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Creating own Brand Equity Versus Customer Loyalty in a Commercial Enterprise

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Abstract. A dynamic global market aims at creating brands (including own brands) on geographically and structurally new markets, which considerably influences the perception and improvement of their image. The degree of trademark recognition within a given line of business is the key factor in brand management planning. Owing to new technologies and reduction in manufacturing costs, producers have access to additional productive capacity, which is used by external entities (including commercial enterprises) to create their own brands with their own image and identity, which often differs from the concept and strategy of the manufacturer brand.

Keywords: manufacturer brands, private label brands, brand value, brand equity, LTV index.

JEL classification: M30, M11.

The own brand is economically justified as well as the future of a commercial enterprise is concerned. The exclusiveness of the own brand, which is one of the factors determining company's existence and value, helps a company stand out among its competitors. In practice it is common that several competing commercial enterprises constantly reduce prices of the same manufacturer brands they offer, thus facing the necessity to operate at very low margins for rendered services. In long-term future such a situation may lessen developmental chances as far as investments are concerned. It may also reduce company's profit generation capacity, as well as its ability to improve other financial indicators despite larger turnover from operational activities.

Having unique value enables enterprises to develop special customer relationships. In long-term future they can be manifested as loyalty towards the brand identified with emotions which often go beyond the product's functional form. This gives rise to strengthening customer relations and fostering customer loyalty towards the brand. In comparison with a producer, a commercial enterprise is in a better position as far as the choice and use of tools for building customer relationships are concerned due to a 'shorter distance' to the customer. This, in turn, allows a company to adjust and respond flexibly to the requirements of the market.

Modern literature identifies several kinds of brand, which may be divided into two main groups: **manufacturer brands** and **private label brands**, which are defined as brands owned by enterprises (in most cases commercial ones including retailers), which do not produce these particular brands within the scope of their main activity (in the literature terms *commercial brand, private label brand, distributor's brand* and *private brand* are used interchangeably). In practice, sometimes a producer has own brands as well as *private labels*. However, such situations are uncommon, and usually arise due to acquisition or taking over. In the subject literature generic products are also mentioned. However, not having a specific, individually identified trademark classifies them as no-name products, not generic products. This results from the definition of a brand, according to which a brand must have unique and distinguishing features that differentiate it from other trademarks given to similar products.

Terminology used in the theory of literature has not been systematized because in many countries there are differences in markets' organizations which are at various stages of their development. In mature markets the term *private label* is used to refer to the sector of own commercial brands, and this term is also used in the theory of international literature. This term refers to products that are given brands by trading companies, not producers.

While the share of private label brands in the global market is becoming increasingly important on mature markets (it increased globally from 14% in 2000 to 30% in 2010), the literature in most significant university centres is involved in research on trends and market tendencies in order to follow the changes and anticipate future trends, in Eastern Europe including Poland, still quite limited literature concentrates on traditional marketing, which aims to fight with private label brands identified with poor mass quality, strange, often unaccepted and incomprehensible image.

It is expected that in all Eastern Europe the share of own brands in consumer goods sale will reach only 7% in 2010, while in 2000 it constituted 1%.[1] Such a situation results from the fact that, for example in Poland, most private label brands are owned by retailers, while international retail trade networks are mostly owned by corporations with foreign capital, which results in the offer lacking well-known, traditional, local and easily-identified products which are replaced by processed products with unfamiliar ingredients and chemical additives. There is a close correlation between the degree of market development, as far as the consolidation of modern retail network channels are concerned (Great Britain has a dominating share in Europe), and the power which develops own brands. This situation arises from a completely different distribution by retail networks in Western and Eastern Europe including Poland.

Immature markets are still capable of accepting another category of own brands, which could fill up the gap between producers' standards and quite an unclear message of private label brands offered by international retail networks. At the same time, it is essential that the strategy makes allowances for own brand management that would anticipate maturing of the market and adapting to existing Western European standards. Taking a longer view, present distribution channels of these brands should possibly be transformed into a retail sales channel.

