The Role of Strategic Cost Management in Marketing Decisions: A Case Evidence of Brand Acquisition Assessment

Richard Kristoffer S. Manapat^a, V. G. Sridharan^b

^a*Institute of Certified Management Accountants, Australia, and
Philippine Institute of Certified Public Accountants, Philippine*

^b*Adelaide Business School, The University of Adelaide, Australia*

Abstract

While the role of strategic cost management (SCM) is heralded to pervade through all the links in a firm's value-chain (Anderson, 2006; Shank & Govindarajan, 2004) the specific role of SCM in relation to a firm's marketing function has thus far been limited to a few areas such as product pricing and analysing customer profitability through activity-based cost allocations (Datar & Rajan, 2018; Foster & Gupta, 1994; Van Raaij, 2005). This paper presents a case study to show how SCM concepts can be extended to evaluate brand acquisition by a large organisation. Using shareholder value analysis for pricing the brand and combining with financial statement analysis and strategic positioning models such as Porter's five forces and SWOT, this paper conducts an assessment in order to offer recommendations for a multi-billion peso investment of a large Philippine-based processed foods company seeking to acquire a new brand.

Keywords: Brand; Shareholder Value Analysis; Strategic Cost Management

1. Introduction

The role of strategic cost management (SCM) in assessing the benefits to the different links (e.g., design, purchases, manufacturing, and marketing) in the value-chain of an organisation is entrenched in the cost management literature (Anderson, 2006; Shank & Govindarajan, 2004). However, the roles relating to how SCM benefits the marketing function has thus far been limited to offering pricing methods and examining the

profitability provided by different customer groups (Datar & Rajan, 2018; Foster & Gupta, 1994). This paper extends the SCM techniques to a different marketing activity, brand acquisition¹, to conduct an assessment and make recommendations to the senior management.

Over the past few years, brand acquisitions have emerged as a viable expansion strategy for rapid business growth (Sinclair & Keller, 2017). Motivations for acquiring brands include the economies of scale it generates, as well as synergistic effects in administrative, sales, market share and corporate reputation (Balmer & Greyser, 2003). Despite its increasing popularity, barring a few studies (e.g., Guilding, Cravens & Tayles, 2000), there is surprisingly little in the literature relating to the intervention of SCM in assessing brand values. This dichotomy (between the popularity of brand acquisition concept and the limited SCM applications in the concept) offers considerable opportunities for further research. A comprehensive brand value assessment has significant practical and policy prescriptive implications (Basu, 2006). Our paper is a small attempt in filling this gap.

The remainder of the paper is structured as follows. Section 2 provides the background of the case study within which the author had a participative role in conducting the assessment of the brand value. The section ends with a statement of the research problem. Section 3 presents the diverse brand-related data including product development, supply sources, marketing, management information system and financial summary. Section 4 outlines the conceptual SCM framework that is used to conduct the analyses. Section 5 describes the analyses and presents the findings. Section 6 concludes.

2. Background and Research Problem

Samsan Food Inc.² (SFI) is one of Philippine's largest food companies that aggressively seeks to acquire competitive brands apart from improving its own brands. SFI's core business is in manufacturing, marketing, and distribution of protein-rich poultry products. In a span of 80 years, SFI has built 20 in-house brands and acquired eight other

¹ In theory, analysis of brand acquisitions are alternatively subsumed under mergers and acquisitions (M&A) literature (Bahadir, Bharadwaj, & Srivastava, 2008; Basu, 2006; Guzmán et al., 2012)

² The names of both acquiring and acquiree companies along with their brands have been concealed to protect the privacy of the entities.

businesses, which have become immensely popular in the market – almost becoming ‘household’ names. SFI has seven manufacturing facilities across the country, strategically located adjacent to supply sources.

In 2017, SFI received an offer to acquire the brand *Good Boy*, the market leader in processed cheese, from IN-JAE Corporation (IN-JAE). Upon review of its portfolio, IN-JAE decided to shift its focus to its core category of wholefoods and spin off the Good Boy brand to SFI, which has more product alignment. IN-JAE seeks a 5 billion pesos valuation for the Good Boy brand as well as its manufacturing equipment.

The CEO of SFI handed over the project of assessing this offer author, who in turn, obtained a participatory role in conducting this case analysis. The project execution encompassed end-to-end analysis of both strategic and financial viability, thus culminating in a recommendation. The research problem thus was: ‘Should SFI acquire the Good Boy brand at 5 billion pesos?’

