

MENA Private Equity focus: Unlocking the value of portfolio companies through strategic brand solutions?

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The rise of Private Equity (PE) in the Middle East & North Africa (MENA) region over the last four years has been nothing short of meteoric. By the end of 2008, there were more than 120 private equity houses present in the region having raised a combined \$21 billion in total assets under management.

How quickly the world changes in 12 short months. The number of deals closed by MENA funds in the first nine months of 2009 fell by 65 percent to 12, coupled with a 75 percent fall in investments to \$359 million compared to the same period in the year before. Industry observers estimate that there are now less than 40 PE houses remaining after a year that has witnessed the first contraction in the region's total GDP in more than two decades.¹

But from the wreckage of the last year new opportunities are emerging. In this weakened economy, an increasing number of companies are looking to either prune their portfolios to raise cash or exit non-core businesses. Conditions are ripe for players with aggressive ambitions to strengthen their market share or make cross-region consolidation plays. Industry analysts predict there will be **an estimated \$5-6 billion in new capital flowing into the region during the next four years,**² and that cash will be looking for strong investment partners that can deliver solid returns.

Private equity's entry into the MENA region was propelled by a period of unprecedented growth. As with any fast moving market, deal volume was the name of the game which naturally led to an emphasis on the acquisition side of the investment process. Any operational improvement activity within portfolio companies was primarily limited to financial restructuring and management transfer. However, in the current economic climate the market has changed, and correspondingly, so have the tactics of the leading PE players. **Many firms are using the slowdown in deal activity to take the time to deepen their due diligence process and generally become more active in the operational aspects of value creation within their portfolio companies.**

While it is heartening to observe this positive and much needed trend, we still frequently observe a neglected area—branding. It appears that when PE firms are considering the many potential improvement activities available within the value chain of a portfolio company, branding is often either ignored or relegated to a list of marketing to-do's. It should be a priority action.

+ BRAND STRATEGY HAS A CRITICAL PART TO PLAY IN BOTH DUE DILIGENCE AND OPERATIONAL IMPROVEMENT. FAILURE TO ADDRESS THIS WILL ULTIMATELY MEAN THAT POTENTIAL PROFITS WILL REMAIN UNREALISED.

An intelligently aligned brand strategy will directly and positively impact financial returns. It is both a driver of operational change and a critical success factor in enhancing brand equity and elevating investments

Examples

Take Kuwait-based Agility for example, which grew year-on-year revenue by 26 percent and landed six major, long-term contracts in 2007 after simplifying its brand architecture and integrated identity.³

Global payments company, American Express, reinforced its brand by streamlining its global product portfolio, enabling it to grow total cards-in-force by 41 percent between 2001 and 2006—adding more than 22 million cards in circulation.³

The financial community started to recognise the financial value of brand names in the early 1980s. It is now commonly known as Brand Equity and contributes considerably to the total market value of an enterprise. In 2003, *Fortune* magazine reported on a study of the market value of 3,500 U.S. companies that clearly demonstrated this phenomenon. It showed that the **relationship of brand equity to book value increased from 3 percent in 1978 to 72 percent in 1998.**

Putting these percentages into context. **In 2009, the top five publicly listed Gulf Corporation Council (GCC) power brands (Emirates, Qtel, STC, Zain and Etisalat) had a combined brand value of \$11.5 billion.**⁴ They still have a long way to go to reach the ranks of Wal-Mart (\$40.6 billion) or Coca-Cola (\$32.7 billion), but their growing value clearly demonstrates the benefit of taking a strategic approach to brand building.

Since 2005, companies in countries adopting International Accounting Standards (IAS) must consider “acquired brands to be intangibles which can be separately identified and have separate economic lives to be valued and included in the balance sheet.” Brand valuation is now recognized as a primary tool in management decision making and is used for value-based marketing, M&A planning, and for the recognition of intangible assets on company balance sheets.

For private equity firms, a strategic look at branding can add an interesting and profitable dimension to portfolio management. Essentially, there are two areas where brand strategy should be incorporated into your process:

1. Pre-acquisition assessment—Incorporating Brand Valuation and a Brand Audit into the due diligence stage

Brands are incredibly powerful in altering demand patterns, and a brand’s value can be equally volatile. As with all balance sheet assets, brand value is a snapshot figure, and it is important to understand the underlying characteristics. The due diligence stage is a critical opportunity to gain a deeper insight into a brand’s potential for growth and could make the difference between a positive or negative ROI.

Brand Valuation has a number of approaches, and the chosen method is largely dependent on the quantity and quality of information available to support your calculation⁵). The most commonly used valuation methods are based on:

- + **Cost**—this is the most simplistic method and looks at all the costs that were incurred in creating the brand or what it might hypothetically cost to recreate the brand. However, unless the brand has been severely mismanaged, the resulting figure from this calculation is usually substantially less than the actual value.
- + **Market value**—this method compares market transactions involving brands in the same competitive set. The reliability of the resulting figure rests upon the comparability of the set and availability of accurate pricing.
- + **Economic use**—this is a calculation of the economic value of the brand to its current owner in its current application. It is based on the discounted earnings (gross profit) attributable to selling a branded rather than a non-branded good.

- + Royalty relief—in this method, the brand is treated as a separate entity which charges a royalty to the operational side of business for use of the name. The valuation is based on the net present value of the future royalty revenue stream.

