and in theory at least could be assessed within goodwill. In practice it is only aspects of goodwill such as patents that have been readily separated out for valuation. But other intangibles can in theory be separated out and one of relevance to this discussion, is brands. The recognition of brands as an asset to the company is not new to firms making consumer products but, hitherto, it has been largely ignored by industrial companies. In effect there has been a failure of industrial companies to recognise that brands do have a value, including the possibility that they also have a value on the balance sheet. However, as already mentioned, that the company name and brand are often one and the same in industrial markets, presents additional difficulties.

Internal valuations of goodwill are the subject of some contention in accountancy circles. Conventionally, it has been accepted that goodwill is something which only arises when a business is sold and until this happens the value of goodwill is not included in balance sheet assets. In this view goodwill is the difference between the price paid for the business the value of its net assets at that time.

This view recognises three components to goodwill. Two of them are of little importance for this book. The first includes any benefits which the company possesses, perhaps because it has a monopoly position or because it occupies a particular niche which others would find difficult to enter for legal or technical reasons. The second component arises from the fact that accountants find it difficult to precisely value all the identifiable assets and so there will be some over or under valuation which enters into the equation. It is in the third component of goodwill, the value of separately identifiable intangible assets, that our interest lies as it is here that any value attached to brands would fit but so too would any value that could be recognised in a company's distribution routes, key personnel or customer lists. Up to recently all these things have been lumped together as it has been deemed too difficult if not impossible to separate them from each other and the other components of goodwill.

