The Company's Brand Evaluation on The Base of The Financial Markets' Instruments[1]

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Article info	Abstract
Key words: value of a brand, financial markets, information, capital structure, depositary receipts, common stocks.	In this article we offer a principally new method of brand valuation. Let's mention the bounds of application of this approach. The method can be used for the companies which have the brand, the mature market of the common shares and the market of share depositary receipt.
JEL: F31, G15, G3, M3	The core of the method is that the return on equity of the branded company and the depositary receipt issued for the same share reflect different information volume. The digital value of this difference gives us the numerical prediction of the brand earnings or the valuation of the brand's changes during some period. It appears that knowing the brand earnings is more useful for the brand management than the calculation of its absolute value because it allows observing the process dynamics including daily measurements although such frequent overseeing can be unnecessary.

INTRODUCTION

This article consists of two main blocks. The first block includes the theoretical foundation pretending to novelty and the second one – the questions devoted to the practical aspects of the methods implementation in practice and the difficulties appearing at that. In the third block will be examined on the point of view of the position of the structure model of capital.

I. THE THEORETICAL FOUNDATION

To prove that the digital value of the difference between the earnings price share and the depositary receipts give a quantitative evaluation of the brand we will analyze a range of theses.

At first we will review what exactly is reflected in a company's share value and then in thesis 3 will pass on to the earnings price share. It is also desirable to remember that the data can be objective as well as subjective (emotional) and that a person get information through verbal and nonverbal channels. To say briefly, nonverbal channels are the channels which are not controlled by the consciousness of the human but are effected by so-called the collective unconscious. Therefore, the author considers that the brand's formation and the widening of the areola of its existence happen through the nonverbal channels.

So then we will view 3 theses.

Thesis 1. On the domestic stock market the price of the branded company's share reflects not only financial and economic information (objective, coming through verbal channels) but also the information relating to the brand (subjective or emotional information, coming through nonverbal channels). In other words, native traders (investors) are influenced by the brand when they make calculations of the company's financial position (for example, when they discount its cash flows) and it makes them do some instinctive correction to the company's value in addition to the other instinctive or almost instinctive amendments which they make on basis of the analysis of the objective data.

Thesis 2. At the same time on the offshore market where depository receipts of the Russian branded company are traded foreign investors take to consideration only objective parameters relating to the receipt value because they are not under the impression of the far brand existing only in Russia (which is known only to Russian population).

As digression, we must note that foreign and Russian investors do similar instinctive corrections to the company value which are initiated by the objective information and which are hard to consider in some other way. These corrections will be similar in case of the same level of the investors' professionalism. In this case we can ignore these corrections.

Thesis 3. Now taking into account point 1 and 2 we may state that any new brand information appearing on the market will be understood differently by the native and foreign investors. More specifically the Russian investors' reactions will be much stronger (because they are affected by the brand) than the reactions of the foreign investors who will not get any intense emotional impression. Consequently the different strength of response to the entered information will appear in a different earnings price share and depositary receipts.

At points 1-3 the evident market behavior is described. Now let's view some inner market's mechanisms supposedly leading to such result.

Of course all the arguments should be based on the strong conceptual apparat. The main problem of every brand valuation technique is the difficulty of the definition of the term «brand» itself. The definition made in a proper way should not include any terms which need further interpretation. For example, such definition as «brand – is a branded trade mark» will be incorrect for 2 reasons. First of all, the word «branded» is emotional and ambiguously interpreted. Secondly, the phrase «trade mark» is not officially vested in legislation and needs further explanation.

Here are some other well-known examples of brand definition. Although the authors of these definitions are the competent practicing authorities their brand determination raises many questions.

- «**Brand** – name is a name, term, design, symbol, or other feature that distinguishes products and services from competitive offerings …» (P. *Kotler, 2000).*

- «**Brand** is a promise of matching of price and quality, consumer and symbolic product features or conformity of the service to the potential customers' expectations» *(Aaker, 1991).*

- «**Brand** is a set of perception in the consumer's imagination» (*Paul Feldwick).*

- «**Brand** is a complex of consumers' impression which is raised by any trade mark» (*I. Solovieva, Interbrand Russia).*

In first occasion the brand is called sound and image, in second – a promise, in third – a perception, in fourth – an impression. At the intuitive level it is clear what the author wants to say but for the formation of a seriously reasoned model none of these definitions will be good enough. They use emotional phrases which can be understood differently by the readers.

