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INDEFINITENESS IN ACCOUNTING — THE CASE OF TRADEMARKS IN CANADA

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The valuation of an intangible asset is based on its useful life, among other factors like cash inflow generating capability and risk. For trademarks,[3] valuators regularly opt for an indefinite life, when no obvious factors exist that would limit the future economic life of the trademark. However, almost all brands are finite, and only a small proportion of all brands ever introduced have the potential to exist a hundred years and longer. Assuming indefiniteness can have two serious effects — one on value and one on accounting. The following article discusses such effects and suggests some guidelines and tools to analyze the lifecycle of a brand and to estimate its remaining useful life (RUL). It also presents new research that examines indefinite-lived trademarks in Canada and traces their reporting over the past 10 years.[4]

The Accounting Framework

Determination of useful life and amortization of intangible assets is governed by accounting standards. Generally all the established accounting standards require that entities assess whether the useful life of an intangible asset is finite or indefinite. International Financial Reporting Standards (IFRS), in particular, state that an intangible asset should only be regarded as having an indefinite useful life when, based on all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.[5] Therefore, if management has the intention and the ability to maintain an intangible asset so that there is no foreseeable limit on the period over which the asset is expected to generate net cash inflows for the entity, the asset is regarded as having an indefinite useful life.

More important, 'indefinite' does not mean 'infinite'.[6] There does not need to be an expectation that the cash inflows generated by the asset will go on forever but simply that, at the date of assessment, there is no foreseeable point at which the cash inflows will cease.

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3 The terms trademark, brand and tradename will be used interchangeably.

4 This article is based on an earlier version covering the reporting of indefinite lived trademarks in the U.S. Christof Binder and Robert B. Morrison, "Indefinite Is Not Infinite—Solving a Dichotomy in Trademark Valuation," Business Valuation Update, Vol. 21 No. 5, May 2015, pp. 1-12.

5 IAS 38:88.

6 IAS 38:91.

If an intangible asset is determined to have an indefinite useful life, it shall not be amortized until its useful life is determined to be no longer indefinite. Instead, the asset shall be tested for impairment at least once in each reporting period by comparing their recoverable amounts with their carrying amounts.[7] An additional impairment test is required whenever there is an indication that an intangible asset may be impaired.[8]

If an asset has been assessed as having an indefinite useful life, resulting in the asset not being amortized, that assessment is revisited each period to determine whether events and circumstances continue to support an indefinite useful life for that asset. If not, the change in indefinite life assessment is accounted for as a change in accounting estimate in accordance with IAS 8.

Legally, the protection of trademarks can be renewed and extended any number of times, and economically trademarks can successfully subsist for a very long time as long-lived brands like Coca-Cola, Colgate or John Deere demonstrate.[9] For these reasons, trademarks are often assigned an indefinite life. However, the decision to assign an indefinite life to a trademark has two important effects. In discounted cash flow (DCF) based valuation, indefiniteness results in infiniteness — revenues or cash flows are projected into perpetuity. In accounting, the problem is only postponed. Like any other assets, trademarks are wasting. At some point in the future a decision must be taken as to the finiteness of the trademark's life.

IAS 38:93 states that "*Uncertainty justifies **estimating** the useful life of an intangible asset on a prudent basis, …* " This wording suggests that the standard setters preferred — whenever possible and advisable — an estimated definite to an indefinite life.

To avoid misunderstandings, it is not the intention of the authors to motivate valuators and accountants towards avoiding indefinite lives in valuations. For example, for goodwill this would be simply impossible. We would, however, like to increase the awareness of the problems inherent in infiniteness, and when and how to estimate a finite RUL of trademarks.

Observations in the Accounting Field

Indefinite-lived intangibles were introduced into corporate accounting in the United States through FAS 142 in 2001, and internationally through IAS 38 in 2004. Less comprehensive guidance existed prior to these dates under both under U.S. GAAP and IFRS. In Canada, CICA 3062 was introduced simultaneously with FAS 142 (replaced by CICA 3064 in 2008), and IFRS/IAS became mandatory for public enterprises since 2011. Under these rules, valuators and accountants are required to consider the option of indefiniteness in their valuation of trademarks. In a recent article, Rüssli and Binder analyzed in detail what useful lives valuators and accountants applied in the field since 2003.[10] According to MARKABLES[11] data, one half of all trademark valuations performed between 2003 and 2013 assume an indefinite life. For the remaining half of trademarks with a finite life, the RUL ranged from less than 6 months to a maximum of 50 years, with an average of 10.7 years.

Assuming that corporations develop detailed business plans and forecasts for a five-year period, a RUL of five years and less would be equivalent to a clear intent to cease the brand and its products or to replace it by another brand within this period. Therefore, the determination of trademark RUL in such cases is more a part of corporate business planning than a specific estimation by the valuator. Based on the MARKABLES data, 36% of all trademarks with definite RUL[12] fall

7 IAS 38:107.
8 IAS 38:108.
9 We all tend to forget the numerous brands and trade names that disappeared. In mature industries, the number of vanished brands is much higher than the number of those that remain.
10 Stefan Rüssli and Christof Binder, "The useful life of trademarks," World Trademark Review, Dec. 2014, pp. 22-25.
11 MARKABLES is a self-service online database providing comparables from over 6,700 audited and published trademark valuations worldwide: www.markables.net.
12 Corresponding to 18% of all trademarks in the sample.

into this category of "clear intent to cease." In the remaining cases of RUL extending beyond the five-year planning period,[13] the valuator had to analyze and estimate RUL. Only 39% of these trademarks were assigned a definite life by the valuator; and 61% received the status of indefiniteness.

