MANAGING BRAND EQUITY RISK: ADDING EXOGENOUS RISKS TO AN EVALUATION MODEL

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Abstract: Risk can no longer be ignored when talking about brand management, as risk management can no longer disregard brands for manifold reasons. Building on the risk-based brand equity model, this paper contributes to the development of an evaluation model, by suggesting formulas for 3 exogenous risk sources related to the market and competitive structure: the new brand marketing effort, consumer behavior change, and the extant brands adaptation.

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Key words: brand equity; brand-related risks; brand management; accounting researches

1. INTRODUCTION

Risk is one of the most salient issues that have been tackled in the scientific literature of the last three decades. Diverse expertise – from finance and stock markets to management and behavioral sciences - has been employed in order to gain insight of how risk can be evaluated, which are the risk sources and how companies and individuals can manage risks. Though, not the same interest has been shown for risk in branding. Scholars and practitioners have concentrated to emphasize the benefits of developing strong brands and the ways to do that, but have forgotten almost completely about the incumbent risks.

Thus, brands are unanimously seen as crucial assets for successful businesses in both business-to-consumer and business-to-business, and practically, any businessman would gladly want to rely its activity on a strong, well-known, reputable brand, able to enhance future profits. On the other hand, the more "hope" a company puts in its brands, the more likely is that an unwanted evolution of the brand causes serious damage on the business as a whole.

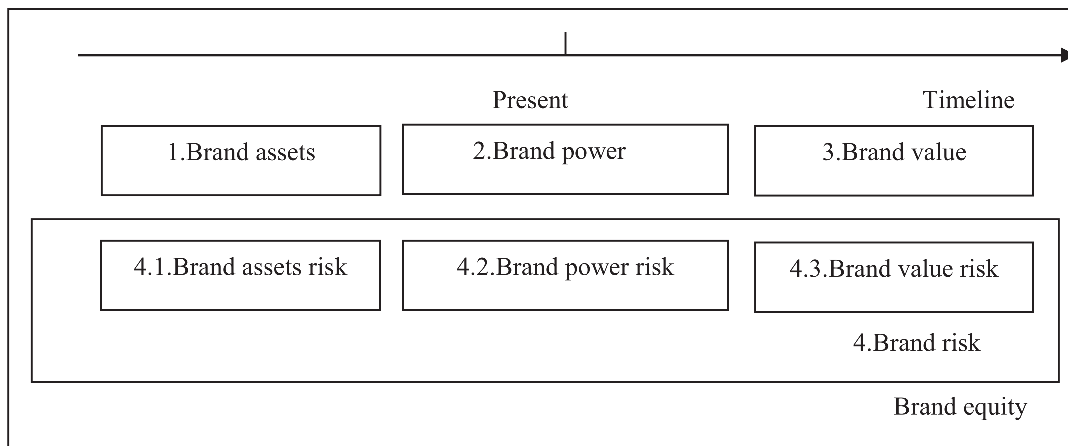
The duality profit - risk is common for any kind of economic assets, and so, brands are not an exception. Though, brand-related risks drive a particular inconvenient for the brand owner. Brands are considered "bridges" between past and future

(Kapferer, 2012, pp. 13-14) for their capacity to make future performance foreseeable. This capacity is due to the original function of brands, to ascribe a product or service to a certain producer or provider. But risk has an undermining effect on any forecast, transforming the most desired asset of the contemporary economy into a double-risky asset.

This paper tries to contribute to the development of a reliable instrument for tracking brand risk, using a scoring system that measures different sort of independent risks. The implementation of this model requires a systematic concern for updating the status of every risk type and to gain insight of the company's own experience in adjusting the sensitive parameters of the model.

2. Previous achievements

These instructions are also formatted as a sample for your paper layout. Abrahams (2008) was the first to theorize brand risk by developing a model that comprises 6 components: identity risk, presence risk, equity risk, reputational risk, status risk, and market risk. Despite providing a clue of how brand risk can be understood, this model doesn't enable us a rigorous evaluation of the integrative concept. Florea and Munteanu (2012a) propose a conceptual model that integrates risk into brand equity by adding a risk to each of the three "states of aggregation" of brand equity – brand assets, brand strength, and brand value – in line with Kapferer's (2012, pp. 13-15) differentiation (Figure 1).



Source: Florea and Munteanu (2012a)

Figure 1: The risk-based brand equity model

According to this model, one can either try to assess the risk of the financial component – brand value – or the non-financial components – brand assets and brand power – of the risk-based brand equity, in order to evaluate the current state of risk of a brand. The financial assessment has the advantage of a monetary unit of measurement and gives the possibility to study how the investments in brand building activities bring benefits, but on the other hand, it is argued that it tends to underestimate risk when it's

very high and it's biased by financial inertia (Florea and Munteanu, 2012b). Thus, the second direction was chosen for being closer to the marketing vision, although it has the drawback of not having a clear unit of measurement.

