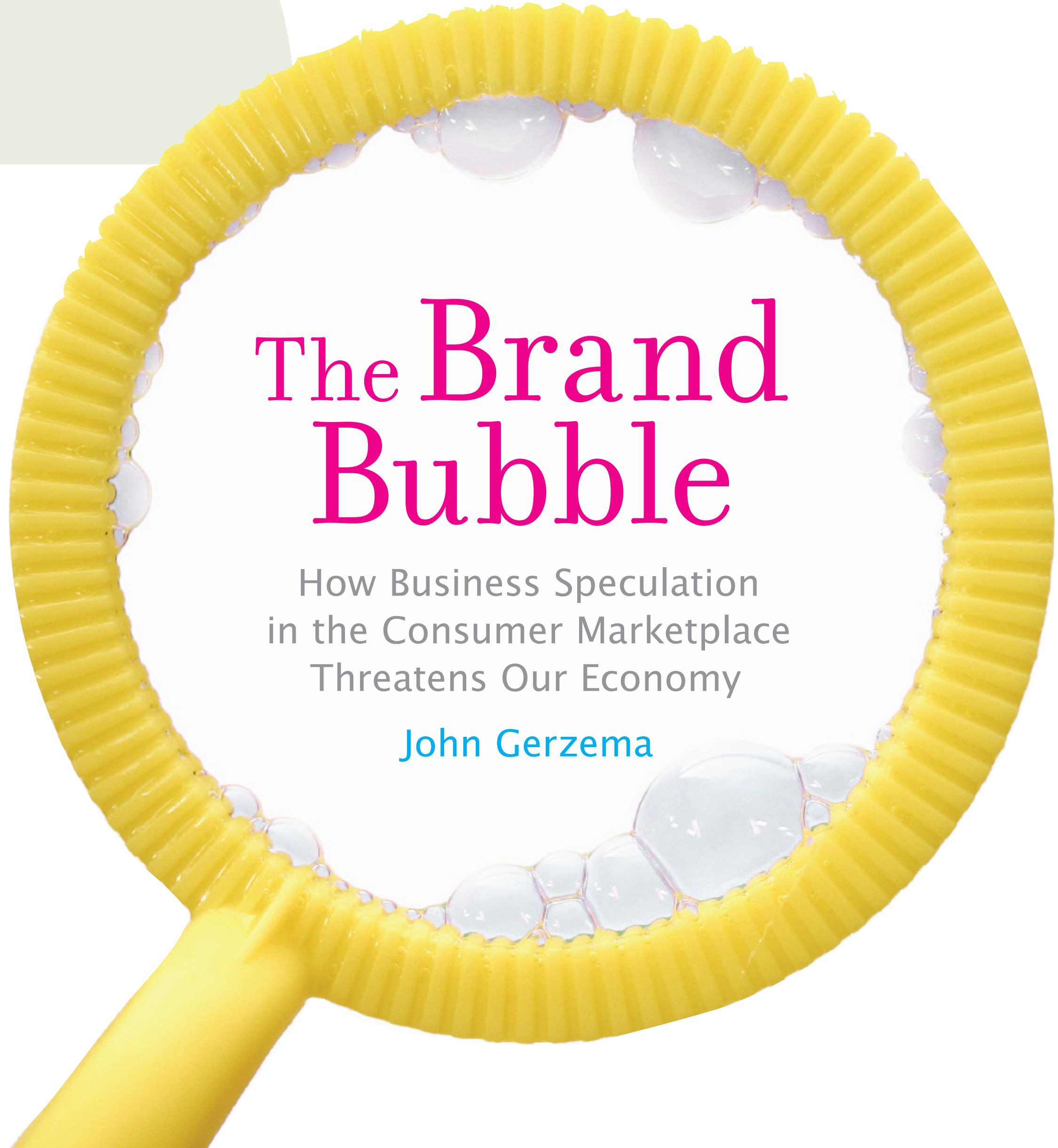

The Brand Bubble

How Business Speculation in the Consumer Marketplace Threatens Our Economy

John Gerzema

Today's housing bubble and the tech stock bubble from the last decade reveal a widening gap between market speculation and how typical Americans value things.

