Leveraging Brand Equity: A Life Cycle Approach To Sharing Economic Rents

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Abstract

Traditionally the owner of an asset collects the economic rents generated by that asset. However, in this paper we recognize that there are situations where it is optimal for the owner of the asset to share the rents with others. Specifically we consider brands and identify situations where it is optimal for brand owners to share rents with the distribution channel (intermediaries). The basic notion is that the intermediaries frequently can take action that enhance or maintain brand equity or sales, and consequently increase the rent generated. Sharing rents can be used to influence intermediaries behavior, and as such rents subsidize promotional strategies. In this paper we use a brand life cycle perspective to examine when the use of rents is useful to enact the optimal mix and intensity of 'pull' (manufacturer) and 'push' (distribution channel) promotional strategies.

Introduction

Brand equity has received much attention in the last few decades (Keller, 2001). A strong brand is an asset that does what assets are supposed to do - bring economic rents. This rent generation does not take place in a vacuum. There often is a distribution channel of several interdependent organizations involved in forging the brand experience for the final consumer. In this paper, we consider the option of using the rents to subsidize the efforts of distribution channel members. We further examine the basic promotional strategies of ‘push’ and ‘pull’ in considering the optimal amount of rent sharing. Finally we consider the changing role of promotion and channel participation over the life cycle of a brand or branded product.

Brand

A brand is a distinct trademark name, a logo, or similar identifier, differentiating its holder from competition (Keller, 2002). So defined, brand is in itself an intangible addition to the bundle of characteristics of the product (service, etc.). To the consumer the brand becomes a symbol; a perceived representation of everything the branded product is about, far beyond the tangible (weight, length, etc.) and intangible (style, looks) attributes of the product itself. Branding a product creates a three-part image: the image of maker (corporate image), the image of user, and the image of product itself (Biel, 1992); it obtains personality and character (Aaker, 1997; Keller, 1993), and reputation.

Consumers form relationships with the brand (Aaker, 1997). Customers use brand names to resolve two problems of asymmetrical information. First, information on product quality is, at least partially, unobservable to them prior to purchase. To the consumer, the brand stands for the product’s features/quality, thus providing a convenient mental short-cut (Keller, 2002) when making buying decisions. The brand identifies the producer and allows for the reputation to be accrued and trust to be formed (Aaker, 1991). Therefore, consumers see it as a risk-reducing measure (Keller, 2002). Consumers’ perceptions of a brand’s characteristics (quality) can carry over to an

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entire branded product line, even when the consumers are aware of contradictory objective information regarding a specific product (Betts & Taran, 2002).

Second, information about themselves is unobservable to other people with whom they wish to interact. The brand conveys symbolic meaning related to personality, status and lifestyle. It not only identifies for the consumer what the product is, but also helps them identify who and what they are to themselves and others. In economic literature, brand value has been used in researching problems of adverse selection (asymmetrical information) and moral hazard (incentive to act inappropriately given the asymmetrical information) and their relation to reputation. The trademark is used as an indicator of reputation (Tadelis, 1999; Shapiro, 1983).

This role of brand as a signal is quite valuable to the producer, beyond the straightforward benefits of being able to legally protect their product’s unique features through trademarks and streamlining of operations (Keller, 2002). This notion is supported by the acquisition of well-established companies by market giants at prices far exceeding the accounting balance sheet value of assets of the sold firms. Among many such cases are the sales of Kraft (Kraft cheese™, Breyers ice cream™, etc.) to Philip Morris for $12.9 billion, more than four times its book value for tangible assets, and Rowentree (After Eight™, Polo Mints™, etc.) to Nestlé for $4.5 Billion, more than five times its book value. The premium paid has been justified by assumed extra profits attributed to the brand name, as well as the huge expenses of creating and maintaining a major brand name. In accounting terms, such a difference between the value of identifiable assets and the value the firm is being sold for is called “goodwill.” “It [goodwill] is usually the amount above market value that the purchasing company is willing to pay. It's the amount paid for reputation and recognition” (deProphetis, 2000, p.1). Recognizing the brand value as an asset, some firms with strong brand names incorporate brand value into publicly released balance sheets. For example, Smirnoff™ and Burger King are listed on Grand Metropolitan’s balance sheets (Murphy, 1993). Such “value added by the brand to the product” (Farquhar, 1989) has been called brand equity (Aaker, 1991; Park & Srinivasan, 1994). David Aaker (1991, p. 15) provides a more comprehensive definition of brand equity as “a set of assets and liabilities linked to a brand, its name and symbol, that add to or subtract from the value provided by a product or service to a firm and/or to that firm’s customers.”