This research question is analysed using two different lenses – Strategic and Financial:

Strategic

- a. Is Good Boy a valuable brand to acquire?
- b. Is this acquisition aligned with SFI’s strategy?

Financial

- a. What is the financial health of the Good Boy brand?
- b. What is the valuation and the justifiable acquisition price for the brand?

3. Case Data

This section provides an overview of the case data relating to the product, market, logistics and supply sources, and financial position.

3.1 Product Overview

Good Boy brand entered the Philippine market in 1986 with a one-product strategy through the launch of its iconic sliced cheese. Today, Good Boy maintains an expanded portfolio that includes cheese spreads and cheese dips. Table 1 highlights these details.

Table 1. Historical Sales Per Product

<i>Product</i>	<i>2014</i>		<i>2015</i>		<i>2016</i>	
	<i>Mil. ₱</i>	<i>% Share</i>	<i>Mil. ₱</i>	<i>% Share</i>	<i>Mil. ₱</i>	<i>% Share</i>
Sliced Cheese	2,134	67%	2,347	67%	2,653	68%
Cheese Spread	300	9%	315	9%	334	9%
Cheese Dips	752	24%	842	24%	926	23%
Total	3,186	100%	3,504	100%	3,913	100%

3.2 Product Development

All recipe and bill of materials are owned by IN-JAE and are proposed to be transferred to SFI after successful acquisition. All products are produced in the plant of IN-JAE in Pasig, Philippines.

Product development is mainly done by IN-JAE's research and development (R&D) group in coordination with the Marketing Department. Generally, Marketing gathers the insight from the consumers, comes up with the ideal new variant or product, and works with R&D for the formulation. This entire process takes approximately six to twelve months.

3.3 Marketing Program

The Good Boy brand has been on the market for over 30 years and, throughout its history, the brand has been subject to various marketing campaigns that cater to its target markets. Its campaigns range from highlighting health benefits such as Calcium, Vitamin A, and Protein, besides promoting its delicious taste or its versatility in application to different dishes.

In 2016, the advertising and promotion expense of the Good Boy brand reached 438 million pesos or 11% of Sales (see Table 2). During this year, advertising and promotion stood out to be the largest expense of the Good Boy brand next only to the product cost. Presumably, this cost was needed to steadily increase the sales revenues over the past three years.

Table 2. Advertising and Promotion (A & P) Support in 2016

<i>Product</i>	<i>Sales (Mil. ₱)</i>	<i>A & P</i>	<i>% of Sales</i>
Sliced Cheese	2,653	323	12%
Cheese Spread	334	15	4%
Cheese Dips	926	100	11%
Total	3,913	438	11%

3.4 Sales and Distribution

The Good Boy brand is sold directly to more than 400 accounts nationwide. It is available in all supermarkets and groceries. It is also available in downline stores such as sari-sari stores (mom-and-pop stores), mini groceries, and public market stalls.

In terms of sales channels, Modern Trade (MT) and General Trade (GT) account for 55% and 45% of the business, respectively. The top 10 MT and GT stores account for 78% of sales and are considered to be the brand's pareto accounts. Table 3 presents the breakdown of customers in the two types of channels.

Table 3. Breakdown of Customers in Sales Channels

<i>Channel</i>	<i>Customer</i>	<i>Sales (Mil. ₱)</i>	<i>% Share</i>	<i>Rank</i>
Modern Trade	Drake Store	743	19%	1
	Only One Mart	548	14%	2
	Shop Mart Inc.	196	5%	6
	Lucas Store	168	4%	7
	Lia Mart	78	2%	9
	Others	419	11%	
	Sub-Total	2,152	55%	
General Trade	Mirel Distribution Group	509	13%	3
	Gold Wholesales Inc.	352	9%	4
	Medusa Merchandise	293	7%	5
	Kapihan Tindahan ATBP	117	3%	8
	Ethan Corp	59	2%	10
	Others	431	11%	
	Sub-Total	1,761	45%	
Total		3,912	100%	

3.5 Management Information Systems

SFI uses Epicor as its ERP Tool and Sandbox Planning Analytics as its Financial Planning Tool. The historical data of the brand coming from IN-JAE will be provided to the buyer in order to come up with proper financial model, sales projections and forecasts, and distribution assumptions.

