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A Lippincott Mercer Commentary

Strategic Branding for M&A Success

Dealmaking is back. More managers understand that brands play an important role. But in the heat of everyone's desire to close a deal, too many mergers and acquisitions are wrapping up with little formal review of the long-term impact of the companies' brands.

This Commentary explains why early inclusion of brand issues is now a matter of some urgency for dealmakers. Too little attention, or failure to understand how each brand works, can result in overpayment for assets not used, value-destroying constraints on future business strategy, or barriers to post-merger integration. It is essential to place a timely focus on how brands shift demand in order to validate and shape the deal, and to guide customers and employees smoothly through the transition.

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It’s accepted wisdom these days that when a merger or acquisition is under way, the demands of negotiations and the pressure to close the deal often create a short-term focus and short-sighted actions. When the heat is on, it’s hard to stay focused on how value will be created after the deal. Nowhere is this more true than with brands.

The missing link in M&A deals	Recognition of the role of brand in the business logic of the deal and in the post-deal implementation–currently hidden by backward-looking asset valuation of brands
Why it matters	Risk of overpaying for assets not used Increased post-merger implementation risks Opportunity cost of “free” awareness-building at time of announcement
What to do ahead of the deal	Future-looking assessment (vs. backward-looking asset valuation)of how brand will contribute to the merged business • Based on how the brand(s) shift demand in practice • Linked to the deal strategy • Linked to overall brand strategy Exploitation of brand as part of the transition process from Day One

Although managers today are more aware of the asset value of brands during merger and acquisition (M&A) talks, the problem of gauging brands’ long-term contributions looms larger than ever. That is as worrying as it is surprising.

It’s a concern because wider awareness of brand value is bringing a new set of risks. Brands do have an asset value, but that value is more volatile than it is for most other assets. A brand’s value is not fixed in isolation: it is as much a consequence of the M&A deal and subsequent strategy as it is an input to them. That’s why the risk is not just of ignoring a brand’s value; there’s the potentially bigger risk of valuing a brand in a way that has no relation to how you plan to use it in the new business. The result is either a big future write-down, or an equally big constraint for your future business strategy.

You don’t have to look very far to see the outcomes in the poor performance of some of the major deals of the late 1990s. Studies show that 70 percent of major acquisitions fail to deliver real long-term value for shareholders. One recent survey notes that more than a third of executives who’ve done major deals now acknowledge that they got “too caught up” in the bidding process to do effective due diligence. You can guess the kind of attention given to long-term expectations of the merged companies’ brands.

M&A Activities and Key Players

There are distinct points at which brand assessments should be made during the pre-deal and post-deal phases.

Specifically, there are crucial brand audit and valuation steps that help determine the brand strategy and architecture for the merged entity—steps that inform the “intent to merge” announcement. It is also important to plan the brand transition strategy and earmark the necessary resources and budgets before the deal is declared complete. Afterward, the actual launch or relaunch of a brand calls for detailed design and implementation activities, followed by continued evaluation and monitoring of the success of the new brand.

The project flow shown here describes development of a new brand following a merger or acquisition, but the key points about pre- and post-deal initiatives hold true for any brand assessments made during a deal.

1. Pre-Deal Phase

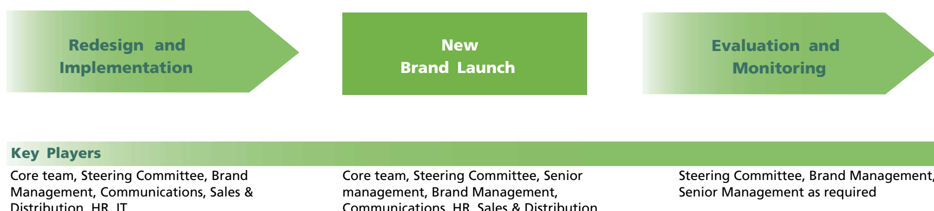
The Pre-Deal phase is driven by senior and strategic management for both parties and determines the brand strategy and architecture for the merged entity.

2. Brand Transition

Significant brand transition planning involving most functional areas should occur prior to deal close.

3. Post-Deal Phase

In the Post-Deal phase, a number of activities should be carefully coordinated to ensure successful implementation and brand rollout. Most functional areas of the organization need to be involved.



