

CMO Council:

*Marketing
Performance
Metrics Forum*



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Chicago, May 17 2005

Brand Equity and Shareholder Value

Jonathan Knowles
Director, Brand Finance
Senior Strategist, Wolff Olins

My Agenda for Today

- Situate brands in their business context
- Outline what finance people want from marketers

| Marketing Perspective | Financial Perspective |
|----------------------------------------------------------------|-------------------------------------------------------------------|
| “Value” and “equity” are defined from the customer perspective | “Value” and “equity” are defined from the shareholder perspective |
| Value is the ratio of perceived benefit to price | Value is revenue minus economic costs |
| Equity is defined in terms of satisfied customers | Equity is defined in terms of shareholder value |
| Focus is on ways to enhance customer utility | Focus is on ways to enhance business efficiency |
| Goal is to create preference | Goal is to generate profit |
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Talking at Crossed Purposes

When marketing people talk about what they do, the variables they cite are not the ones the CEO cares about.

Customer awareness, customer satisfaction and market share are metrics, and they are nice to know about. But the CEO is more concerned with shareholder value, market capitalization, return on assets and return on investment.

In marketing, people don't talk that way.

Don Lehmann
Professor of Marketing
Columbia Business School

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Zeitgeist of Accountability

Twelve months can't really be neatly summed up in one or two big trends. But it seems pretty safe to say that for the marketing world 2004 was the year of the ROI (or ROMI) obsession.

There was an almost frantic escalation of the fixation by marketers on precise measurement and proven return on (marketing) investment as the year progressed.

This is largely because CEOs and CFOs within marketing companies are demanding more assurance before committing to spending, and proof of performance after the fact.

Marketing

December 13, 2004

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Finance People Are Not Unreasonable

- Finance people recognize that branding is complex
- Finance people are NOT looking for perfection from marketers – but they are looking for a willingness to define where and how marketing is supposed to impact the value of the business
- Specifically, they want:
 - To be reassured that marketing strategy is aligned with the business strategy
 - To be given some indication of how valuable an asset the brand is, and what causes its value to increase/decrease
 - To understand the value levers (profit, growth and risk) on which the impact of marketing spending should be observed
 - To be shown that marketers are serious about tracking their own performance

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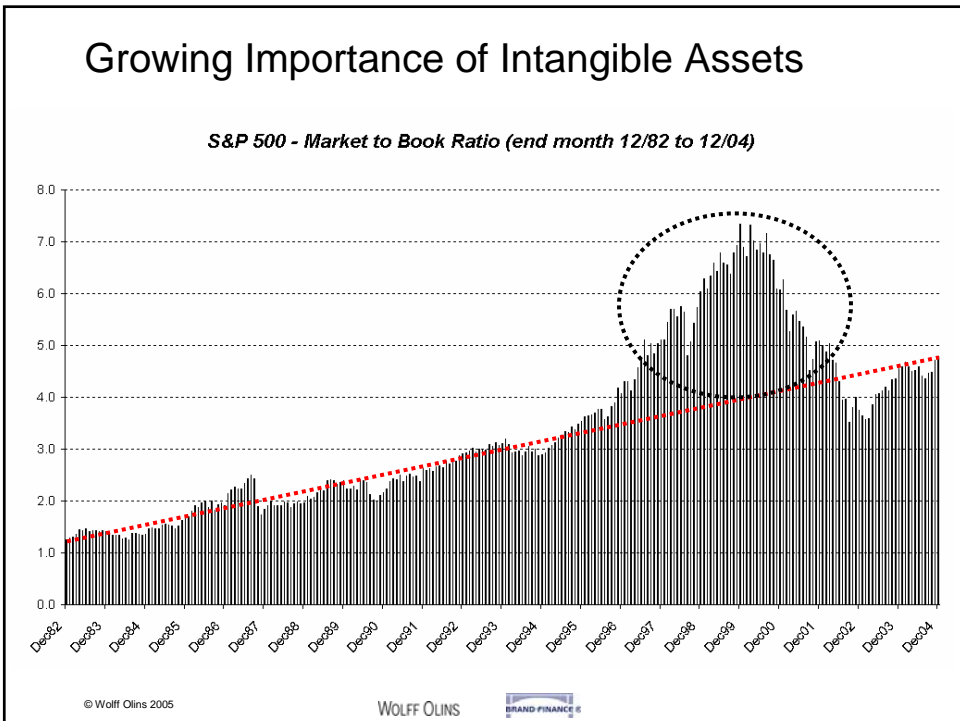
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Brands in Their Business Context

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A Market/Book Ratio of 4.6 Means That...

