

Touching on the intangible

Carlton Curtis, formerly Vice-president of Corporate Communications for Coca-Cola, once said: "If all of Coca-Cola's assets were destroyed overnight, whoever owned the Coca-Cola name

could walk into a bank the next morning and get a loan to rebuild everything."

Perhaps. But if you were that bank manager, how much would you be willing to lend? Does Coca-Cola's value as a brand stem from public recognition? Maybe it's the

relationships that the brand enjoys with suppliers. What would it lose to its competitors in a period of absence? What about the value of the secret recipe – is it worth anything?

These questions may have been hypothetical in years past, as accountants stuck to valuing factories, land and equipment, but since the 1980s the intangible value of businesses has grown by staggering proportions. The notion of valuing the intangible, particularly a brand, has become a serious concern.

David Haigh, CEO of Brand Finance, cites the changing market-to-book ratio, which compares the stock valuation of a company to the net value of its assets, of the Standard & Poor's 500. From an average of 1.4 in the 1980s, it reached a value of 4.7 by 2003, indicating that investors put 75% of the value of a company to its intangible assets. Lowell Bryan, a director of the consultancy firm McKinsey, reckons that in 2005 the intangible capital of the world's largest 150 companies was US\$7.5 trillion. In 1985, the figure was US\$800 billion.

Figuring out how much a brand is worth is a global business, and becoming critical to boardroom decision-making
By Ryan Swift

In the 1980s, accountants more or less put every part of a business that was intangible under the heading “goodwill”. Little provision was made for brands, trademarks, reputation or patents. Stock prices, the ability to finance large purchases, insurance policies – virtually everything connected to a business – stemmed from the valuation of its tangible assets. But that was set to change as a wave of mergers and acquisitions in the 1980s forced a rethink.

The most important indicator of the growing strength of a brand value came in 1988, when a UK-based food company, RHM, became the object of a takeover bid. In an effort to convince creditors and investors that the bid offer was inadequate, management conducted a valuation of all its brands, and added them to its balance sheet. It was the first time that such an exercise had ever been done. With this information, RHM’s management was able to convince investors that the bid was too low. The valuation was conducted by brand consultancy Interbrand.

“It took a long time, but now the goodwill portion of the business – even a manufacturing business – has become so huge that something had to be done, and that led to the change in accounting rules,” says Jan Lindemann, Global Managing Director for Interbrand’s brand valuation services.

Accounting regulatory bodies – the groups in the US and the EU that govern accountancy procedures – responded in the 1990s and in the early 21st century with rules that are supposed to identify the individual value of intangible items (trademarks, patents, brands and so on). Previously, they would all have been lumped together.

As the rules for accounting intangibles – and by extension, brands – have been clarified, so has the business of valuing brands and the need for a sophisticated and commonly agreed-on method. Interbrand, the first company to seriously look at valuing brands, is the market leader. The Interbrand method (see sidebar) is now widely reported in magazines such as *BusinessWeek*, which publishes a list of the 100 most valuable

Interbrand’s evaluation

The way in which Interbrand tried to measure a brand’s dollar value has been called the “economic use” model by Jan Lindemann, Interbrand’s Global Managing Director for valuation.

Lindemann says the Interbrand method combines financial and market analysis to provide the truest estimation of a brand’s value. Interbrand first looks at the market segmentation of the brand to see how much the brand can influence customer choices based on factors such as geography, distribution, product sophistication and so on.

The next step is to forecast the intangible earnings that are likely to come from the specific segments identified above. Intangible earnings are defined as brand revenue minus operating costs, relevant taxes and a charge for the use of capital. The role of the brand in driving demand for a company’s services is then assessed, and the percentage of intangible earnings are attributable to the brand decided. From this is derived the brand-based earnings of the company.

A brand discount rate is then calculated. This is a measure of the strengths and weaknesses of the brand in relation to other brands, as well as other issues such as the volatility of the brand’s market and its legal status. The brand discount rate is subtracted from a net value to the company of the projected brand earnings. From this figure, a final brand value can be derived.



brands as ranked by Interbrand.

Lindemann regards the Interbrand way as the most authoritative in the field. “We marry modern market research and financial analysis into this unique way of looking at brands, and that’s what’s changed the way people look at brands. We had a debate about it initially, but most people who are in this field, and most companies, will follow our approach, because there’s really no other way of doing it.”

But while Interbrand does rule the roost, the challenges are not over. In 1996, David Haigh, then the director of valuation at Interbrand, left the company to found Brand Finance. Primarily using a brand valuation technique known as the Relief from Royalty method, Brand Finance calculated the brand value of Coca-Cola at US\$43 billion.

