

# Brand Valuation: Financial - Marketing Interface of Metrics

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## INTRODUCTION

The international accounting standards have given brand assets recognition as an intangible asset separating itself from goodwill, though, the U.S. GAAP and the IAS do not recognize internally generated brands as assets (FRS 142, IAS 38). However, if it fulfills these criteria as “identifiable”, “controllable” and “liable” to have “future economic benefits” over its “useful life”, then it would be recognized as an intangible asset. The controversy that surrounds accounting professions is that though a brand meets the above mentioned criteria, it has so far not been accounted for separately in the balance sheet (Cravens and Guilding, 1999; Mather and Peasnell 1991). Numerous empirical studies have been conducted by financial accounting and marketing researchers to determine approaches of brand valuation. The scope of manipulation and ambiguity draws the reluctance of financial standards to include brand asset valuation on the balance sheet. The biggest challenge comes with regard to the companies accepting the best alternative way for recognizing and accounting intangible assets as “brand”. For the last two decades, concepts from the marketing perspective have come up as brand equity (Aaker, 1996) and linking it with customer based brand equity (Keller, 1993). Different dimensions have been considered in measuring brand, and an eventual growth from the term “brand” to “brand equity” has also been incorporated, extending the scope of brand valuation to different measurement metrics. The researchers have again opened up the debate of placing brand assets on the balance sheet (Yeung and Ramasamy, 2007; Keller and Lehmann, 2006). Yeung and Ramasamy, (2007) tried to establish a relation of brand value with firm performance in their study of 50 US companies. They presented that the brand equity and the performance of the firm in the stock market have a strong link. The value relevance of this information and its usefulness would prove successful to place it in the balance sheet. The objective of the first section of the paper is to draw the background for accounting for brands. The second section of the paper is to review the existing approaches for accounting brand from both financial-marketing and marketing perspective and their measurement metrics that can be used in brand valuation the last section deals with discussion and further research to be undertaken.

## LITERATURE REVIEW

### 1) THE BACKGROUND FOR ACCOUNTING FOR BRAND

The objective of provision SFAS 142 was to improve the financial reporting of the business and the accounting practices of intangible assets after they have been initially recognized. This Statement was also to provide more information of intangible assets, however; the Statement users did not consider goodwill amortization expense as better useful information in analyzing investments. **Zang (2008)** stated the abolition of goodwill amortization may confuse investor in their assessment of the firm's value; the accounting standards facilitate companies with goodwill to report a jump in earnings. The reason is that the market cannot differentiate the cosmetic difference in the earning cause by the provision FRS 142 and the additional changes in the earning. **Churyk (2005)** examined that the amount of goodwill reported may also reveal an overpayment for the acquired firm as the '*excess of fair value*' measurement method is proposed to capture the excess value created by the company. **Sevin and Schroeder (2005)** in their study pointed out that a noteworthy percentage of small firms accounted negative earnings in the period (year 2001) of FAS 142 implementation. On the contrary, the large firms reported negative earning as a usual trend before the adoption and after 2001. Their findings suggested that the negative reporting was a consequence of the 'big-bath strategy' which