In 2003, the net tangible assets on the balance sheets of the companies comprising the S&P 500 accounted for only 22% of their market value

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This is A Global Phenomenon

- Based on the 6,000 non-financial companies included in the market index of the world's 25 leading stock markets, we found the following:
 - the average ratio of net tangible balance sheet assets (NTBSA) to market value (MV) is 35%
 - The US market has the lowest NTBSA/MV ratio in the group (26% once financial companies are excluded), and Russia the highest ratio (84%)
 - The industry sectors with the lowest NTBSA/MV ratios are consumer non-cyclical (21%), technology (22%) and communications (27%)
 - The industry sectors with the highest NTBSA/MV ratios are energy (45%), basic materials (49%) and utilities (53%)

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Tangible Asset Ratios by Industry Sector

S&P 500 (excluding financial companies) for 2003

| SECTOR | # OF COMPANIES | MARKET VALUE \$mns | NTBSA* AS % OF MV |
|-----------------------|----------------|-----------------------|----------------------|
| UTILITIES | 32 | 771,579 | 58% |
| ENERGY | 28 | 880,634 | 47% |
| BASIC MATERIALS | 29 | 457,519 | 37% |
| CONSUMER CYCLICAL | 74 | 1,568,219 | 36% |
| COMMUNICATIONS | 43 | 1,555,449 | 23% |
| TECHNOLOGY | 57 | 1,288,112 | 18% |
| INDUSTRIAL | 64 | 1,771,461 | 17% |
| CONSUMER NON CYCLICAL | 90 | 2,584,433 | 15% |
| TOTAL | 417 | 10,877,407 | 26% |

NTBSA = Net tangible balance sheet assets (essentially physical assets plus net working capital)
 MV = Market Value (market capitalization, plus debt, plus cash)

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“So, Where’s The Value Coming From?”

What are the other assets that companies have that do not appear on the balance sheet?

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International Financial Reporting Standard 3

Asset Types

Technology-based

Contract-based

Artistic

Customer-related

Marketing-related

Underlying intellectual property

- Patents, software, trade secrets
- Construction permits, servicing contracts
- Copyright
- Customer lists, order backlogs
- Trade names, trade dress

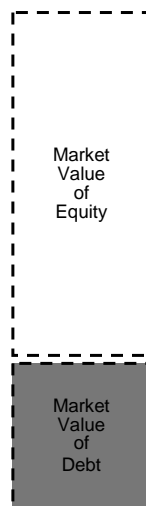
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De-Composing the Value of a Business

Funding Perspective



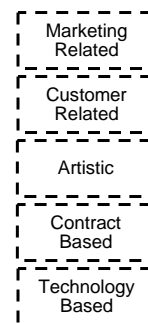
Enterprise Value



Tangible Assets



Intangible Assets



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Asset Class Importance by Industry Sector

ILLUSTRATIVE DATA ONLY

| SECTOR | TNGBL | TCHNLGY | CNTRCT | ARTSTC | CSTMTR | MKTNG |
|-----------------------|-------|---------|--------|--------|--------|-------|
| UTILITIES | 58% | 7% | 23% | 0% | 7% | 5% |
| ENERGY | 47% | 11% | 23% | 0% | 11% | 7% |
| BASIC MATERIALS | 37% | 17% | 33% | 0% | 10% | 3% |
| CONSUMER CYCLICAL | 36% | 11% | 23% | 0% | 18% | 11% |
| COMMUNICATIONS | 23% | 15% | 19% | 15% | 19% | 8% |
| TECHNOLOGY | 18% | 33% | 13% | 0% | 20% | 16% |
| INDUSTRIAL | 17% | 30% | 24% | 0% | 18% | 12% |
| CONSUMER NON CYCLICAL | 15% | 14% | 22% | 0% | 22% | 27% |
| TOTAL | 26% | 18% | 22% | 2% | 18% | 14% |

NTBSA = Net tangible balance sheet assets (essentially physical assets plus net working capital)
 MV = Market Value (market capitalization, plus debt, plus cash)

