Brand investment and valuation – a new, empirically-based approach

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ARF Experiential Learning

Re!think 2016

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Source: ARF Experiential Learning
Issue: Re!think 2016

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Summary

The "brand" is one of the largest assets that a company owns. But unlike tangible assets like factories which are quantified on the balance sheet, a brand's financial value often goes unrecognized. This puts marketing and finance teams at a disadvantage for assessing investments in the brand such as media.

To bridge this gap MASB sponsored an ambitious project that brought together leading academics, marketing and finance practitioners from six blue-chip corporations, and specialists from several research companies.

An eighteen month tracking study of over one hundred twenty brands was used to

- identify a cornerstone brand strength metric - one with the strongest proven relationship to share-of-market and, ultimately, cash flows
- link this metric to other marketing metrics
- validate a practical model for brand valuation that finance teams can easily implement

As demonstrated in case studies this provides a roadmap for monitoring marketing investment return and bringing financial rigor to the budgeting and project authorization process.

Introduction

Brand building is among the most common objectives of marketing. By improving the place the brand holds in the hearts and minds of customers, brand teams strive to impact both short and long term financial return. But how does a company know that these have been good investments? Unlike tangible assets like a factory where the cost and return are easily quantified and tracked, the intangible nature of a brand results in its financial value being unrecognized and unmonitored. This difficulty in quantifying a brands contribution to the bottom line can even put marketing teams at a disadvantage versus other corporate functions in acquiring needed resources.

To rectify this situation the Marketing Accountability Standards Board (MASB) determined that conceptual and mathematical linkages needed to be made between marketing and financial metrics. Specifically, if changes in brand strength were accurately measured and translated into cash flows, marketing investments could be treated by finance teams in the same way as other corporate investments. Furthermore, like is done with tangible assets, finance teams could place a value on the brand itself by applying a present value calculation to the expected stream of brand-driven cash flows.

But this approach requires a proven 'cornerstone' measure of brand strength that captures the full extent of the brand-consumer relationship. In managing brands, marketing teams have turned to numerous measures of brand strength. Often called 'health' or 'equity' metrics, some of these concentrate on specific aspects of the consumer-brand relationship. Examples are awareness of the brand, intent to purchase or use the brand, and willingness to recommend the brand. While each of these provides valuable information in understanding part of brand strength, none alone captures the full extent of the brand relationship and therefore none provide a sufficiently strong relationship to financial metrics forthe purpose at hand. However, an academic review of the research literature uncovered a different type of measure with a strong track record of predicting financial outcomes; brand preference. Instead of focusing on a particular aspect of the brand-consumer relationship, brand preference strives to capture the total effect. It does this through a behavioral exercise in which consumers are incentivized to choose the brand they truly want from the set of competitive peers. In this way it captures the result on choice from both affective and cognitive motivations.

Drawing upon this knowledge base, MASB sponsored a multi-year longitudinal study to establish the needed linkages.

Study Design

Six blue chip corporations participated in the study by providing unit sales, pricing, and distribution data for their own and competing brands for two categories of their choosing. The twelve chosen categories represented a wide variety of product types and market conditions. Individual unit prices ranged from less than one dollar to over thirty thousand dollars. Some of the categories were highly fragmented while others had only a few competing brands. Average purchase cycles varied from a week to up to a decade. Even the consumer decision process varied dramatically, with some categories being of a more spontaneous nature while others were much more deliberative and often included multiple decision makers.

For six of the categories the corporations also provided 'equity' and 'health' measures from their proprietary brand tracking systems. While each included category specific measures, seven common classes were found across at least four of the categories; unaided awareness, aided awareness, advocacy, loyalty, purchase intent, relevance, and value.

The above financial and brand tracking information was compared to brand preference data provided by MSW.ARS Research. This patented implementation of brand preference was chosen for a variety of reasons. It has undergone the rigorous MASB Marketing Metric Audit Protocol as part of the APM Facts/CCPersuasion copy-test measure[1]. As such it has a long established record of meeting the ten characteristics of an ideal metric including being simple, objective, calibrated across categories and geographies, reliable, predictive of business results, and sensitive enough to detect even small changes driven by marketing activities. As deployed in this study it also has the advantage of isolating brand strength from product factors such as price and distribution. The data was collected monthly from a United States demographically representative sample of four hundred online panelists. Each of these individuals was given the opportunity to choose the product they truly wanted within each category from among a competitive product set as part of a prize drawing. Brand preference was calculated as the percent of individuals choosing a product from that particular brand.

