Do brands actually contribute to firm performance?

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Brand equity, in simple terms, is the public's valuation of a brand. The power of brand equity therefore lies in the hands of the consumer. So, how does consumer-based brand equity (CBBE) influence the performance of an organisation?

When investors and managers evaluate potential investments, they tend to do so based on two things: risk and return. Whilst investors concern themselves with assessing both a firm's expected returns and the associated risks, marketing activity has tended to ignore risk and focus solely on returns.

Marketers often state that brands (as market-based assets) can allow firms to not only increase returns but also lower the risks associated with these returns, thus increasing their value. However, with the growing evidence linking brands and stock returns, more research is needed into the effect of brands on firm risk. So the real question is: what is the role of CBBE in explaining firm risk?

A recent study, using data from 252 comapnies from the EquiTrend database, COMPUSTAT and the Centre for Research in Security Prices, has offered insight into the impact of consumer-based brand equity on firm risk. These companies involved were operating in consumer markets during 2000 - 2006.

The authors adapted risk measures that are well established in finance literature, using credit ratings to capture debt-holder risk and the standard deviation of stock returns to measure equity holder risk. This was then broken down further into 'systematic' and 'unsystematic' equity risk.

Without delving in too much detail into the methodology of the study, the results of demonstrated that a firm CBBE is associated with firm risk and this can be used to explain changes in risk measures. The study also took a closer look at existing finance models and explained the "risk relevance" of CBBE beyond the changes explained by these models.

Essentially, what the results indicated was that CBBE has a stronger role in predicting firm-specific unsystematic risk rather than systematic risk. It also has a strong role in protecting equity holders from downside systematic risk.

Higher levels in the average CBBE of a firm's brand therefore have a strong impact when it comes to reducing debt-holder risk. This, in turn, directly contributes to lowering the cost of capital for the firm. Furthermore, firms that possess brands with strong CBBE are able to reduce their equity risk quite considerably.

So what should marketers take from this research?

The results of the study strongly suggest that investments in brand equity affect firm performance. Marketers therefore need to communicate that brands matter in their contribution to firm performance and this is done by managing firm risk. Marketers should also include calculations regarding the firm's cost of capital when influencing chief financial offers so that they can demonstrate reductions achieved through investing in a firm's brand assets.

Furthermore, the results suggest that investments in creating and maintaining CBBE are a direct way for managers to reduce risks that are distinctive to the firm. What this means is that brand management should be viewed as an additional tool when planning and executing a firm's risk-management strategy. Overall, the results suggest that managers should make brand management part of the firm's risk management strategy and should protect or even increase investment in CBBE during periods of economic uncertainty.

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