ARCHER MALMO

THE IMPORTANCE OF MEASURING BRAND VALUE AND BRAND EQUITY

Brand value and brand equity represent two different, yet intricately linked, concepts. Brand value is the net present value of future cash flows from a branded product, minus the net present value of future cash flows from a similar unbranded product — or, in simpler terms, what the brand is worth to management and shareholders. Brand equity is a set of perceptions, knowledge and behaviors on the part of customers that creates demand and/or a price premium for a branded product — in other words, what the brand is worth to a customer. Brand equity may also be defined as a set of elements such as brand associations, market fundamentals and marketing assets that help distinguish one brand from another. While measuring brand value has its usefulness, the act of measurement by itself will not make a brand more valuable or less risky. Quantifying and managing brand equity, however, using a customized measurement model, is critical to transferring value to a corporation's shareholders.

BRAND VALUE

The value of every asset, whether tangible or intangible, can be estimated. Some assets are easier to value than others, and some valuations are more precise than others. Intangible assets, such as brands, often fall in the more difficult, less precise valuation category. While the valuation of brands requires techniques that are quite different from those used to value stocks or fixed assets, the basic principles are the same. First, from a shareholder's perspective, the value of a brand is equal to the financial returns that the brand will generate over its useful life. Second, any financial returns attributed to a brand must be discounted to account for market uncertainty and asset-specific risks. These two principles apply to the valuation of all assets, not just brands.

USES OF BRAND VALUATION

There are various circumstances that will require a corporation to measure the financial value of its product's brand and/or of its corporate brand. These include:

MERGERS AND ACQUISITIONS. Rarely will a corporation pay book value to acquire another business entity. The difference between book value and the acquisition price paid is called goodwill. Goodwill is often defined as the value of a business entity not directly attributable to its tangible assets and/or liabilities. Estimating the financial value of a brand helps determine the premium over book value that a buyer should pay.

LICENSING. One of the ways to cash in on the equity of a strong brand is by extending or licensing the brand. It is possible for both the licensor and the licensee to benefit economically from a licensing arrangement. The licensor benefits from a new source of revenue that requires little capital investment. The licensee benefits by having lower channel, advertising and customer acquisition costs.

FINANCING. While corporations do not carry brands on their balance sheets as long-term assets, financial markets recognize the contribution brands have on shareholder value. Companies with strong brands regularly obtain better financial terms than companies with poor brands. The higher the value of the brand, the better the terms.

BRAND REVIEWS. Usually, brand investment reviews entail the comparison — across brands and against competitors — of hard measures, such as sales and market share, and soft measures, such as reputation and awareness. For some brands, it is also important to determine financial value. Brand valuations allow companies to gauge their return on brand investment and to develop appropriate investment strategies across a portfolio of brands.

BUDGET ALLOCATIONS. Market mix modeling is employed by marketers who must make decisions about the allocation of budget and resources. Companies can now more accurately estimate the mix of marketing vehicles required to maximize both budget efficiency and marketing effectiveness. For some companies, brand valuations are an essential element of market mix modeling.

BRAND VALUATION METHODS

Several methods are commonly used to establish the financial value of brands. All of them should establish the future economic benefit of brand ownership, discounted for market and brand-specific risks. The most commonly used valuation models are: discounted cash flows, book-to-market, gross profit differential and relief from royalty. Before reviewing these models, though, it is important to have a clear understanding of the role that risk plays in estimating future financial value. This reflects the concept of risk beta, which can be explained as follows.
Every investment has an expected return, and that return has a certain level of risk, or variance, attached to it. The variance is a measure of the gap between expected and actual returns and is commonly referred to as the beta. In order to determine this variance, a company's performance is benchmarked against a larger portfolio or market. A market such as the S&P 500 or the Dow is assigned a beta of 1.0. Companies with a beta of less than 1.0 will have low volatility or risk, and those with a beta higher than 1.0 will have a higher risk. Regardless of the method employed to value a brand, it is important to first estimate its beta. The right approach would be to use the company's market beta and to adjust that beta for brand-specific risks. For example, the Altria family of companies may have a low beta, but its Marlboro brand will have a high beta once it is adjusted for legal and/or brand equity risks.

DISCOUNTED CASH FLOW. This is the most commonly used approach to brand valuation. A discounted cash flow model estimates the value today of a brand that will generate anticipated cash flows in future years. In other words, it suggests what the future economic benefit (cash) of the brand is worth today. Anticipated cash flows must be discoun$\frac{C}{(1+r)t}$o account for future risks and uncertainty. In simple financial terms, discounted cash flow can be expressed as:

$$DCF = \Sigma$$

Where **DCF** is the discounted cash flow, **C** is the cash flow inflow attributed to the brand, **r** is the discount rate or risk factor and should be calculated using the brand's beta and **t** is the number of discounting periods.

The actual formula used may be somewhat more complex. Enough data on cash inflows and risk factors must be compiled, and the right set of assumptions must be determined before any data modeling takes place.

BOOK-TO-MARKET. The book-to-market approach is used to estimate the value of an asset or brand by subtracting its book value from its market value. Book value is calculated by adding a company's total assets and subtracting liabilities and intangible assets. Market value is estimated by looking at market capitalization — that is, the value of all outstanding shares. This approach lets market forces determine the value of a brand. There are limitations to this approach, though. First, in the attempt to estimate the value of one of many brands, it is difficult to attribute a specific market capitalization to it. For example, what is the value of the Tide brand relative to the Procter & Gamble brand? Second, if the company is privately held, this approach will not work because a private company does not have market capitalization. The formula for book-tomarket valuation can be expressed as:

$$bv = m - b$$

Where **bv** is brand value, **m** is market value and **b** is book value.

