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MARKETING

Why Strong Customer Relationships Trump Powerful Brands

by Christof Binder and Dominique M. Hanssens

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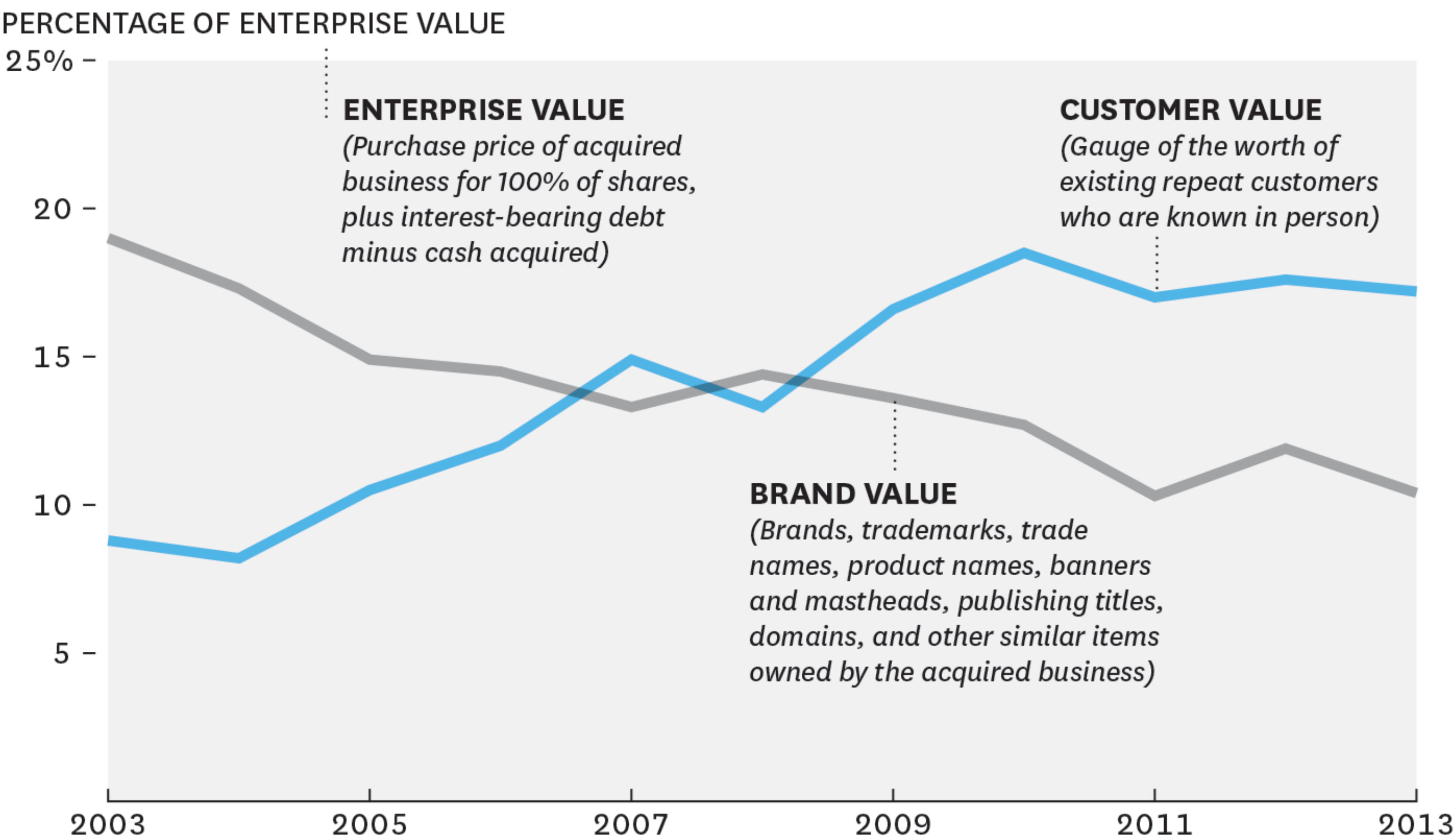
Since the birth of e-commerce, marketing experts have disagreed about the future role of brands. Some have predicted that digital technologies will hasten the demise of brands because customers will have ready access to information they need to make purchase decisions, and “brand” will therefore become less relevant. Others have prophesied an increasing importance of brand as a simple way to evaluate choices in an era of information overkill.

