Brand Valuation Forum

G·E·M Gesellschaft zur Erforschung des Markenwesens e.V.

MARKENVERBAND

Ten Principles of monetary brand valuation

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Introduction

What is the purpose of the ten principles of brand evaluation?

Starting point

The monetary evaluation of brands faces a dilemma: Fundamentally brand evaluation is considered to be extraordinarily important, however its significance is neglected at present. This dilemma has been illustrated by a number of studies.

A striking starting point for the present discussion of the monetary evaluation of brands was provided by the authors of these ten principl-es in the study that was initiated in 2004 by PricewaterhouseCoopers and the trade journal "absatzwirtsc-haft": "Die Tank AG": How nine experts evaluate a fictitious brand". The study made clear that the different methods lead to a great range in mon etary brand values. Even if the divergence in valuation may be explained partly by different tax treatment, the perception arose of a certain arbitrariness of the values in the market.

A further source of uncertainty derives from annually published brand values, these being independent of the comp-any concerned and intended to provide some indication of value on the basis of externally available data. Regrettably, here, too, major differences and countervailing tendencies are visible. The valuation basis is mostly less than transparent.

Standardisation of monetary brand valuation

At present, a number of efforts are under way to standardise the valuation methods. For instance, the German standards association, Deutsches Institut für Normung, has elaborated a standard that it has submitted to an international ISO procedure. Meanwhile, the institute of certified accountants in Germany, IDW, has published a standard on the evaluation of intangible assets (IDW S 5, see www.idw.de). Although compatible with each other, these standards focus on different valuation occasions.

Brand Valuation Forum

It is against this background that the leading brand valuation experts involved in "Die Tank AG" met again and established the Brand Valuation Forum (BVF). This is a workshop of the Gesellschaft zur Erforschung des Markenwesens (GEM) [– the association for the research of brands –] and the Markenverband [the brands association]. The aim of the working group was to develop uniform principles on the basis of the main valuation methods in the market in order to enable the different methods on offer to be examined.

Hence it was not the aim to produce any levelling among the valuation methods in order to secure a standard. Nor would this be desirable. Different occasions require individually adapted brand valuation approaches. For this reason, it is questionable whether a standardised method can ever do justice to all occasions.
Hence no attempt was made to straitjacket the complexity of monetary brand valuation into a single method; on the contrary, it was affirmed that different valuation methods each have a right and proper place. None the less, consistency in valuation is required in order to ensure transparency and reproducibility.
The Brand Valuation Forum identified ten principles which any serious valuation method must measure up to. By means of the ten principles, each interested party will be able to make sense of a brand valuation, i.e. what aspects have entered into the valuation of its brand and what might distin-guish its brand value from others.

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Ten Principles of Monetary Brand Valuation

The ten principles that any serious brand valuation must measure up to describe the most important steps in an appraisal process that must be found both in the valuation model and in the expert report. These principles include a summary valuation:

1. Consideration of the occasion for the valuation and its function

Brand valuations are conducted for various purposes (e.g. value-oriented brand introduction or finance-oriented communication). It must therefore be ensured that the method applied is suitable for the purpose.

2. Consideration of the kind of brand and its function

Brands occur in very different guises, for example, as a product, umbrella or company brand. There should therefore first be an exact definition of what sort of brand is involved and its function in the marketplace. This differentiation is essential for any appropriate assessment of the brand risks (see Principle 9).

3. Consideration of brand protection

Brands are intangible assets of a company. As such, they are volatile. The initial evidence that they actually exist is the brand protection. Any valuation must proceed on the basis of secured brand rights.

4. Consideration of the brand and target group relevance

Each valuation procedure should be based on market data. Even though brands are by definition unique, any valuation must be based on information involving comparisons.

5. Consideration of the current brand status using representative data of the relevant target group

The brand status is determined by identifying the brand's success and its strength.

6. Consideration of the economic life of the brand

A monetary valuation that is based on revenue surpluses concentrates exclusively on the future brand-related receipts. Against the background of future and brand-specific income, each valuation will, therefore, provide the rationale for whatever is determined as the likely useful life of the brand.

7. Isolation of brand-specific cash flows

In principle, a number of valuation methods may be conceived of for brands. For some purposes, a computation on the basis of licence prices alone may be sufficient. There is, however, considerable consensus that the method to be preferred will take into account the income that a company obtains by being able to distinguish itself from its competitors in the marketplace by virtue of its brand. Although this brand-specific income may be computed in very different ways, it must lie at the heart of any valuation method and be described exactly.