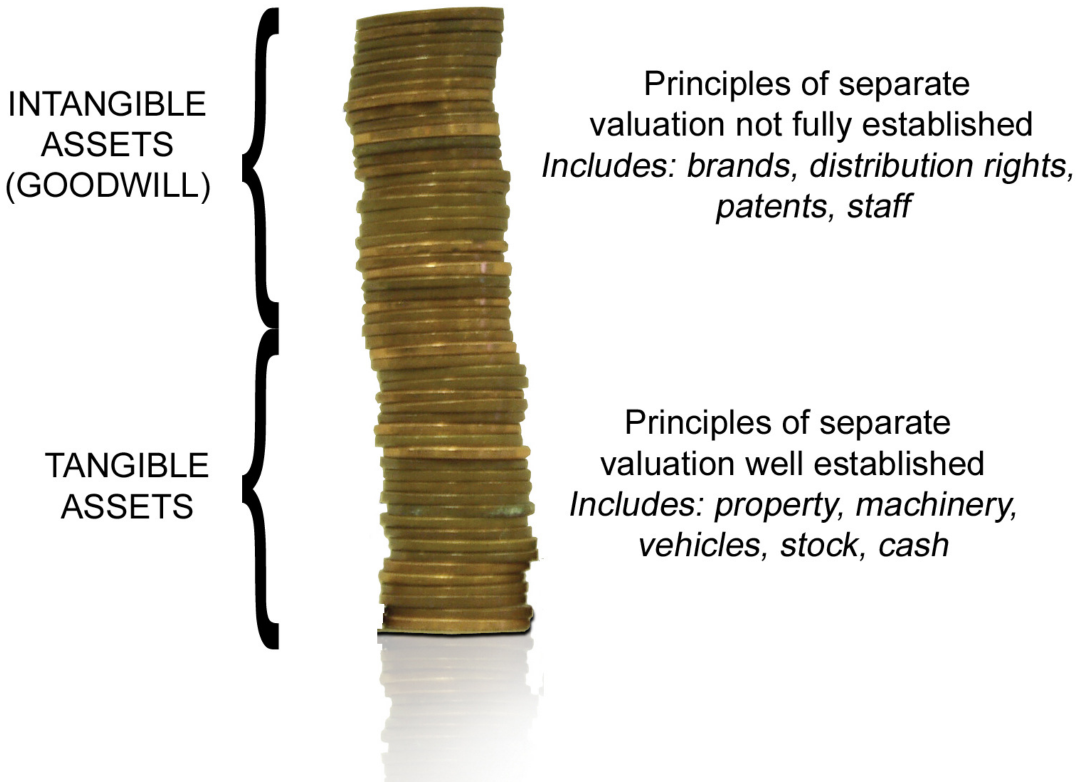

Figure 13.1 – Brands within the valuation of a company

Capitalising the value of brands

Over the last few years a number of companies have had separate valuations made of their brands, effectively giving them property rights which enable them to be taken out of goodwill and labelled as an identifiable asset on the balance sheet whether or not there is any intention of selling them. The brands which were singled out as having the potential for capitalising on the balance sheet were big names in consumer products because here it was easier to see them as something which could be removed from the company and sold separately. In other words they were given special status and not treated as part of the goodwill. Grand Metropolitan was one of the first companies to recognise this potential when, in August 1988, it arrived at an assessment of £565 million in respect of the brands, such as Smirnoff Vodka, it had acquired during the previous three years. This was followed shortly in November of that same year by Rank Hovis McDougall who capitalised its internally created brands, (ie not ones which had ever been purchased for cash) such as Bisto, Hovis and Mr Kipling, placing a value on them of £678 million. The significance of this act can be seen when it is set against the perspective of the company's net assets at the time which were only around £300 million.

Cadbury Schweppes was another pioneer in brand valuation and introduced a monetary assessment of its brands into its accounts in 1989. This acted to boost the asset value of the company bringing it closer to the share price valuation which had always been much higher as it included shareholders' appreciation of the potential of the company and recognition of the value of the brand's goodwill.

The controversy about brand valuation rumbles on because there are an increasing number of companies, purporting to have very high assessments of their brands, and they are not all in consumer fields. For example, in 1993 the US magazine, Financial World produced its annual listing of consumer brands and their valuations and there was one significant surprise. Jumping straight into third place, behind the world's two biggest brands, Marlboro and Coca-Cola, was the semiconductor giant, Intel with a brand valuation of $18 billion. This accomplishment followed a number of years of hard work on the part of Intel to make its mark in the world but how has it got there when it has spent nothing like the promotional budgets of its neighbours in the list which include Nestlé, Kellogg's and Kodak, not to mention to the two brands out front? And Intel is still up there in 2006; ranked 5th behind Coca-Cola, Microsoft, IBM and GE it has a brand valuation that has nearly doubled from that of 1993.

In the case of RHM or Cadbury Schweppes it is easy for us to see how one of the brands could be spun off and sold to another company without any disturbance to customers. As long as the brand continues to deliver the same qualities in terms of the product and its surround, most customers will not care who owns the factory. But what of a situation where the brand is the company, as in many industrial firms, the subject of our concern? Here the brand and the company are intertwined and because they are inseparable, one cannot easily be sold without the other.

Problems of capitalising the value of brands

Brands are vulnerable in being dependent on such intangibles as people's perceptions of them. Building these perceptions can take many years as reputations are earned by repeated proof that a brand justifies its position. The perceptions can, however, be destroyed overnight. When Hoover launched an offer of free flights in exchange for its vacuum cleaners and other products, it hoped that its market share would increase and the brand would become stronger. Market share was certainly won but at a substantial cost and not without rancour from customers who found catches in the offer. This was followed by thousands of words of unwanted comment in the media which ridiculed the scheme and lowered, not raised, the brand's image. By any measure, Hoover's communication was ineffective and this would surely have reduced its image and brand valuation. If the brand name had been capitalised, the asset value of the company should, arguably, have been reduced to reflect the harm caused by the free flight fiasco.

The world is full of stories of brand disasters from Ratners crap jewellery to Perrier's benzene contaminated water to a recent scare of salmonella in Cadbury's chocolate.

