BRAND VALUATION

Brands are one of the main assets of organizations today. They express the promise of the organizations purpose, through their names, terms, signs, symbols, and logos that identify goods, services, and companies. Brand Value is more than a number, it is the financial expression of what it represents in its relationship with all its stakeholders. The ability of a brand to keep offering newer products and technology, and the connect with stakeholders, is who give it a premium. Brands help stakeholders to select from products or companies, create engagement with them and ensure proper communication of the intrinsic quality of products and services. It is the importance of these functions that makes brand valuation extremely important and a tool for any modern decision maker.

What's a brand?

There are several definitions of a brand. The most common is that brand is a "marketing-related intangible asset including, but not limited to, names, terms, signs, symbols, logos and designs, or a combination of these, intended to identify goods, services or entities, or a combination of these, creating distinctive images and associations in the minds of stakeholders, thereby generating economic benefits/values" (*ISO 10668 standard*)

There is some confusion in the interpretation of the concepts of Brand Value and Brand Equity. In a simple way we can define brand value as the company's perspective and brand equity as a composite that defines the stakeholder's perspective. Brand equity is a multidimensional construct composed of brand strength and the way it affects brand value.

Brand evaluation and brand valuation

Brand evaluation refers to the measurement of the value of a brand using relevant indicators of input brand development elements and output dimensions that assess the impact of the brand on consumers. Brand Valuation can be defined as the process used to calculate the value of a brand or the amount of money another party is willing to pay for it or the financial value of the brand. Brand valuation refers to the estimation of the monetary value of a brand to a company in a transaction whether it is internal or external (as with an investment, purchase, sale or licensing agreement). It is the financial equity the company has in the brand as a transferrable asset. Brand evaluation is broader and includes non-monetary considerations, namely Brand Equity. Brand evaluation and brand valuation are related and synergetic with each other. Brand valuation is defined from the entity's point of view. Brand evaluation derives from the stakeholder's point-of-view. The fundamentals of brand evaluation focus on evaluating brand value using both elements and dimensions, thereby determining brand strength, brand performance, and financial results. Elements determine the input which the brand operating entities allocate to the brand, while dimensions measure the external reactions to the brand. (*ISO 20671 standard*)

Current Trend/Practices in Brand Valuation- Importance of standardization:

International Organization for Standardization (ISO) came up with ISO 10668 – Monetary Brand Valuation in 2010, which laid down principles which should be adopted when valuing any brand.

ISO 10668 is a standard which specifies the principles to be followed and the types of work to be conducted in any brand valuation. It is a summary of existing best practice and intentionally avoids detailed methodological work steps and requirements. As per ISO 10668, each brand is subjected to an analysis on three levels – Legal analysis, Behavioral analysis and Financial Analysis. Taking in consideration that the nature and concept of value is difficult to grasp on account of being subjective in nature, these three methods of analysis objectify the valuing of brands.

Legal Analysis is the method that draws a distinction between the trademarks, the brands and the intangible assets involved and defines them as separate entities. After the brand valuer has clearly determined the intangible assets and Intellectual Property rights included in the definition of the 'brand' in concern, (s)he is required to assess the legal protection afforded to the brand by identifying each of the legal rights that protect it, the legal owner of each relevant legal right and the legal parameters influencing negatively or positively the value of the brand. Extensive Risk analysis and due diligence is required in the legal analysis and the analysis must be segmented by type of IPR, territory and business category. In other words, the valuer needs to observe and assess the legal protection afforded to the brand by identifying each of the legal rights that protect the brand, the legal owner of each of those legal rights and the legal parameters positively or negatively influencing the value of the brand.

Behavioral analysis involves understanding and forming an opinion on likely stakeholder behavior specific to geography, product, and customer segments where the brand is operational. For perusal using this method, it is necessary to understand the market size and trends, contribution of the brand to the purchase decision, attitude of all stakeholder groups to the brand and all economic benefits conferred on the branded business by the brand. Here, the brand valuer must also investigate why a possible stakeholder would prefer the brand in comparison to that of the competitors' and the concept of brand strength which is comprised of future sales volumes, revenues, and risks.

Financial Analysis is the most frequently used brand valuation method and uses four approaches – Cost, Market, Economic. Each case must be evaluated on individual basis, based on how much value the buyer can obtain from the market as a result of this purchase, and how much of this value the seller will be able to obtain from this buyer.

The evaluator has an obligation to justify the strength of the indicator, the sources of data that inform it, the frequency of data accessibility and its limits in reflecting the contribution of the dimension toward brand value.

