Brand Management

Professor Abhishek Kumar
Dept. Of Management
Army Institute of Management, Kolkata

Week - 08
Lecture - 38

Now, let us move further and look at one or two real acquisitions in terms of details. Now, one of the earliest brand acquisition that was made by an Indian company, an acquisition of a foreign brand by an Indian company happened in the year 2000. We spoke about this acquisition earlier also during the course of this lecture. Today we will look at it in some detail. Now, in the year 2000, the brand Tata tea acquired another brand called Tetley. Now, both are tea brands.

So, Tata tea all of us know is a tea brand. We often use Tata tea brand on a daily basis and then there is a brand called Tetley, which is a British brand and it is a global brand. Tetley is a brand that no matter which part of the world you go and if you say Tetley, most people would be able to recognize this brand. Now, in the year 2000, the turnover of Tata tea was 114 million US dollars and in that year, the turnover of Tetley brand was 431 million US dollars.

So, you can see that Tetley was almost four times bigger than Tata tea. But at that time, Tata tea again had the ambition, had the courage and had the necessary finances to make a bid for a brand a company which is four times bigger than itself. So, Tata tea sorry, Tetley perhaps had some problems at that time, they were not able to manage the organization, which was the case with Corus, which was also the case with Jaguar Land Rover and so on. So the parent company, the company which is selling the brand or selling the company is perhaps having trouble or the challenges in managing the organization. So, they think that they would give it off or sell it off to another company which is interested in running that brand and organization.

So, at that time Tata tea made a bid and Tata tea actually won it. So, Tata tea acquired this brand called Tetley. This was as I said it is one of the first or first acquisition of Indian brand of foreign brand by an Indian brand and it made a big splash in the global newspapers and in the global marketplace. Everybody suddenly started noticing what brand of which company is this Tata which can acquire a brand as big as Tetley. Now, this is something that happened in the year 2000.

And today, we are in 2023 and we can see that in last 23 years, Indian brands have many of the Indian brands have been very aggressive and they have gone to the global marketplace and bought many global brands. Most of you would be familiar with you familiar with this development. And if you are not, I would urge all of you to go to the internet and look for this keyword Indian brands acquiring foreign brands. The kind of results that will show up, you will be amazed to see that the value at which Indian brands are buying global brands. Let us move further.

This is another acquisition that happened which did not have Indian brands participating. Here there is a company called Roundtree and this Roundtree was acquired by Nestle. Now Roundtree at that time owned brands like Kit Kat, Fruit Pastille, Aero and Quality Street. These are chocolate brands and these are very we are of course familiar with Kit Kat, but other brands are not present in India. Now Nestle Roundtree perhaps was in trouble and they were selling themselves off.

They were selling not just the brands, but they were selling the whole business. They were selling the factories, they were selling the offices and so on. But Roundtree when they were selling Nestle realized that there is a good connect between products of Nestle and products of Roundtree. So at that time Nestle and this happened in 1988. Nestle paid 4.

5 billion US dollars to buy Roundtree. Now why was Nestle paying such a huge amount? Even today it is a big sum. At that time 1988 imagine almost 12 plus 30-35 years back it was a very large sum. So at that time Nestle paid 4.5 billion US dollars to acquire Roundtree.

And why did it pay such a big sum? Is it because of the factory, the land, the offices, the people? Is it because of that? No, because building factory people etc. all of them can be created on your own. If you spend money, it is not very difficult to get people, get land, get factories etc. But creating a brand is not that easy. Even if you spend so much money, you may not be able to create a brand like KitKat, Fruit Pastille, Aero and Quality Street.

So Nestle was paying so much money to buy the brand, not so much for buying the factory or the offices. This is something that you must keep in mind as student of brand management and student of marketing. So what is for sale is not so much the factory and the offices and people and the hard assets. What is for sale is the brand. It is the brand that makes a difference.

So when Tata buys Air India, of course it is buying the aircrafts and it is buying all the things that are associated with the aircraft, the pilots, the air hostesses and so on so forth. But more importantly, it is buying that Air India brand. Because moment someone thinks of Air India, they have a certain image in their mind, that image says that it belongs to

India, it is a conventional airline, it is known for good service. And if it is not known for good service, it was once upon a time known for good service. And when this merger in the mind of consumer, when this merger happens between Tata and Air India, suddenly consumers feel that there becomes a new possibility of Air India again in becoming one of the better or the best airlines of the world.

