The Theoretic Methods for Evaluating Trademarks

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Abstract

In modern economy, trademark is not only a distinguishing feature of an enterprise (corporate trademark) or of its products (product trademark), but also an instrument to ensure a lasting competitive advantage to the same enterprise.

This paper aims at providing a contribution to the topic of estimating the economic value of trademarks. For this purpose, an analysis of the theoretic methodologies to estimate the assets' value will be done, together with some comments and in-depth studies on the subject-matter.

Introduction and Objectives

In modern economy, trademark is not only a distinguishing feature of an enterprise (corporate trademark) or of its products (product trademark), but also an instrument to ensure a lasting competitive advantage to the same enterprise.

The strategic importance of such intangible asset, therefore, motivates transactions to acquire trademarks on a stand-alone basis (i.e. independently from the relevant enterprise), as well as mergers, demergers and transactions for the acquisitions of business (or going-concerns) aiming at acquiring the more or less "famous" trademarks (Zanda, Lacchini and Onesti, 1994; Semeijn, Van Riel Allard and Ambrosini, 2004).

The high number of transactions aiming at purchasing corporate trademarks and, most of all, their importance in qualitative and quantitative terms, have brought scholars to develop specific methodologies for the valuation of the distinctive sign autonomously from the rest of the business.

In this paper, an analysis of the theoretic criteria to estimate the assets' value will be done, together with some comments and in-depth studies on the subject-matter.

Criteria based on revenues for evaluating trademarks

Among the so called*theoretic*methodologies to estimate the value of a trademark (Yu, Zhao and Wang, 2008; Labroo and Lee, 2006; Raju, Unnava and Montgomery, 2009),there are:

1) Criteria based on the measure of the size-flow, which measure the value of a distinctive sign by quantifying, over a predetermined period of time, the current value of the flow of income expected from the relevant intangible;
2) Criteria based on "costs".

Regarding the first criteria, it represents the economic value (Wm) of a trademark as function of the income expected (Rm) from considered sign. For the application of this

method, it's necessary to identify with reasonable precision the type and the characteristics of the expected income (Rm). It can be alternatively constituted:

a) By all the income correctly imputable to the product/good distinguished by the trademark object of evaluation;
b) By the differential income brought to the company by the distinguishing trademark. This value represents the difference between the income guaranteed by the product provided with the specific trademark and the one that could be gained from the same product without the trademark, or distinguished by a "new" trademark.

The alternative (a) could be accepted only in the hypothesis that the core-business of the company that own the trademark is finalized only to the economic utilization of this good (mono-business firm). Owing to the small area of application, it is preferable the choice of a criteria of evaluation based on the discounting, for a determined number of years, of the differential flows of income (so called "incremental") guaranteed to the company by the trademark object of evaluation (Zanda, D'Amico, Laghi and Oricchio, 1996).

Moreover, the terms of the analysis change sensitively according to the minor or major distinctive capacity associated to the brand object of evaluation, to which could result an utilization of this sign limited to mark only goods that belong to the same merceological category of the ones already sold, or potentially "extended" to goods of differentnature from the original ones (Kumar, 2005; Meyvis and Janiszewski, 2004).

In the first of these hypothesis, it looks good to estimate the value of the future income flows (Rm) as difference between the income flow that a product/good with the sign could realize in the future and the one theoretical achievable from the selling of the same product without the brand, or with a "new" brand not known to the public (Raju, Unnava and Montgomery, 2009).

From this point of view, the procedure of definition of differential expected income is like as below articulated:

1) Estimate of income (Rs) that products with the brand under evaluation are presumed to produce in each period;
2) Calculation of income (Rs^) that the same products could generate, in each period, if sold without the specific brand or with a "new" brand;
3) Consequent definition, by difference, of the differential income value expected in the future from the distinctive sign (Rm = Rs – Rs^).

The comparison between the two income measures Rs and Rs^ should be done, in the author's opinion, under the same conditions, and consequently the goods without the brand, or with a "new" one, should have not only the same aesthetic, technic and qualitative characteristics of goods marked with brand object of estimate, but also they should have the same promotional and distributive channels. In other words, the only one variable element of the comparative analysis should be the presence, or the absence, of the specific brand on considered goods.

