Marketing Metrics: A Surrogate of Firm Valuation

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ABSTACT:

Purpose of Research: Valuation has always been of an interest for financial purpose nevertheless, with the brand valuation; marketing practitioners understand the prominence of valuation with marketing metrics such as brand valuation and customer equity. The subjectivity exists because there are no standardized valuation models. What can be the components of marketing metrics and do they evade the intrinsic value. Concepts such as brand equity and customer equity are being commonly linked to firm value and shareholder value. Can investors rely on financial statements that divulge such metric as brand value? The aim is to develop a framework that identifies the key metrics and link to business performance.

Methodology: An extensive exploration to excavate the financial and marketing metrics for the valuation of brands. Examine existing literature on the impact of marketing metrics on the firm value.

Major Finding: The firm size, royalty rates, market share, marketing productivity, return on investment and the likes are common metrics for brand valuation. Emerging studies are equating the impact of marketing metrics such as brand equity, customer equity and customer satisfaction, customer lifetime value as surrogate parameters on return on the marketing, shareholder value and the firm value.

Implications: Marketing practitioners must decide how to report brand specific data, valuators must understand the company specific need instead of tailored made valuation models. The management decisions to use brand valuation models need to change in the light of growing comprehensiveness and investors' demand. The metrics selection, whether financial or marketing will be according to the changing business model.

Keywords: Brand equity, Customer equity, Financial Metrics, Marketing Metrics, Firm Value.

Extended ABSTACT:

Valuation of firms has always been of interest for financial purposes nevertheless, marketing practitioners understand the prominence of valuation with marketing metrics such as brand valuation and customer equity. The subjectivity in the basic components of valuation exists because there are no standardized valuation models. What can be the components of marketing metrics and do they evade the intrinsic value. Concepts such as brand equity and customer equity are being commonly linked to firm value and shareholder value. Can investors rely on financial statements that divulge such metric as brand value? The aim is to develop a framework that identifies the key metrics and link to business performance. The advantage of management decisions and valuation of intangible assets and brands are that they provide companies with the abilities to develop and protect their assets. An increase in brand value always increases the firm's value or vis-à-vis. As there is no market price prevalent for brands thus the acquisition/licensing price is its inherent value. Literature in the past have drawn a synthesis of the accounting and marketing in the valuation of marketing assets as brands (El-Tawy and Tollington, 2008; Inglis, 2008; McManus and Guilding, 2008, Sidhu and Roberts, 2008), while other studies have tried to differentiate between the two (Gleaves et al., 2008, Roslender et al., 2008). Brand valuation sparked a debate whether a marketing asset should be capitalised in the financial statements. The same controversy stimulates a debate three decades hence. Brand related information can give the investors about the future prospects of the company. Investors invest in companies that generate future cash flows and because brands are so intertwined with business components, therefore, to differentiate brand as a separate identity is a unique application. Brands in the past have been valued by their potential to generate royalty cash flow through licensing to a third party. The royalty rate can be determined by the discounted cash flows or multiplier (El-Tawy and Tollington, 2008). Companies with recognised brands must consider how brands can be valued and protected as an intellectual asset; hence, companies should strive how these two features should increase the value and scope of the brand and a firm as a whole. Increasing companies are endeavouring to put intellectual assets such as brands on the balance sheet. Brands have been valued for acquisition and taxation purpose in the past. Established brands can obtain required cost of capital at a relatively less price for their continued

growth. Studies under brand valuation are interestingly emerging in three domains viz.; first, that evolving number of studies has shown the relationship of brand equity to brand value (Raggio and Leone, 2009a) and as a result brand value creating customer equity (Raggio and Leone, 2009b), second, research has provided evidence of a link between brand valuation and marketing ROI (Haxthausen, 2009), and third, marketing assets were built to reflect the long term performance and the firm value (Keller and Lehmann, 2009). The objective of this study is to explore the measures that methodically evaluate the brand value and potential for future growth. We look at two primary areas that include both the financial and the marketing measures. The related advantages of financial measures are calculation of future cash flows and to a determinate the measures that can be incorporated in the brand valuation model by the researchers. The financial measures are basically looking at the short term perspective based on historical data. The marketing measures define the long term prospective of the marketing assets hence, assimilating the forward looking feature such as the projection of future cash flows. Emerging studies are associating the impact of marketing metrics such as brand equity, customer equity and customer satisfaction, customer lifetime value as surrogate parameters on return on the marketing, shareholder value and the firm value. The next section describes the review of literature with discussions on previous findings. The subsequent section describes the findings with conclusion and points out future direction of research. The paper aims at the literature on the marketing metrics and provides an overview using qualitative analysis. Investors determine the future cash flows or after tax cash flows attributable to the brand, then discounting them with the present value by using an appropriate discount rate. However, using discounted cash flow, probability theory and real option analysis have anything but tenuously difficult to estimate the intrinsic value of the brand or intangible asset. Financial metrics are backward looking as these metrics only disclose the after being capitalised on the balance sheet (Clark and Ambler, 2011). Financial metrics represent the economic impact on the company such as return on investment. Ambler and Roberts (2008) in their study reviewed three popular financial metrics ROI (return on investment), DCF (discounted cash flow) and ROC (return on customers) and specified the limitations. Ambler and Roberts (2008) recognised the fact that customer equity and customer lifetime value are the more adequate measures for measuring marketing performance. However, the reluctance of the accounting proponents about the "*additivity*" principle omits brand value from the balance sheet (El-Tawy and Tollington, 2008). Marketing researchers are being

