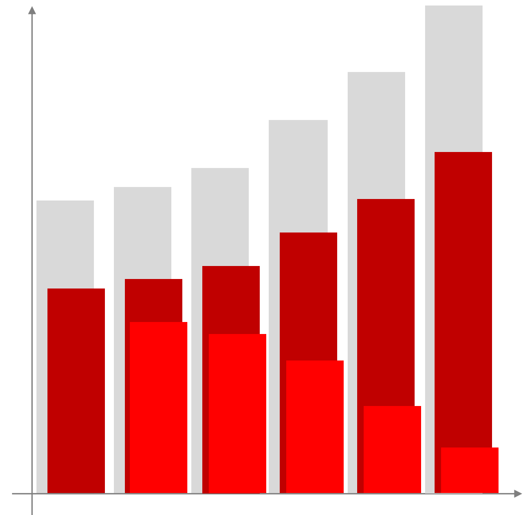
The brand strategists' toolkit #21

Brand valuation



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In the spirit of full disclosure, I should admit from the outset that I used to lead the brand valuation team at Interbrand. When I started out as a graduate in 1999, the majority of the valuations we conducted were for tax and accounting purposes: businesses wanted to reflect the value of acquired brands on their Balance Sheets, or wanted to calculate fair royalty rates to charge subsidiaries and third parties for the right to use their trademarks. By the time I left Interbrand in 2006, the balance of work had shifted towards developing financial valuations for strategic purposes: from helping marketers establish a case for investing in their brands, to making financially sound decisions about which brands in a portfolio to invest in, divest, or migrate.

The chances are you've come across a league table based on brand values: Interbrand, Kantar, Brand Finance and Forbes all publish annual lists of the world's most valuable brands. The original idea behind these league tables was to encourage business owners and investors to think about brands as assets (to be optimised), rather than costs (to be minimised). They were intended to establish branding as a serious and worthwhile profession by demonstrating that brands are often businesses' most valuable assets. Because these league tables are produced and marketed by rival organisations, they inevitably disagree – sometimes considerably – in terms of their assessments of brand value. For example, the value of the Apple brand in 2020 is calculated at US$352bn by Kantar and US$141bn by Brand Finance.

That's a discrepancy roughly equivalent to the annual GDP of Greece.

Unfortunately, these sorts of discrepancies have provoked a great deal of cynicism about putting precise financial values on brands. This cynicism is warranted. You'd have to be crazy to believe brands have precise values (this was my job for seven years). But that doesn't mean that brand valuation is a pointless exercise. Putting a financial value on a brand is a difficult thing to do. It forces you to think about why and how brands create value. And how you might be able to apply tried-and-tested valuation techniques to establish a reasonable estimate of the value brands create. These are important questions for anybody involved in brand strategy: great brand strategists are financially literate as well as creative.

Let's start at the beginning (or somewhere close to it). In 1988, Grand Metropolitan (which subsequently merged with Guinness to form Diageo) became one of the first companies to include the value of its acquired brands on its Balance Sheet. This decision followed a review of the business' key strengths, which revealed that its ability to develop and manage successful brands was a principal source of competitive advantage. The group focused its strategy on acquiring, building and supporting strong international brands. But this strategy came with a significant drawback: in accounting terms, any acquired brands were assumed to be worthless.

While the value of acquired tangible assets such as land, machinery and buildings could be added to the Balance Sheet, the prevailing accounting practice was that brands should not be valued. For example, in 1987 GrandMet paid $800m for the business that owned Smirnoff. Tangible assets accounted for only £235m, leaving £565m to be written off as goodwill. On paper, it looked like GrandMet had wasted over half a billion dollars. Nonetheless, the acquisition was approved by GrandMet's directors and warmly welcomed by analysts and investors, who understood that simply because you couldn't account for the value of acquired brands like Smirnoff and José Cuervo, didn't mean they were worthless. So, in August 1988, GrandMet announced its intention to value its brands and set out the principles it would use to do so.