8. Consideration of a net present value method and an appropriate discount rate

Valuation methods that focus on future cash flows are derived from financial theory, i.e. on valuations based on capital market theory. Most brand valuation methods are based on a net present value calculation, i.e. expected future surpluses are discounted to the valuation date. In the net present value calculation and therefore in the brand valuation, there is also consideration of the company risk, which is understood in terms of future capital costs.

9. Brand-specific risks (market and competitive risks)

Future income is, as is in the nature of the future, subject to risk, i.e. uncertainty. The corporate risk may be different from the brand risk. Hence a consideration of the corporate risk – understood as capital costs – may, depending on the circumstances, be insufficient. Moreover, brand-specific risks must be accounted for adequately.

10. Reproducibility and transparency

A valuation only has any significance if it is based on the principles of validity, reliability, objectivity and transparency. Below you will find a more precise description of the ten principles of monetary brand valuation that should help you to obtain more transparency. For each principle, an explanation is provided of why it is important for the judgement of the brand valuation methods and what are the relevant aspects.

Preamble

The first step in evaluating a brand is to examine the brand itself and ponder the best approach to its valuation. Brand valuation is complex and requires an understanding of the individuality of the brand concerned. The decisive factor in determining the valuation parameters is the question of what makes a brand valuable in the first place. This involves looking at its economic functions.

The economic value of a brand lies in generating a higher demand for the products and services it stands for and in securing this demand for the future. In order to record the use of the brand for the brand owner, the brand value is defined as the net present value of future cash flows that can be attributed solely to the existence of the brand.

Basically, a brand fulfils three economic functions:

1. Seen as a communications platform, one of the fundamental tasks of the brand is to signal orientation and convey an unmistakeable message of the provenance of the product or service. This enables the brand to guarantee both recognition and communicative continuity. In this respect, the brand is a precondition for efficient investments in communication. The synergies are expressed in higher operating efficiency and hence lower investment, in relative terms.

2. By helping consumers differentiate, brands shape perceptions and enable consumers to identify in some way with the product or service, thereby influencing the purchasing decision in favour of the brand.

As technologies, markets, processes, know-how and indeed the specific range of offers become ever more similar, there is a shift in value creation to assets which successfully set themselves apart over a long period and cannot be copied. The specific property of the brand and its differentiation enables the company to market its products or services at higher prices (price premium) and/or to move into new business fields or product generations and communicate these convincingly to their (new) customers and other relevant groups. This function is reflected in higher future cash flows.

3. The brand often constitutes the only recognisable constant in the relationship between the company and its customers. All experiences with the brand and the benefits represented by it are associated with the brand and, as it were, stored in it. As an embodiment of higher valuation, the brand creates customer loyalty and secures future demand. A strong brand creates higher customer loyalty than a weak one. The future cash flows of a weak and risk-prone brand must therefore be weighted differently than the same future cash flows derived from a strong and secure brand. A brand that operates in a growth market, enjoys a prominent position there and high familiarity, is strong and

Principle 1

Consideration of the occasion for the valuation and its function

The valuation methods are in principle suitable for use on the following occasions:

- Value-guided brand management
- Financial communication
- Legal transactions with brands
- Infringements of brand rights
- Fiscal occasions

Valuation for the purpose of brand management is addressed to the company control function and works by determining the value drivers relevant for the brand value. The valuation supports the control or the controlling of the brand management in connection with current business activity.

Financial occasions for the valuation of the brands can exist in particular in accounting and other mandatory or voluntary external reporting, for transactions and in the identification of factors influencing the company control function. To the extent that valuations are made for accounting purposes, the valid national and international commercial law or fiscal regulations must be obser-ved. In an individual case these may be more intricate than the existing rules.

Transactions involving brands may represent a valuation scenario if the value-in-use of the brand must be determined. The value-in-use defines the value that the brand represents for its owner or its legal successor at the time of valuation.

Brand protection infringements are the occasion for brand valuations when there is a need to specify the monetary damage caused by the infringement. Similarly, the valuation serves to determine an appropriate license rate on awards of licenses.

Fiscal triggers occur when the brand is transferred or with the licensing of brand rights to third parties. The purpose of the monetary brand valuation is to determine the commercial value of a brand, to meet documentary obligations for transfer pricing, to avoid double taxation and, in some circumstances, to optimise tax rates at an international level. Here consideration must be given to the fact that fiscal laws may deviate from the rules presented here.