For the further analysis it is necessary to give a definition to the term «brand».

Basic supposition. Taking into account the opinion that the terms «Brand» and «Trade mark» have basically different meaning the author takes as a basis of further reasoning next supposition: «**Brand is a fact of mass production of uniform emotions as a product held for sale**». The author is sure that it is a proper definition

but do not see any reasoned ways to confirm this thesis that is why the author accept it as a basis proposition for further reasoning.

With such definition the tangible goods called branded acts only as a mean of delivery of «good-emotion» to the consumer, a kind of a packing for the real product. Let us remind that we mean the uniform emotion is a real product. «Uniform» –because absolutely different people buying the branded product obtain similar emotions.

As far as «Brand» and «Trade mark» were mentioned as different terms we should explain the author's understanding of this difference: «Trade mark» is a form of admission that the product has a good quality.

Consequence 1. Thus we can make next statement on the base of basic supposition: «Every branded product is in fact a mixture of two independent goods one of which is a tangible good (it means that it exists physically and you can touch it) and another product is an emotion and of course you can not touch it.

To illustrate this statement we will use a usual example – Pepsi-Cola. Buying a bottle of Pepsi the consumer purchases more than only liquid – it will not help you when you are thirsty or need health-improving – he buys some special mood which is considered to be celebratory. In this example the glass (metal) bottle and the liquid in it are just a mean of delivery of a really popular product which is the emotion of happiness. Hereafter for short a tangible good will be called « packing» and the emotion of happiness – the real good - will be called «goods-emotion».

Consequence 2. Developing this idea we can define some features of the company: A branded company is a combination of two independent businesses one of which produces «packing» and another produces «goods-emotion».

Moreover, it can be admitted that the company develops (supports) brand if it advertises happiness, joy and other emotions which you get when you buy their products.

Consequence 3. The following peculiarity of the concept points to the stock market and allows applying stock market instrument in brand analysis: «A common share of a branded company is a portfolio of financial assets made up of two relative shares, one issued to produce «packing», another one – to produce «goods-emotion».

Now we can summarize. The unusual behavior of the market can be explained from the point of view that a share of a branded company is a portfolio consisting of two relative shares. The unusual behavior consists in a different volume of information which was reflected in a share value and depository receipt. Now we can say why. The depository receipt is an analog of relative share issued only for one of two businesses of the branded company. And the share of a branded company is an analog of two relative bond-like papers.

II. THE PROBLEMS OF IMPLEMENTATION

Now basing on the developed scheme the question of brand evaluation can be narrowed down to calculation of yield of a relative share issued in frames of business «goods-emotion» and to the formulation of some recommendations on the basis of the analysis of dynamics.

$$R_B = (R_{CS} - R_{DR}*W_{DR})/W_B \qquad [1]$$

R_B – yield of brand

R_{CS} – yield of common share

R_{DR} – yield of depositary receipt

W – weight/share of the stocks in the "portfolio".

Besides profitability the level of yield standard deviation can be calculated as the standard of a brand's risk and the number of beta for the relative share in the business of emotions production. In overall to calculate the value of relative share issued in the frames of the business of «goods-emotion» production it is necessary to subtract the earning power ratio of the business producing «packing» from the yield of the branded company share (in other words to subtract the yield of the depository receipt of the branded company).

In addition it is necessary to realize the correction of the depository receipt yield for the local speculative activity of the foreign market and make amendments for the brand «Russia». The correction for the speculative activity can be made on the basis of Capital Asset Pricing Model (CAPM). The rate of correction for the brand «Russia» is determined on the basis of difference between the yield of inner public bonds and external public bonds (Eurobonds). The examples of the splitting results see in the table 1.

The results of the splitting of common shares of a branded company into 2 relative shares, August 2006

Table 1

№№	Company (the calculations done by the students of MSU)	The parameters of the portfolio consisting of two relative shares (common share)		The parameters of a relative share issued for the business of «goods-emotion» production	
		Profitability	Yield standard deviation	Profitability	Yield standard deviation
1.	MTS (Kondakova Anna)	0,51%	1,43%	**0,36%**	2,35%
2.	VimpelCom (Kamynina Elena)	0,58%	3,49%	**0,19%**	2,91%
3.	Lukoil	-0,10%	1,49%	**-0,16%**	1,72%

