

## Brand Valuation: Why & How

### Background to Brand Valuation

Branding is by no means a new concept. However the process of valuing a brand and placing this value on the balance sheet in the same way as you would for tangible assets is.

In the 1980's asset strippers and corporate raiders purchased companies with substantial brands and paid significantly more than their net asset value in the process. This led to extremely large goodwill values that needed to be accounted for. It also led to the recognition that brands and other intangible assets needed to be accounted for in a manner than could be stated on the balance sheet and hence write-offs could be avoided.

Ranks Hovis McDougall is said to have been the first company to ascribe a value to its portfolio of brands and include this figure on its balance sheet. It capitalised its brands in defence of a takeover bid by Goodman Fielder Wattie.

Since this first brand valuation much work has been conducted to develop the process and through the introduction of both International and UK based accounting standards, guidelines have been set as to the manner in which brand valuations should be conducted. Almost 20 years after the first brand valuation was conducted it still remains a somewhat contentious issue especially within the accountancy profession and it is apparent that further work is needed to give the process the credibility it deserves.

Possibly the strangest facet of the current accounting legislation surrounding brand valuation is that internally generated brands can not be capitalised as this would involve the resurrection of costs that have already been written off to the profit and loss account, giving rise to the possibility of creative accounting.

### Uses:

The uses of brand valuations can be split into two broad categories, namely Accounting and Marketing.

#### Accounting:

- Balance sheet reporting
- Tax Planning
- Licensing & Franchising
- Mergers & Acquisition
- Litigation Support
- Investor Relations
- Securitised borrowing

#### Marketing:

The focus of this publication is marketing it therefore seems appropriate to expand on the list of applications that brand valuation increasingly has as a tool in aiding marketing management:



- *Portfolio reviews:* The creation of a brand valuation model will enable a company to develop / rationalise an existing portfolio to maximise shareholder value.
- *Budget determination:* Brand valuation and competitor benchmarking can help companies develop above-the-line budgets for marketing activities.
- *Resource allocation:* The first step in brand valuation is agreeing on a suitable level of segmentation to be utilised in the valuation process. When a brand is valued in an individual market or consumer segment decisions can be made as to an appropriate split of resources behind these segments based on the value they generate.
- *Performance tracking:* The adoption of brand valuation as an ongoing tracking tool allows varying brand strategies and marketing investment as well as the performance of different marketing teams across an organisation to be monitored.
- *Internal communications:* The financial measure of brand value plays a role in explaining performance within a company and as a motivating factor to management.
- *New product development:* By using a financial model using predictive research the brand's impact on volume and price can be used to identify if new product development through brand extensions or stretch is viable.

## **Approaches:**

A number of different approaches can be adopted when faced with the task of valuing a brand. In brief they are as follows:

*Cost:* This method looks at all the costs that were incurred in creating a brand or what it might cost to recreate a brand hypothetically. This valuation methodology is, in reality, very rarely used as the costs incurred are more often than not substantially less than the actual value of the brand in the same way as the price of a property is not identical to the cost of the raw materials and labour utilised in building it.

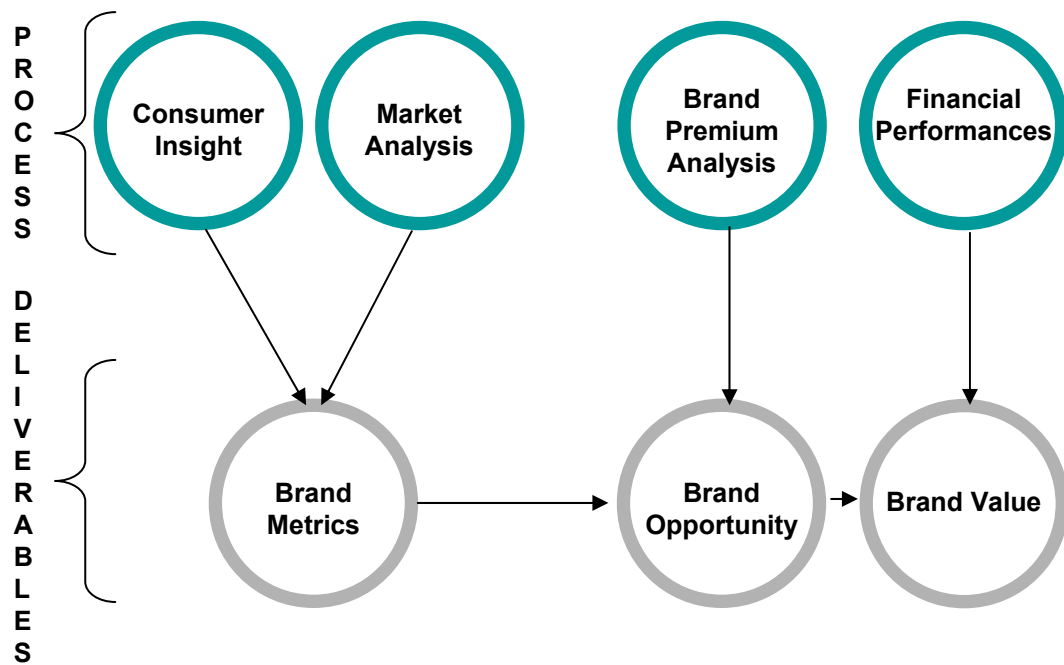
*Market value:* It is theoretically possible to estimate a brand's value based on market transactions involving comparable brands. However this process relies on two factors the first being that these market transactions are publicly available, which is often not the case, and the second being that they are comparable, this is also unlikely as brands by their very nature are unique.

*Economic use:* This process records the economic value of the brand in its current use, to its current owner. It is similar to a cash flow valuation that analysts use to value shares merely focussing on the gross profit attributable to selling a branded rather than a non-branded good. Originally economic use valuations were based on a multiple of historical brand attributable earnings however they are now more commonly based on the discounted value of future brand earnings.

*Royalty Relief:* This valuation process is based on the assumption that if the company in question did not own its own brand it would need to license one from someone that did. In doing so a royalty rate charge would be made based on turnover. The fact that the company does own a brand leads to the name 'royalty relief' as it does not need to incur this charge. Future sales (rather than future gross profit as for the Economic use approach) are forecast, a royalty rate applied to provide an income attributable to the brand that is then discounted back to a net present value.

# VIEWPOINT

The diagram below illustrates the brand valuation methodology utilised by Intangible Business Ltd. It is based on the Royalty Relief methodology:



Copyright Intangible Business Ltd. 2002