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Maximization of “Brand Value” in M&A transactions:

How to identify and monetize brand potential in the course of corporate transactions

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Evaluating brands is often a challenging aspect of an M&A-transaction.
This holds especially true for brands that have not been supported and developed optimally so far. Standard evaluation methods are either overly focused on the past (e.g. Multiples), or suffer from an inadequate database (DCF-method) to fully exploit the true fair value of a brand.
The instruments *market positioning* and *market potential analysis* can bridge the existing evaluation gap and thus contribute to transaction security with a reasonable amount of effort.
A combination of expertise in the areas of brand strategy and M&A consultancy is required to identify and evaluate additional potential cash flow contributors outside of the brand’s current business segments.

1. Introduction

When brands are being sold as part of an M&A-transaction, their optimal evaluation poses a particular challenge.
Standard valuation models, such as Discounted Cash Flow (DCF), Trading Multiples, Transaction Multiples) focus on and relate to existing business segments of a company. For branded companies it is economically sound to also identify and evaluate future brand potential beyond existing business segments, in order to reach a fair company valuation.

Consumer-centric IT companies with high growth potential (e.g. in the mobile sector or digital platforms) are already using evaluation methods for their brands and business models that exceed the standard models. They work with the number of loyal customers or active users as bases for their evaluation. Theoretically, this could also be applied to the potential of brands in the consumer goods industry. However, this would come with significant weaknesses due to the large diversity in potential of the brands in question.

For the seller of a company, however, the consideration of *future* customer potential is essential to the evaluation of brand /company values in order to realize the best possible enterprise value.
This article examines how future growth potential of brands can be reliably assessed and considered for valuation processes. This is based on the fact that standard valuation methods for brands, particularly those brands that have not

been optimally supported so far, usually exhibit a valuation gap: Multiples tend to focus on past results, and DCF-analyses often lack reliable data on the actual potential of brands.
To profoundly asses a brands' potential, the following questions need to be addressed:

- How do you describe the brand's positioning in a clear, structured manner, to have a base for further building and growing the brands core business?
- How do you integrate the brands potential in new, future segments into the valuation – next to the evaluation and prognosis on the core business?

2. Brand positioning as the basis of the brand's growth strategy

Brands are made by people: They are often strongly linked to the personalities, ideas, and visions of their company founders.
This holds true for both classic branded goods and the new digital mega-brands: There would be no *Kellogg's* without Will Keith Kellogg, no *Adidas* without Adi Dassler. *Apple* and *Amazon*, too, would not be the same brands without Steve Jobs' and Jeff Bezos' visions of what these brands should and could stand for.
In the beginning, a brand only exists in the minds and hearts of these people. It is usually not manifested in writing, but is alive through systematic compliance with the founders' principles.
When a brand grows over time, it is mandatory that everybody involved – top management, R&D, brand managers, everybody across all geographical regions - has a common understanding of what the brand stands for, how it appears, and also which directions its growth may take. Additionally, a clear understanding of the brand's limits is also vital: What should the brand not offer? How is the brand never allowed to appear?

A concise market positioning in writing defines the framework for a successful marketing and growth strategy. The brand needs to be fostered to maintain and grow its power to influence purchasing decisions. *"A brand exists when it has acquired power to influence the market."*[1]
While the brand needs to be carefully adjusted to evolving consumer needs and changes in the competitive environment, its roots must never be neglected.

Kasper Rosted, Chairman of *Adidas*, on the question *"What is the soul of Adidas?":* "The endeavour to make the best products for athletes... We are a sports company, not a fashion company - a very clear statement. ... One of the reasons why Germany won the World Cup in 1954 were our shoes - everybody here thinks so. A young company has numerous advantages but it lacks history."[2]

This understanding has to be passed on to the new brands owners in case of a brand's acquisition – just as it has to happen in the course of top management changes.
Brand positioning has been defined as "...the act of designing the company's offering and image to occupy a distinctive place in the mind of the target market"[3] Or, in the words of David Ogilvy: „What does the product do, and who is it for?"[4]

[1] The new strategic brand management, Jean-Nöel Kapferer, 2012
[2] Interview with Stern, December 17, 2017.
[3] Philip Kotler, Marketing Management: Analysis, Planning and Control, 15th edition, 2015
[4] David Ogilvy, Ogilvy on Advertising, 1972