The decision to adopt a brand-centric corporate strategy was based on management's perception that successful brands created value in two ways:

1. Strong brands stimulated significantly higher profits than similar non-branded or generic products, and
2. The ownership of a strong brand meant an almost guaranteed profit stream for the foreseeable future – potentially even indefinitely

This last point is important. Unlike many tangible assets, brands have indefinite lives. For example, the Stella Artois brand has been in continuous use since 1366. In accounting terms, this means that unlike factories and machinery, which depreciate over time, brand value can theoretically sit on your Balance Sheet forever. In practical terms, it means that brands need to be managed as long-term assets, which is one of the many reasons why I believe branding and sustainability will converge over time.

At first, GrandMet's valuation of its brands used a rudimentary methodology, based on a multiple of earnings: the stronger the brand, the higher the multiple. As with any new idea, the initial response to GrandMet's valuation of its brands was cautious; over the intervening decades, as the practice of brand valuation has become more commonplace, the variety of methodologies has grown. Three broad types of valuation approach are now permitted by International Accounting Standards (IAS 38) and the International Organization for Standardization (ISO 10668). But not all methodologies are created equal. Many of the permitted approaches to valuing brands are totally crap.

Here's a summary of the good, the bad and the ugly:

Market approaches

These methods for valuing brands rely on comparison with historical transactions for similar brands. The fundamental problem is that brands are by definition unique. Pepsi is probably the closest brand to Coke, but that doesn't mean we can assume that they have the same value (in fact, by Interbrand's estimates, the Coca-Cola brand is worth around three times more than Pepsi). Moreover, neither of these brands has been bought or sold and both are part of sprawling brand portfolios. There's no active market for brands, in the same way there is for houses, or bonds, or cryptocurrency, so any approach that relies on comparisons with "similar" transactions is doomed to fail.

Cost approaches

Cost-based estimates typically involve estimating either the total historical cost of building a brand, or the hypothetical cost of replacing a brand. Both approaches are dodgy in practice. Firstly, what counts as a brand-related cost? Certainly marketing spend, but what about investments in product innovation and customer experience enhancement? In theory, any activity that positively affects how people think about a brand could be construed as an investment in brand-building, so who's to say where you draw the line? And even if there was a reliable way to do so, why assume every dollar invested in brand-building results in a dollar added of brand value? There isn't an investor in the world who would invest a dollar just to gain a dollar: there's zero benefit… Literally! Typically, the historical cost method is used to establish a baseline value for newly created brands, but even this is decidedly dodgy: Boo.com spent $135m marketing its brand in the 18 months up to its liquidation in May 2000. The brand wasn't worth anything close to that amount and is now associated with the greatest dot.com bust in history. There's simply no basis for believing that a dollar invested in a brand will yield a dollar of brand value.

Income approaches

Income approaches determine brand value by estimating the present value of the earnings a brand generates over its useful life. There are (at least) three commonly used approaches. Two of these aren't very good:

- **The price premium method**: estimates brand value by comparing the price of a branded product or service with an "unbranded" or generic equivalent. Not only is this practically impossible (a Louis Vuitton handbag might cost 2,000 times more than an "unbranded" handbag, however it also costs significantly more to make), but it also ignores the fact that strong brands generate value by stimulating greater demand for a business' products or services, regardless of whether or not these are sold at a price premium.