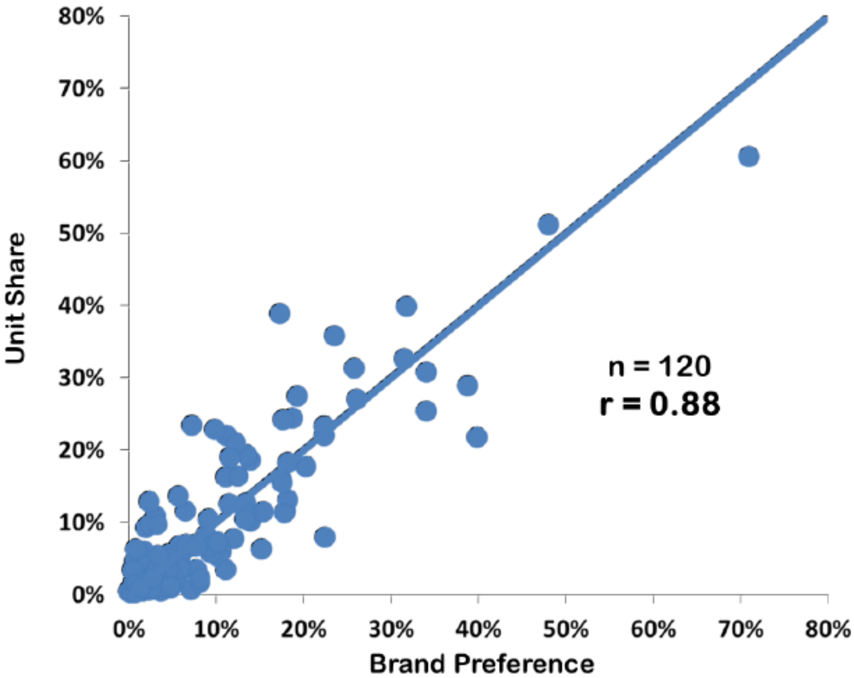
The analysis presented here is drawn from eighteen months of data collection for a total sample size of seven thousand two hundred respondents making choices on products representing one hundred and twenty brands across the twelve categories.

Results and Insights

The first question to be answered was to what extent does brand strength (as measured by brand preference) determine a brand's share of consumer purchases? This is important as explaining unit share is fundamental to brand valuation. By combining an estimate of a brand's unit share of market at a given price point and cost of production with assumptions of future category size based on population and category penetration trends, a projection of cash flow can be made. A discounted cash flow (present value) calculation can then be used to create a brand valuation.

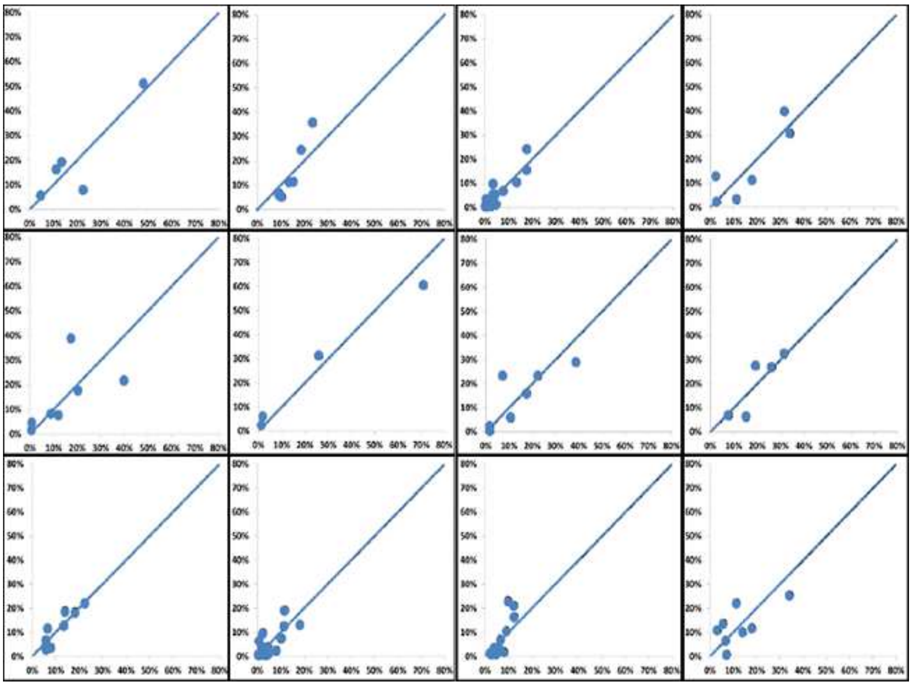
Across the trial categories, brand preferences alone explained seventy-seven percent of the differences in unit shares among the one-hundred twenty brands.