Developing a positioning requires profound knowledge in three areas:

- **Deep understanding of emotional and functional consumer needs in the market in question ("consumer insights").** The personal care brand DOVE, for example, conducted a global study in 2010[5]. The results showed that a majority of women begin to doubt their own physical appearance already at an early age. The feeling of not meeting an ideal that is basically unattainable prevails. DOVE has since successfully positioned itself as "brand for real beauty" and supports women's self-esteem. This emotional positioning is highly relevant to the target group and leaves a lot of room for the brand's range development.
- **A detailed competitor analysis** of the given market, including emerging trends. In the case of DOVE it was common practice on the cosmetics market to work with super models as testimonials, thus competing for "perfect beauty". The new positioning offers a clear differentiation by working with everyday women.
- **A thorough understanding of the brand's history:** Its origin, its product portfolio over the years, relevant communication and packaging developments, etc. From the very beginning, DOVE has been a gentle, naturally positioned brand, even though this was initially rooted in the product itself: The first product was a soap that, in comparison to other soaps, did not dry out the skin - the soap basically worked *for* the skin and not against it. The new positioning transferred this functional base benefit to a new emotional level.

From this input, the positioning can be derived. Simply put, it takes up position in three areas:

- Relevance to the target group: Which "consumer insights" does the brand base its promise on?
- Unique promise: What benefit can the brand offer to consumers - better than competition?
- Brand values and reasons to believe: Why should you trust the brand to be capable of delivering on this promise?

There are numerous models to describe brand positionings. A classical model is the so-called "Brand Key"[6] , developed by Unilever and named after the lock-and-key model: This key is used to provide access to consumers and their purchasing decisions by being perfectly aligned to their needs.

[5] „Die ganze Wahrheit über Schönheit", Study by Dove, May 2010. Global survey of 6407 women aged 18 to 64 on the topic of beauty and self-esteem in 20 countries. Source: www.dove.de

[6] https://www.unilever.com/Images/2004-goldman-sachs-conference-presentation-niall-fitzgerald-chairman-unilever-plc_tcm244-422069_en.pdf

Fig. 1: Models for brand positioning: Example Unilever Brand Key
Source: Unilever

Additionally, visual design elements are often defined to provide clear-cut brand recognition in the long-term.

The mere existence of a clearly developed brand positioning builds trust in the brand on the side of the brand acquirer and makes the brand attractive for a larger number of potential buyers. The actual value of a brand can only be realized when the company or an external strategic brand consultant cooperates as early and closely as possible with the M&A-consultant responsible for the disposal process. By sharing the clearly defined brand positioning with the M&A-adviser, he will be empowered to describe the brands current and future scope, thus increasing the brand's value over the course of the bidding process.

The M&A-adviser's transaction know-how has to be combined with the brand expertise of the company or its strategic brand consultant.

3. **Strategic growth options: Renovation vs. Innovation**

Once the positioning has been clear de-fined, strategic growth options can be de-rived from it.
The objective is to develop a wellbalanced mix of ongoing improvements / relaunches of the existing product portfolio

(renovation projects) on the one hand, and true innovation projects on the other hand:

"When faced with a choice to renovate or innovate, pick both. Innovation can help attract new buyers and new usage occasions. ... But don't neglect the other side of the coin. Renovations come in many shapes and sizes. .... Generally, the objective is to refresh your core, evolve your brand and keep it contemporary. Renovating your brand periodically helps you protect your core and build sustainable platforms for future innovation and growth."[7]

As an example: Since its initial launch in 1998, Apple has relaunched its iMac numerous times. Design, technical features, and performance have been improved continuously. The iMac has continued to be a significant revenue- and profit-driver for the company and has not been neglected despite other - more prominent - innovations. „... even with the iPhones, iPods, and iTunes dominating today's news, we shouldn't forget that Apple's 21st century success can be traced directly back to iMac's launch..."[8]

The innovations that Apple introduced to the market after the iMac and the MacBook left their core business (desktop / laptop computers up to that point) and moved the brand into entirely new business segments, and thus entirely new competitive environments:

- The iPod competed with the Sony Walkman in the portable music sector.
- The iPhone competed with Nokia, Samsung, and Ericsson in the mobile phone sector.