These are the averages over a 10-year period. When looking at the trend it is apparent that valuators increasingly try to be more precise and to determine definite RULs more frequently. During the observation period the share of indefinite lived trademarks decreased from 80% in 2004 down to 40% in 2013, and the average RUL of the finite lived trademarks decreased from 12 years to 10 years. There seems to be an increasing awareness among valuators and accountants of the importance of assigning an appropriate and reasonable life to trademarks where able and of the difficulties that can arise from indefiniteness.

As for Canada, 62% of all trademarks were assigned an indefinite life. Indefiniteness in Canada is thus more frequent than in U.K. (28%) and U.S. (49%), but less than in Germany (77%) and France (88%).

From Ambiguity to Clarity?

IAS 38 expressly states that "*The term indefinite does not mean (the same as) infinite…*" To account for this, the International Accounting Standards Board (IASB) developed two additional concepts. One is that indefinite-lived assets shall be tested at least annually for impairment. The second is that the RUL of an indefinite lived asset shall be reviewed annually to determine whether events and circumstances continue to support an indefinite useful life. In other words, the standard setters did in no way contemplate the creation of an asset category that would sit on the balance sheet forever.

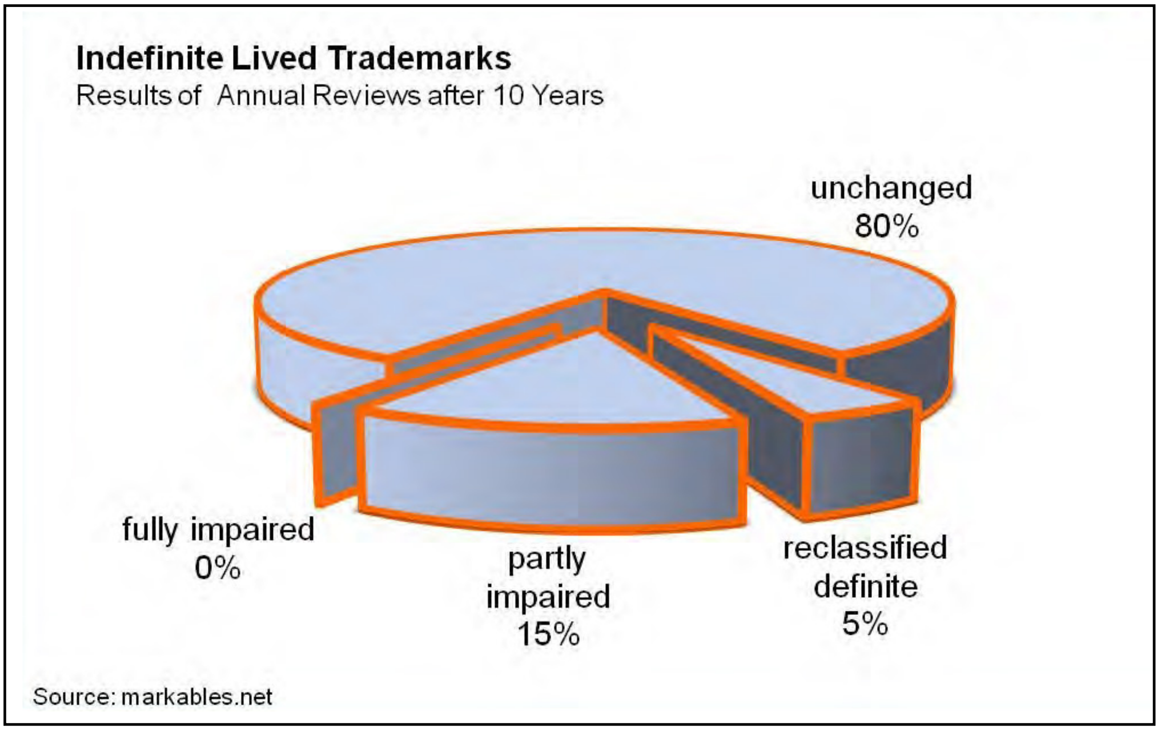
With this in mind we tried to understand what happens to accounted trademarks once they are assigned indefiniteness, and to find out if IASB's vision of a later finiteness would come true. Therefore, we analyzed how 50 brands (or brand portfolios) that had been valued and accounted between 2004 and 2007 with an indefinite life developed in the accounts in the years thereafter. The sample was taken from the MARKABLES database[14] and included the 50 largest trademarks (or trademark portfolios) resulting from business combinations and reported in between 2004 and 2007 by entities listed in Canada. We traced the reporting of these trademarks from 2004 until 2014 reporting season.

A first finding is that nine brands (18%) from the original sample later became part of another transaction, resulting in a new business combination and a new valuation. In these cases, the issue of infiniteness sorted itself out and eventually restarted from zero.

The remaining 41 brands were presumably subjected to annual impairment test and RUL review. The results of these reviews after nearly 10 years are illustrated in Exhibit 1. 80% of the brands remained unchanged, and the remaining 20% experienced some sort of depreciation:

- Six brands (15%) were partly impaired. The impairments range from 3% to 90% of the original value, with an average impairment of 42%, or 4% per year.
- None of the brands was fully impaired.
- Two brands (5%) were reclassified as definite-lived, with RUL of five years for both brands.