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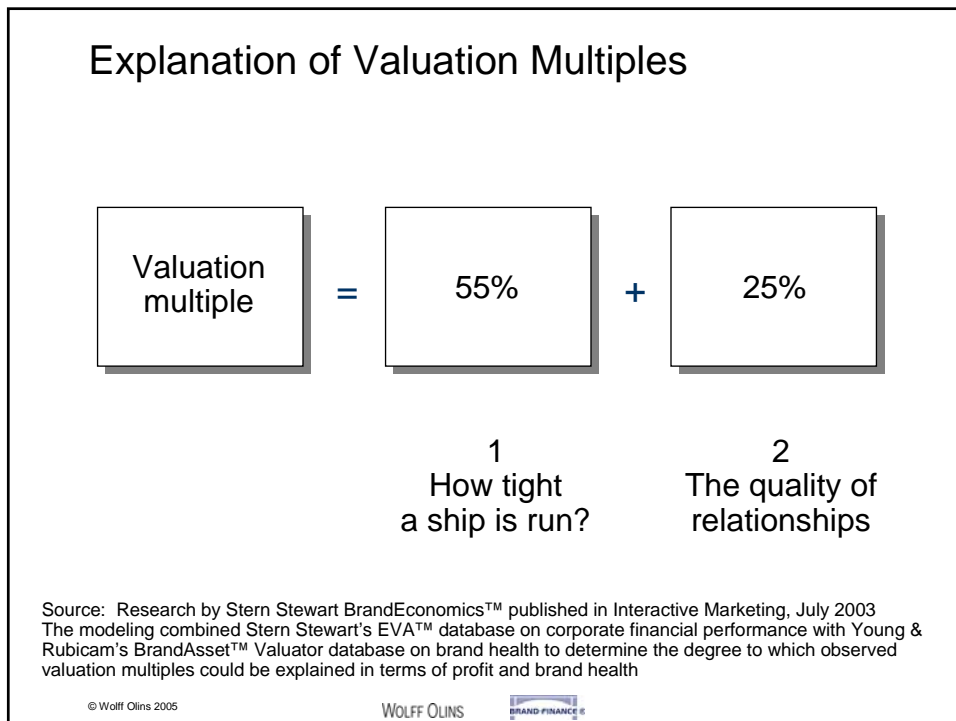
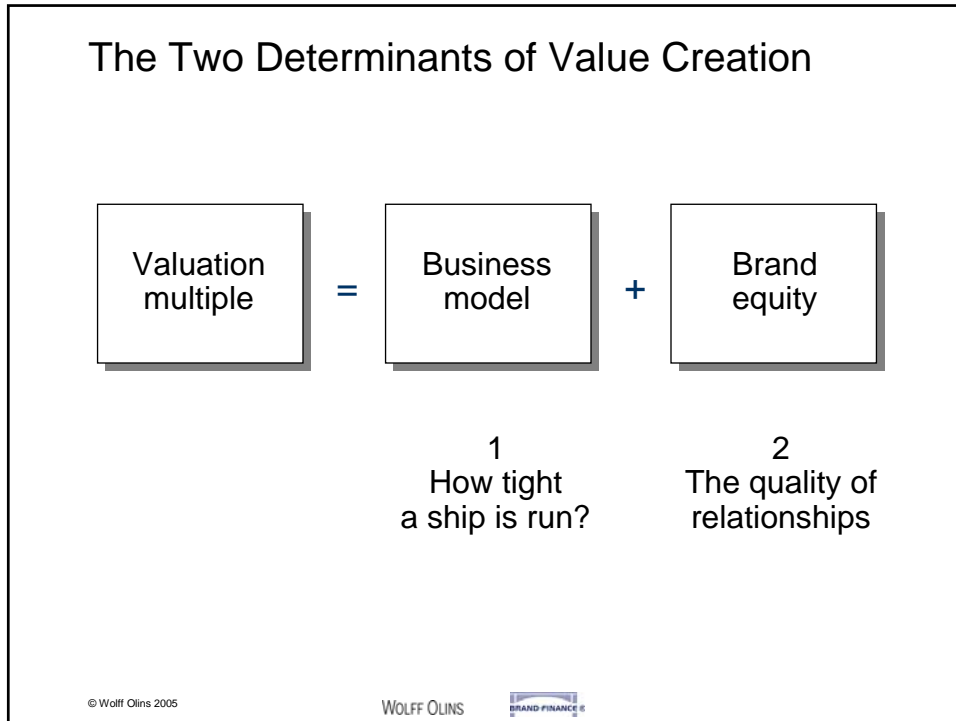


Brands and Shareholder Value

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Madden, Fehle and Fournier 2003

Measuring the Performance of Strongly Branded Companies



For the period 9/1994 to 12/2000, a portfolio of 111 strongly branded companies produced a monthly return 0.57% in excess of the market, and at a beta of 0.85

Value of \$1,000 invested

Source: “Brands Matter: An Empirical Demonstration of the Creation of Shareholder Value Through Brands” May 2003 (not yet published but draft available on www.ssrn.com)
Research by Tom Madden and Frank Fehle (Moore School of Business at the University of South Carolina) and Susan Fournier (Tuck School of Business at Dartmouth)

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Business Valuation

$$\frac{\text{nopat}}{(\text{wacc} - g)}$$

nopat:
net operating profit after tax
wacc:
weighted average cost of capital
g:
long-term growth rate

Three Key Variables

Profit
Growth
Risk

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Marketing Performance Measurement

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The Spectrum of Measurement Options

| | | |
|----------------|---------------------------------------------------------------------------------------------|---------------------------------------|
| Brand equity | Tracking research | Corporate reputation Brand value |
| Multiple media | Marketing Mix Modelling (MMM) Integrated Mktng Comms (IMC) Agent Based Modeling (ABM) | |
| Single medium | Campaign/event measurement | Adstock measurement Press mentions |