So because of that positioning in the mind of the consumer of Air India, Tata feels that it is a very important buy for the group and therefore they have bought it and see they have almost turned it around even in just about one year. So they are paying so much money for the brand, not so much for the hard assets that the brand may own, because hard assets can be created with the help of money, but soft asset like a brand cannot be created or at least it is not easy to create a soft asset like a brand. You can see that Air India has been created over last 75 years or about 60 years. Now how do we calculate these figures and on this slide, you can see one or two figures and one or two terms like PE ratio and you also see something called PE multiple. Now what are all these terms and what is this figure? Well, the whole rule is that when someone is buying another brand, they do 10 to 30 times of the PE ratio.

Now what is PE ratio? PE as I have told you is price and E is earnings. Now exactly it is P is the share price, which is suppose you are buying say Tata Steel today, so the share price of Tata Steel today and earnings per share, earnings per share means suppose the price of Tata Steel today is 100 rupees in last one year, this share of Tata Steel has given 5% return. So perhaps in this year, at the beginning of the year, the price of Tata Steel was 95 rupees. Now it is 100 rupees. So the earnings per share is 5 rupees.

So share price is 100 rupees and earnings per share is 5 rupees. So PE ratio becomes 20. So 20 is the PE ratio and when you buy the company, what you do is buy outs are often 10 to 30 times the PE ratio. So if the PE ratio is 20 for Tata Steel, you will have to pay 20 multiplied by the revenue of the company. So if the revenue of the company is 50,000 crore, for example, then if someone wants to buy Tata Steel 50,000 crore into 20 means 10 lakh crores.

So today if you wish to buy Tata Steel, you will have to buy you will have to pay an amount of 10 lakh crores. So that is how it is a very loose calculation 10 lakh, yeah, 20 to 5. So this is a very loose way of calculating approximate valuation in which a company can be bought. But this is something that you can keep in mind as a thumb rule. So in this case, when Nestle purchased Roundtree, Nestle used a multiple of 26.

So its PE ratio must have been something and they use 26 times multiplied by the revenue of Roundtree, which was roughly 4.5 billion dollars. The price which Nestle paid to Roundtree to buy the whole company and what were they essentially buying? They were buying KitKat, fruit, pastel, arrow and quality street brands of chocolates. This is how we roughly calculate. Now a few insights which are related to this area from the historical perspective.

Now if you look at this slide, you will see that in Australia Rupert Murdoch is an Australian company and the name of his company is an Australian company, News Corporation is the name of the company. So in Australia Rupert Murdoch's News Corporation included a valuation of some of its magazines on its balance sheet in 1984. So what does it mean when he is using valuation of a magazine? Now see magazine business is not a very large business. The revenue of the magazine may not be very high because it may be say a monthly magazine. Monthly magazine means in a year you will have only 12 issues and 12 issues how many advertisements can you really have in one magazine? The amount that you would earn from magazine cannot be very high.

However these magazines have very high value in terms of recognition. Many people know about it, they read it and so on. So the top of the mind recall is very high. So while the business may be small but the brands are very big. So what Rupert Murdoch did in 1984, he included the brand valuation of some of the magazines into his balance sheet.

Similarly British firms they also started using value of the brand to boost their balance sheet. So if they add the value of the brand suddenly the balance sheet becomes better looking because it has higher amounts shown under assets. Similarly in the United States generally accepted accounting principles mean placing a brand on the balance sheet would require amortization of that asset for up to 40 years. It means what? It means that in the US the government rules or government laws are saying that the life of a brand is 40 years and in 40 years you will have to amortize the brand which is 40 years. So if you look at the which means suppose you are placing the value of your brand as 1 billion dollar you have to divide it in 40 years to make it 0.

So he says that the life the rule says in US that life of a brand is 40 years and imagine 40 years itself is a very very long time. So when you are creating a brand in you are perhaps creating an asset which will last for 40 years. This charge would severely hamper from profitability of course because you are amortizing it for over 40 years. What does it mean? It means 1000 billion 1 billion dollar divided by 40. So every year you are having 25 million dollar going away from your balance sheet which means if your profit is 30 million dollar 25 will go into the amortization and therefore only 5 million dollar will remain as a profit because of which what will happen? One of course your profitability will come down but more importantly which is an immediate fallout is because you will show less profit you will have to pay less taxes.