If you thought those bubbles were bad, get ready for another, even bigger one on the horizon that represents over $4 trillion dollars in S&P market capitalization. That alone makes it twice the size of the sub-prime mortgage market. But, unlike other bubbles, the assets that are at risk cannot be traded away or hedged against uncertainty. Rather, they are the fundamental drivers of competitive advantage for most companies—their brands.

Through extensive research using brand and financial data on thousands of brands, I and my colleagues at Young & Rubicam have found that the multiples that markets place on brand valuations far overstate actual consumer sentiment. This means that the value creation most brands are bringing to their companies, and ultimately to their shareholders, is greatly exaggerated.

Put simply, most businesses and the financial markets think brands are worth more than the consumers who buy them.

For the past fifteen years Young and Rubicam's BrandAsset® Valuator (BAV) has been tracking how consumers perceive brands. We've invested almost $115 million dollars in building the largest brand database in the world. Working with professors from Columbia Business School and other noted institutions, we have produced one of the most stable and predictable financial models for valuing brands and branded businesses. We have over 35,000 brands measured against over 75 brand metrics. We conduct surveys in more than forty languages. From Arabic to Zulu, we ask consumers how they feel about local, regional and multinational brands, media, and even celebrities.

A WORRYING SIGN IN THE DATA

Our research reveals that while brand values have risen steadily over the past decade, **brand awareness has declined 20%, brand esteem 12%, perceived brand quality eroded by 24%, and trust in brands is down a staggering 50%**. (See Chart 1.)

CHART 1

The "Valuation Gap" According to Consumers.

Perception	Reality
If brand value is increasing, so should brand trust.	**Brands are less trusted than ever.** Trustworthy ratings dropped almost 50% over the last 9 years.
If brand value is increasing, brands should be more liked and admired.	**Brands are less liked and respected.** Esteem and regard for brands fell by 12% in 12 years, and very few brands are widely regarded across the general population.
If brand value is increasing, brands should be better known.	**But brands are less salient than ever.** Awareness of brands fell by 20% in 13 years.
If brand value is increasing, quality perceptions of brands should be increasing as well.	**Consumers feel brands are less quality.** Brand quality perceptions fell by 24% over the past 13 years.
If brand value is increasing, more brands should be clearly differentiated.	**Brand differentiation declined in 40 of 46 categories studied by Copernicus/Market Facts.** And only 7% of prime time commercials were found to have a differentiating message.

Source: BAV 1993-2007 brand data. Copernicus, Jack Trout, and Kevin Clancy.

And it's not just our data: The fact that consumers are losing interest in many brands is validated by several sources, from the Henley Centre in the U.K. to The Carlson Marketing Group, who found the percentage of people who said they were loyal to one brand declined from 40% to 9% since 2000. Most notably, positioning guru Jack Trout and Kevin Clancy's research found that brand differentiation declined in 40 of 46 categories as studied by Copernicus/Market Facts.

Why would brands be failing, and if so, why at this point in time? Curiously, this diminution of brand value is occurring precisely at the same time that media fragmentation and technology is creating tectonic shifts in how consumers interact with brands. Far from a mere coincidence, it's a canary in a coalmine, because this pattern extends into 2,500 brands we studied over three years time, where almost 70% were stagnant or declining in differentiation. And, the 30% that had some kind of change were twice as likely to be declining. (See Chart 2.)

