How Big is Brand?

April 2008

The Marketing Paradox

Many senior managers have noticed a paradox in how firms perceive marketing. On the one hand, every chief executive and mission statement puts marketing at the very top of the agenda… At the same time, marketing professionals, marketing departments and marketing education are not highly regarded…
The paradox will never be resolved until marketing professionals learn to justify marketing strategies in relevant financial terms."

Professor Peter Doyle
University of Warwick
Author of "Value Based Marketing"

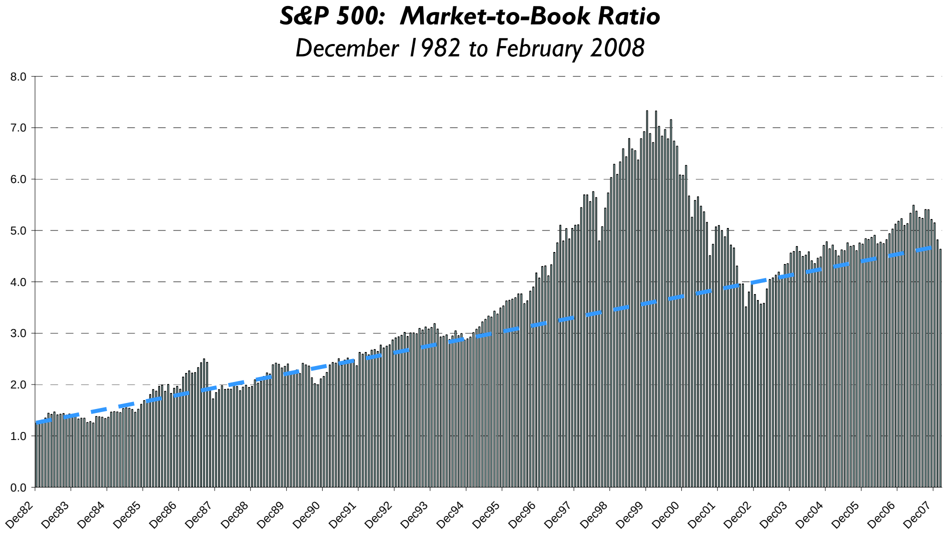
The Goal of This Presentation

To talk about brands from the perspective of Accounting and Finance

Key Point #1

Intangible value is a hot topic for Accountants

The Growing Importance of Intangibles



Source: Type 2 Consulting analysis using Bloomberg data

Book value defined as net tangible balance sheet assets excluding investments

A Market to Book Ratio of 4.5 means that

The net tangible assets on the balance sheets of the companies comprising the S&P 500 account for less than 25% of their market value

A Big Question

What does this intangible value represent?

Trite Answer

The product of human ingenuity

The Accounting Treatment of Intangible Assets

1998
UK introduces Financial Reporting Standard 10 that amends the treatment of "goodwill" in mergers and allows the value of acquired brands to appear on the balance sheet of the acquiring company post merger

2001
US introduces Financial Accounting Standard 141 that eliminates the "pooling of assets" option in mergers but allows for the capitalization of the intellectual property of the acquired company

2005
The International Accounting Standards Board follows the UK/US lead and introduces International Financial Reporting Standard 3 - helpfully, this includes suggestions for five categories of intangible assets between which the acquisition premium can be allocated

IFRS 3 - Suggested Categories of Intangible Assets

Asset Types	**Underlying intellectual property**
Technology-based	Patents, software, trade secrets
Contract-based	Construction permits, servicing contracts
Artistic	Copyright
Customer-related	Customer lists, order backlogs, market research
Marketing-related	Trade names, trade dress