As M&A activity surges again, such issues take on new importance. According to Mergerstat, 2004 was "a year to remember" for U.S. and European deal-makers alike. In the U.S., the number of M&A announcements climbed by almost 15 percent and cumulative deal spending rocketed by nearly 44 percent to more than $775 billion – the best overall performance since 2000. The story in Europe was similar.

The drivers of the upsurge are numerous, foremost among them a growing business confidence along with mounting cash hoards and stronger stock valuations, a huge backlog of investment capital among private equity firms and greater liquidity on the part of the banks. The outcome, though more urgent, does not change: acquiring managers must find ways to weave brand considerations tightly into all phases of the deal-making process—pre-deal at least as much as post-deal. The issues have only grown more complex with new Financial Accounting Standards Board guidelines last year to account for intangible assets and with more acquisition activity by private equity firms.

The Bentley story

If ever there were any doubt about the importance of brand in M&A deals, the tale of Volkswagen's 1998 acquisition of Rolls-Royce Motors will erase it. As critics charged at the time, VW slipped up by paying £430 million for the Rolls-Royce company without acquiring the world-famous Rolls-Royce brand as part of the deal. Instead VW's arch-rival BMW acquired the rights to the Rolls-Royce brand and its visual icons for £40 million.

Due to a history of company splits, brand cross-licensing and legal trigger clauses, Rolls-Royce effectively had to sell the brand separately from the company. Confirming the value of the brand, BMW created a new business that is already arguably the size of the original, starting from only a name and a radiator grille. It claimed for 2004 "the largest number of Rolls-Royce brand vehicles to have been sold for 14 years." That is the value that VW missed out on.

But there was much more to the story than that. VW found hidden value in the business that it purchased. The Rolls-Royce Motors company included the Bentley brand—lustrous in its own right, but long overshadowed by the Rolls marque. VW set about transferring some of the Rolls-Royce brand equity to Bentley. In 1998, the year of the deal, Rolls-Royce Motors had sold 1,600 high-end cars—a mix of Rolls and Bentleys. Five years later, when BMW sold 800 Rolls-Royces, VW sold 700 Bentleys—along with more than 6,000 of its new Bentley Continental GT, a racy new model priced at $200,000, which is quite affordable for that market segment.

In short, VW has deftly used its new, higher-volume Continental GT not only to grow the Bentley business in its own right, but also to create the visibility that Bentley needs to be an aspirational luxury car brand. For proof of VW's success, just look at the crowds gathered around the GT display models at major European airports.

Have the lessons of Rolls-Royce been learned?

An acquired brand should not be neglected even if the acquirer's long-term strategy calls for it to be subsumed. The story of French travel agent Havas Voyages shows why.

When German travel company C&N (now Thomas Cook AG) bought Havas Voyages from Vivendi Universal in 2000 it did not acquire indefinite rights to the brand. It may not have seemed to matter: under the acquirer's master-brand strategy, the company was re-branded as Thomas Cook in January 2004. But that could prove to be a costly oversight. Despite its 15-month absence from the public eye, the 65-year-old Havas Voyages name showed up as the fourth most recognized tourism brand in France in a recent survey. In March 2005, rival travel company TUI bought the rights to the Havas Voyages name from Vivendi and hopes to open as many as 150 branches across the country in the next few years.

Both VW and BMW have achieved impressive successes with their respective acquired brands. Although commentators at the time of the deal saw BMW as the clear winner, their "rear-view mirror" perspective of historic brand asset value blinded them to the potential value of the Bentley brand, now realized by VW through its business, product and brand strategies. (Interestingly, BMW can tell a similar success story about the MINI, previously an iconic British brand.)

The real lesson of the story is not just about the importance of brand in the deal. It is also about assessing brand value in the post-deal context. That requires an approach to valuing, negotiating, and managing brands during M&A that:

- Is based on how the brands shift demand in practice.
- Is specific to your deal strategy and overall brand strategy.
- Supports, and is supported by, your transition plan.

We have observed that some companies have mastered the skills necessary to take this approach. Our analysis of their tactics yields these three guidelines:

1. Gauge value by how the brands will affect demand

Many senior managers of target companies come to the bargaining table with impressive facts and figures on the value of their brands. The figures may seem logical to the managers on the other side of the table, but they owe it to their companies (and to the shareholders) to do their own research or risk overpaying for assets that may have lost their luster—or that may not translate to the post-deal world.