GROSS PROFIT DIFFERENTIAL. For certain product brands, the easiest way to determine brand value is by using a gross profit differential approach. In this approach, the value of a branded product will be equal to the price of that product minus the average price of similar non-branded products. For example, the brand value of Scope mouthwash will be equal to the price of a unit of Scope minus the average price of all other non-branded mouthwashes times the number of units of Scope sold. In mathematical terms, this can be expressed as:

$$bv = (p - n)\ x$$

Where **bv** is brand value, **p** is the price of a branded unit, **n** is the average price of similar, non-branded products and **x** is the number of branded units sold.

RELIEF FROM ROYALTY. In this approach, a corporation uses the royalty fee it charges to license its brand as a proxy for brand value. In other words, if the company does not own the brand being valued, the company would have to pay the owner a royalty for the right to use the brand. The royalty is based on a percentage of income and is a function of the right being granted and other microeconomic and macroeconomic factors. Once a royalty fee is ascertained, a variation of the discounted cash flow method is used to estimate the actual value of the brand.

BRAND EQUITY

Brand equity consists of elements such as the brand associations, market fundamentals and marketing assets that distinguish one brand from another and that influence a customer's perceptions of or knowledge about a brand. When brand elements are favorable in a customer's mind, brand equity is considered to be positive. When they are not favorable, the brand equity is negative.

Positive associations of a brand in a customer's mind are generally stronger and more sustainable than those of a product, assuming that sufficient investments are being made in appropriate brand management. Brands with positive equity will consistently generate, maximize and grow cash flows. They achieve this by commanding a price premium, allowing for brand extensions and licensing, creating barriers of entry, attracting and retaining more valuable customers and reducing the costs of customer acquisition.

Positive brand equity drives customer value, which in turn drives shareholder value. To leverage positive brand equity, marketers must take a measured approach to identifying, developing and managing brand elements relevant to the corporation and its products.

BRAND ASSOCIATIONS. A brand association is a specific perception, whether real or imagined, that a customer has about a product, service or organization. For example, someone might associate Enron with corruption and Kia with low cost. For each of these brands, the association elements that must be measured and managed would be different. For example, Enron's level of awareness would be less critical to measure than Kia's. Commonly used measures of brand associations are awareness, quality, loyalty, image, relevance and value proposition. However, the list of elements that one would measure could be endless. What gets measured depends on a brand's unique map of brand associations and assets that make it possible to manage and optimize brand equity in order to identify, attract and retain customers.

BRAND ASSETS. The elements that drive brand equity go beyond customer associations to include a brand's business assets. These assets include, but are not limited to, intellectual properties, business processes and distribution reach. For example, it does not matter how many positive associations a customer has of a brand if that product cannot be found where the customer shops. Gillette's most important brand asset is its business process. For Coca- Cola, it is its distribution reach (see below).

THE VENEZUELA COLA WARS

Between 1970 and 1995, Pepsi had a stranglehold on the Venezuelan soft drink market. Pepsi's investment in marketing had helped it acquire a 45% market share. In contrast, Coca-Cola's investment of millions of marketing dollars over the years in an effort to wrestle market share away from Pepsi had resulted in a meager 10% gain. Pepsi felt confident that its strong brand associations would make it impossible for Coca-Cola ever to be a serious competitor in this market. But Pepsi's lack of understanding of its own brand equity led it to ignore one of the most important elements: distribution reach. In 1996, following years of inattention by Pepsi to its distribution partners, Coca-Cola surprised Pepsi by acquiring a controlling stake in Pepsi's oldest and largest bottling franchise in Venezuela. In just three months, Pepsi's market share in Venezuela was virtually wiped out by Coca-Cola.

MARKET FUNDAMENTALS. Corporations do not operate in a vacuum. A brand's equity can be negatively affected by actions taken by governmental and non-governmental organizations. A city ordinance banning smoking will dilute the equity of a tobacco brand. Brands are also affected by competitors' actions and business strategies. A drop in price by one airline will become a brand liability for another airline. It is important to assess how market events increase or decrease brand equity risks.

A MEASURED APPROACH

William Bruce Cameron once said: "Not everything that counts can be counted and not everything that is counted counts." There are a number of methods that can be used to estimate the financial value of brands. As we have seen, financial brand valuations can be useful under certain circumstances. However, it must be stressed that financial measurement alone will not make a brand more valuable. To create value for shareholders, corporations must also focus on qualifying, measuring and managing the equity elements of their brands.

Contact Tom Fornoff at Archer Malmo to find out how to optimize your brand value and brand equity: **512.532.2912** or **tfornoff@archermalmo.com**

About Archer Malmo

Archer Malmo, with offices in Memphis, Tennessee, and Austin, Texas, provides brand development, advertising, public relations and digital marketing services for national brands across a variety of categories. The agency's combination of discipline specialists, strategic orientation, creativity and culture yields strong client relationships and positive business results. Founded in 1952, the company has 200 employees, has been recognized by Advertising Age and PR News as a "Best Place to Work," was listed on the 2013, 2014 and 2015 "Inc. 5000", was named a 2016 B2B Top Shop by Chief Marketer, and is one of the Agency Post's top ten agencies for startups.

ARCHER MALMO

For more information on Archer Malmo, visit archermalmo.com or call Tom Fornoff at 512.532.2912