BIZCOMMUNITY

The future of marketing is secure

By Prof Roger Sinclair

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I recently finished teaching my 2007 honours course at Wits University in Johannesburg. As has been case for more than 10 years it is based on the work of Kevin Lane Keller who, young as he is, in my view is the father of brand equity theory and practice in the world. This was arguably one of the brightest classes yet.

What was striking was its make up because it not only comprised South Africans from every side of our colourful spectrum but also from as far afield as the USA, Bulgaria and the northern parts of our continent.

Honours teaching (and learning) at our university is very different from the under-grad approach. It is essentially informal with the students doing a great deal of the work. They present the text book, having read it and extracted the key points. And since their understanding of the text is what the others will absorb and use in their examinations (and in their careers) they cannot afford to misconstrue the book or be parsimonious in their coverage of it. The task of the professor is to provoke, illuminate and ensure they keep on the right track. They also have seminars to prepare and present and must participate in class debate and discussion.

It's worth noting that during the course of this session at least three, to my knowledge, were offered jobs with leading South African companies. I have no doubt they will all be employed by year end.

What impressed me was the extent to which they absorbed the basic and more complex tenets of branding. In the last few sessions it was wonderful to hear them using sophisticated technical arguments to win a point or convince a colleague of the correctness of a position being defended.

These will be brand managers like no others before them because they are among the first to learn about the new role that brands play in business. Not only do we now have formal recognition that brands are financial assets due to the accounting standards that describe them as such; we are now in a process where the way in which brands will be valued under the requirements of the accounting standards is being decided. Unlike many in the industry, this group will have a basic knowledge of financial accounting, sufficient to be able to rationalise a variety of branding decisions on the basis of contribution to shareholder wealth. They can claim as well to have played a role in the debate currently being conducted on valuation methodologies for fair value accounting.

Brand accounting

The introduction of the new accounting standard (IFRS 3 about which I have written endlessly) is not yet turning out to be what it was supposed to be. Last year I wrote on the Barclays takeover of Absa. In the 2005 Barclays plc accounts the acquired brand was indeed specified in notes to the accounts but at a value that I described as risible. I spoke to many experts about it and most of the analysts agree that it was low.

More recently, with the help of Dave Thayser of Ernst & Young, I examined the annual financial statements of all the companies listed on the Johannesburg Securities Exchange (JSE) that had been involved in substantial deals in the 2004/05 and 06 years. I expected to find the requirements of IFRS 3 clearly and obviously stated. I did not. In fact the impression was that there was no new standard. Goodwill was presented in all its meaningless glory and if there was a mention of an acquired intangible it was hidden away and represented a small portion of the premium paid for the business.

I do not know why this is. I have been told by accountants that there are technical reasons for not liking the new standard because of its consequences (whatever those may be). I suggest this defeats the object of the standard writers who felt that investors had a right and were demanding to know what the underlying assets that brought about goodwill were.

I have a strong suspicion that this will change in time because of certain other events occurring. The International Accounting Standard Board (IASB) has a working group in Australia examining modifications to the standard (IAS38) that deals with internally generated intangible assets. The Financial Accounting Standard Board (FASB) in the USA has already drafted such a standard but decided some years ago to push it to the back burner. What might hasten this development is the work being conducted right now by another body, the International Valuation Standards Committee (IVSC). It has prepared and circulated a Discussion Paper (DP) which sets out to guide professional valuers on how to value intangible assets under the Fair Value requirements of IFRS 3. (I have teamed up with Kevin Keller, and we have jointly prepared and submitted a response to the DP for the consideration of the IVSC).

We talked a lot about these issues and the class of 2007 is well acquainted with the accounting standards and what they mean to brand owners and branding specialists.

Brand versus customer equity

It is clear from valuation guidelines issued by the formal accounting bodies and by the detailed draft proposals in the IVSC DP, that the Income method of valuation is preferred. This implies discounted cash flows which in the case of brands means projecting the earnings generated by consumers for periods of time into the future.

The world inhabited by marketing academics has been split over the past decade into those who support brand and those who favour customer equity. “Brands do not create shareholder wealth, customers do,” opined one set of scholars in the mid 1990s. My response to that is that “Brands do not create shareholder wealth, customers do it for them.”

Assets are resources to which future economic benefits will flow. In the case of brands the future economic benefits are customer driven. That is what customer equity pundits measure. They look at the nature of the relationship between the customer and the brand and try to work out how stable or vulnerable that relationship is. The result is a stream of income that when capitalised provides the equity value. One side calls that customer equity; the other describes it as brand equity.

Somewhat influenced by their professor, the 2007 honours group came down firmly on the side of the latter. How, they argued, could customers be an income source unless their cash flowed to a particular resource; such as a brand?

Customer-Based Brand Equity (CBBE)

Professor Keller conceived the idea of CBBE to make it clear that brand equity has the customer as its source. The whole purpose of building, measuring and managing brand equity is to employ marketing practice to find and keep customers for the brand. It is a complex business which is why the text book is over 700 pages long.

From the brand asset point of view CBBE is critical because it regulates and enhanced the cash flows that are the source of the financial strength of the brand asset. The greater the relationship that can be built between the brand and its users, the greater will be the cash stream that flows to the company that owns the asset. Customers who enjoy the brand and for whom it performs in a satisfactory manner will be willing to buy it more frequently, perhaps pay a premium price for it, invest in other products in the brand portfolio and even recommend it to others.

The honours group learned these lessons well.

Marketing as a function

In a manufacturing plant, engineering is a function necessary to maintain and keep running the assets that produce the end product. In the same vein, marketing is not an end in itself, it is a company function employed to build and manage brands. Brands are the assets not marketing. It is important to understand this because in time (if not already) analysts will want to know how the firm is caring for the brand assets. That means asking how much they are spending on acquiring new customers and keeping existing ones; what success they are having and if they are innovating and developing product or service improvements.

Marketing is the function that builds the brand asset which, in turn, contributes in a major manner to shareholder wealth. This is the massive benefit that is and will continue to flow to companies as a result of the new accounting standards and measurement approaches and the heightened status they confer on brands.

The class of 2007 are immersed in these ideas and concepts and will take them into the world next year where they will doubtless practice with distinction.

ABOUT PROF ROGER SINCLAIR

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