For all of the mystique about brands, companies should value them for only one reason: their ability to shift demand. (Usually that implies demand from customers, but it can also mean demand from employees, investors and others.) Understanding how a brand shifts customer demand—and how it will do so long after the deal is done—is what matters. Using only a balance-sheet method for determining value provides little guidance on some of the more subtle predictors of how brands alter demand—and therefore current and future brand value.

The due diligence has to go much further than the figures available in the target's finance department. It's crucial to run detailed primary research on customers and markets, seeking answers to questions such as these:

- Does the brand drive demand, and if so, how fast is demand growing?
- Do customers have a preference for that brand?

- How much of a premium do they pay for it? How is that premium changing?
- How would their buying behavior change without the brand in the marketplace?
- What are the benefits or risks to the brand or to the company if the brand were to be dropped?
- Could its equity be transferred to another brand and if so, how quickly?

Answering these questions requires a different set of research and analysis than a balance-sheet-based valuation.

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When AT&T spun off AT&T Wireless in 2001, management of the new company may have considered marking its independence with a new name. The deal allowed them to continue to use the AT&T name under license, but it must have been very tempting to launch a new brand that would be unaffected by the other AT&T brands in the marketplace. In the end, though, they chose to continue using the AT&T name. The decision was made not because of a financial asset value, but because research showed how much customers valued the AT&T Wireless brand.

Yet when Comcast acquired AT&T Broadband in 2002, the same logic led to the opposite conclusion. Comcast also had the option to license use of the AT&T brand due to its presumed equity in the marketplace. However, by the time of the deal, the AT&T brand was quickly losing its shine. In particular, the company's reputation in broadband services was causing significant customer defection. Comcast's management team made its decision based on its own long-term brand strategy of building the Comcast brand. Their stance: Why confuse the marketplace? AT&T's broadband business immediately became Comcast. End of story.

The conclusion is this: it is critical to conduct your own research and to conduct the right kind—more than just a static dollar value and simple assessments of image and awareness. It is far more important to determine the brand's value in driving business outcomes.

2. Connect the brand strategy to the deal strategy

Mergers and acquisitions have a strategic business purpose. It may be to leverage operational synergies, to broaden a range of products or services, to gain a new geographic presence, reach a new segment or expand share of wallet with an existing segment. The corporate brands and the products'

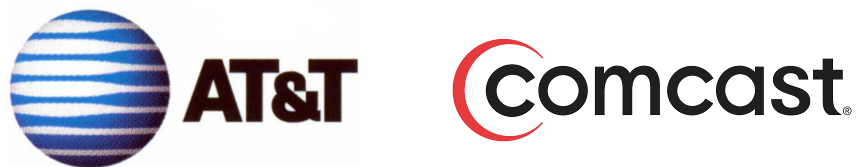
brands may or may not be important to the deal. Executives need to honestly determine that “brand factor” well in advance of the deal’s close.

If the decision has been made not to use the brands of the acquired company, the issue should be easy. Then brand is neither a negotiating point nor a valued asset; there is a quick transfer to the new brand after the ink is dry. A good case in point is when Comcast bought AT&T’s broadband operations for a larger footprint as described above and the merged brand became Comcast. The brand decision was pre-determined, and well-planned communications programs helped ease the transition for customers and employees alike.

It is important to determine a value for the deal relative to the brand’s ongoing value to the acquirer.

Brand managers still meet resistance if brands are to be consolidated after a merger. One of the arguments they hear: “The brand is an asset that can’t be written off.” With new accounting standards in place for recognizing intangible assets, the issue is legitimate. So it is important for executives to have a vision for the brand portfolio—and it’s obviously important to determine a value for the deal relative to the brand’s ongoing value to the acquirer. The question is whether the value is associated with the name or the components of the acquisition. Is the brand asset assigned to the company being acquired or to its products and services? If it is truly the brand name, then under the new accounting standards the acquirer will find it more difficult to eliminate the brand and its related expense.

If your long-term strategy is to migrate to a single brand, it is best to determine the acquired brand’s reasonable value to the company over time. Otherwise, the lack of pre-planning can hurt shareholder value.