13 82% of all cases.
14 www.markables.net. The number of trademarks reported by Canadian listed corporations is considerably smaller than in the U.S., resulting in a population of 50 cases observed, against 100 cases for the US study.

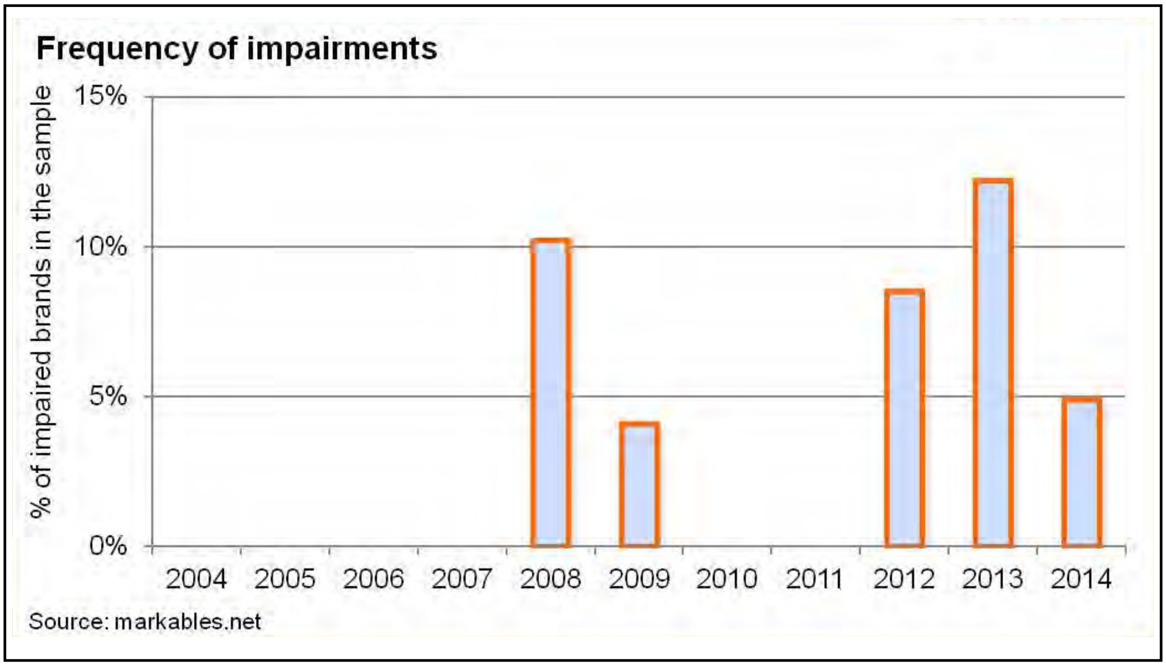


At the end of 2014, the overall value of the trademarks in the sample stood at 92% of its original value. This corresponds to an average annual impairment of less than 1%. Interestingly, the impairments accumulate in the very last part of the observation period. Leaving aside the extraordinary impairments due to the financial crisis in 2008/2009, impairments occurred only since 2012 (see Exhibit 2), but not in any of the previous years. Apparently, the issue of indefiniteness became a factor only since 2012.

If compared to the impairment of indefinite trademarks of reporting issuers in the U.S.,[15] Canadian reporting issuers lag in all aspects. In the U.S.:

- the trademark value of the sample stood at 83% after 10 years (versus 92% in Canada)
- only 47% of the brands remained unchanged (versus 80%)
- impairments (or regular amortizations after reclassification) happened much more frequently. The average impairment frequency in the U.S. stood at 11.5% (versus 4.2%).

15 See footnote 4.



There are two major conclusions from this analysis.

1. A substantial part of all indefinite lived trademarks remains "untouched" during the 10-year period. This tends to happen when the original valuation was conservative and the business ended up growing above expectations. In this situation, the impairment test of the brand will necessarily result in a fair value being higher than its carrying value. The problem is that after 20 years, brands will have the same financial statement measurement amount as 20 years prior, but, in reality, they have little to nothing in common with the original brands.