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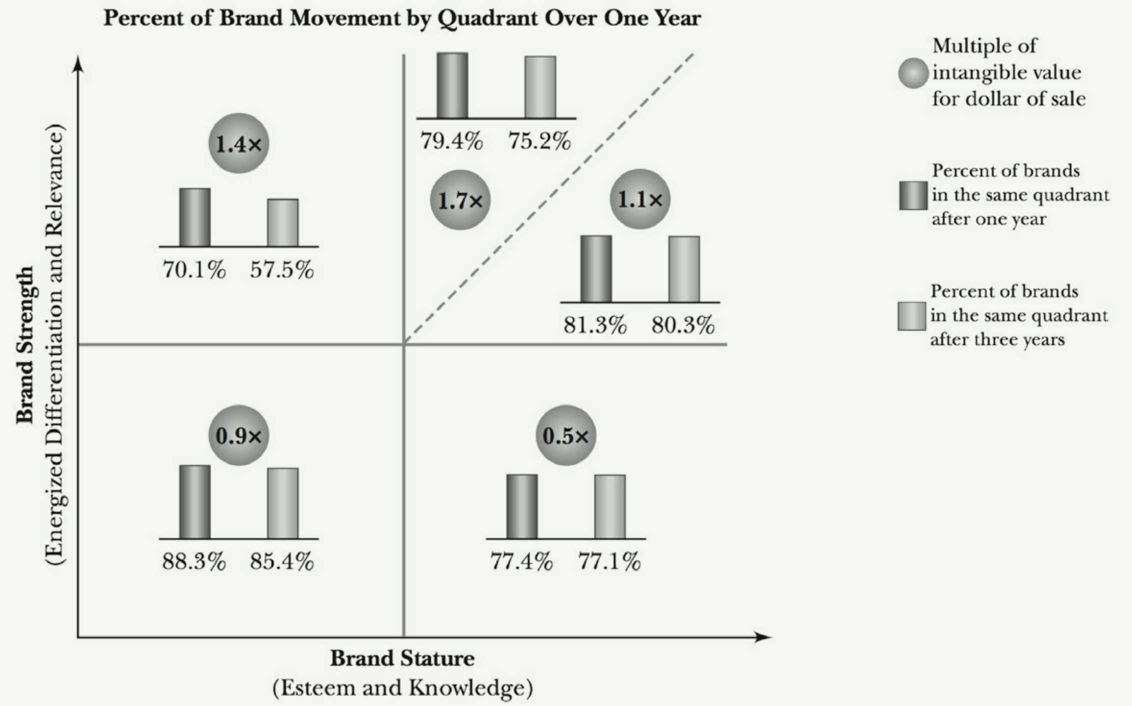
CHART 2

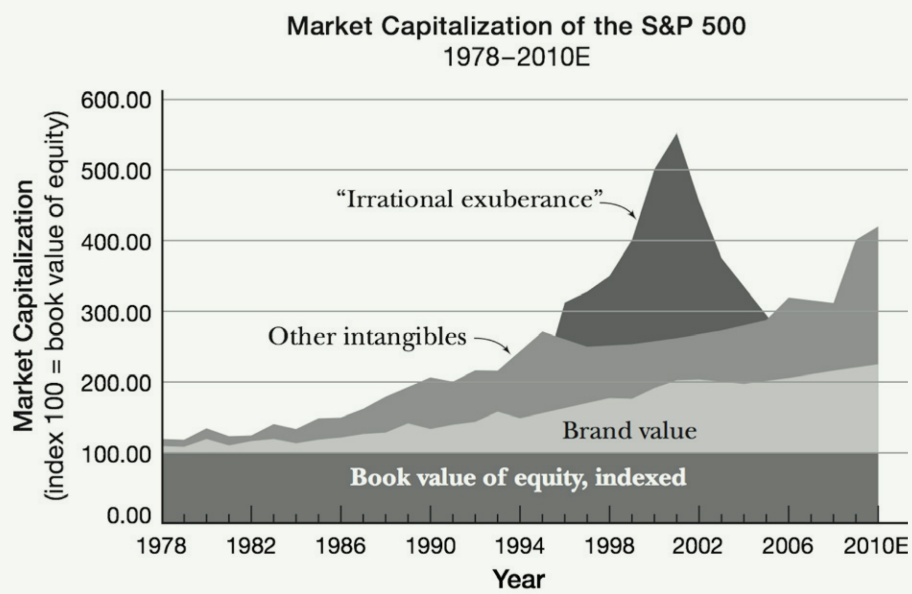


The reason consumer reticence is such an issue is because a brand's position in a quadrant strongly relates to overall enterprise valuation. Based on over 1000 data points over a ten-year period, each quadrant has an average intangible value per dollar of sale. The stronger a brand is on brand strength and stature, the greater it's value. This means brands aren't growing the way business thinks they are, and as a result, their intangible value is, on average, overly stated.

