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Probing the Values of Professional Service Firm Brands

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Although marketing has become more important for accounting and advisory firms, branding is usually not a big issue. The corporate brand typically carries the name of the founders, a combination of the former names of now merged entities, or an abbreviation of the first letters of the founders. The logotype will be updated every now and then, but that's about it. However, things can sometimes change dramatically. This article discusses if, when, and why the brand names of advisory firms are valuable.

Recent skirmish. Recently, a hitherto unknown firm based in Paris appeared from nowhere in the accounting community, boldly claiming to be the legal successor of the defunct Arthur Andersen, which went out of business after the Enron scandal in 2002. By doing so, the French firm, Arthur Andersen & Co. SAS (AAC), challenged the rights to the Andersen trademark of San Francisco-based Andersen Tax LLC, which had emerged as a spin-off of the tax business of defunct Arthur Andersen under the name Wealth and Tax Advisory Services USA Inc. (WTAS). This entity adopted the Andersen name in 2014 after acquiring the rights from the inactive but still existing Arthur Andersen LLP. Andersen Tax did not intend to enter the audit business again, which was at the core of the Enron scandal.

The bizarre fight over the trademark rights became public in March 2017. A French company, Quatre Juillet Maison Blanche SAS (QJMB), domiciled somewhere in rural Brittany, had filed various trademark registrations in September 2014 for the names "Andersen" and "Arthur Andersen." These registrations were accepted, except in the U.S. where Andersen Tax opposed them. Outside the U.S., there seems to be a race to see which organization first occupies territories under the mark by acquisition, association, or licensing. AAC (which has the same president as QJMB) now operates as a franchisor of a network of accounting firms all using the Arthur Andersen name.

Certainly, lawyers and the courts will have their work cut out for them to resolve the case. Apart from this, some rather commercial details became known. Apparently, the French side had offered to sell its trademark rights to Andersen Tax for $87 million—which Andersen Tax firmly rejected. The royalty fee the French firm charged to its independent network affiliates for the use of the Arthur Andersen name is said to be 2% on revenues. These figures exemplify the dichotomy inherent in the value of brand names, in particular with professional service firms. Sometimes, there is a fight over brand names, but, sometimes, brand names are replaced and phased out. It is a question of the perspective and the options.

In relation to Andersen's former size, reputation, and revenues of $15 billion, an amount of $87 million comes close to nothing. For Andersen Tax, with revenues of $197 million, an amount of $87 million would be hard to finance for an asset that does not generate additional cash. The royalty rate of 2% would be high for Andersen Tax, considering that it would be paid on revenues that it is already generating. Faced with the choice, Andersen Tax

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would likely return to its former brand name, WTAS. For Andersen network franchisees somewhere in the Middle East or Asia, paying a 2% royalty for the name may be justified because the Andersen name helps to attract new clients locally, at least more than their current name does.

Two key issues. Two major issues determine the importance and value of the names of professional service firms. One is about the nature of customer relationships. If the business is recurring—such as major parts of audit, accounting, tax, and outsourced services—the name of the service firm is of minor importance. If, however, the business is rather one-time and project-based, the attractiveness of a firm's name is of major importance to secure future business. The other issue is about the specific know-how required to fulfill client mandates. If this know-how is scalable (manuals, instructions), any person can fulfill client mandates. If, however, the know-how is based more on individual skill and experience, a client will look to engage the individual expert or specialist rather than the firm.

Back in 2000, the IT consulting business of Arthur Andersen (Andersen Consulting) sought independence from the audit business, after having successfully operated since 1989 and establishing a leading global business under the Andersen Consulting brand name with annual revenues close to $10 billion. The price for the independence was to give up the Andersen name, so Andersen Consulting was rebranded Accenture in January 2001. How much was the Andersen brand name worth to Andersen Consulting? Nobody knows, but obviously not very much. The company simply dropped and replaced it. The one-time cost for the rebranding was in the area of $100 million and certainly increased marketing expenses during the years thereafter. The benefit was that it saved the firm from paying 15% of annual profits to Arthur Andersen.[1] The new branding had no negative effect whatsoever on the business; the new Accenture continued to grow steadily, even during the dot-com crisis. Apparently, the existing

1 US$300 million in 1999, and equaling a proxy royalty rate of 3.5% on revenues from 1997 to 1999.

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customer relations were strong enough to easily "survive" the new brand name.