	(Gnevsheva Anna)				
4.	Gasprom (Golubtcova Julia)	-0,04%	2,12%	**-0,04%**	0,94%

<center>Source – www.finam.ru. The calculation is based on the suppositions.</center>

The information from the table can be interpreted in the next way. The MTS company business department producing emotions increased the capitalization in 0,36 percent during August 2006. The result of work of the similar subdivision in VimpelCom is a little worse – about 0,19 percent. Thereby if we compare VimpelCom with MTS we will see that the brand production at VimpelCom is more risky (VimpelCom -2,9%, MTS – 2,4%). Hereby MTS department of emotions production functioned more effectively than the similar department at Vimpelcom in the spheres of capital increase and risk minimization.

Gazprom is in a different particular situation. At the moment of carrying-out of an analysis it was impossible to say that Gazprom had its own brand in Russia but the experts considered that it had a brand abroad. It required correction: now to determine the brand value you need to extract share yield (traded in Russia) from the depository receipt yield because a «portfolio of two shares» is already understood as depository receipt.

We should mention that Lukoil has no brand (as it is determined in the author's interpretation). It is a well-known and powerful company but the author did not see any Lukoil ads which advertised not reasoned happiness because of the usage of the company's services. In theory it means that summarizing the results of our calculations we must get the zero brand profitability. But it did not happen because it was connected with a few reasons.

First of all, these are the problems of macroeconomic character. It includes:

▪The low liquidity of Russian stock market which results in the inaccuracy of assets prices and so the inaccuracy in determination of return on assets.

▪Different efficacy of Russian and foreign stock markets which produces some incorrectness in the parameter association of two assets – share and depository receipt.

▪Besides emotion and «packing» the price of the branded good can also reflect other kinds of business. For example, the operations of merge and profit\loss from the multiplicative effect.

Although we can suppose that Lukoil has the brand but it is sold not with a tangible good but with the loan stock. (it is hard to imagine that the drivers refueling their cars at the filling points of the company suddenly feel the emotion of happiness).

Secondly, these are the difficulties of math character. For example there are no strict choice criterion of weight of the relative shares in a «portfolio» and the selection of time lag which is necessary to reflex the emotional (brand) information in an asset value.

Regarding the portfolio allocation we can say the following. There are two ways of forming the structure – in amount of shares or according to share value. In other words the structure is relatively constant or regularly revised. The first point seems to be more real because the brand creation is rather conservative and the proportions of brand production and primary production will be stable.

Let us explain the thesis about the choice of time lag. As it is known objective information entering through verbal channels reflects in an asset value with a time lag not more than 10-15 minutes. Press agencies provide free access to the quotes from stock tender with such a delay. But it is not finally clear with what lag the brand information should be reflected in the asset value. There are different suppositions but they mostly connected with the peculiarities of the branded company.

All the problems mentioned above have technological character and can be met with various level of accuracy. For aim of improving of final results it makes sense to abandon quantitative evaluation and pass to a qualitative one. The received estimate should be an answer to a question: «How did the market evaluate this or another brand-campaign?». The illustration to this statement you can see in table 2.

Now the brand evaluation can look like this. During the week since January 16, 2006 the image commercial «You are better» affected the MTS brand in a positive way or reduced the negative value of profitability.

The next commercial appeared in a month affected the brand in a negative way. But as s comfort we can say that this valuation is unstable because it is connected with a growth of risk value (a standard deviation of brand profitability) and the company doesn't need much effort for its correction.

In such a way we can note that the practical usage of the offered model meets a range of difficulties which should be overcome with a glance to individual peculiarities of the company and also with a pass to quality rating scale.

In spite of these difficulties the brand-component evaluation on the basis of the financial market parameters is a perspective direction of the corporate governance development – foremost, in a negotiation of contradictions between brand-managers and financial directors concerning the ways and methods of the company's capital increase and concerning the part of their contribution to the capital increase. Moreover we should mention that the standard value of brand effectiveness is based on the common opinion received from the interview of specially gathered focus-groups (the number of participants does not usually exceed 30-50 persons). The proposed technique is also based on the opinion but in this case we mean the opinion of thousands of Russian and foreign market participants – the people who risk their investments and are interested in an objective exact valuation.

III. BRAND IN A CORPORATION CAPITAL STRUCTURE

We reviewed the capital structure in its untraditional layer – the capital pointed at the line working and the capital pointed at the brand production. Therefore we will consider the possibility to add the new theses (connected with the separation of brand production in a capital structure) to the most known models of capital structure.