The competitors were overtaken and even eventually forced out of their markets because Apple was able to recognize the consumers' subconscious needs as well as weak spots of existing competitors' products, while being able to invent and introduce better solutions. The claim "think different" was a clear opposite to the sectors' respective "house rules".
The leitmotif in this was the vision centered around the consumers: Maximum usability paired with a "non-technical" design that was very nice to touch and look at. For the most part, Apple forgoes stressing functional features and instead creates an emotional covetousness that makes consumers accept the steep price difference.

However, classic branded companies are often experts in <u>one</u> product category, in which they possess profound technical know-how and production capabilities - for example Nokia in the mobile phone sector. They tend to struggle with imagining areas for brand growth outside of this category. Additionally, they often do not base their innovation strategy enough on consumer needs ("What do people want today?") but rather on their present strengths as manufacturers ("What are we able to produce efficiently today - how can we improve that even further?").

Similarly, also a lot of SMEs have often successfully established themselves in one product category and cannot imagine

[7]Source: http://www.nielsen.com/in/en/insights/reports/2014/innovation-or-renovation--what-really-fuels-growth-.html

[8]Source: https://www.macworld.com/article/1135017/macs/imacanniversary.html

growing beyond that field of expertise. Quite often, the reflex here is: “We can’t produce this – and an investment in new technology would be too high. It’s simply not our business.”
However, in times of high production flexibility e.g. by using co-manufacturing or licensing options, this obstacle does not need to persist.

Whenever forthcoming transactions involve brands, it is advisable to consult a neutral third party that is neither part of the organization that is to be valued, nor part of the M&A-team. The true potential of a brand, especially when undermanaged by its current owners due to different strategic priorities, can then be conveyed more convincingly and thus contribute to the overall transaction value.

By conducting this systematic brand potential analysis, true innovations can be identified, transferring the brands scope into new business segments - next to renovation-projects already in the development pipeline (within the core business). This can in turn lead to tapping into new, additional revenue potential which can contribute to the business result. Doing so increases the transaction value considerably. Here, too, a very close cooperation between the M&A-adviser and the “brand supervisor” (the company or its brand-consultant) is required. This is the ideal way to present the brand’s growth potential within the disposal process in an optimal and transparent way, so that it influences the purchasing price as a whole. Further important steps are detailed below.

4. Development, evaluation, and quantification of new business segments

4.1. Demonstration of potential new business segments through brand transfer outside of the core business

Let’s imagine the brand LEGO was up for sale. The company describes itself as follows: “LEGO Group is one of the largest manufacturers and retailers of play material in the world“[9]
Regarding their positioning, the company states: “According to the motto ‘only the best is good enough’, our company supports the development of children encourages and inspires the ‘architects of tomorrow’ through creative playing and simultaneous learning.”[10]

Children and parents alike often have a high emotional relationship to the brand. Besides, parents consider the products to be very durable. The guaranteed use of non-toxic materials is also a highly relevant functional feature to parents, and a clear positively differentiating factor in justifying the higher price in comparison to competition from the Far East.

A “Brand Key” for LEGO is probably in place, or could be defined and reviewed relatively easily.

A neutral third party can take this Brand Key and develop ideas and concepts, describing which other businesses could be credible for the brand - and relevant for children and parents.

One of those conceivable new business segments could be robust, modular furniture for children consisting of oversized

[9] www.lego.com/de

[10] www.lego.com/de

LEGO-bricks and other solid parts that can be assembled and rearranged safely following typical LEGO-"manuals" - basically furniture that grows alongside the "architects of tomorrow". It's also imaginable to appeal to different target groups analogous to the LEGO core business (different offers for small children vs. schoolchildren), and to create typical LEGO-themed worlds (animal life / Star Wars) for this furniture.

This example is meant to illustrate that even without detailed knowledge of markets, it's possible to develop new concepts - once as the assumption "We are only active in *one* category" is left behind.
The key question is: *What does our target group need <u>OTHER THAN</u> the current products we offer - and how would this new offer need to be set up, to fit the brand's positioning and clearly differentiate from competition?*

As long as there is a logical and consistent connection between the new business sector and the brand, the mere demonstration of further and new ways of utilizing the brands potential leads to an increase in the brand's value. Consequently, the brand will be considered more valuable during the course of an M&A-process, at least by those parties becoming interested in further developing these ideas.
Naturally, in an actual case, the person in charge would carry out a detailed market analysis and a more substantial development of the idea, as well as an evaluation of its feasibility and potential risks. This, too, shall be sketched below.