Ever since its rebranding, Accenture's success story continued. Sixteen years later, in 2016, Accenture was listed on all of the four major 100 Top Global Brand rankings. Its brand value was estimated in a range from $12 billion to $23 billion and had a mean value of $15 billion.[2] It must be noted that these are noncommissioned outside-in valuations, without access to relevant internal data. Typically, these brand value rankings serve as a marketing tool to promote brand-related consulting services. We are left to wonder whether these brand value estimates for Accenture are realistic.

High interest. There seems to be a high level of public interest in the brand values of the Big Four in particular. *Economia*, the member publication of British chartered accountants, ran an article last February titled "PwC Has Most Powerful Brand of Big Four"[3] and another one in April, "EY Has UK's Fifth Most Powerful Brand."[4] Brand Finance, a specialized brand valuation consultancy, published its 2017 ranking on the world's most valuable commercial services brands in April.[5] *Australian Financial Review* commented last February under the headline "Rapid Growth of Deloitte, EY, KPMG and PwC Puts Brands at Risk."[6] The article discusses brand value of global professional service firms, including the Big Four, Accenture, and McKinsey, and the risk of brand dilution resulting from ever-increasing revenues and service range extensions.

According to Brand Finance, the brands of the Big Four plus McKinsey and Accenture enjoy the highest brand strength in their sector, resulting in brand ratings from AAA+ (PwC and McKinsey) to AA+ (Accenture) (see Exhibit 1). Considering revenues and profitability, PwC has the highest brand value, followed by Accenture. Back-solving the brand values estimated by Brand Finance under the relief-from-royalty method, we find implied royalty rates for the brand names between 4% and 5%.[7] Such royalty rates are typically found for consumer staples brands, so we have reason to doubt whether these royalty rates reasonably apply to high-end B2B services.

Reality check. Looking at real-world evidence, the Accenture case provides an insightful plausibility check. Accenture is ascribed a mean brand value of roughly $15 billion by the brand valuation firms, from revenues of $34.8 billion and a market cap of $62.8 billion in 2016. Assuming that Accenture would have to buy back its brand from somebody else because it would—hypothetically—not own it, it would certainly not pay an amount of $15 billion (roughly one half of revenues). This is very reminiscent of Accenture's not wanting to continue paying for the Andersen brand when it sought its independence in 2000 and very much like Andersen Tax recently refusing to acquire the Andersen rights for $87 million.[8] Andersen Tax would rather rebrand again, pay the one-time replacement cost, and increase its advertising spending.

Using a cost-based approach, we find that Accenture reports annual advertising spending of

2 Millward Brown/BrandZ: No. 38, $22.813 billion; Forbes: No. 42, $13 billion; Brand Finance: No. 95, $12.687 million; Interbrand: No. 37, $12.033 billion.

3 See Raymond Doherty, "PwC Has Most Powerful Brand of Big Four," *Economia*, Feb. 2, 2017. economia.icaew.com/en/news/february-2017/pwc-has-most-powerful-brand-of-big-four.

4 See Raymond Doherty, "EY Has UK's Fifth Most Valuable Brand," *Economia*, April 27, 2017. economia.icaew.com/en/news/april-2017/ey-has-uks-fifth-most-valuable-brand.

5 brandfinance.com/knowledge-centre/reports/brand-finance-commercial-services-50-2017/.

6 See Edmund Tadros, "Rapid Growth of Deloitte, EY, KPMG and PwC Puts Brands at Risk," *Australian Financial Review*, Feb. 7 2017, www.afr.com/business/accounting/rapid-growth-of-deloitte-ey-kpmg-and-pwc-puts-brands-at-risk-20170203-gu4ras#ixzz4djkVh8Yg.