Link between Brand Preference and Unit Market Share[2] Point-In-Time: Brands across All Twelve Categories



This positive relationship was also seen within each of the categories. Given the wide variety of category conditions represented, the implication is that brand preference is a powerful indicator of brand strength at any given time for any given brand.

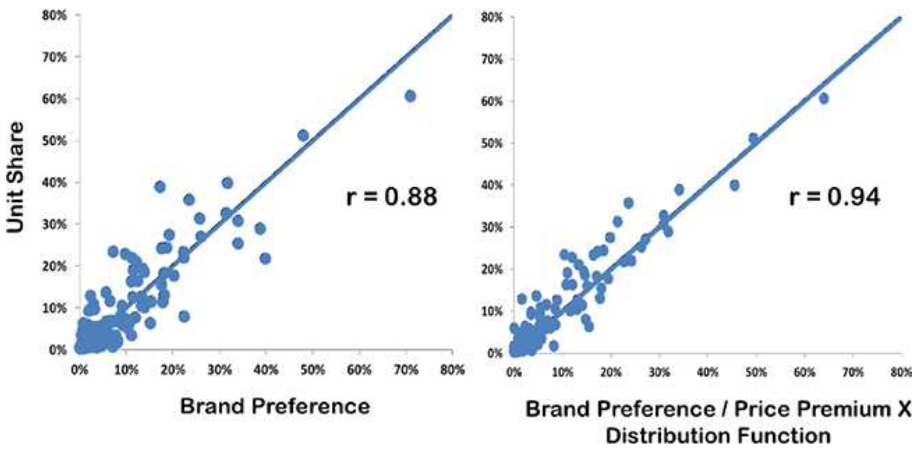
Link between Brand Preference and Unit Market Share[2] Point-In-Time: Brands within Each of the Twelve Categories



But what explains the remaining twenty-five percent of the variance in unit shares? And how do these factors interact with brand preferences? Previous studies[3] have shown an interaction between brand preferences, product price and product distribution. Therefore residual analyses were deployed to examine this interaction with price and distribution. Brand preference for each case was divided by its corresponding unit share to create an index. A clear relationship was seen. Brands with relatively high prices on average have unit shares which under-perform their corresponding brand preference level. Contrarily, brands with relatively low prices on average have unit shares which over-perform their corresponding brand preference level. Similarly, brands with relatively high distribution on average have unit shares which over-perform their corresponding brand preference level. While brands with relatively low distribution on average have unit shares which under-perform their corresponding brand preference level.

When brand preferences are combined with relative price and distribution the variance explained in unit shares increases to 89% across the trial categories. This level of explanatory power leaves little room for improvement suggesting that brand preference by itself is a sufficient measure of total brand strength. Consequently, this suggests that it must capture the majority of the predictive power of brand awareness and other partial brand strength measures.

Link between Brand Preference, Price, Distribution and Unit Market Share[2] Point-In-Time: Brands across All Twelve Categories



A correlation analysis was conducted using the participant supplied tracking data to confirm this directly. Unlike the behavioral brand preference technique which efficiently provides data for all brands in a category, the realities of "verbally" gathered survey measures restricted coverage to only the largest brands within each category. Across the six categories thirty three brands were represented. To align with this, the brand preference and unit share were recalculated. Regarding the types of measures gathered, seven broad concepts emerged which were each present in at least four of the six categories:

- **Awareness Unaided** - report of brand name when prompted with category (no brand list given)
- **Awareness Aided** - brand name recognized from a list of brands
- **Brand Loyalty** - brand is one that they plan to consistently purchase/use when need arises
- **Value** - brand provides good value for the money
- **Purchase Intent** - likelihood to purchase brand in future
- **Brand Relevance** - brand fits lifestyle and/or needs
- **Advocacy** - brand is one that they would recommend to others

For each of these seven concepts and brand preference, the correlation and variance explained in unit share was calculated. Since the question wording and scale of these concepts varied by category, it was not possible to directly combine cases across categories. Instead, the variance explained was calculated for each category with the mean and median taken across them. Also, to provide perspective on the consistency of relationships across categories, the number of categories meeting the common rule-of-thumb correlation of 0.30 was determined.

