The useful life of trademarks

Trademarks are often deemed indefinite simply because they can be continually renewed. However, almost no asset is imperishable and the indefinite life assumption has serious consequences for the values ascribed to trademarks

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Expected remaining life is a major determinant of any asset's value. The longer the asset generates profitable returns into the future, the higher its value. Most intellectual property has a finite life. With patents, remaining lifetime is determined by expiry of the patent itself; within a few years, the patented technology will become available to everybody. With copyrighted works such as music, films, text or pictures, their economic life is typically determined by how up to date they are; most copyrighted works depreciate fast and few are timeless. Similarly, software and databases need continuous updating to remain useful. Know-how and trade secrets cannot even be updated and are typically deemed to lose all of their value within a few years. Thus, intellectual property generally has a limited life in a world of continuous innovation. However, the situation is different for trademarks.

Accepted opinion among trademark practitioners is that trademarks are ageless and perpetual. Legally, no restrictions exist as to the registration and continued renewal of a trademark over time. Economically, the future lives of trademarks are often deemed indefinite and thus infinite. As such, trademarks have a special position among intangible assets, whose remaining life is typically finite and often short lived. In effect, many of today's most famous brands have been with us our whole lives and were even present in the lives of our parents and grandparents too. So, why should the lives of trademarks be limited?

There are two answers to this question. First, the reference brands cited in this context (often beverages such as Coca-Cola, Rémy Martin and Heineken) are just a few exceptions – most brands disappear sooner or later. Unfortunately, we do not count the many brands that have disappeared over time, such as those for cars, motorcycles, tractors, local beers, fashion, detergents and construction companies. The laws of competition and survival apply to brands just as they do to any other asset. Second, the longevity of trademarks is much more volatile than most of us believe; once undernourished, they can decay very fast indeed.

Time and competition will tell us when a brand's time is over. So why do we contemplate the lifetime of brands here? In fact, it is not just a simple matter of time. Brand assets are important parts of transactions and these transactions need a price tag. However, it is not possible to calculate the current value of a brand without having an idea of its remaining lifetime. Obviously, it makes a big difference if you expect revenues or excess earnings from the acquired brand for 100 more years or only for 10. It also affects your business, your branding strategy and your brand investments. As such, the remaining useful life of a brand is a vital determinant of its value.

To start our analysis of the expected lives of brands at the date of acquisition, we look at the standard issued by the International Accounting Standards Board (IASB). International Accounting Standard (IAS) 38 states: "An intangible asset shall be regarded by the entity as having an indefinite useful life when, based on an analysis of 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." This open definition reflects the fact that the legal right and ownership in a trademark and its ability to generate cash are not clearly limited. A limit might be foreseeable, but how can it be determined in numbers? The standard leaves the task of determining future lifetime to the appraiser. Appraisers usually hasten to add that 'indefinite' does not necessarily mean 'infinite', as a trademark can be impaired at any time in the future and its useful life can be changed from indefinite to definite. As such, the determination is only postponed.

How do appraisers cope with that challenge in reality? To understand more about this, we have analysed the trademark lifetime assumptions from 4,500 acquisitions of branded businesses between 2003 and 2013, which we retrieved from the MARKABLES brand valuation database. Overall, in precisely 50% of all trademark valuations, it was concluded that no limit was foreseeable. Accordingly, an indefinite lifetime was assumed and revenues from that trademark were expected and projected into perpetuity. For the other half of the cases, the appraiser determined a definite future lifetime averaging 10.7 years. The range of lifetimes extended from less than six months to 50 years. Unsurprisingly, the four round numbers five, 10, 15 and 20 years accounted for 55% of all definite lifetimes and illustrate the difficulty of precisely determining a foreseeable lifetime.