Insteadin the hypothesis of transfer of a brand with a high distinctive capacity, so well-known by the public independently from the merceological classification of goods marked, it seems desirable, for the determination of the economic value of the brand, not to limit to the estimate of the differential income flow originates from its application on the same type of goods already marked, but also to quantify the surplus of income associated to its potential extension to other product categories different from the original one (so called *brand extension*) (Kapoor and Heslop, 2009; Bhat and Reddy, 2001).

In other words, it is necessary not only to estimate the suggestive capacity of distinctive brand already tested by the transferor (and so estimated by the value of differential income flow originated from the selling of products on which the brand is placed), but also

the theoretic attitude of the evaluated brand to satisfy consumer needs different from the original ones (Lane and Jacobson, 1997).

In the lack of objective and verifiable quantitative data referring to future value that could be assumed by Rs^, and especially by Rs, it is evident that the utilization of the methodology based on the actualization of expected differential income not allow to quantify with reasonable reliability the expected value (Rm) coming from an “extension” policy of the brand, so it is necessary to assume hypothesis and assumptions that inevitably could compromise the reasonableness of all cognitive process.

To overcome this applicatory limit of the methodology under examination it is preferable to calculate the presumed income advantages expected in the future from the brand in differential way towards medium-normal situation of alternative brands, under the condition that these last one result similar, for typology and characteristics, to the sign object of estimate (Van Horen and Pieters, 2012; Besharat, 2010).

So we can assist to the substitution of an endogenous cognitive process, precisely well founded on comparison of income obtainable in presence of the brand and the ones theoretically resulting in case the same goods would be sold without the sign or with a “new” one, with an exogenous cognitive process, assuming that the mentioned comparison would be done taking into account the income results in average and normally obtained from the potential competitors of the company, that put on their products different brands from the one object of estimate.

Moreover, the change of the data of the analysis makes more easily practicable the evaluation procedure, because values absolutely uncertain are replaced with figures more reliable because coming from outside and so related to results really achieved by competitors.

Criteria based on costs for evaluating trademarks

As to the criteria based on costs, differently from the methodologies based on revenues, they do not measure the extent of economic benefits that a distinctive sign can produce in theory. Rather they assess the value of a trademark through a detailed analysis of expenses and charges borne to develop it or to acquire it from third parties.

Methods under evaluation allow a remarkable simplification of the cognitive process and a reduction of the uncertainty inevitably linked to the application of mentioned economic-income criteria. The main “lack” is the inexistence of any link, logic and demonstrable, between the amount of costs sustained (or to be sustained, in case of the *substitution-cost* methodology)for the creation or the acquisition of a trademark and its real economic value, so meaning the quantification of its capacity to produce present and future economic utility.

This lack of attitude is much more evident when the distinctive trademark has renown, and so reasonably guarantee high profits to the user: under this hypothesis, the cost evaluation should result very lower to the real economic value of the brand.

The criteria of the *actualised historical cost* assesses the value of a trademark by quantifying the charges borne by an enterprise over time to acquire it from third parties or produce it from scratch (actualizing them as appropriate, in order to write off any inflation effect).

Regarding the second hypothesis (the simplicity of the first hypothesis non requires, evidently, other analysis), from the author’s point of view the typology of charges and expenses to be considered for the application of this method should be:

1) Cost of devising of distinctive sign, such as fees for designers that create the logo, costs for different types of consulting (in particular legal and marketing ones);

2) Costs for the legal registration of the trademark, so to obtain the protection guaranteed by the legal system;
3) Costs related to the brand introduction into the market and for its consolidation. (in particular, advertising and promotional costs sustained by the owner with specific reference to the trademark under evaluation).

The criteria of the *replacement* (or "copyright") *cost*, instead, assesses the value of a trademark by determining the costs that should be borne, in the relevant period of time, to produce *ex-novo*a trademark having the same features of the trademark to be evaluated (not only with respect to the capacity to generate income, but also having regard to the market share and its public recognisability), in order to contemplate also the changed competitive environment. Mirroring the methodology of the historical cost, the kind of charges to be considered should relate to the entire "investment area"(Brugger, 1989; Kohli, Harich and Leuthesser, 2005) ascribable to the trademark, as well as each phase of its life-cycle.