*From the viewpoint of agency costs problem. A*t the expense of the brand development the competition forms between traditional managers and brand-managers and it contributes to the reduction of agency costs.

From the viewpoint of Stakeholders' motivation. The branded companies have more implicit obligations than the similar not branded companies so the share market will respond to the leverage increase of such companies in a more negative way than to the leverage increase of not branded companies.

From the viewpoint of signal theory states. The spending spree for brand can be treated as a signal that the primary production is maximum effective and further development of its technical and organizational part is impossible because of the objective causes.

From the viewpoint of corporate control theory states. A branded company has more stability from a hostile takeover because the inefficiency of one part of management (both in brand-production and in primary production) can be compensated by the effectiveness of another one.

From the viewpoint of behavioral sciences theory of capital structure. The shares of a branded company are a better instrument of investment in conditions of irrational behavior of the market participants than the shares of not branded company because a relative share issued for brand-production in view of its primordial subjectivity will correspond to the behavior of an irrational market than the share issued for the primary production and described by high objectiveness.

From the viewpoint of development strategy selection. The leverage growth in a capital structure leads to the growth of bankruptcy risk and thus not to allow it the industrial policy should be more aggressive and in its turn this provokes a spending spree in brand production.

From the viewpoint of bonded state debt influence on the companies capital structure. The increase of the part of debt commitment in the structure of state debt leads to the leverage growth in the companies capital structure and in its turn it brings us back to the conclusions of the preceding paragraph.

In case of choice IPO as a capital source. Let's discuss the case when the company invests all the funds received only in one type of business – brand-production or primary production. In this case the common share value will increase or decline depending on which business direction profitableness will be higher. Put it otherwise such an approach provokes the risk that new shareholders can join the company on the terms which will be worse than the terms for the olden shareholders.

In case when the company chooses bond issue as a capital source such a problem does not arise. The bondholders do not care in what way the funds are used because

the rate of their coupon payments is invariable and the shareholders would prefer more profitable way. The only exception is the situation when the risk of one of two businesses essentially differs from the other one. In such case the bondholders can treat negatively to the choice of more risky business as an investment object.

Total all the pluses we can note that in whole the branded company should have debt-equity ratio less than the similar not branded companies.

4. REFERENCES

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The comparison of marketing operations with changes in brand profitability

(for a week)

Table 2.

№	1. Design parameters of conventional financial instrument (brand)			2. Source data about marketing operations			3. The result of comparison (1) and (2)	
	Period	Profitability %	Standard deviation, %	Date	Type	Name / content	Valuation of conventional financial instrument	Valuation stability
	JANUARY 10-17.01.2006 17-24.01.2006	-2,5 -1,9	4,0	**16.01.2006**	Image commercial	"you are better!"	**Positive** influence	–
	FEBRUARY 14–21.02.2006 21.02.-01.03.2006	6,4 -3,2	5,9	**16.02.2006**	MTS commercial on TV	"3 favorite numbers"	**Negative** influence on brand	Instable
	MARCH 09-16.03.2006 16-23.03.2006	0,7 5,6	4,7	**13.03.2006**	MTS commercial on TV	"Bonus"	**Maximum positive** influence on brand	Stable
	APRIL 23-30.03.2006 30.03.-06.04.2006	-6,6 -0,5	1,1	**01.04.2006**	MTS commercial on TV	"intranet roaming"	**Positive** influence	Stable
	30.03.-06.04.2006 06-13.04.2006	-0,5 -1,3	1,1	**05.04.2006**	MTS commercial on TV	"Weekend"	**Maximum negative** influence	Stable

MAY

Period	Value		Date	Event	Description	Influence	Stability
27.04.-05.05.2006	-1,6	6,9	**05.05.2006**	A new MTS mark of quality	MTS presented its renewed brand	**Positive** influence	Instable.
05-15.05.2006	-1,4						
05-15.05.2006	-1,4	6,9	**15.05.2006**	Image commercial	Тизинг х Ревилинг	**Maximum negative** influence	Instable.
15-22.05.2006	-13,7						
22-29.05.2006	5,5	6,9	**27.05.2006**	Image commercial	"Magic"	**Negative** influence on brand	Instable.
29.05.-05.06.2006	-1,7						

Source – www.finam.ru, «MTS» ltd., calculations by the author

11