7 The back-solving was performed with the MARKABLES royalty rate calculator. The main assumptions were a discount rate of 10%, a long-term growth rate of 2%, an average tax rate of 30%, and an indefinite (perpetual) useful life. No tax amortization benefit was applied, as these are value-in-use calculations of internally generated brands. www.markables.net.

8 Again, roughly half of their revenues.

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$80 million, or 0.2% of revenues.[9] For a period of 10 years, and considering amortization effects and upcounting to the current date, the current brand value is not more than $1 billion. In contrast, Accenture spends roughly $3.5 billion annually, or 10% of revenues, on sales efforts (i.e., to acquire clients, business, and projects) and $1 billion on training. We must assume that Accenture's management understands where to invest and how to generate returns and create value. Advertising has a rather low priority. Investing 0.2% of revenues annually for advertising to obtain net returns from the brand of 3.5% on revenues (brand royalty earnings or savings) is not quite plausible.

Exhibit 1. Brand Finance—Top Global Professional Service Firms 2017

	Brand Rating	Revenues $ billion 2016	Brand Value $ billion 2017	Brand/ EV	Brand Royalty % on rev
PwC	AAA+	35.9	18.5	na	~5%
Accenture	AA+	34.8	17.5	30%	~4%
Deloitte	AAA	36.8	16.8	na	~4.5%
EY	AAA	29.6	13.4	na	~4.5%
KPMG	AAA-	25.4	11.0	na	~4%
McKinsey	AAA+	8.4	4.5	na	~5%

Source: Brand Finance Global 2017; royalty rates back-solved with MARKABLES royalty rate calculator.

This situation is not much different for the other firms listed in Exhibit 1. They do advertise, but their main investments go directly into customer relations and people. No doubt, these are great firms that enjoy superb reputations all over the world. They are among the best companies to work for, and their average revenues per consultant are the highest in their sectors. They certainly have strong brands. But they could easily live without them or rebrand. The brand values stated on these rankings seem to be overstated.

The flexible, nonbinding approach to branding has been applied in the accounting sector for over a century. All of the top firms today were involved in mergers in the past. Each of the countless mergers resulted in one of the merged brands being dropped or a new combined brand being established. Coopers & Lybrand, Haskins & Sells, Touche Ross, Peat Marwick, Klynveld Main Goerdeler, Ernst & Whinney, or Arthur Young once were strong and established brand names. Dropping or rebranding these names certainly involved emotionally difficult discussions and decisions; commercially, keeping all of these established brand names was no alternative. Abandoning the former names proved to be more efficient and value creating, indicating that former brand names were substitutable and brand values rather insignificant.

Case evidence. There is some evidence in the business valuation field suggesting reasonable royalty rates for brand names in the professional services sector. In a marital dissolution case from 2002, the Ernst & Young brand name was valued with a 1.5% royalty rate and a useful life of five years.[10] The short useful life might be surprising, but it reflects the fact that Ernst & Young's IT consulting arm had been previously sold to Cap Gemini under a transitional brand name license for four years, the rebranding of many Arthur Andersen branches Ernst & Young took over at that time, and Ernst & Young's own rebranding history. Under these assumptions, the brand names account for 3% only of Ernst & Young's enterprise value.

Another illustrative case involves the MBO of Duff & Phelps from Webster in 2004.[11] In the purchase

9 In the past, Accenture's advertising expenses oscillated between 0.2% and 0.4% of revenues.

10 Valued in a marital dissolution, see *Bobrow v. Bobrow*, Hamilton County No. 29 DO1-0003-DR-166 (Indiana Superior Court).