NOT A BRAND PROBLEM—A BUSINESS PROBLEM

Why is the brand bubble dangerous? What harm could Charlie the Tuna do to our economy? Brands have always been important assets, but business and investors haven't fully come to comprehend their newfound significance. Millward Brown Optimor demonstrates that brand value now accounts for 30% of market capitalization of the S&P 500. This growing portion of brand value as a percent of market capitalization has risen from 5% in thirty years, meaning brands now make up the lion's share of total business value in a company. (See chart 3.)

CHART 3



Now, considering that a third of shareholder value is brand value, this growing disconnect should be of urgent concern to CEOs, marketers, analysts and investors. Are those earnings going to be there in the future? Have most companies properly discounted the risk on their rising brand values? Brands are the single most important intangible asset fueling the growth of companies and our economy. And because of massive contributions that brands bring to business valuations, the brand bubble could erase large portions of intangible value across industries and send another shockwave through the global economy.

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Beyond the write down in value that could result from the weakening brand landscape, we also believe that brand speculation could have a major negative impact on the future earnings of many companies across many industries. To put this in perspective, the 250 most valuable global brands are worth $2.197 trillion dollars, which collectively exceeds the GDP of France.[i] According to Booz & Co., even the value of the world's top 10 most valuable brands exceeds the market capitalization of 70% of the U.S. Public companies.

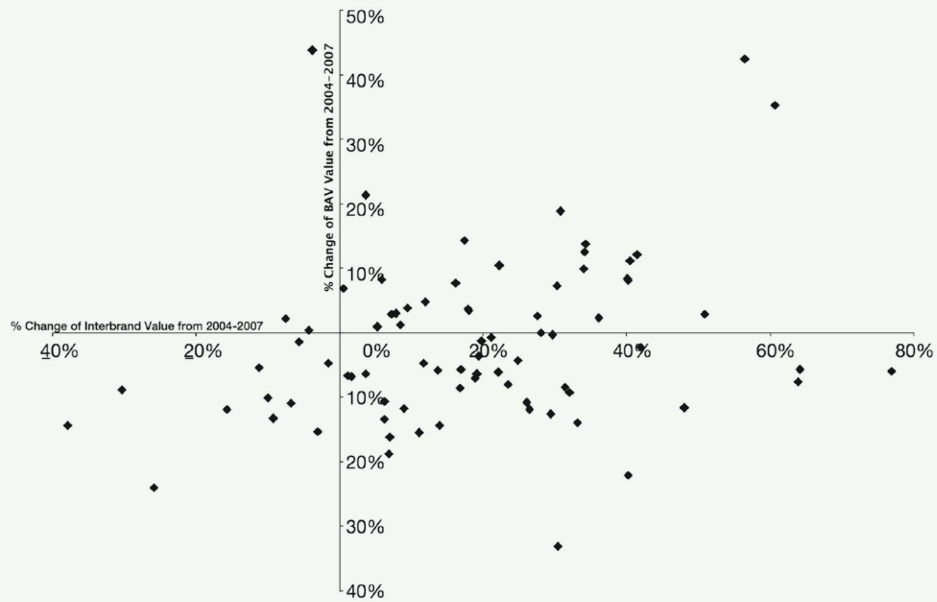
We're talking about a massive sector in of our global economy that's in distress. And yet, unlike other industries, it is entirely intangible and dependent largely on the whims of consumer sentiment.

CONSUMERS DON'T SEE THE HYPE.

Let's then compare what consumers think against what branding experts think. We examined all of the brands that have remained in Interbrand's top 100 since 2004. We overlaid our BAV model against Interbrand's rankings to measure the percentage change in brand value from 2004-2007. The right and left quadrants of the chart represent brands that, according to Interbrand, have either gained or declined in value since 2004 and the top and bottom quadrants of the chart represent brands that, according to our BAV model, have either gained or declined in value over the same period. Based on Interbrand's rankings, over 80% of these brands have gained in "financial value" since 2004 (upper and lower right quadrants).