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made little difference on the standards implementation. **Seetnaraman et al. (2006)** reported some pitfalls on the treatment of goodwill impairment. They outlined the following facts: **First**, goodwill as an intangible asset does not produce its own cash flow, therefore, the impairment of goodwill fair value has become a challenge. **Second**, the guidelines provided were subjective; therefore, the researchers felt there were enough room left for the analyst for interpretation, judgment and biasness. **Third**, goodwill impairment accounting is left in the jurisdiction of the management to define and account it and the fourth limitation was that due to different standard bodies like US FASB, UK ASB and IASB, there has been more confusion to its users practicing goodwill impairment treatment because of its non- convergence, which pilots to the limited application of the Standards for the MNCs on country to country basis. **Sevin et al. (2007)** stated that since the standard does not provide significant guidelines of the implementation process, companies may have difficulty in defining the most appropriate reporting units. The selection of the reporting units and the goodwill allocation may significantly affect the allocation of goodwill impairment that companies will write-off. While **Henning and Shaw's (2004)** study concluded that the provision in the FAS 142 aimed at restricting the amount of goodwill write-off may be unnecessary. They pointed out that the provision methods of measuring goodwill write-off will not be subjected to much material differences. Therefore, the removal of company level goodwill would result in the timely recognition of the reduction in the amount of goodwill recorded. **Bina and Bella (2007)** pointed out in their study the term '*quasi fair value accounting treatment*' in connotation to the impairment of goodwill. They pointed out that the amount recognized to the intangible assets generated internally by the company make up for the reduction in the amount of goodwill in the first stage of the impairment test. The cause is the excessive estimation of the reporting unit fair value. Therefore, the authors' findings show that the adoption of full fair value accounting for goodwill requires the elimination of the two-step approach of impairment testing and the disclosure of additional information subsequent to the first step of the test of the result. **Mercer et al (2002)** pointed out in their paper that the second step of FAS 142 necessitated that companies determine the fair value of the reporting unit's recorded and unrecorded intangible assets. But they argued what amounts to identifiable intangible assets which would be subjected to amortization while others would be spared. They also pointed out that the traditional valuation methodologies lead to different results when applied to the same intangible assets. Further elaborating, they pointed out the discounted cash flow approach could be subject to manipulation in the accounting of intangible assets. **Brain et al. (2002) and Lewis et al. (2001)** argued that using the present value of cash flow would lead to differences in the results. The interest rate changes could reduce the value of goodwill in a situation where there is constant cash flow. **Massoud and Raiborn, (2003)** stated the impairment condition outlined by the standard FAS 142 where companies that do not write off their goodwill were too subjected to impairment test at the operating level. This could be subjected to manipulation, different interpretation and biasness by the analyst valuating intangible assets. **Huefner and Largay III (2004)** pointed out the provision SFAS 142 does not require the companies to disclose the methodologies used when applying the impairment tests. Therefore, the corporate managers in the study by **Hirschey and Richardson (2003)** voiced concern that differences between the pooling and purchase methods of accounting affected competition in the merger and acquisition market. **Hussey and Ong (2000)** brought out another issue in the accounting treatments, they pointed out that the companies had an option 'weakening their balance sheet', otherwise reducing their annual profit. The subject of intangible assets such as brand brought on the balance sheet were not consistent with the impairment treatments. **Barth et al's (1998)** valuation of intangible assets such as brands is expected to be a more discretionary subject. Their study contributes to the literature by showing how significant variation in the market capitalization rates of recognized assets could be observed from companies as the valuation parameters are subjective. They examined that brand value estimates reflect relevant information. In comparison to the US, the U.K firms are adding intangibles to their books as acquired brands assets after formerly writing-off goodwill. **Mullur (1999)** suggested that U.K. firms' decision to capitalize brand values were influenced by the impact that the immediate write-off of goodwill to equity would have an effect on their future acquisition and disposition and on their reported leverage. His findings show that the firms subjected to capitalize separately identifiable intangible assets at the time of acquisition instead of writing them off against reserves as an element of goodwill. **Kallapur and Kwan (2004)** examined the value relevance and reliability of brand assets recognized by 33 U.K. firms. They reported that recognized brand values are significant, though over valuation may be the analysts' limitation as the valuation of intangible assets such as brand is more of an optional. Therefore, their study contributes to the literature by showing that the significant variation in the market capitalization rates of recognized assets could be observed by different companies as the valuation were subjective. **Farquhar et al's (1992)** citation, a proclamation by the Britain's Accounting Standards Committee, that brand