11 Valued in a purchase price allocation, see report S-1 of Duff & Phelps Corp. filed with SEC on May 23 2007.

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price allocation, the Duff & Phelps brand name was valued at less than a 1.0% royalty rate and an indefinite life assumption. During its long history, Duff & Phelps had never changed its branding nor did it merge among equals, which explains Duff & Phelps' different approach to RUL. Usually, Duff & Phelps rebranded all of its acquisitions, including S&P's valuation business, Chanin, Kinetic Partners, and American Appraisal, among others. Duff & Phelps' weak profitability and enterprise value back in 2004 explains the relatively low royalty rate of 1% for the trade name, still resulting in a brand value accounting for 25% of enterprise value.

Value driver structure. Both illustrative cases are rather specific—Ernst & Young for its limited life and Duff & Phelps for its low profitability. To develop a more profound view of brand value in the professional service sector, it helps to look at the overall business and value driver structure and at the interrelations between customer relationships and brand in particular. Accordingly, brand importance and value depends on the following characteristics:

- *Repeat business.* Some professional services are on an ongoing or recurring basis, i.e., audit, tax, accounting, outsourced services (i.e., payroll); management services (hosting, network); and monitoring services (i.e., IP management). Other services are rather one-time or project-based (advisory, corporate finance, consulting, and litigation). For the former categories, the brand name is rather unimportant. The latter involve the acquisition of new clients and engagements at a much higher level and frequency; a strong reputation and brand awareness in the target audience must support such acquisition activity.

- *Degree of specialization.* Branding is typically involved to convey constant quality of the branded products or services. Some professional services are scalable, meaning they can be standardized in some way, replicated in other situations, or repeated for other clients (manuals, handbooks, and guidelines); new staff can be trained to perform such scalable services. Such scalable services include audit, tax, outsourcing, and management services. Other services are rather specialized and linked to individuals and their particular experience (experts and specialists), i.e., strategy consulting and litigation. The more scalable the services of a professional service firm, the more important is the brand.

- *Client size.* The larger an individual client and the higher its contribution to overall revenues, the more efficient the relationship with this client can be handled directly and personally. The more personal the relation, the less important is brand and brand value.

A good indicator of brand value is what happens if a key professional (a partner) leaves the firm. If the clients and the business go with him or her, it is rather a relationship business. If they stay, it is rather a firm and brand business. In any case, professional service firms rely to a much greater extent on strong customer relations than on brands.

Empirical data. Exhibit 2 provides the empirical interquartile ranges for different intangibles assets in professional service firms, depending on their business characteristics. The ratios are derived from a peer group of 18 different professional service firms valued in purchase price allocations. The sample includes audit, advisory, and law firms from three countries.

Accordingly, the average professional service firm has a price/revenue multiple of 1.7x. Its brand

Exhibit 2. Value Driver and Asset Structure of Professional Service Firms

	Brand Royalty Rate	Brand Useful Life	Brand/EV	Customer/EV	Goodwill/EV	Price/Revenue
Low	0.75%	5y	2.5%	17%	42%	1.3x
High	2.50%	indef	9.0%	40%	68%	2.2x
Median	1.50%	20y	5.0%	32%	53%	1.7x

Source: Purchase price allocations 18 professional service firms; MARKABLES

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name is valued with a royalty rate of 1.5% over 20 years, resulting in brand value accounting for 5% of enterprise value. Customer relations with 32% of enterprise value and goodwill with 53% are considerably more important than brand. Goodwill relates to cost savings expected from the combination; to the cross-selling potential in combining territories, customer groups, and service ranges; and to the ability of the acquired firm to master the future beyond the current planning horizon (in particular to create enough new business to keep the firm running at its current profit level). For professional service firms, retaining key individuals is vital for this. Any acquisition of a professional service firm must therefore include clear measures to retain key staff. In light of all this, its brand name is only "nice to have" and can be replaced rather easily, as history shows.

Although they may be highly admired firms, professional service providers are primarily acquired for their existing customer relations and goodwill and much less for their brand names. ◆

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Binder and Rüssli are co-founders and directors of MARKABLES, a Switzerland-based online database providing comparable data from over 9,000 published and audited trademark valuations.

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