What You Should Know About Branding and Brand Value

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The creation and maintenance of brands are becoming more and more important in today's intensely competitive environment. This article will explore the phenomenon of branding and what a strong brand can do for your overall company value. Through the branding process executives and brand managers intend to create recognition and change purchase behavior among their customers. Branding is often related to a product, however, in the mind of the consumer there is no difference between the product and the company. Positive and negative actions by the company carry over to the perception of the product and vice versa.

Investing in branding activities creates brand equity. "Brand equity is a set of assets (and liabilities) linked to a brand's name and symbols that adds to (or subtracts from) the value provided by a product or service to a firm and/or the firm's customers.[1] " Equity exists when the customers are aware of the brand, loyal to the brand and perceive the brand as having quality. Awareness, loyalty and quality perception are three cornerstones of any successful brand. These three components of brand equity are considered individually below.

Brand Awareness

According to several studies[2] it has been shown that familiar products have an edge in the competitive marketplace. If given a choice between two items, consumers will chose the item that they recognize. Efforts spent on branding your product will reinforce recognition with customers and increases chances of purchase.

There are four different levels of awareness. A dominant brand is the only brand that you can think of in a product category. Examples of such brands are Kleenex, Jell-O and A1 Steak Sauce. This is the most desirable category to be in. Top-of-mind brands are the first brand you think of in a product category. However, you are able to think of a few more after naming the Top-of-mind brand. In the cola soft drink category this is true for both Pepsi and Coca-Cola. Loyal Pepsi drinkers think of Pepsi first while others think of Coca-Cola, but consumers of either brand are able to mention the other product name. Recall brands are all the brand names that you recall after you have mentioned the Top-of-mind brand. A consumer may know four different laundry detergents, and after mentioning Tide as the Top-of-mind brand, he can also recall Downey, Surf and Cheer. A brand that is merely recognized is the weakest form of awareness. If asked to name car brands, a consumer may be able to recall ten to fifteen different brands. However, when his unaided recall is exhausted and asked "How about Lamborghini?" the consumer recognizes the Lamborghini brand but would not have thought of it himself.

Brand Loyalty

Customers' loyalty in purchasing a brand time and again is the number one value-creating factor in brand valuation. Customer loyalty contributes to an even and predictable revenue stream. Loyalty can take several different forms and customers are often classified in five categories. Non-customers are people outside of your target group, also known as non-users. They are non-customers because they either do not use this type of product or they are committed to another brand. Price switchers are consumers who always buy the cheapest product no matter what the brand. Because branding is costly, they will rarely choose a branded product due to price differences. Passively loyal consumers are difficult to understand since they buy the product out of habit rather than reason. They may be persuaded into buying another brand if given a good reason. It is important to understand these consumers' habits in order to facilitate continued sale to this group. Fence sitters are indifferent between two brands. They buy the product of the two that is more convenient and cheaper. If you know that you have one major competitor or a large portion of your customers are fence sitters, you want to focus your brand building efforts on making the product more attractive than the competing product. Lastly, committed clients will go out of their way to find and buy a particular product. Any brand manager should be so lucky as to have a large group of committed customers.

Perceived Quality

Perceived quality has been linked to strong financial performance. Part of the explanation is the price premium that can be charged for quality products. Consumers are prepared to pay more for products and services that they perceive as having higher quality. Keep in mind however, that quality resides in the mind of the consumer. A product has to live up to certain quality standards, which may or may not be tests of true quality. Consumers' tendency to kick tires to test the quality of a car is one example of a consumer quality standard that differs from tests of true quality. This explains, in part, why leading quality brands seldom score well on consumer report type of surveys.

Brand Extension – Leveraging or Killing Your Brand?

More than 90% of all products introduced in the U.S. grocery and drug trade are line extensions. Yet brand extensions beyond the core of the product is the easiest way to dilute the power of your brand and destroy brand equity. Economic advantages are achieved through category focus not by attaching your brand to every conceivable product. If the consumer is not prepared to accept and connect your old brand with the new product, brand equity dilution is the only result. Secondly, when launching new lines that are substitutes for the existing line, a certain amount of cannibalism will take place on your existing brand's revenues. An example of a failure in using brand extension has occurred in the beer industry. For a long time there were three major American beer brands, Miller, Coors and Budweiser. Today there are approximately twenty different varieties of these three brands including Lite, Genuine Draft, Ice, Regular and so on. Despite ferocious marketing campaigns, and money spent on sustaining over twenty lines of beer, beer consumption in the U.S. is not increasing.

What is it Worth?

The value of a brand lies within the price premium that can be charged for a branded product. The approximate value equals the price premium times the number of units. Brands can be valued using the three traditional valuation approaches: cost, market and income. In the cost approach the present value of all historical expenses of creating the brand are analyzed. This method is intuitively appealing. However, in cases of entrenched, strong brands this method may be unreasonable, since the present value of all historical expenses may far exceed the market value of the entire company. This is referred to as brand burden. A similar approach, is the re-creation cost analysis. Here the costs of re-creating a similar brand are analyzed. Again, an intuitively sound method with unexpected consequences in the analysis of powerful and well-established brands.