Principle 2

Consideration of the kind of brand and its function

Brands occur in many guises, and this variety must be reflected in the framework of the monetary brand valuation. Here it makes sense to produce a taxonomy of brands:

with regard to geographic scope:

- Regional brand
- National brand
- International brand

with regard to the kind of branded products or services:

- Product brand
- Service brand

With regard to the brand architecture:

- Individual brand
- Brand family
- Umbrella brand
- Corporate brand

The brand serves to label the product and generate value. Beyond this, the brand also serves the following functions:

- identification, understood as unique characterisation of the provenance of the branded service or product;
- a communicative function, understood as an activation of the consumer's existing brand know-ledge;
- differentiation, understood as distinguishing a product or service from its competitors;
- a quality function, understood as a guarantor of a homogenous service or product quality.

A monetary valuation of a brand must account for the kind of brand and the brand function. In particular, the nature of the brand must be spelled out and an explanation given by how a specific valuation method does justice to the kind of brand concerned. The region in which the brand operates must be specified as well as the level of the brand architecture to which the monetary brand value is to refer.

In appraising corporate brands, consideration must be given to the different stakeholder groups since the effects of corporate brands extend beyond sales markets to encompass other markets of relevance to the corporation such as procurement markets, capital markets, labour markets and so on. All stakeholder groups must be identified and accounted for. Where this is not practicable, the stakeholder groups considered in the brand valuation should at least be named.
In the monetary valuation, the brand functions should only be considered to if the catalogue of criteria of the valuation method relates as far as possible to all functions.

Principle 3

Consideration of the legal protection of the brand

The first step in any brand valuation is verification that the brand is indeed protected by law (this is part of the risk analysis).
In valuations in which third parties are involved, it is recommended that a detailed assessment of the brand rights, if appropriate by a legal expert, be made, and that this then be taken up in the overall computation, either increasing or decreasing the value. The examination should include the countries or regions and the register filings of relevance for the valuation.

In analysing the legal status of the brand, the following criteria apply in determining and verifying whether the brand owner has a sole right of prohibition vis-à-vis third parties:

- Title
- Rights of third parties (licenses, pledges etc.)
- Catalogue of merchandise / services
- Usage situation
- Defence situation

The analysis of the scope of protection of the brand shows on the basis of the examination of the following criteria how strong or weak the legal position in the relevant countries is:

- Type of brand (word, picture, colour, sound, 3D)
- Brand environment / fungibility / competition

Principle 4

Consideration of the brand and target group relevance

Each brand valuation must include an appraisal of the brand relevance in the specific market and industry environment. The brand relevance describes the influence of the brand on the purchase decisions in the target group in a market.

The brand relevance must be considered both for the brand value creation already realised and for specifying the future value creation contributions of the brand. Therefore the valuation must encompass expectations as to how the brand relevance will develop in the market or industry segment under examination.

The brand relevance can be validated by behavioural analyses (parameters of behaviour and attitude) or through indicators of value creation (e.g. share of the brand value creation in the company value creation).

The isolation and definition of the target group or groups of a brand for the existing scope of business as well as for possible brand expansion provides the basis for the valuation of a brand. Simultaneously, purchase behaviour and attitude of the target group or target segments to the brand must be differentiated according to product, market and distribution factors. Against this background, a segmentation and separate valuation of the brand relevance is necessary by homogenous target/customer groups.

Principle 5

Consideration of the current brand status using representative data of the relevant target group

In the course of a monetary valuation, the brand status must be appraised in terms of at least two components:

- the success of the brand in its market, and
- the attractiveness of the brand for consumers (brand strength).

The market success of the brand is modelled – ideally – using quantitative market data reliably and validly – for example, with data from consumer or trade panels. Important indices for a brand's market success are:

- the purchaser range and penetration (purchaser range among the purchasers of the product group) of the brand
- the re-purchase rate (brand loyalty)
- the market share (by volume and value)
- the price and volume premium.

If no suitable panel information is available, information on market success may also be estimated by referring to representative surveys of the target group(s). This latter may apply especially in the case of brands in the service area, industrial goods or indeed luxury goods.
Suitable instruments and methods must be chosen to measure the success indicators mentioned. Attention is required here to ensure objectivity, reliability and validity of the measurement in order that the brand valuation can be considered valid. The latter applies in particular to the recording of the brand strength, which is the second crucial component in the valuation process.

Brand strength

The success indicators described above provide essential information for a valuation of the brand status. However, they measure only the real behaviour of the target groups in the past. These success indicators do not permit any inferences on the individual causes and motives behind this behaviour.

However, in any comprehensive and future-oriented brand valuation, attention must none the less be given to these behavioural determinants. For they supplement and round off the analysis of the present brand status.