Link between Brand Strength Measures and Unit Market Share[2] (Reduced Set of Brands)

	Average Unit Share Variance Explained	Median Unit Share Variance Explained	Number of Categories with Correlation > 0.30*
Brand Preference	68%	80%	6 / 6
Awareness – Unaided	48%	44%	4 / 4
Brand Loyalty	45%	43%	5 / 6
Value	32%	44%	3 / 4
Purchase Intent	27%	26%	4 / 6
Brand Relevance	19%	18%	2 / 4
Awareness – Aided	18%	26%	4 / 6
Advocacy	15%	13%	2 / 4

Unsurprisingly given their widespread use in managing brands, all of these common concepts show mean and median correlations to unit share above 0.30 and correspondingly variances explained above nine percent. But as expected, none of these partial measures of brand strength demonstrate an explanatory power greater than brand preference. In fact, the strongest of these, unaided awareness, explains twenty-one percent less variance in unit share on average and thirty-four percent less on median. Also, brand preference and unaided awareness are the only two consistently meeting the 0.30 correlation level within each category for which it is available. So while the explanatory power of brand preference and unaided awareness transcend categories, the relevance of these other concepts tends to be less universal.

The correlation analysis also supports the contention that brand preference acts as a measure of total brand strength capturing the dynamics of these other measures. Contrasting their average variance explained in unit share to that of brand preference illustrates this. In each case the variance explained in brand preference is greater than that explained in unit share. Therefore, these other metrics are unlikely to add to the explanatory power of brand preference to unit share.

Link between Other Measures of Brand Strength and Preference & Unit Market Share[2] (Reduced Set of Brands)

	Average Variance Explained in	
	Brand Preference (w/Price & Dist.)	Unit Share
Awareness – Unaided	52%	48%
Brand Loyalty	50%	45%
Value	41%	32%
Purchase Intent	33%	27%
Brand Relevance	28%	19%
Awareness – Aided	28%	18%
Advocacy	23%	15%

Application

The opportunity for using this learning to enhance corporate financial stewardship is dramatic. As noted by James Gregory, CEO of CoreBrand, "the percentage of a company's market value represented by intangible assets has grown from 17 percent in 1975 to 81 percent in 2009."[4] Yet, despite the increasing shift in enterprise value from tangible to intangible assets, the use of brand valuations has not become commonplace across organizations. This leaves boards and management teams with little guidance as to the long-term financial impact from allocation of resources to brand marketing activities.

Through MASB, several organizations have worked together to create a 'Brand Valuation Model' with corresponding guidelines and recommendations for calculation of brand valuation from brand cash flows. In February 2015, they presented a set of premises for doing this:

Foundational Premises of the Brand Valuation Model[5]

- A discounted cash flow approach is preferable over any other method, such as the "relief from royalty" method.
- "Brand strength" is an important "risk" indicator of the likelihood that future cash flows will be earned and over what period of time.