CHART 4

US Consumers Believe 45% of Interbrand's Top Growing Brands are Declining, from 2004 to 2007



Base: All Adults BAV Full Year 2004 and 2007 **Source: BrandAsset Consulting 2008**

By contrast, according to BAV, U.S. consumers believe that less than 40% of these brands have gained in "perceived value" (left and right upper quadrants). More dramatic, consumers believe that over 45% of these brands have actually declined in value (lower right quadrant). This means that consumers believe that almost half of Interbrand's most highly valued and growing brands—brands that account for nearly a trillion dollars in brand value—have not only not gained, but actually declined in value from 2004-2007. (See Chart 4.)

How is it possible that brands can be a growing portion of market capital and, at the same time, most brands are not growing? The answer: An increasingly smaller number of brands account for a significantly greater share of market capitalization. This means that fewer brands are carrying the water for everyone else. Sure, you can look at Apple, Nike or Google and think brands are powerful. But, the reality is that a smaller proportion of brands are accounting for the bulk of the value being created. We know this from our own data, as the percentage of brands in our study that beat the S&P 500 index declined by 36% from 2002 to 2007.

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Yet, Interbrand and others gleefully proclaim the robust power of brands. How can this be realistic? This would seemingly make Captain Crunch the only recession-proof investment in the marketplace? But remember, this is only what business thinks of brands, not consumers. Businesses fatten balance sheets with intangible assets like brands. Advertising agencies profit from the creation of brands, while investment bankers and management consultants profit from the sale of brands and branded businesses. Something smells rotten in Brandville…

EARLY SPECULATION: TULIPMANIA

One of the first bubbles on record occurred some 400 years ago in Holland, and the asset that perpetrated this bubble was a tulip bulb. The Dutch aristocracy had acquired a particular fondness for a type of tulip from Turkey that grew very well in the fertile lowlands of Holland. Citizens from all walks of life, from businessmen to average workers and paupers, quickly jumped at the opportunity to invest in tulips. Some even took out a crude form of futures contracts on unplanted tulips.

The market for tulips created such frenzy that no one stopped to question if the cash flows would continue in perpetuity. No one paused to discount the risks inherent in the trade, and instead continued to reinvest in more bulbs. And then at some point between 1636 and 1637, the appetite for tulips plummeted. So too did the fortunes of the thousands who had participated in "Tulipmania."

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WHERE'S THE BEEF?

The rampant speculation in something as benign as a flower exemplifies one of the most basic fundamentals in business: *the concept of value*. Indeed, the core purpose of any business is to facilitate the transfer of value from one entity to another in a way that provides adequate value for customers and adequate returns for shareholders.

The concept of business as a vehicle for value transfer is nothing new, and it is utterly simple. But in today's highly competitive and complicated business environment, it is crucial to understand the repercussions on the way businesses are supposed to operate in a steady state. The transfer of value between a business and customer aims to exist in a state of perfect harmony. The business entity keeps the value created by the difference between cost and price, while the customer keeps the value created by the difference in price and perceived utility.

But interesting things happen in the real world, especially when multiple parties perceive the utility of a good, service or asset to be different. In these situations, value corrections, sometimes drastic, must take place. We have seen it multiple times in the past, from the dotcoms to, most recently, the credit crunch. When multiple parties perceive the value of a good, service or asset to be different, we enter into unsustainable conditions encapsulated by the dreaded "B" word: a bubble.

CONSUMERLAND AND THE DECAY OF BRANDS

That's exactly what's happening right now. Emboldened by the tools of the new world, consumerism is profoundly changing, which is now rapidly accelerating the decay of brands. All of this creates the resulting dilemma: While brands have never been more important, there are simply too few 'important' brands.

Today a sea of sameness engulfs the marketplace. Consumers have more choice than they know what to do with. Yet, they're emotionally invested in fewer brands than ever before. According to a Datamonitor report, 58,375 new products were introduced worldwide in 2006, more than double than 2002. There report points out that "despite the fact that advertising spending was up from $271 billion in 2005 to $285 billion in 2006, 81% of consumers could not name one of the top 50 new products launched in 2006—an all-time high for lack of recognition and a huge leap up from 57% in the previous year."[ii]

Consumers now trust each other more than they trust brands.