accounting was the major accounting controversy of the last 20 years. They stated that disclosing brand values on the balance sheet would be consistent with U.S accounting standards, if it met these few criteria: **First**, the value assigned to an acquired brand should be its purchase price. **Second**, the capitalization or book value of the brand should not exceed the present value of the entity's profits of the brand and **thirdly**, the brand capitalization could be adjusted to the standard pattern of value dissipation over the period of time. The FRS 10 of the Accounting Standard Board in the U.K. recognized intangible assets separately from goodwill and the standard distinctively recognized purchased intangible such as brands (Cravens and Guilding, (2001)). **Guilding and Pike (1990)** emphasized that internal accounting recognition of brand value; the manager would be influenced with respect to the significance of brand and development of brand value. The authors pointed out that due to the conflict with regard to the recognition of intangible assets and objective measurement by the managers, it would be beneficial both in internal and strategic thinking of the organizational decision making. The authors **Guilding and Pike (1994b)** in their study reported that due to goodwill subjected to write-off in the balance sheet, the impetus for brand valuation was more of internal phenomenon and the figures computed were not capitalized in the balance sheet. The omission of presenting brand assets on the balance sheet encouraged hostile takeover that was a consequence of undervaluation of shares and this was pointed out in a study conducted by Mather and Peasnell, (1991). Their results proved that the capitalization of share price was positively correlated with the capitalization of brands in the book value. Further on, Ong (2001) in his study of UK companies reported that due to unsatisfactory regulations on goodwill prior to FRS 10, it led companies to oust their goodwill and intangible assets such as brands on their balance sheets. The confusion whether to capitalize internally generated intangible assets such as brands led companies to adopt different approaches. The result in the authors' study proved that decrease in the ratio of companies capitalizing brands was a consequence of companies including brands as a part of goodwill. **Tollington (1998a)** emphasized the need of recognizing brand assets separately from goodwill. He recognized the fact that the recognition of internally created brands assets should be also accounted for on the balance sheet. He stated that both purchased and home grown brands were liable of future economic benefits and be recognized in the balance sheet. According to the financial norms, assets capable of producing future economic benefits are recognized, thus it reflects contradiction. Therefore, brands should be recognized irrespective of whether internally generated or purchased by the company. Tollington (1998b) pointed that the capitalization of brand was fundamentally based on the recognition of purchased goodwill. Thus, it had become imperative for brand asset recognition independent of purchased goodwill. In their study of "Inter functional cooperation in progressing accounting for brands; The case for brand management accounting", **Roslender and Hart (2006)** in their paper pointed out that in the case of 'home grown' intangible assets, brand valuation have not been much considered in the review of IFRS 3 due to lack of reliability. The purchased brand under business combination would only be of value when it is purchased by the acquiring company. **Guilding and Pike (1994a)** recognized the fact that for the reason that the accounting information is liable to be inward looking and historical, it amounts to having less subjective course. Therefore, an organizational commitment in the direction of a marketing and accounting interface is much looked for (Guilding and Pike, 1990).

## 2) THE PROGRESSION OF FORWARD LOOKING BRAND EQUITY MEASURES

The fair value accounting significance addresses non-financial intangible assets like brands and the question about the reliability of the fair value estimates. **Barth et al. (2001)** stated that the fair value estimates cannot be determined by the indication of market prices, as in most circumstances, no market exists for these assets. Therefore, there is scope of error in their estimation by the management or else by the auditors. **Tollington (1998 a, 1998 b)** pointed further research into brand loyalty, brand awareness and perceived quality attributes of brands that lead to development of brand equity which was brought out by Aaker (1996). **Roslender and Hart (2006)** stated that a comprehensive accounting for brands should integrate from the three perspectives that are financial, marketing and management accounting. **Wyner (2001)** brought out the perspective of forward looking brand equity evaluations that were more focused on decision making orientation. A study conducted by Wiesel et al. (2008) reported that firms could endeavor to have a significant customer base that could be reported forward looking customer metrics. This would invariably influence corporate decision making, more so in the light of investors' perspectives. Marketing researchers went out further, drawing a relationship between market orientation and brand valuation. **Cravens and Guilding (2000)** brought out that brand valuation is a comprehensive measure that incorporates attributes such as customer satisfaction and loyalty. Therefore, a market orientation concept is formed when the focus draws on customers. The authors asserted that brand valuation may be an effective means of assessing customer value, which could provide a platform

for decision making for strongly branded companies.