IN-JAE uses SAP software as their enterprise resource planning (ERP) Tool. One may argue that since this transaction relates to brand acquisition, the system being used by the selling company is not relevant.

Note however that the historical data arising as SAP outputs are required to be re-formatted or customised to fit into SFI's own ERP tool namely, Epicor.

3.6 Supply Information

3.6.1 Sourcing

The main raw materials of Good Boy branded products are milk, cultures, and rennet. These are sourced from different suppliers across the globe to ensure availability of supply at all times, proper price control, and efficient ordering process.

3.6.2 Production

IN-JAE is currently producing these products at its plant in Pasig City, Philippines. If the acquisition were to take place, the equipment from the IN-JAE plant will need to be transferred to SFI's idle plant in Cavite, Philippines. This will enable SFI to bring synergies to its operations by putting the Good Boy's plant close to its poultry plant.

3.6.3 Logistics

SFI has three primary warehouses and 10 sub-distribution centres across the Philippines. It also contracts various trucking and shipping companies to deliver its goods. Good Boy's products will ride on SFI's existing massive distribution structure.

3.7 Financial Summary

The three-year historical income statement as shown in Table 4 was provided by IN-JAE. It will be discussed in detail in Section 5.

Table 4. Comparative Income Statement from 2014 to 2016

	<i>2014 (Mil. ₱)</i>	<i>2015 (Mil. ₱)</i>	<i>2016 (Mil. ₱)</i>
Revenue	3,186	3,504	3,913
Cost of Goods Sold	1,593	1,647	1,879
Gross Profit	1,593	1,857	2,034
Gross Profit Margin	50%	53%	52%
Marketing Expenses	414	350	438
Selling Expenses	159	210	254
Distribution Expenses	127	158	168
Administrative Expenses	96	105	117
Total Operating Expenses	796	823	977
Net Profit Before Tax	797	1,034	1,057
Tax Expense	239	310	317
Net Profit After Tax	558	724	740
Depreciation and Amortisation	80	80	80
EBITDA	638	804	820

4. Conceptual Framework

This section describes the conceptual framework that combines models for evaluating strategic position, environment, financial health and fair price and expected returns.

4.1 Strategic Position: Porter's Five-Forces Analysis

This model seeks to identify and examine the competitive forces that influence an industry and helps channelise a firm's strategic positioning (Porter, 2008). Note that Porter's model can also be applied to even a segment within an industry such as the specific product market in SFI's case study.

4.2 Environmental Scanning: SWOT Analysis

This model identifies the relative strengths, weaknesses, opportunities, and threats that prevail for a specific firm in relation to other firms and the industry. The analysis highlights how a firm can benefit from its strengths and capitalise on the available opportunities while managing the weaknesses and threats.

4.3 Financial Health: Financial Statement Analysis

This analysis examines growth in revenues, gross margins, and net margins and the control of operating expenses of the Good Boy brand from out of the data collected from IN-JAE. Further, the data are collated along with SFI's current performance in order to verify how the brand acquisition is likely to add further value.

4.4 Brand Value and Fair Price: Shareholder Value Analysis

This analysis involves a complementary examination of some strategic and financial models that help assess the brand value and fair price. In the first step, shareholder value analysis (also called 'strategic value analysis) comprises identifying free cash flows (which is earnings before interest, tax, depreciation and amortisation (EBITDA) minus working capital) and adding it with the terminal value (computed as a multiple of price-earnings) of the brand. In the second step, this total value is discounted at a specific rate relevant to the firm (weighted average cost of capital) in order to arrive at the final shareholder value.