innovative by linking financial-marketing performance and how the metrics translate into financial consequence. Srinivasan and Hanssens (2009) review the various financial metrics as returns metrics and risk metrics. Srinivasan and Hanssens (2009) point out certain dependent financial metrics such as firm valuation (Fornell et al, 2006), Tobin Q to measure firm value (Simon and Sullivan, 1993), market-to-book ratio (Rao et al. 2004), stock returns (Srinivasan et al, 2009), cash flow volatility (Gruca and Rego, 2005), systematic market volatility (McAlister et al. 2007) and idiosyncratic volatility (Luo 2007; Osinga et al. 2009).

Rust et al., (2004) states that the
"Existing financial metrics have proven inadequate, leading to development and increasing use of nonfinancial metrics".

The quest of a comprehensive model has made marketing practitioners to cherry-pick metrics beyond a dozen else, discard metrics that have been retained for internal purpose (Clark and Ambler, 2011). There is a growing recognition of the need for non-financial metrics and forward looking measures that can predict the future cash flows. Non-financial parameters such as brand equity and customer equity bring value to the company once used in conjunction with the financial metrics (Ambler and Roberts, 2008; Seggie, et al., 2007; Uzma, 2010). Research has addressed the fact how non-financial marketing measures effectively drive financial performance such as shareholder value (Rust et al., 2004). There are marketing literatures that incorporate product quality (Aaker and Jacobson, 1994; Mizik and Jacobson 2003), customer loyalty (Reinartz and Kumar, 2003; Kumar and Shah, 2004) and customer profitability (Jain and Singh, 2002; Gupta et al. 2004) as marketing measures.

Our framework is based on the four marketing measures; brand equity, customer equity, customer satisfaction and customer lifetime value that are interlinked to the firm value. Consequently, the framework establishes a link between the firm value and shareholder value. For industries, longitudinal industry-level customer data are not available in India. Therefore, companies must adopt primary research methods to collect information for measuring brand equity and customers' behavioural responses, which is an expensive and time taking process. Thus, it becomes altogether more challenging for an individual researcher to carry out an

empirical study to examine the marketing measures in the perspective of marketing productivity such as firm value and shareholder value, especially to be carried out in the Indian situation. To increase the visibility and transparency of brands, companies are progressively making financial disclosures under the current regulations (GAAP/IFRS/AS), however, intangibles such as brand are so intertwined with the business that internally created brand are not adequately reflected or the series of years post-acquisition of a brand. The measurement of brands uses the stream of cash flow attributable to the brand; however, multi branded companies will inevitably undervalue a brand as they generate multiple cash flows. Brands that are not licensed or acquired are difficult to value and cannot be capitalised. Thus it is an invariable need for companies to bring out multiple marketing indicators that can project the company's performance. Therefore, it is imperative for companies to understand how brand equity and customer equity can be linked and how investments in brands and customers are associated with the firm value (Hogan et al., 2002).

As quoted by Srinivasan and Hanssens, (2009).
"*Several econometric models have been developed to parameterize these relationships, and several empirical propositions have been generated to date*".

Conversely, there is no comprehensive list of metrics (Clark and Ambler, 2011), therefore, companies need to determine metrics according to the business models and this purpose these metrics need to serve or predict the future performance. The metrics must reveal how the strategic decisions are made for different categories of products and customer segments, considering the time frame for which the decisions are to be made. The finding is that consumer equity metrics of the brand equity metrics are the of future of marketing metrics, which will not only need to be evaluated at the consumer level, but also as the advantage to surpass more robust measures in the estimation of market based performance (Das et al., 2009). Marketing practitioners must decide how to report brand specific data, valuators must understand the company specific need instead of tailored made valuation models. The management decisions to use brand valuation models need to change in the light of growing comprehensiveness and investors' demand. The metrics selection, whether financial, marketing or both will be according to the changing business model. Use of multiple matrices has also been advocated by Ambler

and Roberts, (2008). Additional empirical analysis needs to be conducted both by marketing practitioners and academician, how marketing metrics can be linked to financial conclusions such as return on marketing, firm value and shareholder value.

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