Conclusions that can be drawn from the analysis of the approach to the issues researched in the national literature are quite clear, and refer to problems concerning the creation of private label brands belonging to modern channels of the retail distribution, which reduces possibilities of successful existence of own brands. The paper will examine determinants that justify the creation of new, identified own brands not owned by retail networks. These brands are created because the market is structurally immature as far as trading is concerned, and because domestic manufacturers do not satisfactorily fulfill customers' needs. There is a need for 'filling up' this niche. If an enterprise does so, it might be able to work out additional values and gain an advantage over its competitors.

International literature examines specific strategies and determinants favouring and determining the strengthening of the value of manufacturer brands, which exist along with

[1] Global 500/M + M planet retail 2005, „*Fortune*".

strong private label brands. Such a situation promises bright future. Various conditions of this peculiar ‘coexistence’ are defined. They specify niches for the development of both categories of brands, and justify entering the market by own brands. Among these conditions are the following:

- the private label brand should belong to the segment of premium products,
- a supplying firm should not be the leader of a given product (it will prevent a manufacturer brand from being cannibalized),
- business entry barriers should be minor, and the offered product should be standard. Private label products should not by supplied by a producer which holds a patent or has a cost advantage over its competitors.
- producing for a retailer should guarantee a significant scale effect (high fixed costs at low variable costs). [2]

A coherent brand management system consists of a number of elements influencing the creation, shape, identity, power and the value of a brand. The issues become complicated when all the elements connected with brand management are related to a dynamic segment of structurally diversified trade, which is characteristic even of EU countries. However, even the system of dynamically changing market forces offers a niche, which enables companies to gain a competitive advantage and work out additional values by introducing their own private label brands.

A strong and recognizable brand positively influences financial factors of a rise in value and valuation elements, thus increasing the value of an enterprise. A strong brand position enables an enterprise:

- to receive a better brand premium (in the sale of goods under this brand, in relation to no-name products), which results in a higher operating margin or growth in revenue from selling an enterprise,

- to extend the period of sales increase;

- to increase cash flow indexes and the stability of generated income, which in turn, reduces business risk, the cost of capital and a discount rate.

Brand value is determined by additional value created by the brand under which products or services are sold. Positive net operating flows obtained due to a strong brand position constitute **brand equity**, which is an asset of a company, but is not included in a balance sheet, as is the case with intellectual capital.

Brand capital determines the significance of intangible assets in the formation of shareholder added value. It is classified as the so-called market capital generated by an enterprise, and it consists of innovative and structural capital (which is mainly constituted by intellectual capital). [3]

Conscious creating of brand value is conditioned by the choice of marketing tools, which should enable enterprises to communicate both with customers and investors. In that case, the brand position and power are of particular significance as they enhance the company image and prestige. Information about brand power may influence investors’ decisions in the capital market, which is then reflected in a company’s share quotation. The high value of a brand may aim at taking over a company which owns this brand.

As far as financial reporting is concerned, there exists a paradox that a brand purchased is included in a balance sheet, while according to [MSR 38] a brand created within a company is not included in a balance sheet, although its creation required high long-term investments and costs. According to the Accounting Law (Art. 3, sec.1, pt 12 ‘assets are reliably measured resources controlled by an enterprise as a result of past events, from which

[2] J. Kahll, *Jak zbudować silną markę od podstaw*, HELION, Gliwice 2006, p.76.
[3] Black A., Wright P., Bachman J.: *W poszukiwaniu wartości dla akcjonariuszy. Kształtowanie wyników działalności spółek.* Dom Wydawniczy ABC, Kraków 2000, pp. 157-159.

future economic benefits are expected to flow to the enterprise') the following conditions must be fulfilled simultaneously in order to recognize resources as assets:

- resources are controlled by an enterprise,
- the value of assets can be reliably measured,
- the enterprise has come into the possession of resources as a result of past events (e.g. a buying operation),
- the enterprise is expected to gain economic benefits thanks to these resources.

From a formal point of view, assets comprise the right to a trademark covered by protection law (according to art. 153 of the law of industrial property, a trademark shall be used only for earning or professional purposes). According to the accounting principles, the right to a trademark - if its value can be declared in a balance sheet – is included in intangible assets, which are a part of fixed assets.