5. Analysis of the Data

5.1 Porter's Five-Forces Model

5.2 SWOT Analysis

<p>Strengths</p> <ul style="list-style-type: none"> • Good Boy brand's Sliced Cheese has 86% market share • Good Boy brand and SFI are currently in a strong financial position • Good Boy's products are aligned with SFI's core competency of producing, distributing and marketing protein-rich products. • Good Boy's will benefit from synergies with SFI's operations (e.g. warehousing, distribution, sales force, etc). • Economies of scale will be in play in the common materials currently being bought by SFI. 	<p>Weakness</p> <ul style="list-style-type: none"> • Good Boy brand's Sliced Cheese is seen as an old category especially by Gen Z and Gen Ys. • Good Boy brand's sizes in Cheese Spread and Cheese Dip are still very small compared to the size of its sliced cheese.
<p>Opportunities</p> <ul style="list-style-type: none"> • SFI will be in the position to utilize its experience in Marketing to further grow the Good Boy's brand. • SFI can enter more categories using the Good Boy's brand name. • SFI can leverage on the demand of Good Boy's Cheese by bundling its products together. • There can also be cost synergies in terms of supply chain, manufacturing, distribution and marketing. 	<p>Threats</p> <ul style="list-style-type: none"> • There is a minor threat of other competitors coming up with a Me-Too product but SFI believes this is a remote possibility given the strength of the Good Boy's brand and the size of prize for the competitors.

5.3 Financial Statement Analysis

5.3.1 Revenue Growth

The Revenue growth rates indicate a healthy increase in sales from 2014 to 2016, with a total compounded annual growth rate of 11% (see Table 6). Under the Philippine setting, this growth rate is deemed healthy since this is roughly twice the annual GDP growth rate. Slower growth rate can be seen in the Cheese Spread product group, and therefore added attention should be given to this product line.

Table 5. Revenue Growth Rates

<i>Product</i>	<i>2015</i>	<i>2016</i>	<i>CAGR</i>
Sliced Cheese	10%	13%	11%
Cheese Spread	5%	6%	5%
Cheese Dips	12%	10%	11%
Total	10%	12%	11%

5.3.2 Gross Profit Margin

As shown in Table 4, gross profit margins were maintained at a 3-year average of 52%. This is an incredibly healthy GP rate for a canned food product, which usually has an average of 30%. It shows the following positive qualities for the brand:

- Strong pricing power (maintain GP margins while being able to increase sales 11% annually).
- Manageable cost of materials and ingredients
- Stable cost of production

5.3.3 Operating Expenses

Operating Expenses (OPEX) as a % of Sales is very stable at 24~25% of Revenues. In the past 3 years, no major swings can be seen in the different OPEX types. The largest share of OPEX went to Marketing

Expense at 52% in 2014 (down to 45% in 2016), while smallest spend is on Admin Expense at 12%.

Likewise, OPEX as a % of GP is very healthy at 49% in 2016. This is an important metric as it indicates how much of GP is spent on OPEX. This resulting figure of 49% simply means that the balance 51% goes to profit and tax which shows a healthy trend for the firm (see Table 6).

Table 6. Operating Expenses as a Percentage of Sales and Gross Profit

	2014		2015		2016	
	<i>% of Sales</i>	<i>% of GP</i>	<i>% of Sales</i>	<i>% of GP</i>	<i>% of Sales</i>	<i>% of GP</i>
Marketing Expenses	13%	26%	10%	19%	11%	22%
Selling Expenses	5%	10%	6%	11%	7%	13%
Distribution Expenses	4%	8%	5%	8%	4%	8%
Administrative Expenses	3%	6%	3%	6%	3%	6%
Total	25%	50%	24%	44%	25%	49%

5.3.4 Profit Margins and Profit Growth

Profit Margins for the Good Boy's is strong at 18-21% of Sales. The 2016 profit margins went down to 19% due to lower GP% and higher OPEX% compared to prior year. This level of profitability is very healthy relative to the profit margins of SFI as can be seen in the Table 7.

Table 7. Profit Margins and Growth

	2014	2015	2016
Net Profit After Tax	558 Mil. ₱	724 Mil. ₱	740 Mil. ₱
NPAT%	18%	21%	19%
NPAT Growth		30%	2%

Profit margins of Good Boy’s is double that of SFI’s. From a profit margin perspective, this acquisition will be accretive to SFI and will raise the latter’s total profit margins (see Figure 1).

Figure 1. Good Boy’s vs. SFI Profit Margins

5.4 Shareholder Value Analysis

The Shareholder value analysis, a widely known approach in measuring the potential financial benefit of a major business decision (Mills & Print, 1995), was used in analysing the acquisition of the Good Boy brand. To project the financials if SFI acquires the brand, a 5-year forecast was prepared (see Table 8) using the historical financials provided by IN-JAE (baseline), coupled with assumptions using conservative numbers:

- Lower figures of 10% revenue growth and 50% GP margins were used year on year.
- OPEX of 25%, which was the highest historical rate of IN-JAE, was also used.
- PE multiple method was used to compute for the Terminal Value. SFI’s average PE multiple is 20-23x. To be conservative, lower multiple of 20x was used.
- SFI’s Internal WACC is at 10%, which was used as the discount factor in computing the NPV.