In a second step, we analysed whether and how these numbers develop over time. With growing experience and know-how from past valuations, would more trademarks be valued with a definite remaining life? The answer is clearly yes. Figure 1 illustrates the breakdown into definite and indefinite over time. Back in 2003, definite lives accounted for little more than 20% of all remaining life assumptions. By 2013 this number had increased to around 60%. Similarly, the mean value of definite lives fell from 12.5 years to around 10 years in the same period (Figure 2). Overall, these trends must be considered a substantial shift towards shorter expected lives for trademarks.

Five major reasons might explain this shift. One is that methodologies to determine the future economic life of assets have improved. Ten years ago, useful life analyses were more or less limited to Iowa survivor curves. Today, more models for the prediction of mortality, diffusion and substitution are applied to extrapolate historical data into future growth trends, including Bass, Fisher Pry, Gompertz, Pearl-Reed, Rogers and regression models. Second, with the Internet, it has become much easier to conduct real survivor and obsolescence analyses of brand samples over a 10-year period. Third is that acquirers realised that the relay of acquired brands and rebranding of the acquired business can be an economic alternative. Fourth is that the annual impairment test required for indefinite-lived assets is costly and more expensive than regular yearly depreciation.

Finally, it might well be that appraisers increasingly realised that the value of brands as capitalised on accounts was exceeding their fair value, and that an extraordinary amortisation or impairment was needed to represent their carrying value. Such impairments certainly help to sharpen the view of the finiteness and mortality of brands. In addition, listed brand owners dislike informing their investors of such impairments. Impairment is like conceding that the business forecast and guidance were too optimistic – bad news for share prices. Hence, having brands with indefinite or long lives and slow depreciation on the balance sheet implies a certain risk of impairment, which brand owners, accountants and appraisers increasingly try to avoid.

In a last step, we analysed whether and how national accounting standards and habits influence the useful lifetime attributed to brands. We were surprised to see the

FIGURE 1: The useful life of trademarks in accounting

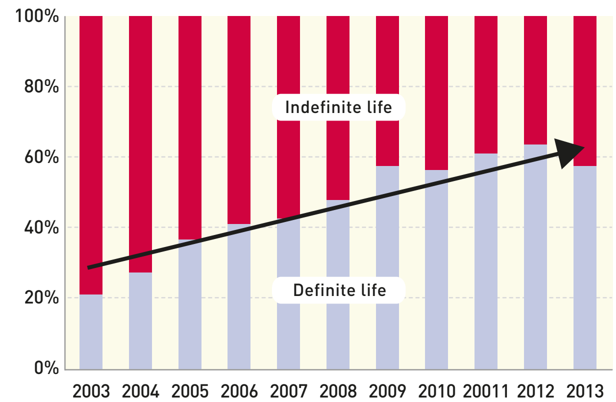
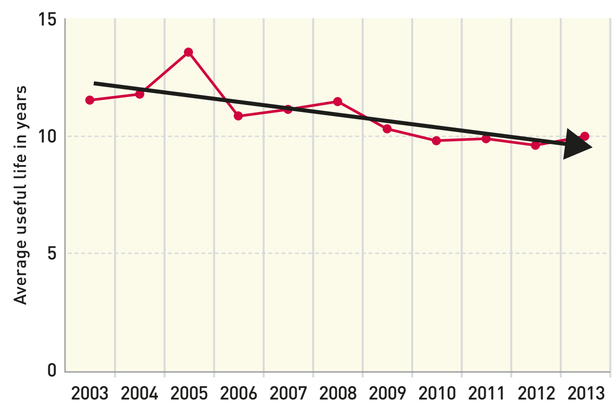


FIGURE 2: The useful life of definite-lived trademarks



differences. The split between trademarks with indefinite and definite lifetime varies from 27:73 for valuations governed by UK accounting and reporting rules to 49:51 in the United States, 61:39 in Canada, 72:28 in Germany and 88:12 in France (see Figure 3). To understand these differences, it is helpful to have a look at the accounting standards of these countries.

