

Brand Valuation

A versatile strategic tool for business

Creating and managing brand value™

Interbrand



Brand Valuation

A versatile strategic tool for business

by Mike Rocha

Compared to when Interbrand first pioneered brand valuation in the 1980s, global business leaders now widely accept the importance and value of strong brands -- and the significant role they can play in enhancing business performance.

Strong brands enhance business performance primarily through their influence on three key stakeholder groups: (current and prospective) customers, employees, and investors. They influence customer choice and create loyalty; attract, retain, and motivate talent; and lower the cost of financing.

The influence of brands on current and prospective customers is a particularly significant driver of economic value. By expressing their proposition consistently across all touchpoints, brands help shape perceptions and, therefore, purchase behavior, making products and services less substitutable. In this way, brands create demand, allowing their owners to enjoy higher returns. Strong brands also create continuity of demand into the future, thus making expected returns more likely – or less risky. Brands, therefore, create economic value by generating higher returns and growth, and by mitigating risk.

Interbrand's brand valuation methodology has been specifically designed to take all of these stakeholders and value-creation levers into account. Role of Brand analysis is about understanding purchase behavior: the brand's influence on the generation of demand through choice. Brand Strength measures the ability of the brand to create continuity of demand into the future through loyalty and, therefore, to reduce risk. In doing this it considers 'internal' (management and employee) and 'external' (customer) factors. Finally, these inputs are combined with a

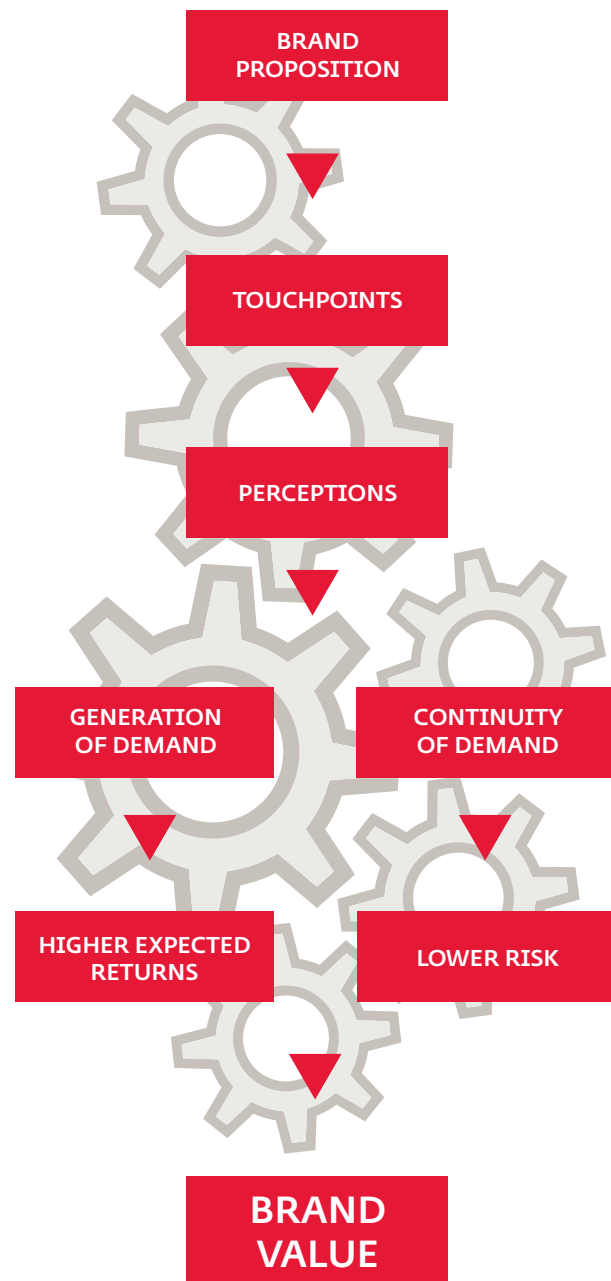


Figure 1. Brand Value Chain

financial model of the business to measure the brand's ability to create economic value for its owner.

It is quite possible that you believe that your brand could be (or is) a significant source of competitive advantage for your business, but you are unsure of how a brand valuation exercise could help you.

The business applications for brand valuation can broadly be categorized into three areas:

- Financial
- Brand management
- Strategy/ business case development

Financial Applications

Increasingly, CEOs are placing more emphasis on their companies' brands in investor communications. Many more annual report column inches are now dedicated to discussing an organization's commitment to its brand, from the CEO down. Numerous companies take their brands seriously enough to report on their value over time to investors.

