Budgeting | January 23, 2018 | CFO.com | US

Brand Value Drives Corporate Value

With the right brand-value metrics and framework, managements can allocate marketing resources to improve both short- and long-term value creation.

Gregory V. Milano and Joseph Theriault

Most CFOs have a good sense of how to evaluate investments in plant and equipment to improve current manufacturing facilities or expand production. The facts are almost always available and clear, and the analysis is straightforward. How much capital is needed, and what's the expected impact on cost, volume, and price? A discounted cash flow model indicates whether the CFO should make the capital investment.

But ask those same senior finance officers how much to invest in marketing for a given brand, and they're often at a loss for fact-based insights. And when it comes to allocating marketing resources across a range of products and geographies, the value-maximizing solution can be even more of a mystery.

What impact will this spending have on volumes? On the ability to raise price? If we reallocate marketing dollars from product A in region 1 to product B in region 2, what do we expect to be the impact on aggregate sales and profits? And what effect do these decisions have on long-term brand value and stock price?

For the last 25 years or so, the standard approach to allocating marketing resources has been through marketing mix modeling. The approach is based on a statistical analysis of periodic marketing and sales data to estimate the near-term volume impact of raising, lowering, or shifting marketing resources.

Advocates of the method apply mix modeling in an effort to increase the effectiveness of marketing allocations. But the analysis ignores most of the cost structure and the balance sheet.

While the mix modeling approach seems somewhat logical, critics claim that it's too short-term focused and doesn't aid in building long-term brand value. They contend that mix modeling stresses current sales through promotion and price discounts, but in a way that doesn't necessarily build, and may even destroy, long-term brand value. Those criticisms imply that although mix modeling may assist in meeting or exceeding quarterly earnings guidance, it may do little to drive the share price over the next one, two, or three years.

For those who don't think long-term brand value is an investor priority, consider the case where the activist investor Trian Group criticized Heinz management for putting too much money into trade allowances and promotion, which drive short-term profits, and not enough into creative advertising and product innovation, which drive long-term brand value and stock price.

After a failed proxy fight and acceptance of some new board members, Heinz acquiesced and bumped up its advertising program. With such a long-term emphasis, this certainly was not your parents' activist-investor situation.

So what can CFOs do to avoid the short-termism trap of mix modeling, and ensure they allocate marketing resources in way that will drive long-term value? Are there metrics and decision tools available that can drive the right balance between delivering current performance and building long-term value?

A relatively new firm, BERA Brand Management, has developed one of the largest brand-equity assessment platforms in the world, so we decided to use their database of brand attributes to study the relationship of brand attributes to financial performance and valuation.

BERA captures many brand traits and collects some important attributes in two overarching metrics they have named "Today" and "Tomorrow." Today is a combination of brand regard and familiarity, and Tomorrow combines a brand's uniqueness and meaning (a way of measuring brand differentiation).

Fortuna Advisors provides strategic resource-allocation services and is considering using the BERA brand data as an input in allocating marketing resources. To test the viability, we completed a bespoke capital markets research study and found strong relationships between these metrics and those for both financial performance and valuation.

We studied a list of more than 160 publicly owned monobrand companies that are in the BERA database. (Monobrand companies are those where the majority of the revenue comes from a single brand, such as Coca-Cola, Delta Airlines, or Facebook.) The study spanned an eight-quarter period from the third quarter of 2015 through the second quarter of 2017.

Our first step was to verify that these brand metrics relate to the ultimate goal of driving higher total shareholder returns (TSR), which includes dividends and share price appreciation. We sorted the monobrand companies into high, medium, and low groups based on the Today score and calculated the median TSR for each group.

The companies that scored highly on Today delivered median TSR that was 0.7% higher per year than the median for companies with low Today scores. That's a slightly positive relationship, but Tomorrow's was stronger. The median TSR for the high Tomorrow companies was a significant 7.3% higher than what it was for low Tomorrow companies.

Next, we tested how Today and Tomorrow relate to periodic financial metrics like sales growth and rates of return, and then we tested how they relate to valuation multiples, which indicate the investor view of long-term value.

The monobrand companies in the top Today group have 2.1% more median revenue growth than the low group. And the top Tomorrow group delivered an extra 2.3% revenue growth. Growth is an extremely important driver of TSR, so the findings that the Today and Tomorrow brand scores relate so strongly to growth are important.

But growth for growth's sake isn't of much value. Thus, we tested the relationship of growth to return on assets (ROA), return on capital (ROC), and return on equity (ROE). In all cases, scoring high on both Today and Tomorrow related to higher and, more importantly, improving returns in comparison to the low Today and Tomorrow groups.

The strongest results were with ROE. The median company in the high Today group delivered 8.4% more ROE and 4.6% more improvement in ROE than the low Today group. The high Tomorrow group delivered 5.0% more ROE and 3.5% more improvement in ROE than the low Tomorrow group.

It is encouraging that higher Today and Tomorrow lead to more sales growth and ROA, ROC, and ROE that are all higher and improving. To complete the study, we examined the relationship to valuation multiples since high and increasing multiples are a signal of increasing brand value.

We evaluated the price-to-earnings (PE) ratio and the enterprise value to EBITDA ratio using both trailing and forward analyst consensus figures. The analysis also included price to forward revenue and price to book value.

For all of these valuation metrics, the companies with high Today and Tomorrow scores were valued higher than companies with low Today and Tomorrow scores. And in each case, Tomorrow showed a more meaningful impact than Today. Since multiples tell us about the value of the future in relation to today, perhaps it is no surprise that Tomorrow seems to be a more powerful indicator than Today.

This research confirms that the BERA metrics are highly related to growth, profitability and valuation multiples, providing comprehensive indicators that are far better than the typical mix modelling signals.

Integrating the insights provided by BERA metrics with value-based financial analysis can materially enhance the allocation of marketing investments by enabling optimization of short-term vs. long-term performance.

Such insights can be used to improve high-level allocation strategy, as well as make tactical allocations deep within the organization more effective by constantly helping CFOs to focus resources where they create the most value. The result will be faster growth, higher profitability, more cash flow, higher multiples and, of course, better total shareholder returns.

Gregory V. Milano, a frequent CFO columnist, is the founder and chief executive officer of Fortuna Advisors LLC, a value-based strategic advisory firm. Joseph Theriault is a vice president.