In the United Kingdom, the useful life of intangibles is governed as follows (FRS 10.19): "There is a rebuttable presumption that the useful economic lives of purchased goodwill and intangibles assets are limited to periods

BRAND DECAY

(Quoted from Jean-Noel Kapferer, *The New Strategic Brand Management*, 5th ed 2012)
A fast-moving consumer goods brand that was number two in its popular category was phased out after it was acquired by number three. After the acquisition, combined number three and two became the new market leader. For some reasons, the discontinued brand was tracked in consumer research for some years. While aided and unaided consumer awareness still kept more than half of their original level 6 years after the phase-out, the brand lost almost all of its top of mind (salience) position that is relevant for purchase. In other words, other brands took over that part in consumers' preferences. While customer memories tend to forget slowly, customer behavior changes quickly. Competitors fully take the free mind space – and the shelf space – within a short period of time. Usually, the acquirer of the discontinued brand will keep the trademark registration alive for a long time. However, this does not alter the fact that the value of the discontinued (dormant) trademark is close to zero. The current owner would not take the risk of selling it for use in the same category so that it could be revived in its own market. And in a different category, its value is small if any.

of 20 years or less. This presumption may be rebutted and a useful economic life regarded as a longer period or indefinite only if: a) the durability of the acquired business or intangible asset can be demonstrated and justifies estimating the useful economic life to exceed 20 years; and b) the goodwill or intangible asset is capable of continued measurement (so that annual impairment reviews will be feasible)." Hence, the accounting and reporting practice is explicitly encouraged not to exceed useful lives of 20 years, the results of which can be seen from the accounting of trademarks. The new version of FRS 102, published in 2013 (§18.19 and 18.20), goes even further. Accordingly, indefinite lives are no longer permitted and definite lives shall not exceed five years unless they can be reliably estimated.

In the United States, the useful life of intangibles is governed by FAS 142: "If no legal, regulatory, contractual, competitive, economic, or other factors limit the useful life of an intangible asset to the reporting entity, the useful life of the asset shall be considered to be indefinite. The term indefinite does not mean infinite." Here, the determination of the trademark's lifetime is left open to the circumstances and analysis of the appraiser or accountant, resulting in a 50:50 split between indefinite and definite in valuation reality.

In Canada, Section 3064 of the Canadian Generally Accepted Accounting Principles (GAAP) reads more or less identically to US FAS 142: "An intangible asset is considered to be of an indefinite useful life when no legal, regulatory, contractual, competitive, economic or other factors limit the useful life of an intangible asset to the enterprise." As a result, the share of indefinite-lived trademarks in Canada is 61%.

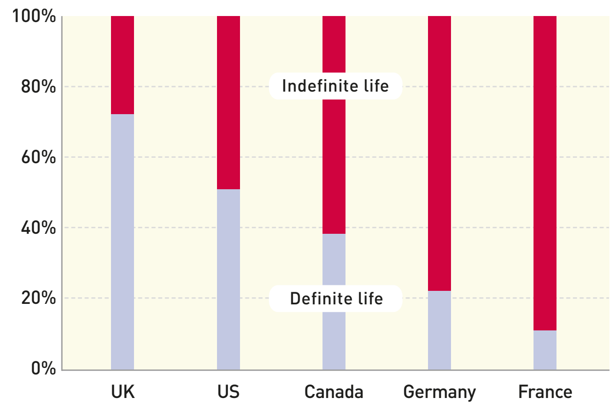
In Germany, the prevailing instructions for the accounting of intangible assets can be found in IDW S5:"It is not permitted to generally assume an indefinite lifetime for trademarks. Product brands typically have a definite life based on product life cycles. Corporate brands typically have indefinite lives." The wording suggests that German accountants start from a general assumption of indefinite life, which is then specified and narrowed in order to avoid all trademarks being assigned an indefinite life. Still, the share of indefinite-lived trademarks is 78% in Germany.

In France, accounting for acquired trademarks is governed by PCG 205. Nothing is specified here regarding their useful life. However, the *conseil national de la comptabilité* issued its view in some opinion letters that trademarks which are intended to be maintained and supported are not amortisable and must have an indefinite life. As a result, we find the highest share of indefinite-lived trademarks in France.