Brand assets risk was built by analyzing the propensity for variability of the 27 metrics that compose Lehmann and Keller's model (2008). Three independent risks – reputational risk, presence and loyalty risk, and halo effect risk – were set in order to avoid the numerous covariance calculations that would appear otherwise (Florea and Munteanu, 2012b).

3. MODEL DEVELOPMENT

Besides this endogenous risks, exogenous risks trouble brands from the fact that they compete on the same market. Actually, two major channels of risk propagation can be set, based on Kapferer's (2012, p.14) statement of brand strength meaning. The first channel is the market and competitive environment, which enforce a zero-sum game, at least for market share, if not also for sales, when the demand is saturated. In these situations, the actions of the competing brands have significant influence on a brand, even when the brand assets – which represent its inner side – are kept risk free. The second channel derived from brand strength definition is the business model that a firm implements in order to get profit from its activity. Despite being largely studied lately, we are interested in one single aspect of the concept of business model for the purpose of this research, still unexplored. A company can yield a higher or a lower role to its brands in profit making. Thus, the more important the role of brands is in value capture, the more impact a brand breakdown can have on the company's performance. Only the first channel is to be further investigated in this section.

We choose to focus on market share in order to illustrate the two channels. From the above mentioned competitive behavioral indicators, market share is the one which insures stationarity. Moreover, working with more indicators would encumber the model, as this indicators are not independent.

Concerning market and competitive environment, a first situation that fit here is when a new brand enters the market or an extant brand is removed from the market. According to Fok and Franses (2004), 3 main factors can induce changes in the competitive structure: the new brand marketing effort, consumer behavior change, and the extant brands adaptation.

When modeling the influence of a new brand marketing effort, we need to have in mind that the same marketing expenditures can drive different outcomes, based on a bunch of reasons. Firstly, the average cost to get a customer to buy the new brand decreases the risk represented by that brand. It's well known that it's much more expensive to get a new customer than to retain one, but as the new brand doesn't have any, it must direct the marketing budget completely to the acquisition of customers. The average cost per customer is a market-specific measure, depending mainly on the average loyalty level. For instance, on the chocolate market – like most FMCG hedonistic products – the loyalty level is lower than on bread market, so a new competitor in the case of chocolate market implies more risk than in the case of bread market. But not only the average matters when we talk about loyalty; the consumer categories that are targeted by the new brand's marketing effort are important as well. We propose here the use of The BrandDinamics™ Pyramid to describe different levels of brand-customer relationship: presence, relevance, performance, advantage, and

bonding (Keller, 2008). Of course, the effort to acquire a customer who has a bond with a competitor brand is higher than in the case of a customer who developed specific associations for the same brands that are in his short list, but without any emotional relationship – performance level. The problem nowadays is that many markets are oversaturated, so if the customers are strongly segregated on brands, a new brand has no alternative, but to fight for high-level loyal customers (Filip, Pleşea and Moise, 2011). Finally, the question is how much will a new brand affect our brand strength. A logical sense let us consider that as more similarity between the new brand and our brand is perceived, the more likely is that our market share will be affected. In this case, we can talk about analogous brands, which are sources of risk also for brand assets, especially for brand identity, value perception and brand recall (Rajagopal, 2008). In the light of these allegations, the score for new brand marketing effort can be modeled as follows:

$$\sigma_{NBME} = \frac{MKE}{\sum_{i=a}^{5} \alpha_i \cdot CPC_i} \cdot \frac{PA}{\overline{CPC}}, \text{ where:}$$

σ_{NBME} - the risk score for the new brand marketing effort;

MKE – the marketing effort in monetary units;

α_i - the percent of MKE allocated to the customer category i - the categories are: presence, relevance, performance, advantage, and bonding;

CPC_i - the cost per customer in the category i;

PA - perceived analogy between the new brand and our brand

$\overline{CPC}$ - the average cost per customer on the market.

The consumer behavior change is the second factor able to shift the competitive structure by resizing the market segments. It's known that a segment integrates the consumers with the same response to the marketing of a brand, so as the response changes in the case of some consumers, they move to another segment. The new brands which make these changes are referred as agitating brands (Rajagopal, 2008). The risk score calculation depends on the segments targeted by the new brand – whether is our brand segment or not – so basically we have 3 situations to deal with:

the new brand targets our segment, in which case our brand loses market share by losing customers to the new brand and also if the new brand marketing is successful enough to enlarge the segment. Though, the new brand attraction favor us if some of the new customers choose to buy of brand;

the new brand targets another segment, in which case our brand is affected only if a migration of customers between segments occurs. The segment decline favors our market share, while the migration of our customers to the other segment decreases our brand strength;

the new brand enters one of our target segments, in which case, besides taking us customers, affects our market share also by changing our consumers behavior – our customers migrate from one of our segments to the other. This situation may result in a loss only if the changing purchase value and frequency drive a negative conjoint impact.