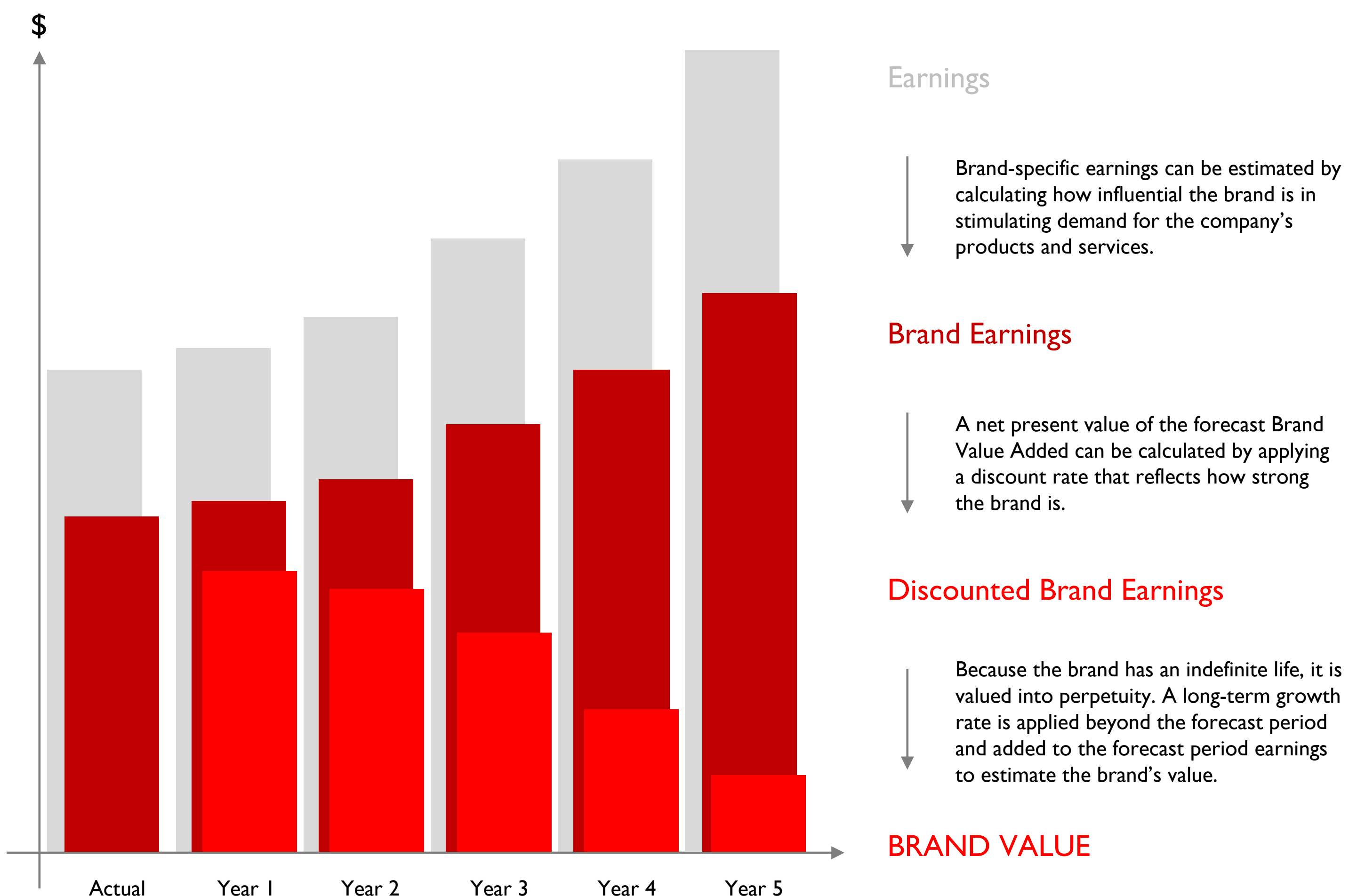
- **The royalty relief method**: estimates the brand by applying the hypothetical royalty rate that an organisation would pay a third party for the right to use its brand. In practical terms, trademark licensing agreements are sometimes made public, and royalty databases gather this data and make it available (generally for a reasonably small fee), so this is a fairly easy method to apply. The royalty relief method beats the market and cost approaches, and isn't bad as a 'sense check', but it does come with significant drawbacks. It suffers from the same issue of comparability as the market approaches: the chances of finding a trademark licensing agreement relating to a genuinely similar brand is small. And even if the brand is comparable, who's to say the agreement contains a fair rate?