## VALUATION METHODOLOGIES

Various valuation methods of accounting the fair value accounting have been studied. These are **a)** market capitalization **b)** discounted cash flow **c)** residual income valuation **d)** cash flow on investment **e)** economic value added. The present value technique is the best option because of its consistency. Moreover, fair value accounting has been mean of subjectivity. **Roslender and Hart (2006)** observed that recognizing the significance of brands by the companies has led to formulate further approaches for accounting for brands. In their paper, they identified brand management accounting as an additional alternative, which goes beyond the traditional valuation techniques as pointed out by Cravens and Guilding, (1999). **Tollington (1998)** pointed out that internally created asset such as brands require an independent valuation. Separable assets thus could be included in the balance sheet. Tollington (1999) further recognized the fact that traditionally, the fair valuation methods such as price premium, earning valuation, royalty payments, market values and historic costs methods lacked consistency and were subjective in nature. Therefore, the level of difference in the approaches could be a significant reason to determine which measurement is likely to be suitable for the brand management purpose, this being the vital reason for the U.S. GAAP ignoring the inclusion of brand values in the financial statements Cravens and Guilding, (1999). Unlike the U.S, **Cravens and Guilding, (2001)** in their study pointed out the situation in U.K and New Zealand were quite different where separate disclosure of home grown and purchased brands is capitalized. The authors, Cravens and Guilding (1999) further pointed out that though the valuation methodologies were subjective in nature, the brand could be measured in monetary terms which would help the company in decision making. After an extensive literature survey, we analyzed that there were many methodologies which could be undertaken in the valuation of brands such as financial, marketing, management accounting (Roslender and Hart, 2006) and strategic management accounting (Cravens and Guilding, 1999; Roslender and Hart, 2003). We would discuss the brand valuation measurement under two approaches: the financial and the marketing approaches. Under the preview of marketing, we would further study brand equity measures and customer based brand equity measures.

### 1) FINANCIAL MEASUREMENTS/EXTERNAL ORIENTATION

Researchers have developed brand equity models integrating a comprehensive and multi dimensional perspective. Financial measurements include those approaches that increase the financial value of the brand in the capital market. Studies have incorporated a marketing-finance interface as CRM (Srivastava et al. 1998, 1999) and customer retention (Thomas et al., 2004). Stock return with different brand equity dimensions reflects the potential discounted value of future cash flow. Quality perceptions (Aaker and Jacobson, 1994), brand attitude (Aaker and Jacobson, 2001), brand extension (Lane and Jacobson, 1995) and name change (Harsky and Swyngedouw, 1987) are also studies conducted with this regard. New models have linked how brand equity could increase the financial performance of firms and how value creation and value appropriation could create financial value (Mizik and Jacobson, 2003). In another study Mazik and Jacobson, (2008) provided how brand asset metrics provide information in the context of accounting performance measures with respect to stock returns and how brand strategies are associated with financial returns (Rao et al., 2004). In the Table 1, the parameters and financial metrics undertaken by researchers in measuring brand value has been depicted.

### 2) MARKETING MEASUREMENTS /CUSTOMER FOCUS ORIENTATION

The five level techniques that lead to the creation of brand equity measures were first conceptualized by Aaker (1991) and Keller (1993). Customer based brand equity has come a long way from the model propounded by Keller (1993), that brand knowledge consists of two dimensions. The first, brand awareness and the second being brand image. A customer based brand equity leads to good customer response, which may be built with the help of marketing mix elements. 'Favourable', 'strong' and 'unique' brand associations are major attributes that a customer holds in the mind and the brand awareness is the major function of customer based brand equity. The comparative study was undertaken up by Agarwal and Rao (1996) of eleven components of customer based brand equity measures to appraise their convergence. On the base of market information provided by the company, the customer can decide which products generate more brand equity (Villas-Boas, 2004). It becomes invariably important for the company in this case to test.