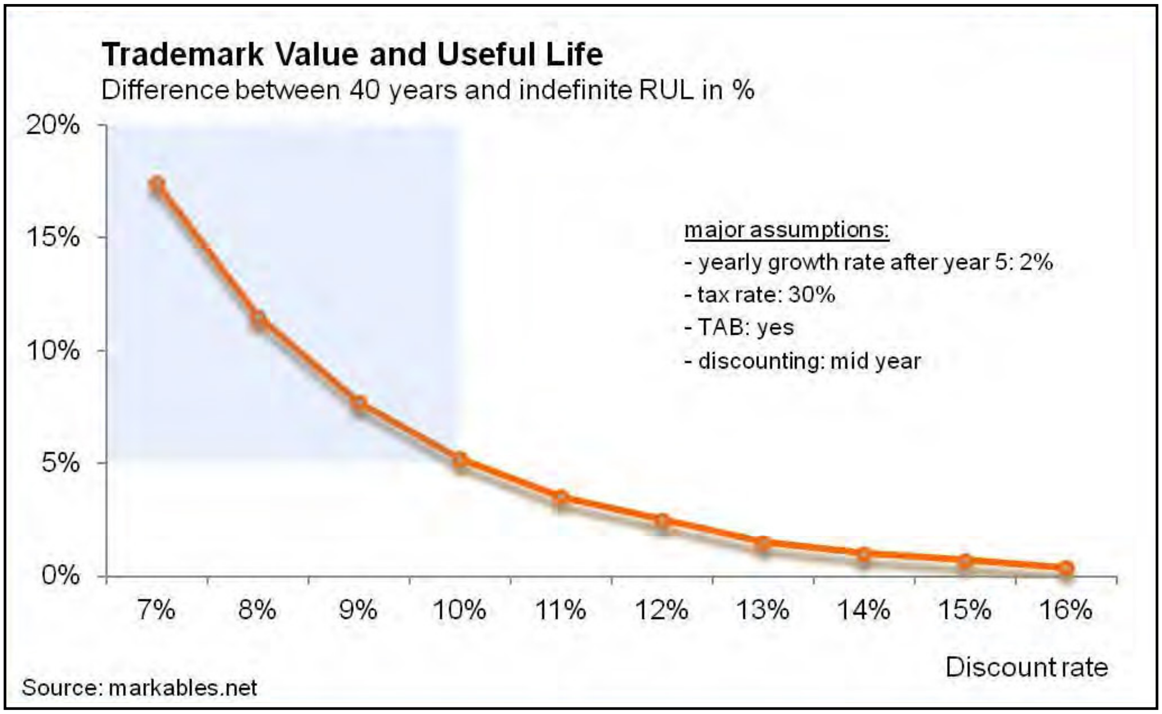
2. Once indefinite — always indefinite. Only in very few cases the option of shifting from indefiniteness to finiteness was chosen. Valuators and accountants who opted for indefiniteness in their original valuation seem to maintain this preference permanently; they continue to prefer annual impairment testing and irregular impairments over a determination of RUL and regular amortization. While not subject to empirical testing, reasons for this may include difficulty in estimating an RUL, lack of objective, observable data, management belief that the trademark will exist into perpetuity, and management's aversion to amortization expense. This approach is, however, not fully in line with IAS 38 stating "*The term indefinite does not mean (the same as) infinite.*" At some point in time, an end of the trademark's life should be foreseeable.

The Discounting Sensitivity of Indefiniteness

Almost all published trademark valuations apply the relief from royalty method or — in rare cases — the multi-period excess earnings method. Both methods are income approaches that project future earnings from the trademark and discount them to a net present value (NPV). In instances where the RUL is deemed indefinite, the projection of future earnings extends into perpetuity — *the projected income stream will not stop.* As a result of discounting, the contribution of earnings to NPV diminishes over time. The higher the discount rate, the sooner future earnings from the trademark become negligible for its present value.

Simply speaking, the result of a valuation will be different depending on the length of the RUL and the length of the income projection into the future. An income over 200 years is obviously more than the same income over 35 years. This increasing effect over time is overlapped by the discounting. The key question here is at what discount rate the difference between a (long) finite RUL and an indefinite RUL becomes negligible.

This is what some valuation professionals maintain. The validity of this view depends however on the discount rate. To illustrate this, we compared the NPV difference for a trademark with indefinite RUL to a trademark with a RUL of 40 years for different discount rates.[16] Exhibit 3 illustrates that the NPV difference is less than 5% if the discount rate is 10% and higher. For lower discount rates, the NPV difference is higher and approaches 20%.



It is a question of auditor materiality which difference would be acceptable. In the illustration, the 5% threshold would be surpassed at a discount rate of 10% or less, or at a net discount rate of 8% considering the 2% growth rate assumed. In these cases, the resulting trademark value would be more than 5% higher than in the 40 years RUL scenario.

Once again we cite IAS 38 which states: "*The term indefinite does not mean the same as infinite.*" Valuators must be aware that a valuation into perpetuity can result in an overstated value, depending on the discount rate. To avoid this, the valuator may either cap the RUL at a certain point in time, or account for the higher uncertainty of indefiniteness with a higher discount rate, or at the very least a higher discount rate in the outer years.

Understanding the Reasons for Trademark Obsolescence

Our above analysis showed that valuators frequently consider the RUL of a trademark as indefinite if and so long as its owner intends to continue to use the trademark or has no specified

16 We chose 40 years because finite lives of more than 40 years are rarely observable.

plans to the contrary. One half of all valued trademarks are assigned an indefinite life, and a large part of these remain indefinite for quite a long time. However, accounting into indefiniteness was neither the intention of the standard setters, nor is it advisable to follow this simplification in lieu of further analysis of all the factors that may cause the trademark's dormancy or extinction.[17] Valuators ought to perform a detailed RUL analysis before they opt for indefiniteness.

Before one starts to estimate trademark RUL it is important to understand what trademarks are used for, and why they can die. In their beginnings, trademarks emerge to provide for the clear identification and a condensed description of an offering (a product or service), and for an easy orientation of the target buyers. The marking or branding is a prerequisite to establish any commercial offering in the marketplace. Later in their lives, branding and brands become subject to more economic decisions. Accordingly, the returns attributable to a brand should be higher than the cost spent to maintain and develop it. Brand returns are quantified or estimated as additional sales volume plus additional price premium which would not be achieved without the brand, minus expenses for branding. A trademark will die if its use makes no more economic sense.