We recently completed a program in which a company’s brand model (and related strategy) indicated that it should subsume the acquired brand under the parent name. But somehow that fact was lost in the shuffle at the time of the deal and a $350 million value was assigned to the brand in perpetuity. That value will have to be written off if the company’s acquisi-

tion is ever to be in alignment with the desired brand strategy and true value for which it was purchased—the capabilities, not the brand name.

In short, a company's brand model and brand strategy are important to consider in any deal. By not doing so, companies miss the opportunity to be known and valued for their full range of services. A good case in point: when UPS acquired several logistics companies so it could broaden its capabilities beyond package delivery, the company found it couldn't change perceptions about its service offerings.

What was the problem? The brand names of acquired companies such as SonicAir and Martrac remained in use. None of their capabilities accrued to UPS. If the strategic purpose was to acquire the new capabilities, then this would not matter; but if the strategic purpose included broadening customer perceptions of UPS, then the brands should change to UPS and the barriers preventing the change should be recognized and addressed at the time of the deal.

3. Develop (and manage) the brand transition plan

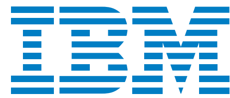
An immediate transition to a new brand can accelerate and energize the transition process. Internally, staff can more quickly feel part of the new combined group, and will more naturally challenge their past ways of doing things, questioning what must be different under the new brand. Externally, immediate adoption of the new brand allows merged companies to capitalize on the free publicity surrounding an acquisition or merger announcement.

Aviva shows why. The insurer—the largest in the UK and the world's fifth largest—does not have a familiar name. Yet the companies from which it grew were widely known. Commercial Union and General Accident merged in 1998 to form CGU; Norwich Union then joined with CGU in 2000 to form what was then called CGNU. The Aviva name came two years later. As a corporate name, it gets little coverage in customer communications, and it missed out on the publicity at the time of the CGNU merger. By the time the Aviva name appeared, there were few cost-efficient ways of building equity in it.

Sometimes a rapid transition will be counterproductive. IBM provides a prime example. When IBM purchased software provider Lotus Development, it left the Lotus brand alone for several years, both as an entity and as a product. The IBM name appeared in small print, but the Lotus brand was dominant during that time.

Why did IBM bend its rules for Lotus? One reason was to retain key talent; the Lotus culture was a world away from that of IBM, and IBM feared that a heavy-footed approach would quickly gut the software company. Another reason was that the IBM and Lotus images were in conflict. At that time, IBM was known as a hardware company while Lotus was clearly

a software company. In order to communicate independence, retain talent and customers, and avoid the image conflict, Lotus was retained as the company and product brand.



Over the longer term, however, IBM managers remained true to their brand strategy. They continued to monitor the market's perceptions of the IBM and Lotus brands to determine the right time to make the switch. Eventually Lotus was migrated to a product brand and no longer existed as a company brand.

Since then, of course, new Financial Accounting Standards Board rulings mean that merging U.S. companies must register brands as separate identifiable intangible assets. The upshot: acquirers will do well to determine how long acquired brands will have value to them based on their long-term strategies and taking into account their decisions about identifiable intangible assets.

Conclusion

As M&A momentum picks up again, managers can look forward to many fresh opportunities to create enduring value. Unlike the merger frenzy of the late 1990s, effective due diligence and more down-to-earth valuations are very much the order of the day. Yet there are worrying indicators that brand issues—albeit with more leverage than ever—are not being built into the due diligence process in the pre-deal phases or into the post-deal transition activities.

Business leaders can no longer view brand management as an afterthought—as something that the marketing staff get to sort out after the ink on the deal is dry. Ideally, acquirers should have detailed brand decision systems in place before the search lists are drawn up. The decision systems should include robust research methodologies for determining both brand value and the true drivers of brand equity.

At the very least, acquirers must establish what they are buying and why. They have to push brand valuations beyond assumed dollar values and well beyond simple assessments of image and awareness. In short, it is crucial to determine the target brands' value in driving long-term business outcomes. Anything less is a disservice to shareholders.

For more information related to the Commentary, please contact:
Suzanne Hogan, New York, +1 212 521 0034, suzanne.hogan@lm.mmc.com
Simon Glynn, London, +44 20 7915 9818, simon.glynn@lm.mmc.com

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