**Table 1: Brand Equity Financial Metrics**

S.No	Financial Metric	Sub-Parameters	Research Proponent
1	<b>Financial</b>	Current and Past Advertising	Simon and Sullivan (1993)
	<b>Market Value</b>	Expenditure	
		Advertising Share	
		Adverting Expense	
		Order of Entry	
		Age of Brand	
		R&D Share	
2	<b>Perceived Quality</b>	The Saliency	Aaker and Jacobson (1994)
		Stock Return	
		ROI and Advertising	
		Quality	
3	<b>Brand Extension</b>	Brand Familiarity	Lane and Jacobson (1995)
		Brand Attitude	
		Category	
		Size	
		ROI	
4	<b>Capital market</b>	Adverting Expense	Barth et al. (1998)
	<b>Valuation</b>	Operating Margin	
		Market Share	
		Currents and Past Advertising	
		Share	
5	<b>Value creation</b>	Advertising Expenditure	Mizik and Jacobson (2003)
		R&D	
6	Branding Strategy	Age of Firms	Rao et al. (2004)
		Operating Margin Leverage	
		Advertising Expenditure	
		Focus	
		R&D Expenditure	
		Acquisition	
		Concentration Index	
		Growth Rate	
7	<b>Brand Attributes</b>	Differentiation	Mizik and Jacobson (2008)
		Relevance	
		Esteem	
		Knowledge	
		Energy	

The customer learning and customer loyalty towards the brands. Research has shown how valuing customers are intangible assets feasible to value firms (Gupta et al. 2004). In their study, Gupta et. al (2004) emphasized that the customers' retention could impact the customer base and value of the firm in the market. Researches are emerging in the direction of linking brand equity to customer equity. The relationships between the brand and customer perspectives were studied by Ambler et al. (2002). They brought up the following fundamental research issues such as **a)** The number of metrics required to measure the brand equity, **b)** A comprehensive study about the relevant brand

metrics for company and c) The parameter of financial valuation of a brand as a company's scale of measurement. **Leone et. al. (2006)** pointed out that both the approaches (customer equity and brand equity) are integrated. In their words “*Customer based brand equity maintains that brands create value by eliciting differential customer response to marketing activities. The higher price premiums and increased levels of loyalty engendered by brands generate incremental cash flow.*” The research undertaken by the authors Leone et. al. proved that linking brand equity to customer equity results in enhancing customer life time value (CLV). The company may benefit from cross selling between product categories, stretching the brand portfolio to different customer portfolio. Further study conducted on customer equity by Wiesel et al. (2008) emphasized how financial reporting prospects facilitate investors, creditors and allied customers to understand that it has become imperative to measure firms' performance and thus the firms' potential to generate shareholder value. **Rust et al. (2004a)** recognized that the transition of brand equity to customer equity were core practices of many firms. This transition led to shift from product based strategy to customer based strategy. The authors studied the different choice models on marketing return on investment. The results showed the shift in the customers' perception. Bringing out different approaches of measuring brand equity by the marketing researchers had their advantages and disadvantages. Aliawadi et al. (2003) stated that there was no complete approach which consisted of all the attributes that would be model for measuring brand equity. Aliwadi et al. (2003) provided an alternative measurement which consists of both direct approaches of marketing or financial methods of measuring brand equity such as price premium measures. The product market measures undertook the middle path between customer perspective and financial market measurements of brand equity. The Table 2 depicts the parameters and marketing-finance interface that are undertaken by researchers in measuring brand value has been depicted.