There are three major reasons why the use of a trademark may cease to make economic sense:[18]

a) Product obsolescence. The products or services sold under a trademark reach the end of their life cycle. With the products dying, the brand attached to them will die, too (Southern Bell, for example). This happens if and when the brand is closely associated with a specific product (a product brand) and has no or little flexibility to be switched to other products. This can be observed in the case of product specialist brands or product names. With short product life cycles — like in hi-tech or software industries — brands eventually move too slowly to climb on the bandwagon of the next product generation. Typically for such businesses, the value of a brand is relatively low compared to the value of technologies and customers. Sometimes, a product life cycle can end abruptly if the market is subject to governmental regulations or subsidies.

b) Trademark obsolescence. Through the course of the years, a trademark itself may grow old and outdated (Tenneco, for example). Often the products, services or ranges sold under a trademark change and innovate faster than the trademark can follow them. This phenomenon is typically called trademark obsolescence.

   Products and services sold under a trademark are continuously improved, renewed, adopted, refreshed or otherwise kept up-to-date. In most industries, this change is substantial. A Ford of today has little in common with a Ford of 1970. An Apple computer of today is very different from one of 1990. A fashion brand changes its complete range twice every year. Even for a trademark that seems to be immutable like Coca-Cola, the changes over time are substantial.

   Trademarks (or brands) are rather the opposite. Their main purpose is to provide recognition and trust to the existing customer base. But, at the same time they have to be innovative, launch new products, and renew themselves. Sometimes, brands are adapted too, for example through a modernized logotype. Essentially, brands are not made to keep pace forever with the dynamic product or service ranges sold under them, and one day they may become signs of the past for products of today.

17 John Elmore, "The Valuation of Trademark-Related Intangible Property", Willamette Insights, Winter 2015, p. 72.

18 In reality, these three reasons are not fully independent of each other and may overlap; for simplification, we discuss them independently here. Further, it is not helpful to include all and any extraordinary mortality risk like catastrophes, assaults, accidents, and so on in the analysis. If such incidental events happen, testing for impairment applies.

There are different root causes for trademark obsolescence.[19] The most important is technological innovation resulting in improved and/or cheaper products. Think of the changes happening in the handheld or PDA category. From walkman and MP3 player, integrating telephone, camera and small computer, to the smart phone. In dynamic markets, such changes can happen very fast. A second cause relates to changes in consumer behaviour. This does not necessarily involve innovation, often it relates to old or existing products. For example, low carb food products existed long ago, but their recent success results from a substantial shift in consumer preferences. Trademarks associated with the "old" behaviour may then be perceived to be out of date. A third cause relates to changes in social behaviour. In some areas of life, people want to be part of social groups, thereby being distinguishable from people belonging to other social groups. Often this is referred to as lifestyles, and it involves their selection of brands. Lifestyles change over time, and with age; trademarks may face difficulties to cope with such changes in lifestyles. Often, such changes in social behaviour relate to products where styles and look are important.[20]

c) Trademark consolidation. Sometimes, businesses own and operate more than one brand in the same category, often as a result of merger activities. In these cases, the trademark becomes subject to a corporate consolidation, whereby one trademark is replaced by another established trademark of the same owner to increase efficiency and to lower cost (Eaton's, for example). The cost of the re-branding plus the losses from customer confusion must be outweighed by the present value of future cost savings from dropping one brand. This is the simple principle, and in many cases it works provided that the business and customers of the abandoned trademark can be kept to a large extent. This is probably one of the most frequent reasons for a trademark to disappear, for the very simple objective of trademark economies of scale.

Peer Group Analysis of Trademark RUL

Accounting standards, textbooks, course materials and relevant literature provide an overview of the different factors that might influence the RUL of trademarks, but little to no guidance on methodologies and tools to quantify or estimate it. In a first step towards estimating trademark RUL, it is helpful for trademark valuators to understand the general mortality risk of trademarks in the subject industry. Two simple tools help to achieve this.

a) Randomly pick a population of competitor brands that were active in the subject industry five to 10 years ago. The composition of the population is less important; more important is the size (ideally 20 brands, minimum 10), and how many years passed since the observation of the population (ideally 10 years, minimum five). The source of such historic population can be: all participants at a specific trade fair at that time; all brands that advertised in the trade magazine at that time; the members' list of the industry association at that time; all brands that were then covered in the report of the consumer research or market intelligence company. Then find out which of these brands still exist today. By dividing the number of remaining brands by the number of brands in the former population, you get an approximate survivor ratio, and an annual mortality rate.