The preferred approach for anybody serious about valuing their brand is to follow the same logic as GrandMet's management. Remember: their strategy was based on the perception that successful brands created value in two ways:

1. Strong brands stimulate significantly higher profits than similar non-branded or generic products, and
2. The ownership of a strong brand means an almost guaranteed profit stream for the foreseeable future – potentially even indefinitely

This logic isn't unique. It applies to pretty much any asset. Whether you're valuing a factory, a database, a brand or a pencil, its value is a function of:

1. The profit you expect it to generate over its useful life,
2. adjusted to reflect how certain (or uncertain) you are that those profits will materialise.



This approach to valuing assets is known as the Discounted Future Earnings method and is commonly used by analysts to value businesses. A modified version of this model is used to value brands: starting with an earnings forecast, using market research to estimate the brand's influence in stimulating those earnings, and then using a measure of the brand's strength to determine an appropriate discount rate to apply to the forecast brand earnings.

To the best of my knowledge, the brand valuation approaches employed by the likes of Interbrand, Brand Finance, Kantar and their competitors all follow this method. With the right data, it tends to produce credible values, which can be used to make sensible decisions about brands. But it's important to take these values with a large pinch of salt: they have the appearance of exactitude, but they are little more than educated guesses. The quality of the guess doesn't just depend on the quality of the data that goes into the model, it also depends on the quality of the assumptions that underlie the model.

The good news is that the value itself doesn't particularly matter for brand strategy. You don't need to be able to value a brand to be a great brand strategist. But you do need to know what makes a brand valuable. This is why the theory behind brand valuation is important to know.

Based on the Discounted Future Earnings method, the value of a brand depends on three important factors:

1. How effective the brand is at stimulating and growing demand (top line growth)
2. How effective the business is at turning this demand into profit (bottom line growth)
3. How strong the brand is (the stronger the brand, the lower the rate at which future earnings are discounted)

As strategists, we tend to obsess about the first factor:
"How can we grow our brand?"
"How can we attract more customers?"
"How can we increase penetration?"

But growth isn't even half the story. The ability to convert revenue into profit is also important to creating a valuable brand. Top line growth counts for nothing if it comes at the expense of bottom-line growth. That's an important thing to consider, whether you're developing an acquisition strategy, a brand positioning or a portfolio strategy. A strategy aimed at attracting more customers is very different from a strategy aimed at attracting more profitable customers. And the best-selling brand in your portfolio might generate less value than the most profitable brand in your portfolio.
Great brand strategy embraces the bottom line as well as the top line.

The third factor is just as important as growth and profitability to brand value. Brands like BP and Shell aren't valuable because they stimulate greater demand for oil, or command higher oil prices (they don't). The BP and Shell brands are valuable because they help their respective businesses operate with lower risk: by inspiring confidence amongst the governments whose resources they are trusted to extract; by reassuring investors they are acting responsibly and thinking about the long-term; by attracting the most talented engineers and managers; by engaging positively with the communities who give them licence to operate. Brand strategy for brands like BP and Shell isn't aimed at stimulating demand or profit: it's aimed at ensuring society will continue to give these businesses permission to exist.

Great brand strategy considers risk as well as reward.

One aspect of this involves thinking expansively about the audiences who interact with your brand. Not just how to attract customers, but how to position your brand so investors compare you with businesses with high multiples. How to earn the goodwill of those communities you rely on to exist. How to attract talented people to work for you and how to motivate them to grow your business.

Another aspect involves anticipating the long-term forces that will affect the future of your brand, even if they aren't important today: societal changes; long-term economic drivers; the shifting political and regulatory landscape; emergent technological innovation; climate change. Great brand strategy isn't just built on insight: it also requires a healthy amount of foresight and inspiration.

All I've done here is to focus on the most popular concept of value. But there are other, more exciting concepts out there that can help us to push ourselves beyond basic commercial awareness and to think about value in broader terms: concepts like option pricing theory, shared value and the Triple Bottom Line. Brand valuation consultants will struggle to keep up with these, but as brand strategists we can benefit from thinking in even more ambitious and comprehensive ways about the type of value brands generate, who for and how.

As our concept of value becomes bigger, so does our ability to create it.