Regarding this point, in author's perspective this area of investment should include:
1) Costs for the creation of a new sign. In this ambit there are costs for devising of brand (such as fees for graphic consultants that "create" the logotype, or fees for lawyers that verify the existence of requisites for its valid registration, and also costs of registration);
2) Fees for advertising consultants and marketing experts that periodically analyse the markets, and verify the correct goods positioning;
3) Costs for the organization of selling network and for advertising and promotional politics.

The method under examination, even if it is not appropriate to express the real economic value of a brand (common issue, as already said, to all methodology based on "costs"), not considers only, or re-express to current values, fees related to the past for the introduction and the consolidation of a specific brand in the market, but rather experiments different strategies, that become necessary from (reasonably) changed conditions of competitive environment, so to define a "new" distinctive sign but in any case equivalent to the brand evaluated in terms of income capacity and awareness.

Of course, it is not possible to deny that the methodology under examination is characterized by a potential unreliability risk higher than other methods based on "costs", because of the subjectivity of estimates and suppositions necessary for the identification first, and then for the quantification of the different categories of costs to be considered. So, moving from historical cost to reproduction costs, the evaluation method improves under the conceptual validity point, but gets worse in terms of objectivity (Zanda and Lacchini, 1991).

Moreover, from author's point of view the method under examination it is not very much proper to evaluate famous or renowned trademarks and so recognizable from customers: they have in fact peculiar nature and qualities hardly repeatable, and so they can't be reproduced effectively "in laboratory".

The criteria of the *cost of the loss* assesses the value of a trademark byquantifying the economic damage that the enterprise would suffer in case of exit of the trademark from the business assets. Indeed, the loss of a trademark, most of all a famous one, inevitably causes the loss of a series of surplus value which, at the end, causes a decrease of the income capacity of the enterprise owing the trademark.As the damage must be quantified through methodologies based on income (i.e. based on the actualisation of the foreseeable losses of revenues that the enterprise would suffer as a consequence of the loss of the trademark),it may be inferred that such methodology can be considered among those based on costs only nominally,as its logic-applicativebasics require it to be included, more appropriately and coherently, among the already mentioned economic-income methodologies.

Conclusions

According to what analysed in previous pages, from author's point of view neither the methodologies based on the measure of the size-flow (revenues), neither methods based on costs, allow to quantify with reasonable precision the theoretic economic value of a trademark, in particular if it is known from the public.

Criteria based on the measure of the size-flow, which measure the value of a distinctive sign by quantifying, over a predetermined period of time, the current value of the flow of income expected from the relevant intangible, looks very difficult to be applied.

Specifically, it is very difficult to estimate the differential income brought to the company by the distinguishing trademark. In theory, this value should represent the difference between the income guaranteed by the product provided with the specific trademark and the one that could be gained from the same product without the trademark, or distinguished by a "new" trademark. In practice, each step of the method under examination is characterized both for high difficulties to implement them and an high degree of discretionwith regard the definition of the amounts to be considered:

1) Income (Rs) that products with the brand under evaluation are presumed to be produced in the future;
2) Income (Rs^) that the same products could generate, in the future, if sold without the specific brand or with a "new" brand.

Methods based on costs allow a remarkable simplification of the cognitive process and a reduction of the uncertainty inevitably linked to the application of mentioned economic-income criteria. The main "lack" is the inexistence of any link, logic and demonstrable, between the amount of costs sustained (or to be sustained, in case of the *substitution-cost* methodology) for the creation or the acquisition of a trademark and its real economic value, so meaning the quantification of its capacity to produce present and future economic utility.

This lack of attitude is much more evident when the distinctive trademark has renown, and so reasonably guarantee high profits to the user: under this hypothesis, the cost evaluation should result very lower to the real economic value of the brand.

In conclusion, it can be considered that the theoretic methodologies for evaluating trademarks, that quantify the economic value of a brand independently from the quantification of the value of the company that owns it, lead to very vague and discretional results, so that their scientific merit is quite limited.

Further research

Additional studies will be required to verify empiricallywhich is/are - among those analysed in this paper, the methodology/ies used (and the relevant frequency) in the Italian and international professional practice.

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