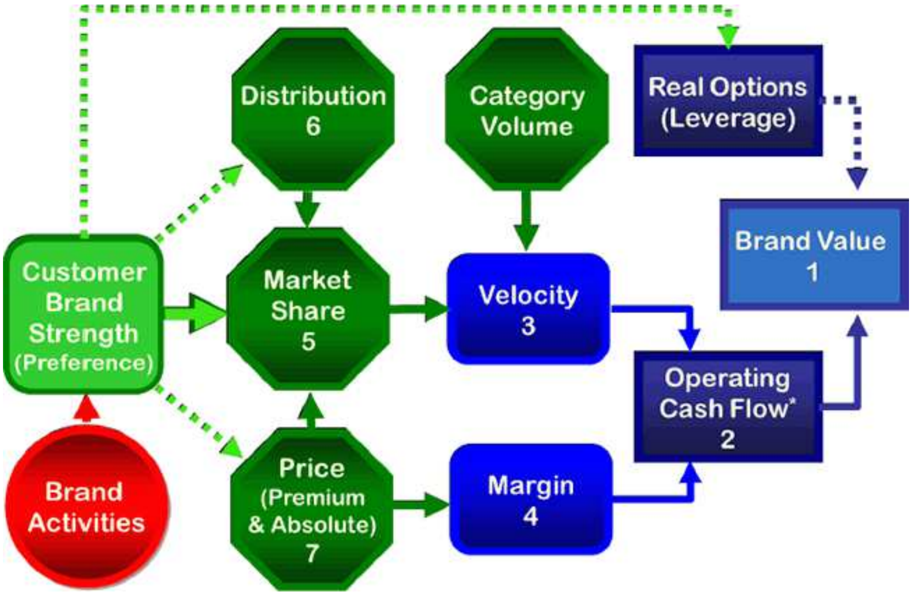
- "Brand strength" is predominantly driven by marketing effectiveness, competitive factors, and external environmental conditions, and it therefore can be reasonably inferred and factored into the model.
- Brand valuations are not intended to establish amounts to be recorded on the balance sheet (or to specifically test for impairment), nor are they intended to establish or represent a transactional valuation.
- As important as reasonable accuracy at a point in time is the consistency of approach and assumptions overtime which will allow management to see relevant valuation movement to aid in decision-making.
- The model should also enable sensitivity analysis and "what-if" modeling.

Within this foundation brand strength not only serves as a bellwether of future cash flows but also provides a means of highlighting marketing's unique contribution to the financial success of the firm. Jim Meier, MillerCoors Senior Director of Marketing Finance, explained it this way:

The manufacturing side of the business can purchase and maintain an asset. Marketers can create and grow one... Brands could 'earn' a higher valuation based on improved brand preference which would remove uncertainty relating to future financial assumptions and the longevity of the brand.[5]

In August 2015, these foundation premises were applied to the results from the longitudinal study. The end result was a robust, practical model for brand investment and valuation. The model which is housed by MASB provides not only provides the conceptual linkages but also the underlying mathematics.

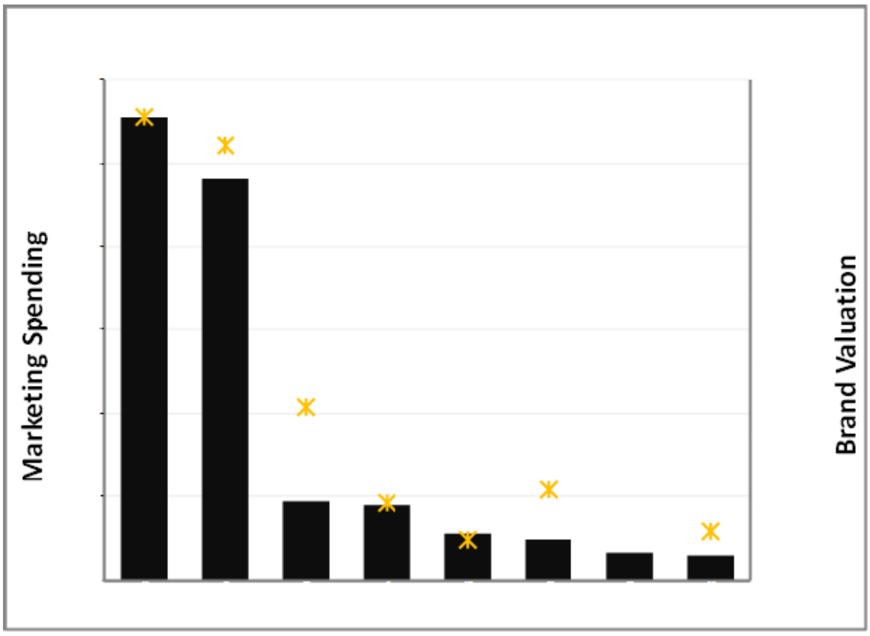
Brand Investment/Valuation Model - Conceptual Linkages[2]



*Current and Future Cash Flows including volatility & risk

By applying this model finance teams can easily tie changes in brand strength to changes in financial metrics. Furthermore, the resulting cash flows can be used to project a brand valuation which can be tracked over time. As an example, this model has been used within one company to demonstrate the relationship between long-term marketing spending for their brands and their corresponding brand valuations.

Marketing Spending vs Brand Valuation[2]



In short, there is now a proven roadmap available for monitoring marketing investment return and bringing financial rigor to the budgeting and project authorization process.

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