The market approach focuses on transactions of brands. While scarce, this data can be bought from a few sources in the U.S. If one is able to identify a brand that is comparable to the subject brand and use it as a proxy, the market based valuation analysis is reliable. However, to find a good comparative brand that has been involved in a recent transaction may prove to be challenging.

In the income approach, a combination of a discounted cash flow model and an excess earnings method is used to establish the value. The return that can be ascribed to other asset categories is subtracted from the net free cash flow and any residual earnings are considered the return from the brand itself. The value is derived by present valuing returns attributed to the brand.

Income Approach – Example

In the following example, we have valued the brand of "Bubbles", a soap manufacturing company. Bubbles, has been around for 50 years and is a very strong brand in the Mid-West. Bubbles owns its own manufacturing plant located in Boise, Idaho. Bubbles' assets include goodwill from a prior acquisition of a soap manufacturer in Montana (Dish & Co.), the patent on the lathering agent for the Bubbles soap, as well as a proprietary manufacturing processes. The value increases of the assets have been projected for the next six years based on historical value growth and are presented in the following table.

Bubbles, Inc.
Projected Financial Data - Years 2000 through 2005
(dollars in thousands)

		2000	**2001**	**2002**	**2003**	**2004**	**2005**
ASSETS EMPLOYED							
Net Working Capital		$90,000	$91,800	$93,636	$95,509	$97,419	$99,367
Tangible Assets		225,000	229,500	234,090	238,772	243,547	248,418
Intangible Assets		75,000	76,500	78,030	79,591	81,182	82,806
Intellectual Property – Patents		10,000	10,200	10,434	10,612	10,824	11,043
Intellectual Property – Proprietary Technology		15,000	15,300	15,606	15,918	16,236	16,561
LESS REQUIRED RETURN ON ASSETS							
Net Free Cash Flow		**44,080**	**44,887**	**46,956**	**49,112**	**51,361**	**53,705**
Net Working Capital	6.0%	5,400	5,508	5,618	5,731	5,845	5,962
Tangible Assets	9.0%	20,250	20,655	21,068	21,489	21,919	22,358
Intangible Assets	14.0%	10,500	10,710	10,924	11,143	11,365	11,593
Intellectual Property – Patents	14.5%	1,450	1,479	1,513	1,539	1,569	1,601
Intellectual Property – Proprietary Technology	20.3%	3,045	3,106	3,168	3,231	3,296	3,362

		2000	2001	2002	2003	2004	2005
Return Allocable to Trademark/Brand		**3,435**	**3,429**	**4,665**	**5,979**	**7,366**	**8,830**
Terminal Value		N/a	N/a	N/a	N/a	N/a	73,581
Future Cash Flows		**$3,435**	**$3,429**	**$4,665**	**$5,979**	**$7,366**	**$82,410**
Required Return	16%						
Long-term Growth	4%						
Value of Trademark/Brand	**$49,132**						

After calculating the net free cash flow for each of the forecasted years, the return attributable to each asset category is subtracted from the net free cash flow. Net working capital is expected to return six percent per year based on current money market yields. A real estate appraiser provided the nine percent expected return for real estate in the Boise, Idaho area. Goodwill from the acquisition of Dish & Co. has been tracked carefully and is returning 14.0%, which is the internal rate of return that was used in the acquisition analysis. Based on an analysis of the patent, the risk of patent infringement, and the competitive advantage that the patent is providing the company, the return on the patent was assumed to be 14.5%. A similar analysis was performed for the proprietary technology. Because of the lack of patent protection the return on the technology was deemed much riskier than the patents and thus significantly higher, 20.3%. The return from each asset is subtracted from the net free cash flow. Any excess return is attributed to the brand.

A 16% rate of return from the brand was based on data from similar brand transactions. The Gordon Growth formula[3] was used in the determination of the terminal brand value. The interim cash flow from the brand and the terminal value were discounted by the 16% rate of return for a present value of the Bubbles brand of $49.1 million.

Why do you need to know the value of your brand?

Aside from maximizing any opportunity of selling the brand the following is a list a possible valuation scenarios: It is an intangible asset that does not appear on the balance sheet, thus making your company look smaller and less valuable than it is. Increasingly banks use the brand asset as additional collateral for high-risk credit facilities. In corporate acquisitions the greater the amount of the purchase price that is allocated to corporate assets including to an acquired brand asset, the lower the amount of goodwill amortization that must be charged against earnings each year. Therefore, identifying and attributing value to the brand asset increases reported net income and earnings per share, directly increasing the market reported capitalization of the company's stock.

[1] Aaker, David A. "Building Strong Brands"
[2] PIMS data base (annual data measuring more than one hundred variables for over 3,000 business units); Anderson, Fornell, and Lehmann, "Customer Satisfaction, Market Share and Profitability: Findings from Sweden", Journal of Marketing, July 1994; and Aaker and Jacobson, "The Financial Information Content of Perceived Quality", Journal of Marketing Research, May 1994, pp. 191-201.
[3] Next year's earnings/capitalization rate = (e0 * (1+g))/(d-g) where: e0 = this year's earnings; g = long-term growth rate; d = discount rate