	Financial	Brand Management	Strategy/Business Case Development
Applications	<ul style="list-style-type: none"> ◆ Investor relations ◆ Mergers & acquisitions ◆ Licensing/royalty rate setting ◆ Financing/securitization ◆ Tax valuations ◆ Balance sheet valuations 	<ul style="list-style-type: none"> ◆ Brand performance management ◆ Brand portfolio management ◆ Resource allocation ◆ Brand tracking/ dashboards ◆ Return on investment analysis ◆ Organizational brand engagement ◆ Management KPIs 	<ul style="list-style-type: none"> ◆ Brand positioning ◆ Brand architecture ◆ Brand extension ◆ Brand launch ◆ Business case for brand investment ◆ Co-branding/JV analysis
Typical Frequency	One-off	Recurring	One-off
Primary Objective	A robust value with supporting analysis	Ongoing brand management leading to insight and recommendations to grow brand value	Business case connecting brand change/investment to expected financial results

Figure 2. Brand valuation applications

“Brand valuation provides a common language for brand performance around which a company can be galvanized and organized. Responsibility for Brand Strength factors can be allocated to functions, building engagement and a sense of responsibility for the brand across the organization.”

Brand also continues to be a key driver of acquisition premiums in M&A. Often, it is the latent potential of the brand that is driving this premium through its ability to enter new markets and extend into adjacent categories. A broad skill set, combining market research, brand, and business strategy, together with business case modeling, is required to quantify the latent financial potential of the target brand.

Interbrand's brand valuation methodology can also be used to complement other more traditional techniques for setting royalty rates for brands. By identifying the value created by a brand for its business, combined with an evaluation of the relative bargaining power of the parties involved, we are able to advise on the proportion of brand value that should be paid out as a royalty rate in return for the right to exploit the brand.

Brand Management Applications

Ultimately, everything we do as brand managers should be considered through a value creation lens. Considerable investments are made in brands and, ultimately, it is important to determine if these actions are creating value for your customers and, in turn, your shareholders. Interbrand's brand valuation methodology seeks to determine, in both customer and financial terms, the contribution of the brand to business results.

A strategic tool for ongoing brand management, it brings together market, brand, competitor, and financial data into a single, value-based framework within which the performance of the brand can be assessed, areas for improvement identified, and the financial impact of investing in the brand quantified. It also provides a common language around which a company can be galvanized and organized.

Role of Brand analysis lets us know where investment in (and focus on) brand improvements will have the biggest impact. It can be thought of as a measure of 'brand leverage'.

Brand Strength is the key diagnostic tool with which we can measure brand performance and better understand the

reasons behind a brand's strengths and weaknesses, both internally and externally. It supports strategic brand management by prioritizing areas of highest impact for managers.

Typical deliverables from a Brand Strength analysis are:

- A 'heat map,' indicating areas of strong and weak performance for the brand (this can be across geographies, products, or customer groups, for example).
- Drill-down analysis into specific segments in the portfolio to identify reasons for over- and under-performance.
- Recommendations for improvement on Brand Strength factors, together with a cost benefit analysis to inform prioritization.

The core benefits of Brand Strength analysis are that it:

- Enables constructive dialogue about the brand between different parts of the business by creating a common language for discussion of brand performance.
- Provides global and local managers with an actionable tool to make informed marketing decisions—empowering management with insights to implement brand strategy.
- Allows responsibility for performance on the ten Brand Strength factors (see below for further details) to be allocated to functions across the business, building engagement and a sense of responsibility for the brand across the organization.

Finally, when the Role of Brand and Brand Strength analyses are connected to the financial model, they provide a framework for resource allocation and prioritization based on the opportunities to enhance brand performance that are expected to have the greatest impact on brand and business value.

Strategy/Business Case Applications

From time to time, businesses need to evaluate significant changes in brand strategy, whether it be repositioning, brand architecture, brand extension, or even a complete rebrand. These kinds of changes typically involve significant financial outlay upfront, along with a high degree of uncertainty over when, or whether, a positive return will be made on that investment.

Some CEOs are willing to make these critical brand strategy decisions based on qualitative strategic analysis and intuition. The majority, however, are looking for a business case that goes further. They want to understand the likely overall financial impact on the business over time, covering a range of alternative scenarios. In addition to a detailed breakdown of the expected costs to deliver, a rounded business case will also quantify the expected impact on the top line through the modeling of key revenue drivers (these will vary based on the business, but could include customer acquisition, churn, price premiums, share of wallet, frequency of purchase/visit, average basket size, and so on) and on profit margins from any operational changes required to deliver the new strategy. Finally, sophisticated techniques such as Monte Carlo simulation may be employed, running thousands of possible permutations in order to estimate the most likely outcome.