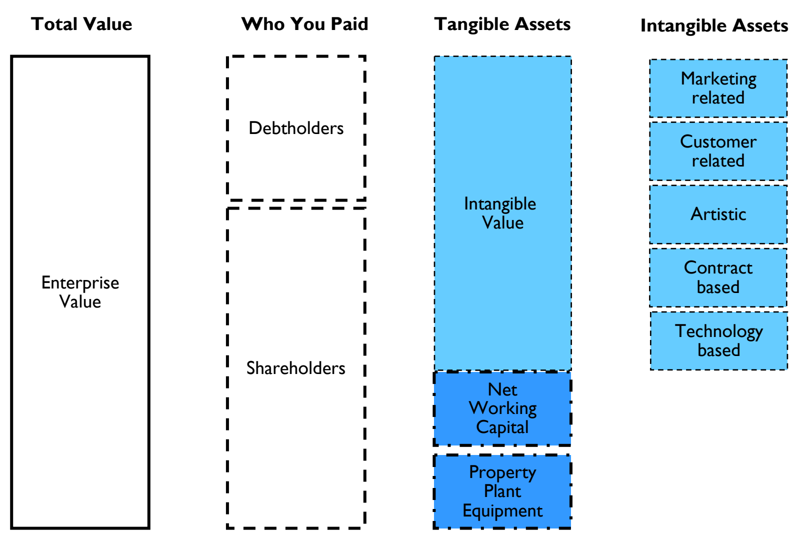
Key Point #2

Accountants do not recognize the term "brand"

Key Point #2

Accountants <u>do</u> recognize the intellectual property on which a brand is based

Decomposition of Enterprise Value



A Big Question

How important are brands as an asset class?

Trite Answer

It depends on the industry

Importance of Asset Classes by Industry Sector

SECTOR	TNGBL	TCHNLGY	CNTRCT	ARTSTC	CSTMR	MKTNG
UTILITIES	58%	7%	23%	0%	7%	5%
ENERGY	47%	11%	23%	0%	11%	7%
BASIC MATERIALS	37%	17%	33%	0%	10%	3%
CONSUMER (CYCL)	36%	11%	23%	0%	18%	11%
COMMUNICATIONS	23%	15%	19%	15%	19%	8%
TECHNOLOGY	18%	33%	13%	0%	20%	16%
INDUSTRIAL	17%	30%	24%	0%	18%	12%
CONSUMER (N/CYCL)	15%	14%	22%	0%	22%	27%
TOTAL	26%	18%	22%	2%	18%	14%

Source: Type 2 Consulting analysis using 2004 Bloomberg data

* Excludes financial services due to the nature of their balance sheets

Brand Valuation League Tables

Three brand consultancies produce annual brand rankings:

Interbrand
"Best Global Brands"
Published in Business Week
Millward Brown
"Top 100 List"
Published in the Financial Times
Brand Finance
"The World's Top 250 Most Valuable Brands"
Published on their website

Observations

- Across the three surveys, brands represented an average of 18% of the market value of their parent companies
- This percentage varied greatly <u>across</u> industries – from an average of 2% among the integrated oil and gas majors to over 40% for luxury goods
- The percentage also varied <u>within</u> industries, reflecting both the relative strength of the individual brands and the nature of their respective business models

Brand Value in the Financial Services Sector (2006)

VARIABLE DATE SOURCE	TICKER	SECTOR	BRAND VALUE % OF MC 2006 MIWARD BROWN	BRAND VALUE % OF MC 2006 INTERBRAND
Company	**Ticker**	**Sector**		
UBS	UBS	financial services	7.8%	7.1%
Goldman Sachs	GS	financial services	11.6%	12.6%
Morgan Stanley	MS	financial services	13.2%	12.1%
JPMorgan	JPM	financial services	4.4%	6.3%
Merrill Lynch	MER	financial services	13.5%	17.5%
American Express	AXP	financial services	26.7%	27.9%
Citibank	C	financial services	12.6%	8.7%
AIG	AIG	financial services	3.3%	
Allstate	ALL	financial services	12.2%	
Banco Santander	STD	financial services	12.0%	
Bank of America	BAC	financial services	11.7%	
Chase	JPM	financial services	6.0%	
Deutsche Bank	DB	financial services	23.6%	
Wachovia	WB	financial services	11.7%	
Washington Mutual	WM	financial services	11.6%	
AVERAGE			10.6%	11.5%