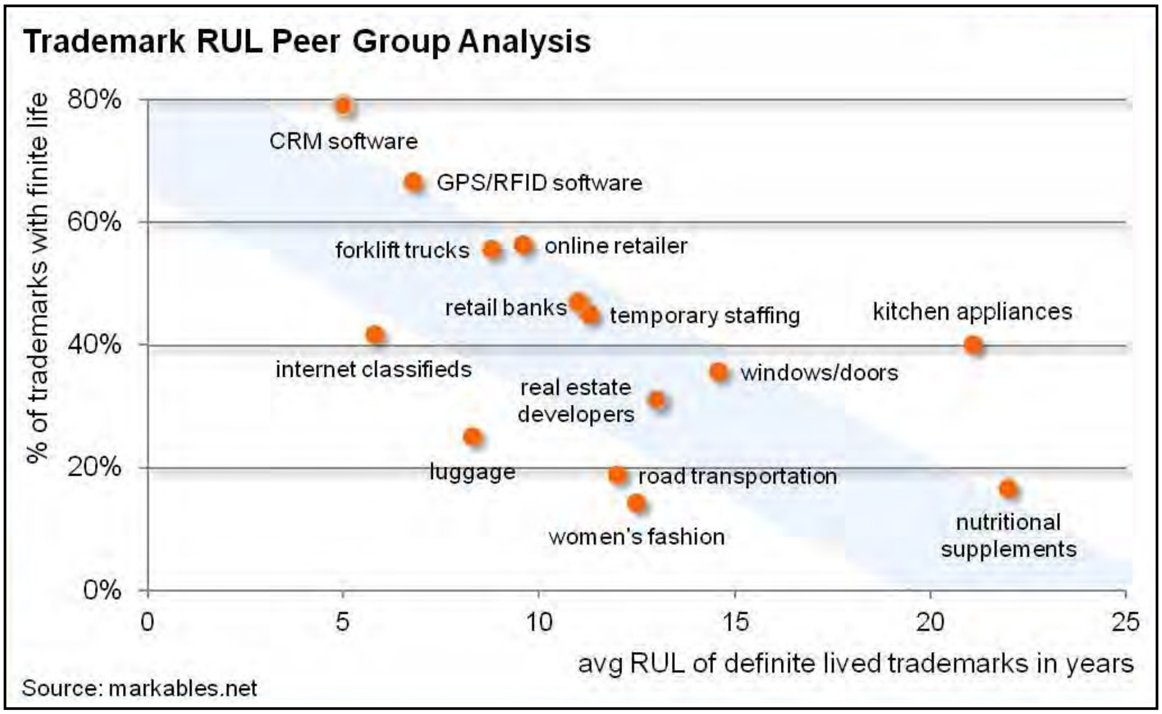
   If four out of 20 competitor brands that existed 10 years ago disappeared in the meantime, the average annual mortality rate would be 2%; assuming a constant mortality rate and

19 Smith and Richey use a different categorization, but discuss similar reasons for obsolescence risks. Gordon Smith, Susan Richey, "Trademark Valuation – A Tool for Brand Management," Wiley 2013, pp. 145-152.

20 It is surprising to see that 90% of fashion and sports brands are deemed to have indefinite lives while in reality many of them will likely not survive the next 20 years.

projecting this trend into the future, all brands will have disappeared by year 40, and the average RUL of the existing brands would be 20 years. Depending on its relative strength against competitors, a subject trademark will have an RUL below or above average.

b) It can be helpful to see how other valuators dealt with similar situations in the past. Therefore, you should have a look at the RULs assigned to other trademarks in the subject industry in earlier trademark valuations. Such data can be found in the financial reporting of listed companies in relation to their purchase accounting and accounting for intangible assets in connection with business combinations. One source is the MARKABLES database. Exhibit 4 illustrates the RULs found in peer group analyses for various industries based on MARKABLES data. The results show that a) trademark mortality risk differs by industry, and b) plentiful guideline data are available.



Such industry-based trademark mortality analyses rarely provide evidence for zero mortality or infiniteness. In almost all cases, some trademarks have disappeared in the observation period or are expected to disappear. Of course, the average RUL resulting from these peer group analyses is not directly applicable for the subject trademark. But it provides a first understanding of the trademark dynamics in the subject industry and a guideline if an indefinite RUL is justifiable or not.

Estimation of Trademark Specific RUL

The RUL of the subject trademark depends on some specific characteristics in relation to its environment and customers. The following analytical steps are helpful to understand the specific position of the subject trademark in various cycles and to provide a best estimate of RUL.

1. **Product lifecycle**. The product lifecycle theory provides five stages in the life of a product or service forming a typical S-shaped curve: introduction, growth, maturity, saturation, and decline. For RUL estimation, two aspects are important. First, it is important to understand

the current position of the trademarked products in the cycle. And second, it is important to anticipate the total length of the cycle. Products incorporating high-technology (like pharmaceuticals, software or semiconductors) can have very short life-cycles, sometimes not exceeding five years. Other products and services (for example coffee or hairdressing services) reached the saturation stage long ago, but exhibit no signs of decline.

2. **Brand specificity and brand architecture**. A brand will not necessarily die because the branded product has reached the end of its lifecycle. The ability of brands to keep pace with change and innovation depends very much on their specificity. Some brands are closely tied to a specific product, like pharmaceuticals or other product name brands. Such brands will necessarily die when their products reach the end of their lifecycles. Other brands are much less specific, having more flexibility in terms of the variance and modifiability of the products or services they carry. They can successfully absorb product variants and new product generations. For the life of such brands, numerous individual product life cycles add to one another, thereby separating the brand's life from products' lives.

   In RUL analysis, it is important to understand the brand architecture of the subject business. Often, businesses operate brands at different levels. Product brand names provide branding at the level of products or individual services. Corporate brand names or umbrella brands provide branding at the level of a company or business unit, grouping different products under one and the same branding. Often, branding incorporates a combination of both umbrella and product brand names. Obviously, product brand names will have shorter lives than corporate or umbrella brand names, and it is advisable to attribute different RULs to brand names at such different levels.

   On the other side, the valuator must understand that the level of specificity of a brand can affect its returns. A less specific brand may have a very long life, but at the same time may have a lower profit margin compared to a very specific specialist brand. In some way, this phenomenon relates to the issue of niche versus mass market branding strategy.

3. **Brand strength**. When a market begins to decline, not all brands will die at the same time or at the same rate. Some will disappear sooner, and some will survive until the very end, or even create the next upturn of the market. This is a question of the strength of each particular brand. Several factors determine brand strength with regards to its RUL.