These findings suggest that the lifetime of trademarks in the United Kingdom, Germany and France is highly influenced by accounting standards. In contrast, the findings from the United States and Canada reflect a more unbiased view of how accountants and appraisers forecast the remaining useful lives of trademarks. Accordingly, 50% of trademarks are assigned an indefinite life and the average finite life of the other 50% is estimated to be 9.8 years.

Internationally, the London-based IASB is in charge of developing and updating the International Financial Reporting Standards (IFRS) and the IAS. The determination of the useful life of trademarks is governed by IAS 38: "An intangible asset shall be regarded by the entity as having an indefinite useful life when, based on an analysis of 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." The wording is close to that of US FAS 142. Although most listed companies assert to adopt IFRS and IAS standards in their accounting and public reporting, the national standards still seem to prevail.

FIGURE 3: Useful life of trademarks by reporting jurisdiction



As we have stated above, the remaining useful live is crucial for the present value of a trademark. Ten or 20 years of projected revenues, or even a revenue stream into perpetuity, can make a big difference, as can be seen in Figure 4. Graph A outlines a typical projection of revenues with indefinite life into perpetuity, growing slowly at a constant rate. Graphs B and D show the same revenue projection, which then stops in years 20 and 10, respectively. Graphs C and E show revenue curves with a steady decline to zero in years 20 and 10. The percentages show the values in these five different lifetime models based on the indefinite model being 100%. We estimate from the MARKABLES database that around 80% of all definite life models assume trademark revenue curves as in B and D, and the remaining 20% as in C and E. This means that when an analyst determines the lifetime of a trademark to be definite instead of indefinite, the resulting present value is on average 42% lower, all other factors being equal (eg, discount rate, tax rate and growth).

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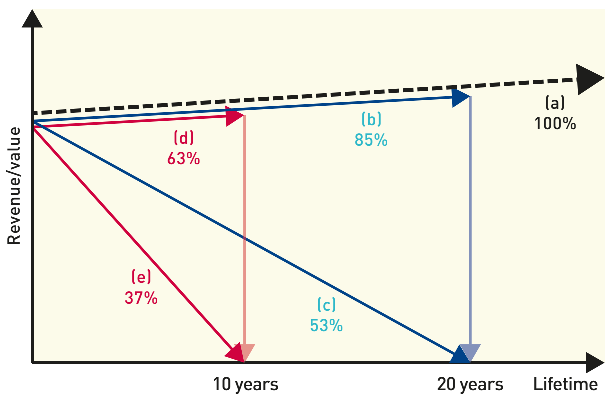
Our analysis results in four propositions:

- Trademark appraisers should proceed with care when assuming indefinite lives. The projection of asset-specific revenue streams into perpetuity is risky and leads to impairments sooner or later. Worldwide, the trend is clearly towards shorter useful lives of trademarks.
- National standard-setting bodies should try to harmonise. It is unacceptable that in some countries the wording of the accounting standard suggests

FIGURE 4: Revenue projection curves and trademark value



not amortising brands, while in other countries it is exactly the opposite – this makes it very difficult to compare the resulting brand values.

- The professional associations of accountants and appraisers and their education bodies should develop methodologies and provide case studies of how to determine the likely lifetime of brands. Current methodologies focus largely on customer churn rates and product technology substitution models which have little in common with trademark life.
- Trademark appraisers must direct their attention to aligning the guideline comparable transaction data (ie, the appropriate trademark royalty rate and/or discount rate) with the useful life assumptions. Most trademark licence agreement last between three and five years. It is a serious error to mindlessly apply royalty rates from short-lived trademark licensing agreements to long-term or indefinite-lived trademark valuations. No serious licensee would ever accept paying a percentage royalty rate on sales into infinity. Three different alignments can take this into account: a lower royalty rate, a shorter (definite) lifetime or a discount rate that increases over time. **WTR**

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