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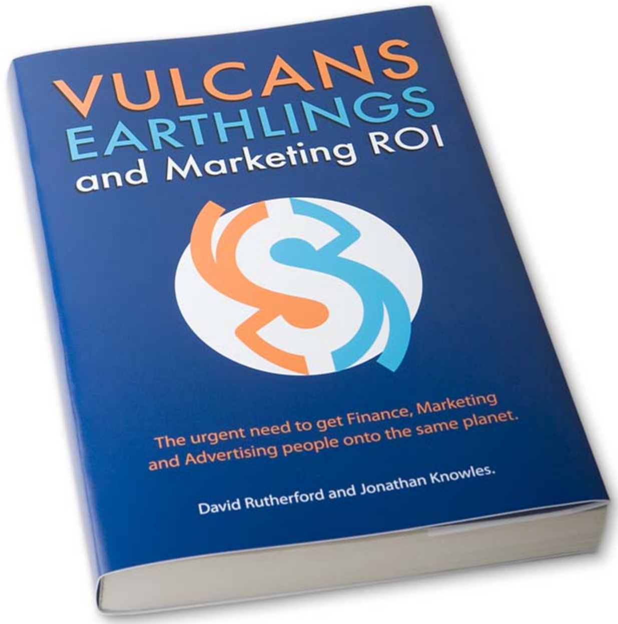
Key Point #3

Marketing accountability means speaking in a language that Finance understands

TYPE 2 CONSULTING



Same Words, Different Meanings

Marketing Perspective

- "Value" and "equity" are defined from the customer perspective
- Value is the ratio of perceived benefit to price
- Equity is defined in terms of satisfied customers
- Focus is on ways to enhance customer utility
- Goal is to create preference

Financial Perspective

- "Value" and "equity" are defined from the shareholder perspective
- Value is revenue minus economic costs
- Equity is defined in terms of shareholder value
- Focus is on ways to enhance business efficiency
- Goal is to generate profit

Two Different Perspectives on Value

Marketing

$$\frac{\text{Customer benefit}}{\text{Price paid}}$$

Finance

$$\frac{\text{Price received}}{\text{Economic cost}}$$

An Integrated Perspective on Value

Business success is built on understanding how to deliver customer value that exceeds its economic cost:

$$\frac{\text{Customer benefit}}{\cancel{\text{Price}}} \times \frac{\cancel{\text{Price}}}{\text{Economic cost}}$$

$$= \frac{\text{Customer benefit}}{\text{Economic cost}}$$

Key Point #4

The key challenge for business is to optimize the relationship between customer value and economic costs

Bridging the Gap

Finance's Request to Marketing

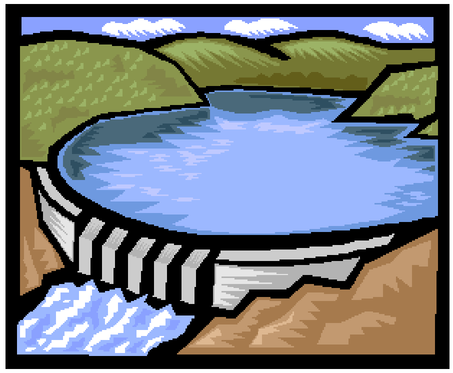
- Define a Causal Model, with identified assumptions, to explain how marketing effort contributes to business success, short and long term
- Demonstrate a willingness to put those assumptions to the test, and to adapt your plans in the light of the findings
- Recognize that although the long term is important, so too is the short term
- Propose and track a set of key metrics for correlating marketing activity with financial outcomes (profit, growth and risk in particular)