“Payback”
(yield)

“Asset”
(value)

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Yield (“payback”) and Value (“asset”)

- All the ROx measures (such as ROI, ROE, ROA, ROCE) are measure of “yield” – they calculate the earnings that have been generated in a given year off some base of resources (investment, equity, assets, capital employed)
- They are measures of **efficiency** and the flow of income generated in that year (or other time period)
- Valuation focuses on the measuring the **scale** of an asset by reference either to what it could be sold for in the market; or to the present value of the stream of future earnings that the asset is expected to generate
- Using an investment portfolio as an analogy, yield is about the dividends you receive in a given year, and value is about the appreciation in the underlying stock
- A critical first step is therefore to define the metrics that correspond to the mandate that marketing has in your organization

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Clarifying The Mandate of Marketing

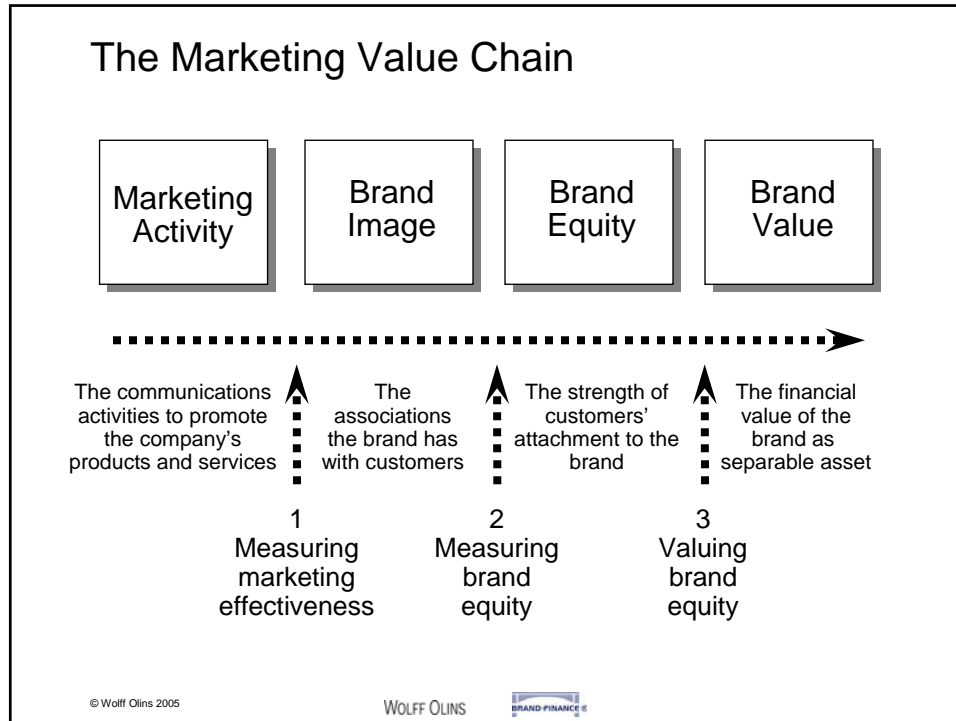
| <i>Service Provider</i> | <i>Advisor</i> | <i>Driver of Growth</i> |
|--------------------------------------------------------------|----------------------------------------------------------------------------------------------|-----------------------------------------------------------------|
| Runs a small corporate staff function | Leads a corporate marketing function | Partner to the CEO in driving the corporate growth agenda |
| Delivers the benefits of centralization of supplier services | Aligns divisional marketing plans with corporate strategy | Directs brand strategy, business development and innovation |
| Co-ordinates marketing service supplier relationships | Ensures compliance with trademark/brand guidelines Co-ordinates best practice sharing | Responsible for driving the marketing capability agenda and ROI |

Reproduced from “Are CMOs Irrelevant?” – a report by ANA/Booz Allen Hamilton (2004)

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Brand Equity Defined?

Brand equity is a reservoir of cash flow that has been earned but not yet released to the income statement

Tim Ambler
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Thank You

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Jonathan Knowles

- Director of Brand Finance and Senior Strategist at Wolff Olins
- More than 15 years of experience in brand consulting from both the analytical perspective (Marakon Associates, Stern Stewart BrandEconomics™, Brand Finance) and the creative perspective (Wolff Olins, Structured Intuition™)
- Professional experience also includes 6 years in banking and a rather briefer stint as the CMO of a Managed Services Provider
- Principal contributor to “Brands: Visions and Values” (2001) and author of over 20 articles on brands and business strategy, including “Measuring and Valuing Brand Equity”
- Passionate believer in the importance of brands for creating customer value and the opportunity for shareholder value
- Main area of focus is on how to integrate the rigor of fact-driven analysis with the creative insight of intuition

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