That compares to the valuation of US\$67 billion given by Interbrand. Both companies maintain that their methodologies are the standards that matter to tax authorities and courts.

What is patently different between the companies is their orientation. Brand Finance is primarily staffed with chartered accountants. It even does referral work on behalf of the world’s top four accountancy firms, according to Rupert Purser, Brand Finance’s Managing Director for Hong Kong. “Our work is regularly peer-reviewed by the major accountancy firms, and our primary valuation approach has been deemed ‘fit for use’ by the IRS, Inland Revenue and the Australian Tax Office,” Purser says.

Interbrand is owned by Omnicom, a global media and marketing firm, and is tightly connected to the marketing

Interbrand/*BusinessWeek* top ten most valuable brands 2006

Rank	Brand	Country	Value (US\$m)	Sector
1	Coca-Cola	US	67,000	Beverages
2	Microsoft	US	56,926	Computer software
3	IBM	US	56,201	Business services
4	GE	US	48,907	Diversified
5	Intel	US	32,319	Computer hardware
6	Nokia	Finland	30,131	Telecoms
7	Toyota	Japan	27,941	Automotive
8	Disney	US	27,848	Entertainment
9	McDonald's	US	27,501	Restaurants
10	Mercedes	Germany	21,795	Automotive

Note: Interbrand does not include brands that are not considered global in their business scope.

Source: Interbrand

Brand Finance top ten most valuable brands 2006

Rank	Brand	Country	Value (US\$m)	Sector
1	Coca-Cola	US	43,146	Beverages
2	Microsoft	US	37,074	Computer software
3	Citigroup	US	35,147	Financial services
4	Wal-Mart	US	34,899	Retail
5	IBM	US	34,074	Business services
6	HSBC	UK	33,495	Financial services
7	GE	US	31,850	Diversified
8	Bank of America	US	31,426	Financial services
9	HP	US	29,445	Computer hardware
10	Marlboro	US	26,990	Tobacco

Source: BrandFinance250 League Table

side of the branding. But there are challengers on that end as well. In 1999, Dr Roger Sinclair started Brand Metrics after developing a brand valuation method in conjunction with a professor of corporate finance.

In 2004, Brand Metrics, a South Africa-based firm, was asked by Vodacom to value its brand in South Africa, after Vodacom was given a public brand valuation by Interbrand that it disagreed with. While there is much that Dr Sinclair agrees with regarding the Interbrand methodology, there are important differences. "We use something called Brand Knowledge Structure, which depends on how the most relevant consumer segments are

disposed to the brand. Interbrand does not do this. We do it because that's where the value lies," he says.

Nonetheless, Dr Sinclair feels that the Relief from Royalty method favoured by companies such as Brand Finance is too bound up with accountancy to measure the true value of a brand. Clearly, there is still some sorting out to do.

In fact, there are a number of approaches to measuring the value of a brand, and it may be that the situation determines the approach, as much as the preferences of the valuing agency.

There are other considerations as well. While the accountancy regulatory bodies may have made strides in

getting intangibles accounted for under one set of governing rules, there are outstanding issues. A critical one is whether a brand value should be placed on a company's books as an asset. At the moment, a brand is only recognised as an asset on a company's books if the company purchased it. On the other hand, an internally generated brand (the company's own brand) cannot be put on the books.

Such a discrepancy, as well as remaining grey areas in the existing regulations, have caused practitioners to criticise what seem to be obvious holes in the development of a standard way of measuring brand value. If a brand can be purchased and placed on a company's books, why can't a similar value be placed on a company's own books? Brand Finance's Purser thinks that is something that needs to be rectified. As accounting regulations are in a state of constant evolution, it is an issue that will come up again.

But if brand valuations were added to a company's books, it would create a new set of issues in the boardroom. Very often, intangible assets on a company's books must be subjected to an annual impairment test to see if they still retain their value. Should listed companies be required to add an internally generated brand value to their books, it could open up the field of brand valuation much further still. It would also mean that issues of brand management and marketing spend would get a much higher priority in the boardroom.

Large companies are currently using brand valuations as benchmarks for marketing performance, to assist merger and acquisition activity, to prepare joint-venture negotiations and even to secure financing. But if the field continues to develop as it has done, brand valuations may become just as important for listed companies as publishing an annual report. And that may force chief marketing officers and chief financial officers to see eye to eye – for once. ▲