

A New Path To the Boardroom

Finance-based model for brand valuation opens doors for marketers

Matt Phillips—a young CPA and the youngest executive in the long history of Consolidated Household Products to be selected to run the giant food conglomerate—nodded in the direction of his CEO, Alex McKenzie, seated at the head of the boardroom table. Alex shuffled his board papers and winked at Matt. “Let’s break for coffee and then hear what our fearless marketers have to say.” A few minutes earlier, Matt had been given the nod by the board to spend \$28 million on a new mill. As they walked out of the conference room, Alex put his hand on Matt’s shoulder and confided, “Your NPV schedules were excellent. They tipped the decision in your favor. Well done.”

This is a fictitious account of a scene that plays out regularly in businesses that are capital intensive. Board decisions regarding capital expenditures are made on the basis of a well trodden path. The board understands the language of investment. Its members trust the cash flow projections that Matt used to illustrate the anticipated returns the new plant will generate. By using the time value of money concept translated into a present value calculation, they were able to see what earnings the proposed investment would generate. Better still, by commencing the cash flow projection with the investment, they could base their decision on the fact that the plant would be worth more than it cost.

Two unhappy realities separate Josh Applethwait, the Vice President of Marketing, from his technical colleague, Matt Phillips. Matt was a member of the board; Josh was not. Matt could present his request for investment in recognized financial terms; Josh could not. Not being a member of the board was frustrating to Josh, but he knew from his peers that this was not unusual—the incidence of marketers on the boards of major companies is not high. Some estimates put it at no more than one in four. The other disadvantage was his inability to express his marketing investment requests and the returns it will generate in corporate finance terms. Josh thought this was insurmountable.

It is probable that these two problems are closely related. Arguably, it is because marketers tend not to have strong financial skills that they are overlooked for board membership. If the marketing budget—which always

ranks very high on the schedule of costs on the income statement—was viewed more like the investment in assets that Matt was responsible for, more marketers would sit on the board to apply their financial understanding to a wider range of business problems and to explain and report on the crucial assets within their purview.

As it is, marketers are wrapped up in their own language of awareness, attitudes, segmentation, gross rating points, and customer loyalty. These are all worthy measurements of the marketing function, but they have little relevance to board members. The primary responsibility of company directors is to represent the interests of the shareholders who voted them to their positions as guardians of shareholder investments.

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Fortunately, there is a way around this conundrum. Hidden in the early pages of most primer texts on accounting is the definition of an asset. Essentially it states that an asset is a resource, under the control of an enterprise, to which future economic benefits will flow. The last clause holds the secret. While accountants have only very recently allowed themselves to be tugged into the 21st century by largely abandoning their cherished hold on historic cost, they based one of their most important calculations on a view of the future. The only way to honor the spirit of the definition is to estimate the forecasted cash flows that are the future economic benefits.

Brands conform to this definition. They are under the control of the enterprise that owns the registered trademark. In the same way a machine could be sold to

a new owner, so too could a brand. But more importantly, the existence of a brand and its future is solely in the hands of the end users (consumers) who generate the future economic benefits. Brand users can be evaluated through market surveys. Their commitment to the brand can be assessed to provide marketers—and the board—with indications of the risk associated with these cash flows: the bond between user and brand is either strong enough to minimize risks to the future cash flows, or the relationship is tenuous, thus posing a risk to predicted income.


Over the past thirty years, the concept of economic profit has taken on renewed meaning for business managers. The idea of a class of profit that differs from accounting profit because it takes account of the cost of employing the shareholders' investment is not new. It dates back to the 17th century writing of the Scottish economist Adam Smith. Its resurgence is due in large part to the work of New York financial consultancy Stern Stewart and its far-sighted founder, Professor Joel Stern. These days, books on corporate finance routinely state that economic profit is unsustainable because competitors will be attracted to the category or sector and enter it themselves in increasing numbers, thereby pushing down prices to commodity level.

That is not correct. Successful 21st century firms not only earn profits that exceed their cost of capital, but continue to do so for prolonged periods of time. Where the text book writers are right is in stating that a major reason why these profits are earned is because the company has developed valuable intangibles and brands are invariably included in the list. Carving out the portion of economic profits attributable to the brand is the equivalent to isolating the income generating power of Matt's mill: there are credible ways to accomplish this.

Measuring the economic profit achieved by a brand and the ability to account for the risk inherent in the cash flow expectations by evaluating consumer perceptions provides visionary marketers with a solid finance-based approach to marketing accountability. It is also possible to evaluate the sector in which the brand sells in terms of its ability to support the long-term earning of economic profit for all the brands in it. Factors such as sector maturity,

predictable market share, the extent of price stability or volatility and the influence of external pressures such as government regulations, the availability of raw material, and the vagaries of interest rates and consumer inflation that might affect the earning power of the category bucket of brands.

If the trademark is registered, the brand is under the control of the enterprise. Once the brand is in the market and earning income from consumers, it is generating future economic profits. Market research can predict how safe or risky these future earnings are and can point the way for marketers to strengthen the link, thus reducing the risk or sustaining a brand at a leadership level if that is where it is. A reliable algorithm that combines these variables in a credible and open manner could transform the marketing function from an annual expense into a long-term investment in the brand asset.

This process introduces a pathway that links the consumer as the source of income flows to the asset with a concomitant opportunity to present budget requests in a net present value format. With recent changes to accounting standards, this type of valuation would be suitable for measuring the fair value of brands for inclusion in the balance sheet when this is called for by the standards. For marketers like Josh, this finance-based model for valuing brand assets has the added benefit of opening up for him and his peers a new route to the boardroom. 

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