   One factor is the relative size of the brand, or its relative market share compared to its competitors. Small brands will very likely disappear faster than market-leading brands. Another factor is relative growth. If the subject brand grew more slowly — or declined faster — than market average, it will likely disappear sooner than other brands. And a last factor is brand profitability. The more profitable a brand is relative to its competitors, the more likely it can survive until the final consolidation in its category.

4. **Industry consolidation cycle.** One major reason that trademarks disappear is trademark consolidation.[21] If a business owns and operates more than one trademark in the same category or segment, it has the option to merge one of the trademarks into another. This option should be considered and carefully analyzed by the valuator even if management expresses its intent to continuously use the subject trademark indefinitely in the future.

   The structure of an industry is often described by concentration measures. Concentration is a function of the number of competitors and their respective shares of the total market.

21 See further above.

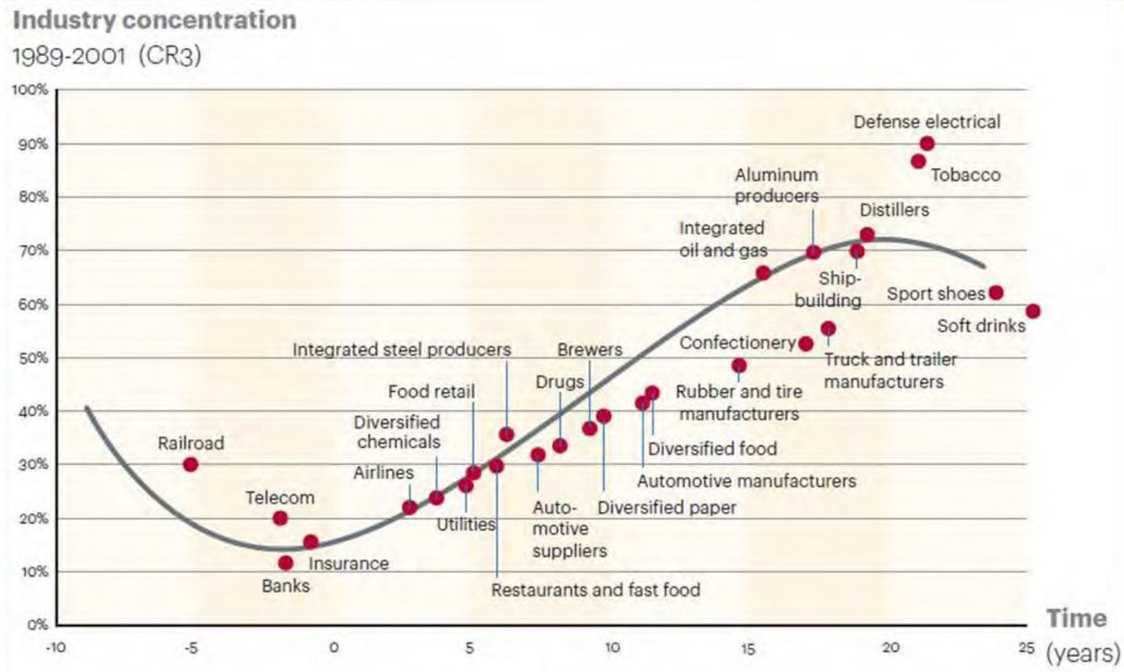
In competition and antitrust law, the Herfindahl index[22] is the most frequently used concentration measure. Another, more convenient concentration measure is the sum of the market share of the top three or top four players, described as CR3 or CR4 ratios. CR3 50% means that the top three players of the industry hold a combined 50% market share.

Structure and concentration rates of industries change over time. Typically, industries follow a concentration curve which resembles the S-shaped product life-cycle curve.[23] In the emerging stage of an industry, the concentration rate CR3 will be high (sometimes 100%), with very few competitors. The more promising and growing this new market, the more players will enter, thereby reducing the market share of each player and the CR3 rate. Very fragmented markets with many players can have CR3 ratios of less than 10%. With decreasing growth rates, the industry will start to consolidate through mergers. The number of players will decrease, and CR3 will increase to a maximum level. In very mature industries, there are not more than a handful of players left, and CR3 reaches 80%. In the mature stage of the curve, the need to consolidate further is very limited.[24] Sometimes, such mature industries decline to their demise; sometimes new small entrants make their appearance and attack the old players with new varieties, thereby reducing CR3 again. Exhibit 5 illustrates the typical S-shaped curve of industry consolidation. For the trademark valuator, it is important to understand the shape (the duration) of the S-curve of the subject industry and its current position on the curve.

22 The Herfindahl or Herfindahl-Hirschman Index (HHI) is a measure of market concentration and is expressed as: HHI = (s12 + s22 + s32 + … + sn2) x 100 where sn is the market share of the nth firm. The U.S. Department of Justice considers a market with an HHI of less than 1,500 to be a competitive market while an HHI of 2,500 or greater to be highly concentrated: www.justice.gov/atr/public/guidelines/hhi.html.

23 For further detail, see Graeme Deans, Fritz Kroeger, Stefan Zeisel, "Winning the Merger Endgame," McGraw-Hill 2003; Graeme Deans, Fritz Kroeger, Stefan Zeisel, "The Consolication Curve," Harvard Business Review, Dec. 2002; Jürgen Rothenbuecher, Joerg Schrottke, Sandra Niewiem, "The Merger Endgame Revisited," ATKearney White Paper 2013.