**Brand and RBV**

In the resource based view of the firm (RBV) the firm is a combination of heterogeneous resources allowing the firm to achieve competitive advantage when the resources are employed in an efficient and unique manner (Wernerfelt, 1984; Barney, 1991). The competitive advantage is realized through capabilities, that is “capacity for a team of resources to perform some task or activity” (Grant, 1991). Successful brands are rare, valuable, inimitable and non-substitutable organizational resources, meeting the RBV criteria for being a source of competitive advantage (Barney, 1991). Substantial expense and considerable time are required for a brand’s development (Capron & Hulland, 1999). The resultant investments, unique history and experiential associations make the brand rare, valuable and inimitable. The ability of a strong brand name to attenuate problems of asymmetrical information cannot be substituted by any other strategic resource.

A well maintained brand is considered among ‘market based assets’ (Srivastava, Fahey & Christensen, 2001) that maintain their rent-generating capacity in a sustainable way (Hunt, 2000). Environmental turbulence that shortens the life span of most resources, may actually lengthen the life span of a brand and/or corporate reputation (Grant 1991). Brands can also increase industry attractiveness (Grant, 1991) by creating barriers to entry (Srivastava et al, 2001). Despite the value of brands at both the firm and industry level, few attempts have been dedicated to connecting RBV and marketing (Srivastava, et. al. 2001; Hunt, 2000; Capron & Hulland, 1999).

**Brand and Rent**

Economic rents can be considered above-normal returns accrued to a resource or capacity. Economic rent requires rejecting the equilibrium assumptions of neoclassical economics and assuming market imperfection, the cornerstone of strategic behavior aimed at the creation of sustainable competitive advantage (Hunt, 1995). Rent can be generated at the industry or firm level. The overall capacity of an industry to produce rents is related to barriers
Individual companies can generate rent through resources and capabilities that are rare, too difficult, too costly or impossible to imitate (Schoemaker, 1990).

Disequilibrium occurs because customers find value in the brand per se (Keller, 2001), or, in other words, finding additional utility in the branded product, the product demand curve shifts to the right. Brand influences demand in two ways, through highly positive components of consumer’s utility functions compensating for the disutility of higher prices, and decreases in consumers’s price sensitivity (Erdem, Swait & Louviere, 2002). These effects shift the demand curve for the branded product to the right of the average industry demand (see figure 1). By shifting the demand curve brands bring in economic rent above and beyond what would be expected for the industry as a whole (Amit & Schoemaker, 1993).

The supply curve is shifted up from $S_G$ into $S_B$ because of the extra expenses involved into building and maintaining the brand. The demand curve is shifted from $D_G$ to the right into $D_B$. The new equilibrium is now in the point $X_B$, at the price $P_B$. The full rent extracted by the manufacturer is constrained by the $X_BP_0B$, and the rent accrued due to the brand name is that minus the rents that would have accrued to the manufacturer in the generic case, without the brand name, contained in $X_GP_0G$. The rents generated by the brand will vary depending on the relative increase in demand versus increase in expenses.

FIGURE 1. Economic Rents Accrued Due to a Successful Brand

![Diagram of economic rents](image-url)
Rents and Distribution Channels

Marketing Channels And Brand

A marketing channel is “The external contractual organization that management operates to achieve its distribution objectives” (Rosenbloom, 1999, p. 9). If the product is not carried by the channel, it can never sell (Aaker, 1991), therefore it actualizes the demand by making it possible for the customers to purchase the product. Marketing channels gather and distribute information, promote, provide contact points contact with perspective buyers, match the offer to buyers needs (packaging, assembly, etc.), negotiate, physically distribute the product, provide financing and share risks associated with distribution and sales (Kotler 1997).

Channel members (retailers, distributors, dealers, etc.) can influence demand for the branded product and/or affect brand equity. Brand positioning strategy calls for a concerted effort to creating a focused image of the brand in the consumer’s mind. When a product is carried, the channel member can undertake efforts uphold the manufacturer’s (brand owner’s) overall brand positioning strategy; and take action to boost the selective demand for the product or brand. Regarding retailers, the product’s location inside the retail outlet, service provided to the customers, promotions run by the channel member all contribute the brand’s image which may or may not be what the manufacturer designed (Kotler, 1997). For example, activity such as excessive price promotions that is perceived by the customer as an attempt by the channel to get rid of excess unwanted merchandise of a certain brand might lead to short-term increase in its sales. This increase in sales might be accompanied by an increase in price sensitivity (Ailawadi, 2001) and erosion in the brand equity (Moreau, Krishna & Harlam, 2001), lessening potential the economic rents from the brand in the future. Intermediate channel members (reseller/distributors) also can run promotional activities that may either uphold and enhance brand equity, or undermine it (Moreau et. al., 2001), depending on if the promotions are in line with the brand strategy.