To find out which school of thought is more accurate, we looked at the value of brands and customer relationships as revealed by M&A data covering over 6,000 mergers and acquisitions worldwide between 2003 and 2013. The beauty of M&A for examining valuation trends is that M&As reveal the dollar valuations of all assets at the time of the acquisition. Upon acquiring a business, companies have to value the different assets they acquired for their accounts and balance sheet in accordance with accounting and reporting standards. These valuations include - among other assets - brands (trademarks) and customer relationships.

This graph, based on data from the MARKABLES database, represents brand and customer relationship valuations as a percent of total enterprise value. The percentages come from fair value assessments done by purchase price allocation experts according to established accounting standards.

The Declining Value of Brands (and the Rise of Customer Relationships)



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As the graph bracingly shows, brand valuations declined by nearly half (falling from 18% to 10%) while customer relationship values doubled (climbing from 9% to 18%) over a decade. All other categories of intangibles remained stable. These numbers reveal a dramatic shift in the strategic approach to marketing over the last 10 years. Acquirers have decisively moved from investing into businesses with strong *brands* to businesses with strong *customer relationships*.

In the past, M&A strategies often concentrated on brands and on growing brands through better brand management and internationalization. Today, such brand growth strategies appear to be either limited (for example, there is limited growth potential in mature markets) or too expensive. Instead, M&A strategies now concentrate more on acquiring firms with strong customer relationships - with all the loyalty and cross-selling benefits that confers.

This trend is powerfully reinforced by digital technologies. These allow more direct interactions with customers, bypassing expensive middlemen and reducing the cost of sales and marketing; they allow firms to optimize customer lifecycle management based on detailed data and analysis of customers' needs; they improve efficiency and quality across the value chain as a result of continuous customer feedback; and, finally, they facilitate the realization of merging two brands into one, or rebranding. As a result, the price of direct engagement with customers relative to traditional branding and media campaigns has dropped while the effectiveness of such marketing efforts has grown.

There is a parallel development on the demand (customer) side. Digitalization makes information, including information about brands, easily accessible. For example, a customer shopping for a new car can now instantly examine and compare the specifications and performance of different car models. Thus, purchasing decisions have become more fact based, and less brand-image based. Customers still value strong brands, but what constitutes a strong brand is now more dependent on customers' direct experience with an offering, and with their relationship with the firm that produces it.

That suggests that marketing resources now directed at brand building should be more fully integrated with those designed to reinforce relationships. The value of "brand" or "brand image" as an entity distinct from the offering itself, we think, will diminish. However, marketers should be careful not to take this too far and underinvest in classic branding. With brand messages becoming more and more individualized and diverse, brand equity needs to stay strong to perform its overall integrative role. Strong brand communications are and will remain important especially in attracting new customers and in enhancing desirability for higher price premiums.

Finally, our analysis might provide a reality check on some of the gigantic brand values now published by leading brand valuation companies as it reveals that often the lion's share of value lies in customer relationships. Although closely intertwined, brand equity and customer equity are different concepts that need to be measured and reported separately. The real art of brand management will be to integrate the two concepts without being stymied by friction between the camps that typically manage brands and customer relationships. As Peter Drucker said, well before the advent of the information age, the sole purpose of a business is to create a customer. It's clear that brand building will only go so far.

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Jonathan Knowles 7 days ago

The observation I would make about the data is that the sum of the two assets (brand value and customer value) has remained constant over the time period. As other commentators have observed, brand value and customer value can be viewed as two sides of the same coin - and the coin is the quality of the franchise of the business.
Over the time period shown in the graphic, a company's ability to identify its customers and develop a direct

relationship with them has increased considerably thanks to the internet and social media. It is therefore entirely logical that the accountants charged with doing post-purchase goodwill allocation should now be attributing a greater proportion of franchise value of the business to customers than to brand. This is a story about attribution - not a story about a change in the fundamental dynamics of business.
International Financial Reporting Standard 3 distinguishes between two classes of intangible asset - what they term "customer-related assets" and "marketing-related assets". As a company you can think of these assets as representing "what we know about our customers" and "what they know and feel about us". A successful business knows that it needs to nurture both sources of advantage. As the article concludes, the challenge is to get away from zero sum arguments among departments within the company to focus on a strategy that focuses on strengthening the overall franchise of the business.

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