24 I.e. because of antitrust or complexity.



Note: CR3 is the three-firm concentration ratio, the sum of market share of the top three players.
Sources: *Winning the Merger Endgame* by Graeme Deans, Fritz Kroeger, and Stefan Zeisel; A.T. Kearney analysis
Source: The Merger Endgame Revisited, copyright A.T. Kearney, 2013. All rights reserved. Reproduced with permission.

The U.S. Census Bureau publishes concentration ratios every five years for the four, eight, 20 and 50 largest firms by NAICS codes. Exhibit 5 illustrates that some old industries are still very fragmented (like banks), and some younger industries are much more concentrated. Obviously, intensity and speed of consolidation follow different, industry-specific patterns. The major reason for this is cost structure, more specifically the fraction of fixed cost. The higher the share of fixed cost in an industry, the higher the advantage of being large, and the higher and faster consolidation. Hi-tech industries typically have a high share of fixed cost for R&D. Surprisingly, the beer industry is another example of high fixed cost;[25] its concentration rate CR4 in the US stands at around 90% for 15 years now and has reached its maximum, constant level.

From the existing concentration rate, the current number of remaining players, and from M&A and consolidation rate in the past years, the valuator can develop a projection of the likely average annual consolidation rate for the next period, until a mature and stable stage will be reached. Such consolidation at company, firm or business level is a strong indicator for the pressure on the consolidation of trademarks. However, even if companies or firms merge and consolidate, they can still continue to use more than one trademark in the same industry. Their decisions to consolidate their trademarks are the result of trademark-specific economies of scale which require some additional analysis.

5. **Trademark consolidation economies.** As discussed above, one major reason for trademarks to disappear is trademark consolidation. If a business owns and operates more than one trademark in the same category or segment (often as a result of industry consolidation and M&A), it has the option to merge one of the trademarks into another. This

25 Raw materials and labour are cheap; fully automated plants and high cost for marketing and sales is mostly fixed.

option should be considered and carefully analyzed by the valuator even if management expresses its intent to continuously use the subject trademark indefinitely in the future. The key question is if the cost savings from the trademark consolidation outweigh the additional costs and the eventual loss of business/customers from the rebranding.

Cost savings from a trademark consolidation can be estimated by comparing the variable cost of brand marketing of the larger brand with the total cost of brand marketing of the smaller brand (in % or revenues). Eventually, there would be an additional gain from reorganizing or combining two separate sales forces. The net present value of these savings projected into the future represents the total consolidation gain which needs to be larger than the one time cost of the rebranding. In most businesses, cost of brand marketing is more fixed than variable/marginal, thus supporting trademark consolidation.

The cost of rebranding is determined by the nature of the customer relation. In a direct and personal relation, customers can be informed directly about the rebranding, at low cost. In anonymous relations, it takes time and expensive media budget to make sure that all customers get the message. In addition, there is the — often negligible — cost of redesigning graphics, layouts, packaging, business stationery, and so on. The replacement of illuminated signs and advertisements can be expensive. The rebranding of a business-to-business brand or a subscription based-consumer goods brand will be relatively inexpensive while rebranding a stapled consumer goods brand sold through retail channels can be quite expensive.

Further, the cost of rebranding includes an estimation of the loss of business resulting from the confusion of customers, or from customers who are not willing to purchase the rebranded offering. Such loss may occur if a) the information of existing customers is incomplete and not fully comprehensive, b) the nature of the brand to be consolidated is rather image-based than feature or performance based, or c) the consolidated brand had a perceptibly different positioning, value proposition or customer group.

It is important to understand that the likelihood of trademark consolidation will increase over time after a merger. Immediately after the merger, the acquirer is often concerned about the stability of customer relations and about losing business and customers due to a rebranding. The more confident the acquirer becomes through the course of time about the loyalty of these customers (and the acquired sales force), the more likely becomes the option of rebranding in the future. The valuator may consider the likelihood of such trademark consolidation/rebranding sometime in the future in his estimation of trademark RUL if the difference between savings and additional cost is already small today.

Conclusion

The determination of trademark RUL somewhere beyond five years but before infinity can be a difficult challenge. The standard setters considered these difficulties, providing for the possibility of indefinite useful life on one side and for the admission of "best estimation" instead of "determination" on the other. The valuator should be aware that an indefinite RUL can be a delicate route. Under certain circumstances, indefiniteness may result in overstated value, or in an old trademark sitting unalterably on the balance sheet.

Still, best estimation of trademark RUL needs some sort of quantitative analysis and justification. A careful analysis of all relevant factors, including the current situation of the brand as well as past and future lifecycle and consolidation dynamics helps to develop such best estimate. The purpose of an RUL analysis is not to conclude with a precisely determined RUL of, say, 22.5 years.

Its first purpose is to develop a clear understanding of the likelihood that the subject trademark will live longer or shorter than 40 years. If shorter, the second purpose is to best estimate if the RUL will most likely be closer to 10 or 40 years, or somewhere in between.

The data analyzed suggest that the prevailing practice is to conclude (perhaps with a preconceived notion) that trademarks have *indefinite* lives. Further, the data suggest that once determined an *indefinite*-lived asset, it is rare that a finite life is subsequently assigned to the asset. The reasons for this, some of which are suggested in this article, are elusive. However, the accounting literature is very clear: *indefinite* does not mean *infinite*. As has been proven in the past, the accounting standard-setters and regulators may, if need be, establish policy regarding issues such as this if the profession (i.e., chartered public accounting and intangible asset valuation) does not do so on its own.