It is true that accounting has rejected assets valuation methods based on historical methods (methods based on purchase prices of assets) in favour of valuation methods based on future economic benefits, which may be attributed to a given asset (including, above all, fixed tangible and intangible assets) [MSR 16] and [MSR 38], but these values are still not included in a balance sheet. In spite of these weaknesses of assets valuation methods, enterprises which own strong brands make valuations of their brands when they conclude licensing agreements or franchising contracts with other enterprises. As parts of these contracts they let them use their trademarks. Brand valuation is also used in judicial proceedings, when damages are claimed for piracy, that is the imitation of strong brands. Brand value is also a criterion for evaluating the results of company operations and the efficiency of managing board as far as the creation of company's additional values is concerned. Looking after brand value is an important element of business management included in internal processes. [4]

Brand value may be examined from the point of view of a brand owner or a consumer. From a consumer point of view, brand value is created by marketing, while the analysis of brand value form an entrepreneur point of view is dealt with by finance and accounting.

Since one universally accepted and precise valuation method of brand value does not exist, it is difficult to disclose the value of brands and include them in a balance sheet. At present most brand value appraisal methods are based on models used to evaluate the value of an enterprise. Basic brand value appraisal methods include [5]:

- cost-based valuation,
- market-based valuation,
- discounted net cash flows, which evaluate the so-called economic use (economic use valuation),
- royalty relief valuation.

The discussion of the valuation of a trademark (brand) is synonymous with the discussion of the process of value measurement. However, bearing in mind different definitions of value, one can speak of various concepts and standards of value. Therefore, presented models (methods) correspond to specific concepts of value depending on the purposes of analyses. We may distinguish:

- retrieval value [MSR 38],
- economic value,
- value in use,
- market value,

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[4] R. Kaplan, D. Norton: *Strategiczna karta wyników. Jak przełożyć strategię na działania.* Wydawnictwo Naukowe PWN, Warszawa 2001, pp.43 and 108.

[5] P. Doyle: *Value-Based Marketing. Marketing Strategies for Corporate Growth and Shareholder Value*. Wiley, Chichester 2000, pp. 36-60.

- fair value,
- replacement value,
- substitution value,
- liquidation value.

The most frequent definition of a trademark (brand) complies with the standard of economic value, and refers to additional financial benefits gained thanks to products sold under this trademark; these benefits consist in an increase in cash flows generated by an enterprise and a reduction in business risk; brand value is a contribution to an increase in company's market value. The concept of economic value of a trademark reflects future net economic benefits which may be gained by the owner of the trademark right.

Therefore, the most common brand valuation method is a method of discounted net cash flows, which are generated thanks to a strong and recognizable brand. This method is used to appraise the economic value of a brand. Brand value is appraised by financial indexes, but also by marketing factors, which indicate the correlation between the power of a brand and customers' loyalty and their view of it. The latest research conducted at Harvard University indicates the significance between the LTV (Lifetime Value) index and an increase in the power of a brand (translating into brand value in general). This index is also based on discounted values of future flows connected with a change of decisions about purchasing a given brand, and relating to a future maturation period of retained and loyal customers (their affluence, world view, experience, social status, etc). The index also shows that attracting new customers is a far more expensive process than retaining present customers and developing loyalty strategies in order to classify them as 'loyal/followers'.