All brands have a value. The question is how much is it worth and how should it be capitalised if at all? The valuation of the brand at the time of the sale of a company is not usually a big issue as all aspects of the goodwill are wrapped up and that is the figure that someone is prepared to pay over and above the tangible assets. What is more contentious is the capitalisation of the brand's worth on the balance sheet as this requires brands to be separated out from the other intangibles. For, as in the case of Hoover, brand value can melt away quickly. So, whether or not the value of a brand can be separately assessed realistically, there remains the problem of confirming or reassessing its value each year. Similar problems face accountants in the valuation of other assets such as property (whose value can also fluctuate). The difference in the case of brands is the lack of an efficient market for them. The procedures and practices of valuation in this area are not yet agreed.

Procedures for valuing brands

A number of solutions have been proposed for placing a monetary value on brands but none are without controversy. One of the most publicised approaches is that devised by the branding consultancy, Interbrand. In this model of brand valuation there are four steps:

1. **Financial Analysis** - to identify business earnings and 'Earnings from Intangibles' for each of the distinct segments being assessed
2. **Market Analysis** - to measure the role that a brand plays in driving demand for services in the markets in which it operates and hence to determine what proportion of Earnings from Intangibles are attributable to the brand (this is measured by an indicator referred to as the 'Role of Branding Index')
3. **Brand Analysis** - to assess competitive strengths and weaknesses of the brand and hence the security of future earnings expected from that brand (this is measured by an indicator referred to as the 'Brand Strength Score')
4. **Legal Analysis** - to establish that the brand is a true piece of 'property'

This method of valuation is open to criticism as much can depend on just one or two key issues. In the case of Intel a considerable part of the brand value lies in its technical patents. However, if competitors manage to overcome this in their future designs then this will negate the factor which gave the massive boost to Intel's brand valuation.

Grand Metropolitan has valued newly acquired brands by determining the difference between the acquisition price and the fixed assets required to make them. However, since this equates broadly with accountants' assessment of goodwill, it must be assumed that the capitalisation of the brand also includes other goodwill components such as personnel, distribution rights, technologies and procedures etc. Also this approach is only possible following a sale or purchase of brands.

Yet another method of valuing brands is in terms of the incremental discounted future cash flows that would result from a product having its brand name in comparison with the proceeds that would accrue if the same product was anonymous. For example, when the Kellogg's brand was valued it was determined that in matched product tests with corn flakes cereal, choice increased from 47 per cent when the brand name was not known to 59 per cent when the Kellogg's brand was identified. Based on the financial market value of the company, this method of estimation extracts the value of the brands from the value of the firm's other assets.

This book has argued that branding is worthwhile because it strengthens a company's market position. This is a `motherhood' argument with which few would disagree. We have focused our discussion on the lost opportunity of building industrial brands since to us this is a much neglected area. In ten years time we are likely to look back on the approaches which are used for valuing brands and they will probably be established in the same way as the uncertainty surrounding the valuation of property was overcome. This work has begun on consumer brands which stand alone and can be isolated for analysis. In the future it is likely that the techniques will become still further refined and applicable to the corporate brands of industrial companies.

Summary of chapter 13

Brands clearly have a value to the companies which own them; the business is worth more because of the position of the brand in its market. Traditionally the value of a brand has been regarded as part of goodwill (the extra worth of a business over and above the value of physical assets) and accountants have only valued this at the time a business is sold - up to then it does not appear on the balance sheet.

In recent years some major consumer brands have been capitalised - a value has been put on the brand and included as a balance sheet asset of the company owning the brand. Various approaches to measuring brand value have developed but are not as yet standardised. Problems remain, including that brand worth can fluctuate quickly (eg as the result of some marketing disaster).

In most industrial markets there is additional complication to valuing brands; the brand and the company name are the same. Although, arguably, the two can be separated in theory, how or whether this should be done in practice is as yet uncertain. In the future, however, industrial companies may start to formally value brands and adjust their net worth accordingly.

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