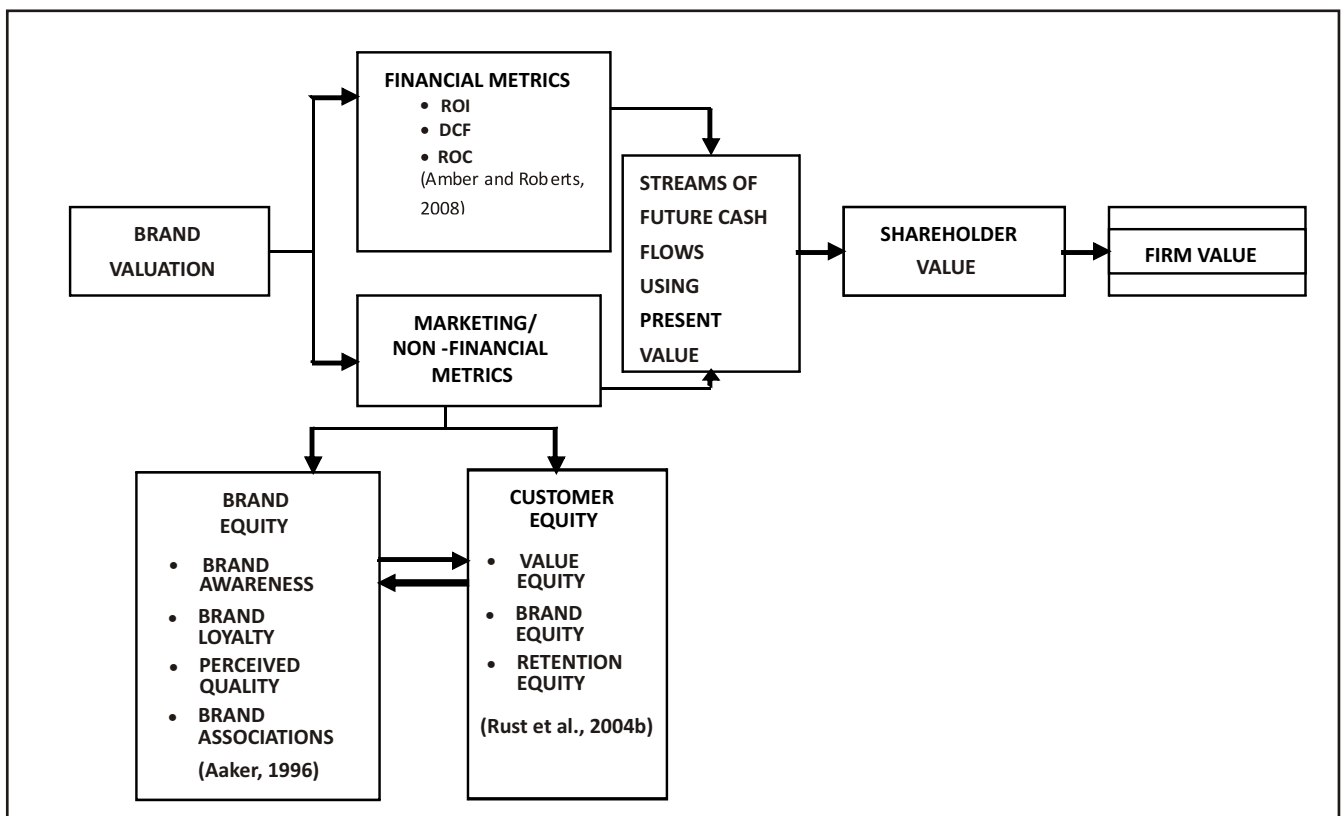
**Table 2: Brand Equity Marketing Metrics**