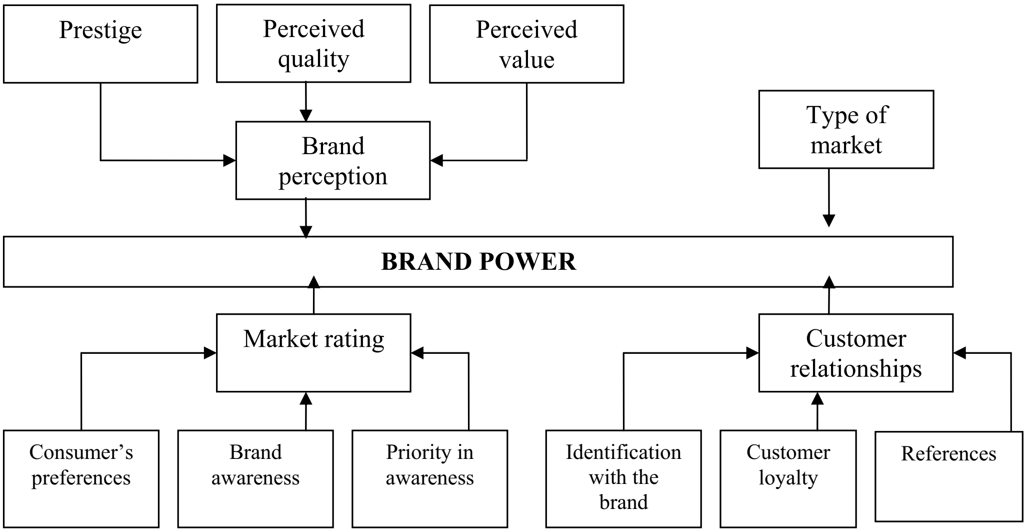
The relationship between a loyalty index and **brand value** and power depends on the value of a **LTV index**, which is dependent on attracting the biggest possible group of loyal customers, and increases proportionally to this relationship.

Brand power, that is its competitive potential, may by determined by a single index developed on the basis of brand equity components measures. Brand power is considerably influenced by its current market position, which reflects buyers' behavior towards the brand, their views and loyalty status. This power represents the position and market share of a brand compared with competing brands. In order to determine brand power, comparative methods with the use of qualitative market research in the following areas are used:

- brand market position,
- customer behavior towards a brand,
- brand perception,
- a type of market in which a brand exists.[6]

The above graph shows that customers' loyalty and perception as well as the influence of the other qualitative components on brand power are significant elements creating brand value. This is of vital importance while creating value for own brands (not owned by a manufacturer), because these brands are particularly sensitive to perception and image compared with recognized manufacturer brands (especially well-established ones). Besides, the field of own brands and their management is relatively new; moreover it was 'spoilt' in the early stages of its development, when products under own brands used to be of much lower quality than manufacturer brands.

[6] G. Urbanek, *Zastosowanie wskaźnika siły marki*, „Marketing i Rynek" 2004, no 12.



Graph 1. Components of brand power
Source: G. Urbanek, *Zastosowanie wskaźnika siły marki*, „Marketing i Rynek" 2004, no 12.

The analysis of the significance of own brand power in relation to its value must include a valuation method, based on brand power, developed by Interbrand and characterized by five stages:

- calculating average annual profit or cash flow gained thanks to the trademark,
- determining brand power in order to calculate the multiplier,
- determining a range within which the value of a multiplier lies,
- defining the value of a multiplier on the basis of brand power,
- setting the value of a trademark.

Factors determining brand power in the valuation model developed by Interbrand include specific components of brand power with specific values attributed to them.

The components of brand power include:

Leadership	- maximum component value: 25
Stability	- maximum component value: 15
Market	- maximum component value: 5
Internationalization	- maximum component value: 15
Trend	- maximum component value: 20
Support	- maximum component value: 15
Protection	- maximum component value: 5
Total	- 100

On the basis of these parametres it is possible to define a curve of relations between brand power and multiplier value. At present the Interband model is commonly used by practitioners as one of the methods which combines qualitative features (derived from marketing) and financial analytical instruments.

Summary

Among numerous methods of trademark valuation, which determine the value influencing intangible assets of an enterprise, qualitative features are of vital importance since they classify a brand as strongly or weakly positioned. Connections with loyalty and the level of relations with customers, who are recipients of brand image and identity, are fundamental components of these relations. This perception (i.e. features that are very difficult to measure), in turn, is apparently a point of departure for analyses connected with a financial perspective of trademark valuation, particularly the valuation of own brands of commercial enterprises.

This paper only draws attention to the complexity of researched issues comprising elements of behavioural issues, which have been analysed by practitioners and in academic circles for the last ten years.

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