FIGURE 2. Contribution to Rents Due to Channel Participation
The contribution to demand that can be attributed to the channel is illustrated in Figure 2. Notice the light dotted line $D_C$ between the curves corresponding to the demand for a generic $D_G$ and branded $D_B$ versions of the product: this is what the demand would have been without the channel support. Similarly the light dotted line $S_C$ denotes the expenses that are covered by the discretionary effort on behalf of the manufacturer. It delineates the increase in expenses due to the manufacturer’s and the channel member effort. Without the brand at all, there would be $X_G$ of product sold at price $P_G$. Without the channel member’s support, $X_C$ will be sold at the price of $P_C$. With the support of the manufacturer, there will be $X_B$ sold at $P_B$. Without the channel member’s support, the rents would be $P_0C X_C P_C$; with the support, it’s the area $P_0B X_B P_B$. The incremental rent is the $P_0B X_B P_B$ minus the increment in expenses with the shift from $S_C$ to $S_B$.

Managing Channels and Distributing Rent

A firm’s ability to appropriate rents determines the realization of competitive advantage stemming from its resources and capabilities (Grant, 1991). While a brand is a resource, the ability to leverage a brand is the capability that determines the rent generating capacity of the brand. In this respect, just as channel members actualize demand, channel management actualizes rent. Indeed much literature has been dedicated to channel relationship management, on the premise that it can boost competitive advantage (Srivastava et al. 2001). Performance implications of channel decisions have been extensively discussed (Ailawadi 2001), analyzed game theoretically and tested empirically (Geyskens, Gielen & Dekimpe, 2002; Ailawadi, Borin & Farris 1995) using both perceptual (Jap, 1999) and objective measures (Buchanan, 1992).

Channel coordination and relationships are often related to information asymmetries. At issue is whether the channel member’s actions are in the interests of the other member (Celly & Frazier, 1996). For example, the potential for moral hazard exists among the channel members. A free rider might get the same revenues as other dealers who put the resources necessary to maintain the brand, while enjoying lower costs and thus higher profits (Srivastava et al. 2001). The channel member may be free riding “horizontally” on other channel members efforts or ‘vertically’ on the efforts of the manufacturer (Mathewson & Winter, 1985).

Channel relationship management is often viewed through the lens of power – power exercising, relative power, balance of power, etc. (Bucklin, 1973; ElAnsary & Stern, 1972). “The power of a channel member is its ability to control decision variables in the marketing strategy of another member in a given channel at a different level of distribution. For this control to qualify as power, it should be different from the influenced member’s original level of control over its own marketing strategy” (El Ansary & Stern, 1972, p. 47 cf Kasulis et al, 1999, p.321). As such, the power of a channel member is the ability to influence the marketing strategy of other channel members. The rents provided by a branded product can be a source of power and be used to influence the channel members. Farquhar (2000) points out that “resourceful companies measure how much value their brands add (or subtract) at each stage of the supply chain, and then redistribute economic surplus to provide enough value to others as needed.”

Push and pull

‘Push’ and ‘pull’ are basic strategies for building and maintaining demand for products that reach the public through intermediaries. A ‘pull’ strategy generate customer interest through advertising, consumer sales promotions such as coupons, sweepstakes, etc, public relations actions such as news releases, sponsoring events, and other tools so that consumers seek the product in stores. A ‘push’ strategy involves the manufacturer inducing the channel to carry its products, primarily through incentives (Kotler 1997, p.627).

Reliance on “Pull” strategy is coupled with the manufacturer extracting and retaining rents, whereas “Push” strategy transfers the rent to the channel members. A pull strategy shifts the balance of power between the manufacturer and the retailer before the negotiations regarding the conditions under which the branded product is sold: it creates a powerful brand in the customer’s mind. The rationale for the pull strategy is that a strong brand that commands brand loyalty will have to be supported by the channel since not only the demand for it is reasonably guaranteed but it also might increase the demand for the retailer’s other products. For a product to be able to have
such a demand, the level of value added service expected of the channel members to uphold the product’s brand equity should be relatively low. For such a product, the responsibility for stimulating the selective demand lies with the manufacturer. It is primarily through the manufacturer’s effort that the shift in the D curve in Figure 1 occurs. As long as the channel members uphold their contractual obligations, the rents will be generated and accrue to the manufacturer.

If the product needs much effort (service, weight of store’s own name, promotional support) from the channel member to build and maintain its brand, then the demand is being shifted through joint effort. “Push” promotional strategy transfers the effort of shifting the demand to the channel members (Farris, Olver, & de Kuyver, 1989). Contracts adequate for unbranded products or “Pull” strategies are not enough in the presence of adverse selection and moral hazard problems threatening the channels. In this case, sharing rents helps to secure the best selection and cooperation of the channel members.

