measuring and valuing brands

Increasingly, intangible assets such as brands are what determine the value of a business. Consequently, according to Caelum Moffatt, finance directors need to become more proactive and systematic in assessing the strength and value of their company's brand.

"The brand is not the product but it gives the product meaning and defines its identity in both time and space."

These insightful words, which offer a brief and simplified description of a brand, are from Jean-Noel Kapferer, widely revered as one of the experts on branding and brand management.

Since 1900, when James Walter Thompson published a house advertisement explaining trademark advertising, companies began to adopt logos and jingles on all forms of media to assist the selling of their product and it was not long before manufacturers started to notice consumers developing an emotional bond with the product.

As brand management developed during the 20th century, major organisations began to realise that it was not the brand which created value – it was the way the brand was managed by the company. It is a combination of tangible and intangible assets that a consumer buys, not just the name.

defining a brand

A brand is a form of 'relational capital'. In effect it represents the value of the company's relationships with customers, suppliers and allies enshrined in the company's image and reputation. A brand is more than a name or a logo. Many companies claim they have a 'brand' when all they really have is some form of name awareness in a specific market and this position may only be a temporary phenomenon.

To be a brand requires the product or service to have a more permanent status. At Moffatt Associates we found the following definition to be more relevant: 'A brand represents a premium valuation, because it is what consumers of the product or service will choose for rational and/or emotional reasons, even though an alternative is available and cheaper'.

In measuring brand strength there are five key attributes that need to be measured using market research:

- **knowledge** – awareness of the brand and an understanding of what it represents
- **quality** – perceived quality of the brand and positive distinctive attributes
- **loyalty** – the willingness with which buyers continue to use the product or service
- **leadership** – the extent to which the brand is seen as superior to its competitors
- **differentiation** – the sustainability of the brand and how it differs from competitors.

building a brand

Brands are not created overnight despite the claims of some advertisers. The process takes time. From a product development and marketing communications perspective, the key challenges are a) turning the unaware into users and b) users into ambassadors. This requires significant and regular investment in both internal and external communications. All four of the following criteria need to be fulfilled:

- **understanding** what the market needs now and in the future
- **knowing** exactly where you are positioned in the market – threats and opportunities
- **creating and promoting** a clear and consistent set of value-added propositions which meet and anticipate market needs
- **ensuring** all parts of the business are capable and willing to deliver the propositions.

brand valuation

Three years ago, the International Accounting Standards Board (IASB) introduced IFRS 3 'Business Combinations' along with revisions to IAS 36 and IAS 38 the 'Impairment of Assets' and 'Intangible Assets' respectively. This ensured that acquired intangible assets were, for the first time, independently valued.

This measure aimed to test the difference between the total of net assets acquired and cost of acquisition (goodwill) annually. In addition, the measure aimed to promote the need for independent specialists to examine and analyse intangible and tangible assets in order to improve the efficiency and reliability of the company's actual valuation.

Valuation by discounted cash flow is a very popular method, where annual income attributed to the brand over a five to ten year period is recorded and the discount rate used is weighted against the average cost of capital. Likewise, another widely used method in the UK is the multiple method using the price/earnings ratio which links the market capitalisation of the firm to its net profits.

case study: Mowlem – brand valuation

Moffatt Associates was commissioned to run a brand valuation for Mowlem in association with KPMG. Following completion of Moffatt's work, Mowlem's then finance director said:

"The Bravo methodology devised by Moffatt Associates highlighted the importance of Mowlem's standing and its brand name. Moffatt Associates evaluated the competitive strength and financial value of the Mowlem brand, and the output of this work can help promote and secure an increase in market awareness of Mowlem and potentially recognise the value of intangible assets on the balance sheet."

Mowlem used these results to better focus its marketing efforts in support services and promote cross-selling within the business. It also revealed that the competitive brand equity value of the business was significantly in excess of its stock marketing rating (£255m compared with £183m). Mowlem's brand value was reflected in the sale price of £290m when Carillion bought the business in 2006.

Since the introduction of IFRS 3 in March 2004, Moffatt Associates has also been working to create a hybrid valuation model integrating, fusing and modifying a wide spectrum of established methodologies which encompass income, market and cost based evaluation. This has resulted in a new method – which we call Bravo – and which is a simple three stage process:

- **market research** – this is performed in order to capture perceptions of the brand and the expectations and experiences of the brand relating to knowledge, quality, loyalty, leadership and differentiation
- **derivation of brand multiples** – the historic and current P/E ratios of similar companies are taken. When given the results for brand strength, the results can be plotted on a sector specific curve which will then reveal the brand multiple for the product or service in question. This multiple is then adjusted to account for the level of brand differentiation of competing brands
- **profit performance** – finally, the business' profits for the last representative period are adjusted for inflation for an average profit figure which is then multiplied by the brand multiple to give a brand value. This process is repeated for each brand within the company.

benefits of brand valuation

The figures presented in the Mowlem case study (see box) for the importance of brand management, valuation and intangible assets speak for themselves. It is a most under-represented and under-estimated area of business, which is only now coming to the forefront of company management and strategy. An accurate brand valuation would:

- increase asset value
- improve market rating
- aid in valuing acquisitions and disposals accurately and efficiently
- improve benchmarking against competitors
- enhance value-added decision-making
- reduce the cost of finance.

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leaving the comfort zone

The secret has been exposed and change must be imminent. Increasingly, intangible assets such as brands are what determine the value of any business and the statistics advocating brand recognition are becoming unavoidable for accountants. Yes, calculating brands is a task of Herculean proportions because each one is different to the next. They are unique and this is what makes them so valuable.

If accountants do not balance the intangibles then we risk unbalancing the future management and protection of our companies, potentially placing them under threat of under valuation and exploitation.

Caelum Moffatt – Moffatt Associates

Moffatt Associates focuses on helping large companies, investors and market regulators evaluate market potential and/or build and measure brand value and improve the effectiveness of management teams. For more information on Bravo, visit **www.valueyourbrand.com** or call Moffatt Associates on 020 7317 2770.