

## Managing a Portfolio of Brands

In 2006 Safeway divulged it would reduce its portfolio of private label brands from 70 to 10. Towards the end of 2009, German CPG company Henkel stated that it planned to scrap a significant number of under-performing brands. The biggest brand rationalization in recent times, however, was by Unilever which in 1996 announced it would be reducing the size of its brand portfolio over four years from 1,600 to under 400 brands.

These companies and others like them must have found it quite hard to decide which brands should stay and which should go. Some would be obvious. Brands that have never penetrated the market and which are bogged down at number three or four in the category should go. Brands which have slipped from market dominance to a lower ranking have seen their best days. They should go. There will be other more internally relevant criteria such as not delivering margin; the rising cost of a crucial raw material; or that the brand is insufficiently differentiated from competitors than it needs to be to compete.

These would guide an initial selection. It would separate the wheat from the chaff and allow the “dogs” to be put to rest. But that will probably be insufficient to reach the target. A more precise and sensitive approach is needed to tease out the more hard-to-identify non-performers from the stars.

The Prophet brand valuation methodology can do just that. It has two components that led a client from a global FMCG company to describe the model as “the most powerful predictive tool she had ever used.” The two parts of the model are its use of economic profit to identify the brand-added value and the survey-based brand strength measurement to determine the economic expected life of the brand being valued.

### Brand Versus Non-Brand

Brand equity theory states that a brand adds value to a non-branded product. The difficulty is to draw a distinction between the two: just how much value does a brand add to its non-branded counterpart?

Economic profit (EP) provides an answer to this. A company that consistently generates profits that exceed its cost of capital has developed intangible assets that

bring this about. The most potent of these is known to be the brand. Relatively new (within the last nine years) international accounting standards recognize this by nominating trademarks and brands as intangible assets that will be recognized when companies have to account for goodwill paid in a merger or takeover.

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Economic profit is universally acknowledged as a measure of wealth creation for shareholders at the corporate level. Since a company is the sum of its revenue developing units, Prophet believes that brands are the basic generators of the company’s cash flows.

The Prophet approach is to calculate brand net operating profit (NOPAT), the brand’s operating capital employed, and a suitable discount rate. This allows an EP calculation to be worked out for each brand. Prophet then applies a specific tool to estimate what proportion of the EP is attributable to the brand’s equity: the extent to which users of the brand category are aware of the brand name and associate the name with attributes that lead them to choose the brand and stay with it. And that is the second part of the model that contributes to brand portfolio management decisions.

### Brand Equity and Economic Life


The Prophet brand valuation tool uses discounted cash flow (DCF) but not in the way it is usually applied. The typical DCF projects the cash flows for a period such as five years at an appropriate growth rate. It discounts these earnings to present value and capitalizes them. It then makes an allowance for the long-term nature of the asset by working out a perpetuity. That is a corporate finance device achieved by dividing the first year following the DCF period by the discount rate. Added together the sum is the asset value.

The Prophet point of view is that brands are different from most assets because they tend to be long lived. Neither can they be depreciated. A successful brand will increase its cash flows over time and add value to the company's balance sheet. To deal with this, the model projects the brand earnings for an initial period called the Franchise Run which normally is upwards sloping and then decays the earnings to an end point to give the brand a long life but with a hypothetical decline that should remain well into the future.

#### A Powerful Tool

Because the methodology uses discounted cash flow and economic profit, a number of management decision aids arise, among which are:

- a value contribution matrix which depicts the contribution of each brand within the portfolio to the overall portfolio value;
- a measurement of the economic profit generated by each brand which might be positive or negative and which can be judged by pre-set ratio criteria;
- the opportunity to test varying budget options against the net present value (NPV) rule to judge what levels of marketing investment are appropriate and over what period of time; and
- an analysis of value drivers which makes on-line scenario planning possible—by adjusting drivers that might be affected by marketing activities, the model matches driver to value deltas.

Portfolio management is a key ingredient in enterprise value in that inefficient portfolio units drag down the rest. The Prophet brand valuation tool offers sensitive and unique facilities for this management function. 

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