Managing the Life Cycle: An Application of Sharing Rents

Product life cycle (PLC) theory is an important tool for the strategic and functional management (Birou, Fawcett & Magnan, 1998), which can be generalized to a life cycle (LC) model applied to various levels of the product (Bayus, 1998): the industry, product category, product form, product technology, product model, brand model. Life cycle is a model of how sales evolve from the time of introduction to the time of withdrawal (Bayus, 1998). During the introduction stage, the product (brand, industry, etc.) is very new, and sales grow slowly. The introduction stage is followed by the growth period, when sales growth increases. The sales stabilize at the maturity level, when the market is saturated. Eventually, the sales start to go down as the product signaling the decline stage.

The response of the brand to marketing activities depends on its life cycle stage (Shankar, Carpenter & Krishnamurthi, 1999), and the amount of channel member support that the branded product needs also differs from a stage to a stage. As the brand or branded product moves from one stage to another, its profitability (and the amount of rents that can be shared) changes. Therefore, the role of channel members and the corresponding decisions on behalf of the manufacturer from the sharing of rents to the choice of distribution channels depends on stages of the brand or branded product’s life cycle (Lele, 1986).

Typical dynamics over the course of a branded product or brand life cycle are summarized in Table 1. During the introduction stage, customers are not very familiar with the product, therefore the promotional effort is high and primarily push. Being an intense push strategy, the distribution channel member should provide additional value-added services, making the customer aware, providing information and possibly instruction, identifying customers and so on. During this stage the rent sharing should be very high, in some cases at a net loss in order to build the brand. During the growth stage as the product matures, such need for the care on behalf of the distribution channel diminishes (Lele, 1986), going from high to moderate and eventually to comparatively low levels during maturity. Along with this decrease in channel involvement is a decrease in general promotional intensity due to the brand being firmly established in the mind of the consumer. The situation changes again as the product declines, with channel involvement becoming necessary to bolster sales of the declining product.

<table>
<thead>
<tr>
<th>Stage</th>
<th>Introduction</th>
<th>Growth</th>
<th>Maturity</th>
<th>Decline</th>
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<td>rapid increase</td>
<td>stable</td>
<td>decline</td>
</tr>
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<td>increase</td>
<td>stable</td>
<td>decline</td>
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<td>Promotion Strategy</td>
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<td>push/pull</td>
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<td>moderate/high</td>
<td>low/moderate</td>
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<tr>
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<td>moderate</td>
<td>low</td>
<td>moderate</td>
</tr>
<tr>
<td>Promotional Intensity</td>
<td>high</td>
<td>high</td>
<td>moderate</td>
<td>low</td>
</tr>
</tbody>
</table>

TABLE 1 - Life Cycle Exemplar
Conclusions

Brand is a valuable, rare, inimitable and non-substitutable asset. It generates economic rents for its owner by increasing the demand for the brand. However, such increase in the demand is partially fueled by the actions of the channel members, and sharing the rents generated by the brand in order to induce the support by the channels may be important to realize the brand potential. The more the manufacturer relies on the “Push” strategy (Kotler, 1997, p. 627), the larger portion of rents is generated through the help of the channel members, and the higher the channel’s expenses on generating the rents are. Consequently, the more the manufacturer relies on “Push” strategy, the more sharing of the rents is warranted. The more the manufacturer relies on the “Pull” strategy, the more the demand is increased through their actions alone, the higher expenses directed at increasing the demand and the less is there a basis for sharing the rents with the channel members.

The overall shift to “Push” strategies within recent decade (Achenbaum, 1987; Achenbaum & Mitchell, 1987) has lead to the importance of further study of sharing the rents due to brand, since it is under the “Push” strategy conditions that rent sharing is warranted. The finding of the best mix of the pull and push (Koop & Greyser, 1987) and optimal sharing of rents should be based on understanding the nature of the changes in dynamics over the life cycle of the brand or branded product.

Further research should investigate the dynamics and influence of relative power of the channel members on sharing of the rents generated by the increase of demand due to brand. A study of various markets/products that would clarify and perhaps classify various products with regards to the demand curves would therefore be a useful tool in investigating how to share the rents. Further investigation of the breadth and depth of both, “Pull” and “Push” (Farris, Olver, de Kluyver, 1989), would help clarify the conditions and results of sharing the rents with channel members. A dynamic approach to brand and sharing the rents due to brand in the process of building brand equity is another important direction for further development.

To sum up, sharing the rents arising due to brand with the channel members is necessary to ensure their support and cooperation. Depending on the life cycle stage of the brand (or branded product) and other factors, the manufacturer either assumes additional expenses in the form of pull strategies, or delegates the increase in demand to the channel members and shares the rents.

References


Notes