4.2. Validating consumer demand for offers in new categories

The first step is to establish and test hypotheses on the current image perception of the LEGO brand. Quantitative online research methods can quickly provide feedback data on consumers approval of these image statements and areas of brand competences. On top, data on aided and unaided brand awareness is available for many categories through market research institutes.

Next, desk research is carried out, analyzing current and emerging consumer needs, the positioning of other key players, and trends on the furniture market. It is highly likely to be able to identify weaknesses of existing players during this analysis - this knowledge should be used to positively differentiate the new LEGO concept.

Finally, a short verbal concept including a visual sketch of the new business idea will be developed. This concept is then validated with the potential target group (buyers of furniture for children), using an online test methodology. Typical questions include uniqueness, relevance, brand fit, and, last but not least, buying interest.

4.3. Quantification of the additional revenue potential

Step 1:
Desk-research on size and development of the furniture market: Revenues, prices, estimated production costs and gross margins, marketing budgets, etc. Data for most business sectors is readily available for example via Euromonitor, Statista, and the trade press. These data will be completed by valid assumptions, if necessary.

Step 2:
Drafting turnover- and market share prognoses for years 1-3 (different scenarios and bandwidths) based on the results of the

concept test, brand awareness, and a launch support plan (distribution setup, promotional support etc.). Market research institutes such as Nielsen offer test procedures that take all of these factors into account. Given their extensive experience in a vast number of categories, they can often advise on specific benchmarks. This makes the prognoses even more valid.

4.4. Business Cases: Evaluation of implementation options

In principle, three options for product development and manufacturing can be considered:

- In house development and/or production
- Development and/or production by a co-manufacturer
- Licensing to a third party

A feasibility assessment, as well as a more detailed turnover-, cost-, and cash flow-plan is created for the most economically viable approach.

Furthermore, an ideal distribution scenario needs to be developed, taking cost-benefit considerations into account.

This will lead to the determination of a possible additional revenue- or cash flow-contribution of the brand. It can be used as an "Ace up the sleeve" of the seller and his M&A-adviser, in order to present not only a good Investment Case, but a TOP Investment Case - thus "inciting" a bidding contest for the brand.

The ensuing competition along with the reduction of the perceived investment risk significantly boost the subjective value for the investors.[11] When assessing conservative vs. optimistic scenarios, demonstrating additional potential alters the risk evaluation. With the additional insight regarding further brand potential, the initial optimistic scenario optimally becomes a rather conservative scenario during the due diligence process, which the acquirer then uses as basis for his valuation.

Duration of the entire process (4.1. – 4.4.):
Roughly six weeks overall, assuming the existence of a relatively clearly defined brand positioning. If this is not the case, circa four weeks need to be added to develop the future positioning. For the most part, the process can run simultaneously to the regular preparatory measures of the M&A-transaction (creation of documents, preparation of the data room). The results of the brand potential analysis can be included into the disposal process effortlessly (especially adaptation of the Information Memorandum and the Management Presentation, as well as completion of the data room).

5. Selected transaction and cooperation scenarios with brand implications

5.1. Carve out of a brand

Low priority brand in conglomerates, that are up for sale in the midterm, have often been "under-managed" for a longer period before their actual disposal, at the advantage of other brands with higher strategic priority. This has often led to insufficient support (e.g. R&D resources,

[11] On the influence of risk aversion on the purchasing price, cf. M. Leitterstorf / M. Wachter: „Takeover Premiums and Family Blockholders" in: Family Business Review 2016, Vol. 29(2), S. 214.

brand management resources, and marketing/sales support budgets). As a result, classic valuation methods arrive at a transaction value that does not sufficiently represent the true value of the brand.

Quite often in these cases, there have hardly been any basic renovation projects in existing market segments for a while, let alone innovation projects outside of current business sectors. The marketing team working on the brand had to focus on maintenance activities instead, keeping the brand at a steady level. In this case, developing a reliable growth strategy with a good mix of renovation and innovation projects will significantly boost the conceivable brand potential and thus also the brand value.