By bringing together market, brand, competitor, and financial data, the brand valuation model is the ideal framework within which such business case modeling can be conducted.

As global competition becomes tougher and many competitive advantages, such as technology, become more short-lived, the brand's contribution to shareholder value will only increase. Brands are one of the few business assets that can provide long-term competitive advantage.

Companies as diverse as Samsung, Philips, Hyundai, and AXA, among many others, have used brand valuation to help them refocus their businesses on their brands, motivate management, create an economic rationale for branding decisions and investments, and make the business case for change.

Although many brand metrics are available, few can link the brand to long-term financial value creation and this, along with its many other applications, makes brand valuation a versatile strategic tool for your business.

Interbrand's Brand Valuation Methodology

There are three key components in all of our valuations: an analysis of the financial performance of the branded products or services, of the role the brand plays in the purchase decision, and of the competitive strength of the brand. These are preceded by a decision on segmentation and at the end of the process are brought together to enable the financial value of the brand to be calculated.

Segmentation

Segments are typically defined by geography, business unit, product, service or customer group. Why is segmentation important? A robust valuation requires

a separate analysis of the individual parts (or segments) of a business to ensure that differences between those segments in terms of the three key components of the brand valuation (financial performance, Role of Brand and Brand Strength) can be taken into consideration. From a brand management perspective, the insights and recommendations that result from the brand valuation exercise will be at the segment level, so it is also important that they are at an actionable level for the client's brand teams.

The number and choice of segments therefore depends on:

- The strategic priorities of the business and of the brand valuation exercise.
- The level at which brand management decisions are taken.
- The number of parts of the business that can be identified where financial performance, Role of Brand and Brand Strength are considered to be sufficiently different to warrant separate analysis.
- The availability of data.

Financial Analysis

This measures the overall financial return to an organization's investors, or its 'economic profit.' Economic profit is the after-tax operating profit of the brand minus a charge for the capital used to generate the brand's revenues and margins. A brand can only exist and, therefore, create value, if it has

a platform on which to do so. Depending on the brand, this platform may include, for example, manufacturing facilities, distribution channels, and working capital. Interbrand, therefore, allows for a fair return on this capital before determining that the brand itself is creating value for its owner.

We build a set of financial forecasts over five years for the business, starting with revenues and ending with economic profit, which then forms the foundation of the brand valuation model. A terminal value is also created, based on the brand's expected financial performance beyond the explicit forecast period. The capital charge rate is determined by reference to the company's weighted average cost of capital.

Role of Brand

Role of Brand measures the portion of the purchase decision that is attributable to the brand, relative to other factors (for example, purchase drivers like price, convenience, or product features). The Role of Brand Index ('RBI') quantifies this as a percentage. Customers rely more on brands to guide their choice when competing products or services cannot be easily compared or contrasted, and trust is deferred to the brand (e.g. computer chips), or where their needs are emotional, such as making a statement about their personality (e.g. luxury brands). RBI tends to fall within a category-driven range, but there remain significant opportunities for brands to increase their influence on choice within those boundaries, or even extend the category range where the brand can change consumer behavior.

“CEOs are placing more emphasis on their companies' brands in investor communications...and the significant role they can play in enhancing business performance.”