Marketing's Request to Finance

- Recognize that consumers usually do not use pure logic and reason when they buy, and that they are often not ready, willing, or able to weigh every option according to its functional merits
- Accept that appealing to these non-functional aspects of customer value can represent a reliable basis on which to build a business strategy
- Allow for the fact that when Marketing has ideas that you think are off the wall, they may just have discovered a source of breakout growth for the business

Tim Ambler's Definition of Brand Equity

Tim Ambler is Senior Fellow in Marketing at London Business School



Brand equity is a reservoir of cash flow earned
but not yet released to the Income Statement

Appendix:
Academic & Practitioner Research

1. Academic Research

- Academics have been observing for more than three decades that business performance is affected by market orientation
- The seminal study by Narver and Slater (1990) demonstrated a substantial positive effect of market orientation on business profitability based on a sample of 140 business units across a spectrum of commodity products businesses and non-commodity businesses
- Specifically, they conclude that firms with a strong market orientation achieve superior business performance via three means:
  - They have a customer focus – they are customer-oriented in all matters, from product development, to sales, to service
  - They emphasize long-run profitability versus short-term profits – their interactions with customers are viewed as a relationship not a transaction
  - They adopt a cross-functional perspective across the firm to achieve a customer orientation and long-run profitability

Reference:
J Narver and S Slater
"The Effect of a Market Orientation on Business Profitability"
Journal of Marketing, October 1990

1. Academic Research (contd)

- Aaker and Jacobson observed that stock returns could be better understood as a function of both changes in financial performance and changes in brand equity
- Mizik and Jacobson observed that the average, next year, risk adjusted return for companies with increased differentiation was 4.8%, while the average for those with decreased differentiation was -4.3%
- They also observed that 1/3 of the effect of an increase in brand assets shows up in current period earnings; 2/3 shows up in future growth value
- Madden, Fehle and Fournier observed that, over the 6 year period 1994 to 2000, a portfolio of 100+ strongly branded companies generated a monthly 0.6% excess return vs. the overall market, and at a beta of 0.85

References:
D Aaker, R Jacobson
"The Financial Information Content of Perceived Quality"
Journal of Marketing Research 1994
N Mizik, R Jacobson
"How Brand Attributes Drive Financial Performance" Report 05-111, Marketing Science Institute, 2005
"Talk About Brand Strategy" Forethought Article, Harvard Business Review, October 2005
T Madden, F Fehle and S Fournier
"Brands matter: an empirical investigation of brand-building activities and the creation of shareholder value"
Journal of the Academy of Marketing Science 2006

The Determinants of Business Valuation

Valuation multiple	=	Business model	+	Brand equity
		1 How tight a ship is run?		2 The quality of relationships

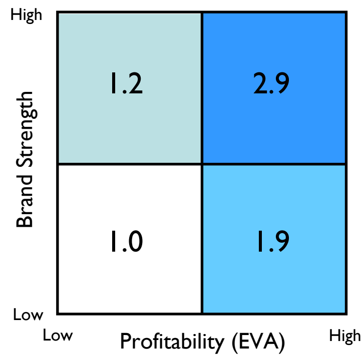
Explanation of the Observed Variance in Valuations

Valuation multiple	=	55%	+	25%
		1 How tight a ship is run?		2 The quality of relationships

Source: "Value-based brand measurement and management" – *Interactive Marketing*, July/September 2003
Research involved the integration of Stern Stewart's EVA® database on corporate financial performance with Young & Rubicam's BrandAsset® Valuator database on brand health to determine the proportion of the variance in observed valuation multiples that could be attributed to differences in profitability and brand health.

1. Research by BrandEconomics

- Integration of Stern Stewart's database on corporate performance with Young & Rubicam's database on brand equity
- Analysis of the relative valuation of 140 companies over a 10 year period
- Companies allocated to quadrants based on whether they had above- or below-median performance on profitability and brand strength
- Research confirmed that profitability is the primary driver of valuation (duh!)
- Brand strength shown to be a magnifier of underlying business performance



Reference:
J Knowles
"Value-based brand measurement and management"
Interactive Marketing, July/September 2003

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