Without such a thorough brand potential analysis, there is no applicable cash flow-data for a DCF-analysis, and thus the company is valued too low.
Ever so often, the seller of an underdeveloped brand will only realize the true value of the brand until the potential is analyzed in the course of preparing the disposal. Since the decision to dispose of a brand usually comes after a company's comprehensive strategic planning, the brand potential analysis introduced in this article will hardly reverse the initial strategic decision to do so. However, the analysis can result in the decision to dispose of the brand to a financial investor in a first step while maintaining a minority share, in order to benefit from the additional growth in value in the medium term. Then, after the growth potential has indeed been realized together with the private equity investor, a significantly higher selling price can be achieved because of eliminated implementation risks and an optimized capital structure.

5.2. Company disposal including a brand

When selling an SME with a strong branding background, the M&A-adviser working for the seller often receives only very limited input regarding the brand's market positioning. Diverse and often rather emotional reasons lead to an extensive "communication ban", restricting communication with e.g. the marketing team, who could actually be able to provide information regarding a brand's positioning and growth concepts. However, the acquirer's calculated enterprise value represents his assessment of the risk that accompanies the transaction. The acquirer further reduces this enterprise value by additional security cushions. Above explanations have shown how a brand owner can significantly reduce the perceived risk on the side of the acquirer with the help of a brand consultant, an M&A-adviser and reasonable effort. Thus, the disposal price and the probability of a transaction closing can be increased considerably.

Well performing brands with growth potential are as valuable for a company as the management team that is "sold" as well. Unfortunately, the added value of a good management team can hardly be quantified. The added value of a brand however, can be calculated more easily, as described. Ignoring this as seller means missing out on parts of the potential purchase price.

5.3. Supporting brand owners in the realization of a brand's potential using strategic alliances

Finally, we would like to address selected cases of brand valuations next to disposals, in which the brand potential analysis could also be applied:

- Joint ventures for brand development
- Licensing models

Supporting brand owners in developing their brands outside of the core business could or even should be an important factor for the development of a branded company's corporate VC-strategy.
On top of evaluating investment in new technologies within the existing core business, brand potential outside of the core business should also be evaluated, in order to specify the range of potential investment goals in more detail. Creative leeway with regard to developing concepts and allocating financial resources available for transactions will lead to a broader spectrum of options. This (missing) open-mindedness and flexibility represents a core problem for the DACH-region[12] in particular, as investments often tend to be rather conservative here.

In the course of a brand potential analysis, business potential outside of the core business may emerge that cannot be realized by the current brand owner alone, due to different production technology or different distribution channels. Joint ventures with suitable partners or licensing the brand or the know-how behind the brand may offer ways of realizing the identified additional brand value. The results of the brand potential analysis support the brand owner in identifying a suitable partner and in realizing economically appropriate agreements.

To stick to the LEGO example:

LEGO could cooperate with a furniture producer that already has production capacity, and/or logistics- and distribution-networks in place. Thus, LEGO could stay in charge of the brand's increasing scope without having to invest into building the new business segment by itself.

6. Conclusion and outlook

Our description of brand valuations in the course of M&A-transactions has shown the following:

1. Classic valuation methods are usually not appropriate to depict the actual value of brands. This holds especially true for brands that have not been supported and developed optimally so far.
2. By thoroughly applying the instruments of brand positioning and brand potential analysis to M&A-transactions, future cash flows of brands can be assessed and communicated much more reliably and credibly, with the required time investment being reasonable. Accordingly, the acquirer's uncertainty decreases - which in return increases the purchasing price he is willing to offer. A significant increase in the seller's bargaining power is just as likely as an increased transaction security per se.
3. Considerable weaknesses of the DCF-method in the course of brand-based transactions can be eliminated by applying said instruments to gain more reliable data. From the authors' point of view, transaction and trading multiples with their focus on the past

[12] Being German-speaking Europe (Germany (**D**), Austria (**A**), Switzerland (**CH**))

or the present are rather unfit for valuing brands with the goal of defining a fair value for the brand seller. In theory, assessments based on the possible added value per (loyal) brand user could represent a solution for this. Due to the diversity of potential in different brands, applying the DCF-method with support of a thorough brand potential analysis (by an independent third party) as explained, seems to be the preferable approach.

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