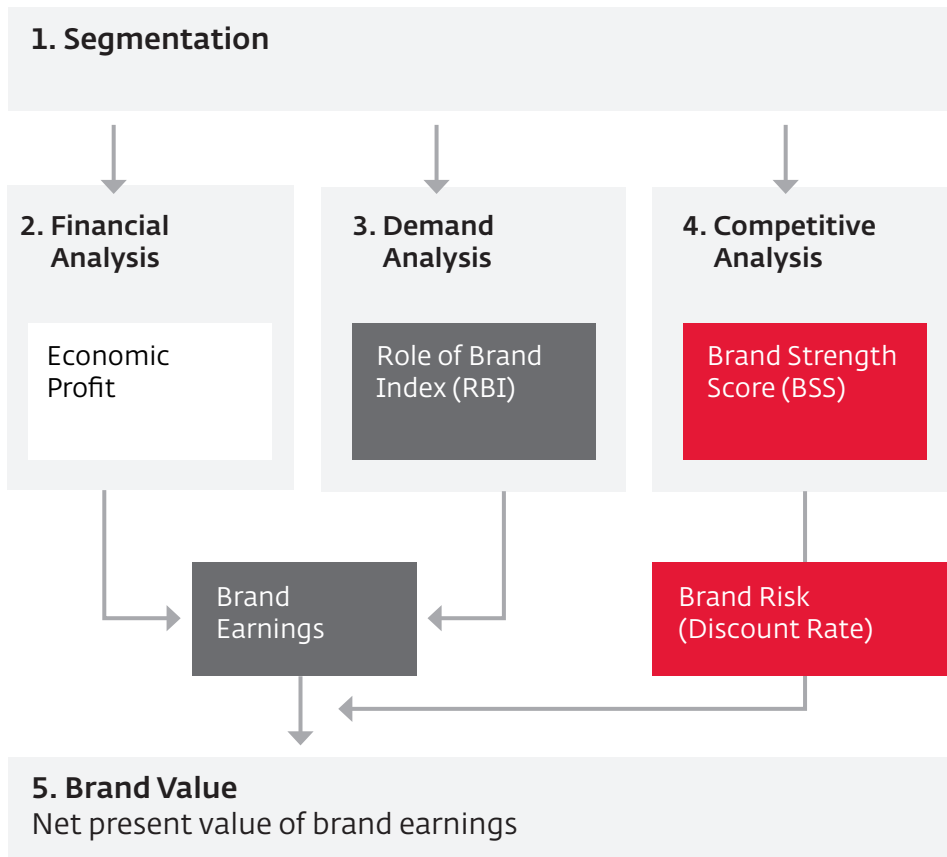


Figure 3. Interbrand's brand valuation methodology

Note: Interbrand was the first company to have its methodology certified as compliant with the requirements of ISO 10668 – requirements for monetary brand valuation, as well as playing a key role in the development of the standard itself.

RBI determinations can be derived in three ways (and are described in order of preference below):

1. Primary research. Specifically designed research, such as choice modeling (although other techniques are available), where RBI is statistically derived.
2. Existing research plus Interbrand opinion. Existing research addressing the relative importance of purchase drivers is combined with Interbrand's opinion on the extent to which the brand influences perception of how the product or service will perform against each driver.

3. Qualitative assessment. Based on management discussions and past experience. This is used where no market research is available.

RBI findings are cross-checked against historical roles of brand for companies in the same industry. Finally, RBI is multiplied by the economic profit of the branded products or services to determine the earnings attributable to the brand ('brand earnings') that contribute to the valuation total.

Brand Strength

Brand Strength measures the ability of the brand to create loyalty and, therefore, to keep generating demand and profit into the future. Brand Strength is scored on a 0-100 scale, based on an evaluation across ten key

factors that Interbrand believes make a strong brand. Performance on these factors is judged relative to other brands in the industry and relative to other world-class brands. The strength of the brand is inversely related to the level of risk associated with the brand's financial forecasts (a strong brand creates loyal customers and lowers risk, and vice versa). A proprietary formula is used to connect the Brand Strength Score to a brand-specific discount rate. (See below for more information on Interbrand's ten factors of Brand Strength).

Brand Value

The brand-specific discount rate is used to discount brand earnings back to a present value, reflecting the likelihood that the brand will be able to withstand challenges and deliver the expected earnings into the future. This is equal to brand value.

Focus on: Brand Strength

Our experience shows that brands that are best placed to keep generating demand and profit into the future are those performing strongly (relative to competition) across a set of ten factors, shown below.

Four of these factors are internally driven, and reflect the fact that great brands start from within. The remaining six factors are more visible externally, acknowledging the fact that great brands change their world. ■

Internal Factors

Clarity

Clarity internally about what the brand stands for and its values, positioning, and proposition. Clarity too about target audiences, customer insights, and drivers. Because so much hinges on this, it is vital that these are articulated and shared across the organization.

Commitment

Internal commitment to brand, and a belief internally in the importance of brand. The extent to which the brand receives support in terms of time, influence, and investment.

Protection

How secure the brand is across a number of dimensions: legal protection, proprietary ingredients or design, scale or geographical spread.

Responsiveness

The ability to respond to market changes, challenges, and opportunities. The brand should have a sense of leadership internally, and a desire and ability to constantly evolve and renew itself.

External Factors

Authenticity

The brand is soundly based on an internal truth and capability. It has a defined heritage and a well-grounded value set. It can deliver against the (high) expectations that customers have of it.

Relevance

The fit with customer/consumer needs, desires, and decision criteria across all relevant demographics and geographies.

Differentiation

The degree to which customers/consumers perceive the brand to have a differentiated positioning distinctive from the competition.

Consistency

The degree to which a brand is experienced without fail across all touchpoints or formats.

Presence

The degree to which a brand feels omnipresent and is talked about positively by consumers, customers, and opinion formers in both traditional and social media.

Understanding

The brand is not only recognized by customers, but there is also an in-depth knowledge and understanding of its distinctive qualities and characteristics. (Where relevant, this will extend to consumer understanding of the company that owns the brand.)

Figure 4. Brand Strength factors



Mike Rocha

Global Director, Brand Valuation