Alternative valuation methodologies

There are numerous alternative valuation methodologies. Below, we can find a brief description of the most used**:**

Cost Based approach is the approach more often used by Aaker and Keller and is primarily concerned with the cost in creating or replacing the brand. It is sometimes possible to value brands based on their cost to create or what it might cost to recreate a similar brand, with equivalent consumer appeal and commercial utility. Such costs typically include naming, research and product design, packaging, design, advertising, trade, and consumer promotional spend. A proportion of promotional spend is short-term maintenance expenditure and only a proportion creates long-term brand value. Consideration is given to all costs (expressed in current values) associated with replacing or replicating the intangible asset, less an allowance for any forms of depreciation that might be present. In the case of a brand, depreciation from current replacement or replication cost is not necessarily present and where it is present, is likely to be associated to a deterioration of market recognition, profitability of goods and services or combination of both. In the case of a very valuable brand, a purchaser may pay a premium over the cost of developing comparative market recognition to avoid the time necessary to do so.

Market based approach basically deals with the amount at which a brand is sold and is related to highest value that a "willing buyer & seller" are prepared to pay for an asset. This approach is most used when one wishes to sell the brand. Also known as the 'sales comparison' approach, this is where fair market value is determined by making comparisons with actual sales of comparable assets, namely actual sales of trademarks or trade names. However, unless they are acquired with all the tangible and intangible assets of a business enterprise, it is uncommon for brands to be sold outright. Therefore, it is rare to find examples of prices paid in outright sales. Furthermore, brands are unique and unless there is a transaction in the actual brands under consideration, any comparison of prices is likely to be either unhelpful or require significant adjustments.

Income Based or Economic Use approach is the valuation of future net earnings directly attributable to the brand to determine the value of the brand in its current use (Keller, 1998; Reilly and Schweihs, 1999; Cravens and Guilding, 1999). This method is extremely effective as it shows the future potential of a brand that the owner currently enjoys, and the value is useful when compared to the open market valuation as the owner can determine the benefit foregone by pursuing the current course of action.

The methods used under this last approach are as follows (*ISO 10668)*:

1) Income split method

This values the brand as the present value portion of the economic profit attributable to the brand over the rest of its useful life. This has problems in that profits can sometimes be negative, leading to unrealistic brand value, and that profits can be manipulated so may misrepresent brand value. This method uses qualitative measures to decide the portion of economic profits to be accredited to the brand. This is the brand valuation method favored by many brand valuers for allocating total branded business value to specific intangibles, one of which is the brands. It looks at the value of the brand from the perspective of the brand operator as an integral part of its business. These kinds of approaches are acceptable for a judgmental allocation of value but are either heavily dependent upon expensive and complex quantitative market research or on subjective judgement on the part of the valuer.

2) **Multi-period excess earnings method**

This method requires a valuation of each group of intangible assets to calculate the cost of capital of each. The returns for each of these are deducted from the present value of future cash flows and when all other assets have been accounted for, the remaining is used as the value of the brand.

3) **Incremental cash flow method or Excess Margin**

Identifies the extra cash flow in a branded business when compared to an unbranded, and comparable, business. However, it is rare to find conditions for this method to be used since finding similar unbranded companies can be difficult.

4) **Price Premium Method**

The premise of the price premium approach is that a branded product should sell for a premium over a generic product (Aaker, 1991). The Price Premium Method calculates the brand value by multiplying the price differential of the branded product with respect to a generic product by the total volume of branded sales. It assumes that the brand generates an additional benefit for consumers, for which they are willing to pay a little extra. The fault in this method is that where a branded product does not command a price premium, the benefit arises on the cost and market share dimensions.

5) **Royalty Relief Method**

To determine the cash flow generated by the brand, the royalty relief method can be applied. This method shall measure the value of the brand as the present value of expected future royalty payments, assuming that the brand is not owned but licensed. This approach hypothesizes two separate businesses, one involved in manufacturing and/or marketing and one in brand ownership. Hence, the value of a brand owned by a company can be approached by determining the royalties it would have to pay if it were the licensee of the brands rather than the owner. The current capital value of the brand is calculated using discounted cash flow to arrive at the current value of the expected future royalties saved by the owner. The value calculated through the royalty relief method thus constitutes the present value of the royalty payments saved through the ownership of the brand. The royalty rate applied in the valuation shall be determined after an in-depth analysis of available data from licensing arrangements for comparable brands and an appropriate split of brand earnings between licensor and licensee and shall be as close as possible to brands with the same characteristics and size as the brand subject to valuation. It should be noted that the level of royalties paid may not equate to a full ‘price premium’, ‘excess margin’ or ‘earnings split’ figure. Royalty rates are usually set in a commercial negotiation by reference to these factors and other qualitative factors. The rate determined is intended to equate to a market rate for the brand. The royalty relief approach is a generally accepted methodology for valuing brands. It is widely used and based in commercial reality. For these reasons OnStrategy believes that this method is most appropriate for huge range of brand valuation exercises as the primary valuation method.