

## Impact of brand valuation on brand management

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### Abstract

The key objective of this study is to explore the effects of different dimensions of brand valuation towards the original brand on the evaluation of brand management. 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. In this sense, many wise marketers and brands will seek inspiration from brands that won in the Great Depression. 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 management, brand value

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### Introduction

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.” 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 rejects 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 favorite brand, one of the panelists, who was speaking on behalf of the anti-globalization movement, replied ‘The Red Cross’. 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. Several studies have tried to estimate the contribution that brands make to shareholder value. The 2003 study by Interbrand concluded that on average brands account for more than one-third of shareholder value.

### 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.” 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 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.” In terms of ethical behavior, 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 according management**

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.

### **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 behavior 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 behavior. 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 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 brand.

### **Application of brand valuation system**

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

- 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 partner.

### **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:

- 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.

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- 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.

### Financial transactions

The financial uses of brand valuation include the following:

-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 time's 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 .”A similar situation to that involving the Coca-Cola Company, where balance sheets showed countries 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 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



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of brand valuation allowing the value of intangibles to be included into the balance sheet during the takeover process.<sup>18</sup> 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). 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.

### Calculation

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 analyses 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 company's 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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