So this is also one way of saving taxes by the companies in the US. Let us move forward. Now we have seen one very loose way of calculating value of a brand and if someone is buying your brand or buying your company how you will calculate the value of your company value of your brand in a loose manner using P-E multiple or P-E ratio where P is the price of the share and E is earning per share in one year. You can take one year you can take more than one year you can take less than one year but generally the period taken in earning per share calculation is one year. Now let us look at three approaches by which theoretically brand equity can be calculated.

You can see this slide is written in determining the value of a brand in an acquisition or merger firms can choose from three main approaches. So these are the three main approaches through which one can calculate the value of a brand. The first approach is the cost approach. What is the cost approach? Brand equity that you are looking at through cost approach is the amount of money that would be required to produce to reproduce or to replace the brand. So suppose say Nestle was buying KitKat and it does not have a KitKat roundtree has KitKat.

Now if Nestle has to create that brand KitKat once again and it may create the same it cannot create the same brand KitKat because it does not own it. So Nestle has to create a brand which is as big as KitKat. Now to create that brand how much money it Nestle would have to spend to reach the level of KitKat. That is the amount once you determine that amount that will be called the value of brand equity of KitKat and this is through the cost approach. The second approach is the market approach which means what? It means the present value of the future economic benefits to be derived by the owner of the asset.

So it means that suppose KitKat continues to remain with roundtree and it continues to sell in the marketplace and it continues to bring revenues to the owner. Now what is that revenue? How much sales will KitKat have over next say 40 years? So what you have to do is say this year the sale of KitKat was X next year it will be 1.1 X the year after it will be 1.2 X the year after so you will keep increasing given the CAGR which is the cumulative annual growth rate. So at the rate at which the brand is or the business is growing the revenues are growing at that rate you will project the figure the revenues for next 40 years and then you will calculate the present value of that aggregated amount for next 40 years.

So when you create the present value the you can aggregate total and then divide it divided by suppose you are calculating at the rate of 12%. So 1.12 to the power 40 so you total the amount divided by 1.12 to the power 40 what you get is the net present value of future economic benefits that the owner will divide. So the figure that you get that figure is the value of the brand equity of KitKat or any other brand when you calculate it through market approach.

The final method is the income approach which is discounted future cash flow from the future earnings stream for the brand. This is something similar to the market approach but here the focus is purely on the cash flows whereas in the market approach you are looking at economic benefits that come to the owner through the brand which may not be only in the terms of cash flows. So it gives you employable it gives it helps you to win war for talent it helps you it gives you prestige in the marketplace and all of that can be converted in the form of economic benefit. So income approach focuses purely on cash flows whereas market approach looks at a larger picture where wider idea of economic benefits that includes cash flows is considered. So this is where we have come to finally we are saying that interbrand is a big company and does that does brand valuation.

It assumes that brand value is the present worth of the benefits of future ownership. So if you own this brand for a long period what is the value the present value of that future ownership and these are the five steps that interbrand talks about when you try to follow when you try to conduct a valuation process. First is market segmentation so which segment this product is serving the market. Second financial analysis.

So what role branding. So if you remove KitKat from the package and sell it as a simple chocolate without the name KitKat how much the revenue will fall. So you identify the contribution of the brand when you are actually projecting the revenue. Then when you are projecting the demand. So one is actual revenue second is how much brand exists because of the brand. How much demand exists for that brand because of the brand.

So you calculate the demand also because cash flow and demand is different. Cash flow is actual realization of the demand whereas demand may be much higher which you are not able to fulfill. And then there is competitive benchmarking which means KitKat versus Cadburys, KitKat versus Amul and how will they interact with each other as you move forward and then in the end you calculate brand value. So this is how this whole calculation of brand equity happen particularly as we have said financial brand equity. So finally brand value calculation means calculate the brand value as the net present value of the forecasted brand earnings.

So this is how we do financial brand. This is how we understand and calculate financial brand equity. This brings us to the end of this section on brand equity. I hope you enjoyed yourself. I hope you did not find it very difficult to understand especially the calculating methods of the value of the brand. Thank you very much. Enjoy yourself.