Brands were originally built and sustained on the backs of mass media, repetition and consumer monologue, but media fragmentation, coupled with the Internet on steroids (i.e. broadband), enabled low-cost competitors to attack from any geography without the need for access to massive capital. Suddenly, all these changes became the catalyst for consumers to morph into different creatures. In fact, let's call it 'ConsumerLand'—a Disneyland-like broadband-fueled world of limitless consumer potential and endless control. The result is that with so much access to content and information, creativity became the currency. And brands that don't have it become boorish and mere commodities in their eyes.

Consumerland embraces and demands creativity. From buying "cheap chic" in Target to posting films on YouTube, consumers have heightened their creative expectations of brands. Yet, most brands exist in state of rational, repetitious and persuasive selling propositions. Without creativity, there is no true differentiation. Today it takes emotion to differentiate yourself and be desirable.

Consumers are also losing trust in brands because of the parade of Enrons, product recalls, dogfights, steroids and political scandals, and the consumer has said "enough already." In fact, *consumers now trust each other more than they trust brands*. Media Edge/CIA found that 76% of people rely on what others say versus 15% on advertising. 92% of consumers now cite word of mouth as the best source for product and brand information, up from 67% in 1977.[iii] No wonder review sites, such as Digg and Reddit, have become the third-most-common use of the Internet, after e-mail and search.

TOWARD A NEW MODEL OF BRAND MANAGEMENT

The new reality is that brands will have to think in new ways and work much harder to be different and special in this new world. The traditional business models and strategies marketers have used for generations no longer work. The birth of a fundamentally different consumer, whose behavior has changed so rapidly and so profoundly, requires an entirely new vision of brand management.

With commoditization a reality of every day life, only the brands that are continuously creative will attract and hold our attention, and our affection.

The world is changing around brands, yet business doesn't get what's happening. Most companies aren't aligning brand strategy with business strategy, consumer insights with capital allocation and marketing with c-suite decision-making. Marketing is often removed from the c-suite, leaving business decision making ponderously out of touch with the marketplace. Managers are too slow to anticipate trends, to invest/reinvest or bring innovation to their brands. Brands simply aren't creative enough to hold attention. Brand experiences (the function of integrated marketing communications) fail to live up to the promise of its advertising.

Most enterprises are continuing to manage brands according to principles that have not changed for decades. Brand management is more like 'brand maintenance': It tries to control brands, creating consistency and predictability in a world that now demands businesses surprise, innovate, adapt and respond. Brand equity is seen in terms of sales, rather than velocity. But the ground beneath brands has irrevocably shifted. Today, brand momentum is brand management: Momentum that creates expectation and anticipation.

Many brands will become commoditized, replaced by new brands or ”Lazarus” brands like Adidas, Puma, LaCoste or Marks & Spencer. Most critically, the economic value of creativity will become front and center. Instead of a “nice to have,” creativity will be a “must have” competitive advantage for business. With commoditization a reality of every day life, only the brands that are continuously creative will attract and hold our attention, and our affection.

End Notes / Sources

[i] Calculation is from the 2007 IMF list based on GDP under purchasing power parity.

[ii] Datamonitor: Schneider/Stagnito Communications/IRI Most Memorable New Product Launch Survey

[iii] Universal McCann study, 2007

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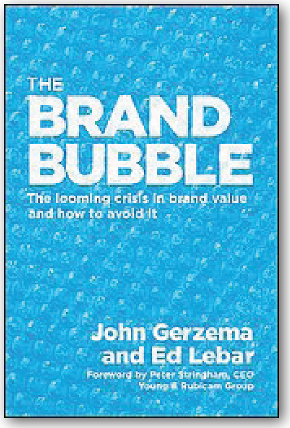

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Get more details or buy a copy of John Gerzema's *The Brand Bubble*.

ABOUT THE AUTHOR

John Gerzema is Chief Insights Officer at Young & Rubicam Group. John and Ed Lebar have written *The Brand Bubble: The Looming Brand Crisis and How to Avoid It*, which was published in October 2008 by Jossey-Bass. More details at thebrandbubble.com including free access to BAV data on over 500 brands in our study.

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