Table 8. Shareholder Value Analysis

	<i>Actual</i>			<i>Forecast</i>				
	<i>2014</i>	<i>2015</i>	<i>2016</i>	<i>Year 1</i>	<i>Year 2</i>	<i>Year 3</i>	<i>Year 4</i>	<i>Year 5</i>
Revenue	3,186	3,504	3,913	4,304	4,734	5,207	5,728	6,301
Revenue %		10%	12%	10%	10%	10%	10%	10%
Gross Profit	1,593	1,857	2,034	2,152	2,367	2,604	2,864	3,151
Gross Profit %	50%	53%	52%	50%	50%	50%	50%	50%
Total Operating Expenses	796	823	977	1,076	1,184	1,302	1,432	1,575
OPEX %	25%	24%	25%	25%	25%	25%	25%	25%
Net Profit Before Tax	797	1,034	1,057	1,076	1,183	1,302	1,432	1,576
Tax Expense	239	310	317	323	355	391	430	473
Net Profit After Tax	558	724	740	753	828	911	1,002	1,103
Depreciation and Amortisation	80	80	80	80	80	80	80	80
EBITDA	638	804	820	833	908	991	1,082	1,183
Net Working Capital	319	421	430	516	568	625	687	756
NWC%	10%	12%	11%	12%	12%	12%	12%	12%
Increase in Net Working Capital				516	52	57	62	69
Free Cash Flow				317	856	934	1,020	1,114
Terminal Value								22,062
Net Cash Flow				317	856	934	1,020	23,176
Present Value				288	707	702	697	14,390
Net Present Value								16,784

Resulting NPV of all Future Cash Flows is computed to be at 16.7 billion pesos. This means that 16.7 billion pesos is the expected future value of the brand to the shareholders.

Since the IN-JAE offer price is at 5B, this will be deducted from the NPV of all Future Cash Flows, which will result in an 11.7B NPV. This means shareholders will get this value despite subtracting the purchase price to be paid to IN-JAE.

The Internal Rate of Return is also computed at 44%, which is way higher compared to SFI's WACC of 10%. This means that this investment would yield higher returns compared to the internal cost of capital of the business.

6. Conclusion

This section summarises the research problem and the procedures adopted in evaluating the brand value and the rate of return for the firm that seeks to acquire the Good Boy brand. This section then concludes with the recommendations to the management of the SFI company. Though prior SCM literature supports for the relevance of the discipline to diverse functions such as design, purchases, manufacturing, and marketing (Shank & Govindarajan, 2004), the evidence in relation to the marketing function has thus far been limited to product pricing and customer profitability analyses (Datar & Rajan, 2018). This paper offers a participant-observed case study evidence on the relevance of SCM principles to assessing the value of brand acquisition. Combining strategic positioning models such as Porter's five-forces model and SWOT analysis with shareholder value analysis, this paper identifies the positive value likely to be generated when the firm SFI acquires the Good Boy brand from another firm IN-JAE. The findings of the study suggest the following:

- Good Boy is a well-known brand in the Philippines and dominates the sliced cheese market. The product brands fit well with SFI's other product lines. There are no foreseeable conflicts of interest or weaknesses of the brand.
- SFI has a long-term ambition of doubling every 5 years. Entry into the cheese segment via the Good Boy brand acquisition expands SFI's portfolio into adjacent categories, beyond its core businesses of protein-rich food. A broader product portfolio catering to different

tastes and needs capture a larger customer base. This also entails a diversification of risk and input price exposures. Also, this acquisition is an opportunity to extract a number of potential synergies, thus lowering production costs.

- The Good Boy brand has healthy financials, good pricing power, and is accretive to the total SFI in terms of profit margins.
- Acquiring the Good Boy brand at 5 billion pesos will result to a net benefit of 11.7 billion pesos to the shareholders and IRR of 44% which is superior to the company's WACC of 10%.
- All factors considered, this study recommends the SFI management to accept IN-JAE's offer and acquire the license for the Good Boy brand and its manufacturing equipment at 5 billion pesos.

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