A **Brand Audit** can enhance an understanding of the elements likely to affect a brand's future equity. Generally speaking, it covers what is known about the brand regarding the:

- + Overall market—a brand's equity is relative and must be considered within the market in which it competes. Key market data is assessed from the perspective of its potential to affect the brand's equity.
- + Competitive set—current marketing and communications strategies of the brand and its key competitors are compared in relation to their impact on brand equity.
- + Current portfolio—Evaluate how the brand would potentially fit into / overlap the brands of your existing PE portfolio.
- + Growth opportunities—Investigate potential product and service categories that could serve as credible extension opportunities for the brand.

The resulting evaluation of the brand's strengths and weaknesses are used to develop insights into the current strength of the brand's equity and what must be done to sustain, increase, and protect it.

2. Post-investment involvement—Brand strategy as an integral component of the strategic planning and operational improvement process

Industry sector growth in the MENA region has now shifted from almost unaided double-digit growth to compounded growth rates closer associated with saturated or even declining markets. Merely monitoring the performance of portfolio companies is no longer an option. With a glut of companies to choose from in every category, consumers will gravitate to those with clear brands and a solid offering.

The **brand decisions that companies make ultimately affect the organisation's long-term ability to achieve its business objectives** and it is imperative that your portfolio companies have a clearly articulated positioning that differentiates them from their competitors. If done correctly, the path to creating a new brand or refreshing an existing one is a journey that will give the entire organisation an in-depth understanding of the market and a clear direction to capitalise on opportunities.

Essentially, the Brand Strategy process can be summarised in three stages:

- + Develop Brand Purpose
Generic company mission statements are not a declaration of purpose. Purpose is the definitive statement about the difference an organization is trying to make in the world and successful organisations always have a strong sense of purpose.

For example:

GE Imagination at work

Brand purpose: Lead the next wave of innovation and solve the world's challenges

P&G Touching Lives, Improving Life

Brand purpose: Improve the lives of the world's consumers, now and for generations to come

Purpose motivates employees, supports true leadership and drives sustainable competitive advantage.⁶ It is a combination of the organizations goals and intentions which must be defined by the leadership of the company and should be used as a force for alignment among all stakeholders.

+ **Ensure Brand Differentiation and Relevance**

Be different in a way people care about. This means really getting to know the market to capitalise on gaps and develop a long-term growth strategy.

The findings from the pre-acquisition Brand Equity Audit will serve as the basis for a more detailed analysis of the market to identify consumer market segment needs and prioritise them according to size and fit within the business. The promise of the brand must then be defined to be relevant to the segments that the company decides to serve.

For example:

JetBlue Airways entered the market a decade ago with one purpose: to provide low- cost American flights with top-notch customer service. The founder and CEO of JetBlue, David Neeleman, is a veteran of the airline industry and he knew this was the weak point in the market and built a brand around a hip, customer-oriented airline. The airline continually works to ensure they remain true to their brand promise and it has been a key factor in their continued success today.

+ **Align the Brand Experience**

Understand where your customers come into contact with the brand. These touch points must be utilised to make the brand a living, breathing phenomenon that becomes firmly embedded in the minds of customers.

For example:

In 2008, within weeks of Howard Schulz retaking the helm of Starbucks, the ailing iconic company he founded, he issued a memo to senior executives detailing the reasons for the decline of the brand. He cited that changes in store design and practices intended to make the business more efficient actually meant that their locations had become devoid of soul, sterile and lacking the warmth of a neighbourhood store. This realisation led to a plan to re-invest in the customer experience and renew the intimacy it once had with customers.

Aligning the brand experience with the brand promise is not an easy task with the proliferation of communication channels, distribution channels and the variety of branding signals in today's market. But it is imperative that the Brand Experience is brought to life with every interaction and that means overhauling people, products, locations, pricing strategies and marketing activities. **Ultimately, the more powerful the experience, the more powerful the brand impression.**

Whether your exit strategy is through secondary buyout or via an IPO, the current and future value of your portfolio companies must be fully understood and communicated if it is going to translate into a return on investment. Be sure to meticulously document your research and strategy development process, as your path to a clearly defined brand strategy will serve as a critical tool in convincing potential buyers of the current and future value of the brand.

Summary

In the current low deal volume environment, PE firms have the capacity to get more involved with their investments. Challenge your team to use their research and analysis skill-base to help your portfolio companies better understand their markets, and where necessary, bring in external resources to develop clear, progressive brand strategies. Future investments targets and your Limited Partners will undoubtedly value the additional contribution of your firm to the growth stories within your portfolio.

We acknowledge that many PE investments in the MENA region are growth capital injections into entities within large family conglomerates and this often adds an additional layer of complexity. Persuading owners and their senior management team of the long term benefits of a strategic approach to branding can be a complicated and sensitive process. Resistance is a common reaction to external advice, even from a major investment partner, as it is often interpreted as “outside interference”. However, the rise of international competition in the region is forcing these traditional operations to become brand savvy. In these situations it is important to demonstrate a deep knowledge of their organisation and genuine audience and consumer insights as part of the pre-deal process. This is a journey of trust and, it is imperative to demonstrate your commitment to being a positive partner that can add real value to their future growth.

Above all, **branding is not a one-time exercise**; it is an iterative process that needs ongoing attention to align the organisation and build trust with its customers. It's a resource intensive activity, but unlocking the potential of the brands in your portfolio can definitely generate significant returns.

References:

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