In any of these cases, we use the segment attractiveness to measure the odds to be targeted by a new brand, which depends on several factors (McDonald and Dunbar,

2012, p.314). We choose the market attractiveness index of Loudon, Stevens and Wrenn (2005, p.164), which contains 3 constructs: market opportunity, competitive environment, and market access. The market opportunity is described by market size, growth rate, buyer power and market potential, the competitive environment is formed of the number of companies, differentiation, ease of entry, and substitutes, while market access contains 4 indicators, namely customer access, company synergies, sources of advantage, and regulation, each with its weight.

The proposed mathematical formulas for each of the three cases are the following:

$$\sigma_{CBC(a)} = \frac{SAI_{S_1}}{\sum_{i=1}^{s} SAI_i} \cdot \left(\frac{BS}{SS} - \frac{BS + BS_{OS} - BS_{NB}}{SS + SS_{OS} + S_t} \right)$$, where:

$\sigma_{CBC(a/b/c)}$ - the risk score for the consumer behavior change in the case a/ b/ c;

SAI_i - the segment *i* attractiveness index;

s – the number of relevant segments;

BS, SS – brand sales and segment sales. For both, we suggest the use of monthly figures adjusted for seasonality for a clear risk approximation;

BS_{OS} , SS_{OS} - brand sales and segment sales obtained from other segments;

BS_{NB} - the sales lost to the new brand;

S_t - the new brand sales corresponding to consumers' trial.

$$\sigma_{CBC(b)} = \frac{SAI_{S_{NB}}}{\sum_{i=1}^{s} SAI_i} \cdot \left(\frac{BS}{SS} - \frac{BS - BS'_{OS}}{SS + SS'_{OS}}\right)$$, where:

BS'_{OS} - brand sales lost to the new brand;

SS'_{OS} - segment sales lost to other segments.

$$\sigma_{CBC(c)} = \frac{SAI_{S_1}}{\sum_{i-1}^{s} SAI_i} \left(\frac{BS}{SS} - \frac{BS + BS_{OS} - BS_{NB}}{SS + SS_{OS} + S_t}\right) + \frac{SAI_{S_1} + SAI_{S_2}}{\sum_{s=1}^{n} SAI_s} \cdot \frac{\Delta(v \cdot f) \cdot NC}{SS_1 + SS_2}$$

, where:

v – the segment average purchase value;

f – the segment average purchase frequency;

$\Delta(v \cdot f) = v_{S_2} \cdot f_{S_2} - v_{S_1} \cdot f_{S_1}$

NC – the number of our brand consumers who migrate from one of our target segments to another.

The last effect of a new brand introduction is the adaptation of extant brands. In most cases, extant brands react defensively or offensively when a new competitor emerges, by employing marketing programs to adjust their positioning to the new competitive context. But brand positioning can change also when brand management

decides to act passively, as various points of differentiation may become points of parity, or brand differentiation loses desirability.

The adaptation of extant brands can drive market wars with negative consequences on the value of most brands, as the marketing expenses for sustaining position rise, while the efficiency of promotional instruments declines. Curiously, the same deed can occur when a brand disappear from the market. The “blitzkrieg” unleashed for the engrossment of the former brand consumers increase marketing costs, usually resulting in a mutual neutralization.

For our purpose, we need to consider the possibility that an extant brand that enters our segment takes some of our low loyal customers, but also that the total segment sales can increase due to the loyal customers who “follow” the brand into its new segment or to the short-term brand trial (Moise and Cruceru, 2012). The more attractive our segment is, the more likely is for an extant brand to decide to reposition into it. Still, we notice that it’s highly unlikely that an extant brand management decides to reposition into our segment, if the new brand targeted it previously.

$$\sigma_{EBA} = \frac{SAI_{S_1}}{\sum_{i=1}^{s} SAI_i} \cdot \left(\frac{BS}{SS} - \frac{BS - BS_{AB}}{SS + SS_{ABLC} + S_t} \right)$$

BS_{AB} - brand sales lost to the adapted brand;

SS_{ABLC} - segment sales growth due to the adapted brand loyal customers.

4. Conclusions

Passing-by risk issue when talking about brand management is certainly a shortcoming of a scientific literature on branding that has to be tackled with priority. Moreover, any risk management system can be considered incomplete without a component referring to the brand portfolio of a company, particularly when the company strongly relies its business model on brand equity.

Following the non-financial direction of brand risk evaluation of the two previously settled, this paper explores how brand risk is affected by the market and competitive environment, which suits the brand strength category from the risk-based brand equity model (Florea and Munteanu, 2012a).

The formulas proposed here need to be integrated in a comprehensive implementation model, such that all the scientific progress in this matter can be cumulated and adapted. The adaptation would mean performing calibration tests in order to ensure judicious contribution of each component to the overall risk score, and the development of several thresholds with a relevant meaning of the brand risk state. These required steps give enough future directions for research and challenging problems for the scientific community.

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