S.No	Marketing Metric	Sub-Parameters	Research Proponent
1	Customer Response	Brand Knowledge	Keller (1993)
		Brand Awareness	
		Brand Image	
2	Measuring Brand Equity	Brand Loyalty	Aaker (1996)
		Brand Association	
		Brand Awareness	
		Perceived quality	
		Market Share	
3	Customer Based Measure	Brand Awareness	Agarwal and Rao (1996)
		Brand Perception	
		Brand Preference	
		Choice Intention	
		Actual Choice	
4	Brand Asset and Customer PErerspective	Brand Awareness	Ambler et al. (2002)
		Brand Association	
		Brand Attitude	
		Brand Attachment	
		Brand Experience	
5	Customer Retention	Acquisition Cost	Gupta et al. (2004)
		Margin	
		Retention	
6	Customer Equity	Value Equity	Vogel et al. (2008)
		Relationship Equity	
		Brand Equity	
		Loyalty Intentions	

## DISCUSSION

Both the financial and marketing oriented measurements of brand valuation which have been empirically studied have been indicators to present value of future cash flows. The main postulate of accounting brand valuation is to bring the future cash flows of brand valuation into the books of accounting for investors to make optimal investment decisions. Corporate firms are able to make assessments that have direct financial implications for the value of brand for its future economic benefits. The stream of future cash flow arising from the brand discounted at an appropriate rate constitutes of brand value. The generation of future earning is the main aim of the present value of the forecasted period and the future time period Leone at al. (2006). Figure 1 projects that fair value measurements of brand valuation lead to future cash flow returns, irrespective to the technique used for brand valuation. The metrics should have a combination of return on investment parameters and brand equity variables so that an objective measurement could be achieved in the valuation of brand equity. Irrespective of the brand valuation approach from the financial orientation or market based orientation, the fair value estimates are more suitable to measure with the multi-dimensional measures and not considering entirely financial metrics that should have long term and short term perspective (Ambler and Roberts, 2008). Ambler and Robert (2008) further concluded that the net present value (NPV), brand valuation and customer equity are all incorporated in the discounted cash flow (DCF). These approaches also act in tandem as an instrument of gauging the firm's performance.

**Figure 1: A Multi-Dimensional Framework of Brand Valuation Metrics**



## FURTHER RESEARCH

Further research can be done to understand what metrics should be considered while deciding the parameters for brand valuation. Is there a relative association by linking customer market with the financial market? The brand equity and customer equity measures are relatively subjective- how reliable can these approaches be in the new age of valuation and at the same time, it poses as a significant challenge to be accepted by the conventional accounting fraternity. Therefore, the recognition of “brand assets”, in particular, internally generated assets use future streams of cash flows

for their valuation and are “inherently non-additive” (El-Tawy and Tallington, 2008). Most of the contemporary valuation approaches are forward looking, therefore, it becomes imperative to understand market value of intangible assets. We encourage further research how these measures can be reported in the books of account that is the balance sheet.

## CONCLUSION

For decision makers in the organization, need to undertake both financial and marketing approaches for decision making becomes imperative. The financial measures help in deciding the royalty or licensing fee and stock market returns (Aaker and Jacobson, 1994), and during mergers and acquisitions (Bahadir et al. 2008) whereas the marketing measures are customer focused (Keller 1993; Aaker, 1996). Evaluation of customer satisfaction and loyalty can be measured in terms of brand valuation. It becomes invariably imperative for the organization to study the external orientation, which is short term but it is more important to promote a long term perspective in order to have a sustainable competitive advantage (Cravens and Guilding, 2000). Brand valuation today could become a comprehensive instrument in decision making for the corporate management in times to come. Many established methodologies have widely been practiced for brand valuation by brand consultancies such as Brand Finance, Interbrand and Brand Metrics. Theories of intangible assets valuation described in the works of Damodaran and Lev have also been brought into mainstream practice (Salinas and Ambler, 2009). Closing the gap between theory and practice, a single metric may not be a conclusive parameter for brand valuation. The multi-dimensional holistic approach of both financial and non-financial metrics of brand valuation is to overcome the limitations of subjectivity and relevance by the academicians, valuers and accounting fraternity.

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