Finally, the emotional appreciation of a brand, i.e. its psychological strength, must be secured for the future success of brands and hence the maintenance of value. Only brands that are attractive for the consumer continue to be bought over the long term. And it is only with such brands that the consumer will build up strong brand loyalty and also be prepared to purchase them at higher prices than other products or services. Hence an estimate of the future development of the brand value and of the specific brand risk is not really meaningful without this second component of brand status.
In the relevant literature, a number of indicators are proposed for the measurement of the psychological brand strength or attractiveness:

- Brand familiarity
- Brand sympathy
- Identification with a brand / a manufacturer
- Perceived brand quality or satisfaction with the product
- Brand loyalty
- Readiness to recommend the brand
- Acceptance of the price

As with an examination of a person's state of health, it is only when a major portion of these indicators are analysed that any meaningful measurement is arrived at of the brand strength.
The criteria mentioned share the common feature that they are not subject to any direct and objective observation. For the analysis of these components of the brand status, the validity and reliability of the indicators applied must be secured, as with brand success. There must not be any doubt about the substantial meaningfulness of the gauges used. Measurement errors – i.e. effects relating to the survey – must be excluded.

Of special importance for the meaningful measurement of this second component of the brand status is the definition of the relevant target group. This target group should include as representative a selection as possible of purchasers of the category that the brand to be evaluated comes from. In addition, the brand strength must also be determined for purchasers from other product categories in which the brand is to be expanded in future.

Principle 6

Consideration of the brand potential and the economic life of the brand

In order to forecast the future value creation earnings of a brand, in each brand evaluation an individual analysis must be undertaken of the brand's potential. This is based, as a rule, on the future potential earnings of a brand in the light of an adopted business plan, this requiring validation on the basis of behavioural analyses with respect to the specific brand.

In particular, for the purposes of a value-oriented brand management, brand value creation forecasts in relevant fields may also be analysed. In the valuation, estimates must be made of the probable economic life of the brand and hence the period of capitalisation of the expected cash flows. Here an explanation should be given of the assumptions made in estimating the useful life.

In evaluating product brands, a limited useful life might be derived (for example) from product life cycles and market analyses, arising from technological change or changes in taste and behaviour. In the case of corporate or umbrella brands, for instance, a limited useful life may be derived on account of the competitive situation or the dominance of just a few strong brands, or indeed the absence of brand relevance in the market segment in question.

Principle 7

Consideration of brand-specific cash flow surpluses by empirical methods in the relevant target group

On the classical understanding, the brand is a physical emblem of the provenance of the branded article. A brand has the purpose of lending individuality to merchandise, services and companies and of distinguishing them from their competitors. This formal understanding of the concept of a brand emphasises the labelling function that arises from the historical development of merchandise and corresponds to the understanding of the brand as an industrial property right. From today's point of view, a brand serves not only to identify the provenance of and to differentiate a corporate product or service; it also assists in the formation of preferences – assuming it succeeds in building up a positive, relevant and unmistakeable image in the eyes of consumers.

From this behavioural perspective, a brand is an unmistakable image of a product or service that is firmly anchored in the minds of its consumers and other relevant groups. This intangible conception of the brand is subject to an independent and subjective positioning in the minds of consumers and is fashioned by components which are affective (emotional, attitudinal), cognitive (knowledge, perception) and conative (behavioural intention, willingness to purchase).

As technologies, markets, processes, know-how and indeed the specific range of offers become ever more similar, there is a shift in value creation to assets which successfully set themselves apart over a long period and cannot be copied. As a rule, the specific features of the brand and its distinctiveness enable the company to market its products or services at higher prices (price premium) and/or to move into new business fields or product generations, communicating these convincingly to old and new customers and indeed to other relevant groups. By helping consumers differentiate, brands create a sense of identification among consumers, thereby influencing the purchasing decision in favour of the brand. The demand is seldom a matter of the brand alone. The labelled performances are often based on further differentiating demand factors that influence the purchase decision, such as the technological innovation of the product, its price, possible locational advantages, etc.

The valuation must clarify the role of the brand in the demand behaviour of the consumers and users. The valuation method must be able to distinguish the brand-induced demand from the preference-formation effect of other, intrinsic aspects, whether these be tangible or intangible. That is, the analysis must be able to isolate the cash flow generated by the brand rather than by other features.

To this end, the brand valuation must compute the share of the brand in the creation of demand objectively by a suitable empirical method. This work step can be based on existing market research data (secondary research) or on a specific investigation (primary research). This investigation should be directed at the behaviour of the target group and its specific motivations in demanding services or products of the brand.

Principle 8

Consideration of a net present value method and an appropriate discount rate

The value of the brand is determined by discounting the future financial surpluses attributed to it to the valuation date. In discounting the cash flows, the discount rate chosen must involve a premium to reflect the risk factor. As a starting figure, the weighted average cost of capital (WACC) may be used. For the valuation of the brand, the WACC must be adjusted to the risk profile of the brand. In evaluating a corporate brand, it may be assumed that the risk profile of the brand will be identical with that of the corporation. If the starting figure used is the company's weighted average cost of capital derived from capital market data, the computation must encompass the costs of equity, costs of debt (after tax) and capital structure.

The equity costs are composed, following the capital asset pricing model (CAPM), of a risk-free base rate and a market risk premium, adjusted to the specifics of the brand (risk surcharge). The base rate is arrived at on the basis of the current yield curve. The residual term of the bonds chosen should coincide with the residual life of the brand. In the event that an end of the use of the brand cannot be foreseen, the life is assumed to be indefinite.

Principle 9

Brand-specific risks (market and competitive risks)

A strong brand creates higher customer loyalty than a weak one. The future cash flow of a weak and risk-prone brand must therefore be weighted differently than the same future cash flow derived from a strong and secure brand. A brand that operates in a growth market enjoys a prominent position there and high familiarity, etc (see brand strength) is strong and so is better placed to actually realise the future forecast cash flows.

A brand that, thanks to its presence in the market, continuously acquires new consumers and is simultaneously able to tie in existing customers will help reduce the operating risk of the enterprise. Reduced risk is reflected in turn in lower financial costs. This advantage must be taken into consideration in the valuation.

A company or entrepreneurial activity can be seen as the interaction of different tangible and intangible assets. Each asset makes a specific contribution to the generation of earnings. The individual components here are exposed to different risks. In their aggregate, they constitute the company risk that is expressed in the weighted cost of capital, WACC. In quantifying the brand risk, it cannot be assumed that this corresponds to the company risk, since this will in many cases diverge from the brand-specific risk.

The strength – or else the inherent risk – of a brand must always be seen in the context of the competitive environment and the market in question and must be accordingly determined and quantified. The valuation must include the competitiveness of the brand and the resulting reliability of the demand in the future (brand risk).

The risks of a brand are diverse and can, in the nature of the case, only be outlined here. The specific situation is finally decisive for the detailed risk definition and its weighting. The following areas of risk can be made measurable and comparable by using the attributes listed immediately below:

- The dynamics and competitive concentration in the market
- Entry barriers
- Market concentration
- Market growth
- Volatility

The status of the brand

- Familiarity
- Brand attractiveness
- Relevant set
- First choice
- Loyalty

Support of the brand

- Investments in the brand (quantitative and qualitative)
- Homogeneity of the brand image
- Continuity of the brand management

Diversification of customer relation-ship

- Geographic diversification
- Offer-specific diversification

Legal protection of brand rights

- Registration
- Monitoring and expansion

In order to determine a suitable discount for a brand to reflect adequately the risk of future realisation, the method applied must account for the brand risk (or indeed the brand strength) in a discount rate that is reasonably transparent. This way of proceeding places the company risk in the context of the brand risk.
Valuation methods that fail to account for the specific competitive strength – and hence the reliability of future brand earnings – fail to consider the risk inherent in assessing the future value creation by the brand and consequently lead to excessively high brand valuations.

Principal 10

Reproducibility and transparency

The brand valuation must meet the quality criteria for scientific work: The measurement of the brand value can claim to be valid if it is free of systemic errors (such as occur when influences are measured twice) and if it is complete and models exactly what is to be measured. The validity of the findings must be verified by applying alternative criteria.
Reliability is arrived at if, after repeated measurement using an identical valuation scheme, the same result is achieved reliably.
All measurement factors are surveyed on the basis of a standardised and scientifically secure method.
Objectivity involves the valuation risk being disclosed and quantified as far as is possible. The data sources need to be specified and the provenance of the data substantiated.
Transparency is achieved if the measurement method is logical and transparent and is presented with a statement of the purpose for making the valuation. The relationship to the purpose of the valuation must be clear.

Berlin, 30th June 2008

Imprint

Publisher:
Brand Valuation Forum -
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Layout//Design:
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CH-8008 Zürich
www.interbrand.ch

Printer:
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Ostring 13
65205 Wiesbaden
www.druckerei-chmielorz.de

Status: 18 June 2008
Initial print-run: 2000