

Brand Equity from a Systems Dynamics & Decision-Making Perspective

Nazir Ahmad, Strategic Decisions Group

Brand equity is one of the most widely used and least actionable concepts in modern business. A suitable understanding of the concept of brands and brand equity would allow companies to evaluate their brands more effectively and thereby develop better brand strategies. A new framework for understanding, valuing, and growing brand equity is clearly needed.

What are the elements of an alternate framework on brand equity, a framework that can guide us to a useful understanding of brand value? This was the question we explored with our colleagues attending the Spring 1998 Quest/SDG Brand Equity Forum. What follows is a synthesis of these discussions and some of my own observations about brand equity.

Historical Perspective

Ron Howard of Stanford University/Strategic Decisions Group observed at the workshop that “a brand is to a product or service what a reputation is to a person.” This perspective fits nicely with the notion of brands that existed in medieval times. During this period, the Vatican stipulated that a product could have two forms of intellectual property: its physical design (trademark) and its reputation. The court of law handled trademark disputes, but a court of *equity* handled any besmirching of reputations.

In the 1950s, the concept of brand first gained prominence in American marketing literature, driven primarily by the advertising community. Advertisers saw branding as a useful device to capture many of the intangibles that might explain customers’ psychological need for a product.

Perhaps because the advertising community was driving this understanding, the early branding efforts focused on brands as a mechanism for advertising communications. Campaigns, advertising imagery, jingles, and taglines were the key definers of the brand. This worked well in the “push and prod” world of Ozzie and Harriet—of visual imagery and mass media.

In the 1980s, however, brands took on a very different significance: the *equity* of a brand became an important topic. The single most important transaction to bring this shift to light and change the way the business community thought about brands was Grand Met’s acquisition of Pillsbury. In this transaction, a substantial sum was assessed as the “intangible” value of the Pillsbury brands, and Grand Met willingly paid the price in real money.

(continued)

SDG is an international management consulting firm that helps clients increase business value. We work with our clients to develop and implement creative strategies for business growth, embrace and profit from change, and transform their organizations through new models of strategic leadership. Collaborative decision consulting is our forté. From offices in North and South America, Europe, and Asia, SDG serves one-sixth of the Fortune Global 500 and equivalent companies worldwide.

As marketers began to understand the significance of the Grand Met acquisition, the importance given to brands also increased. The financial community began to recognize brands as valuable long-term assets requiring investment and stewardship. Today, accounting standards permit the explicit valuation of brands as assets on the balance sheet.

Current Frameworks/Methods for Brand Valuation

Most experts on brand equity, however, have generally failed to reconcile the marketing/communications perspective and the financial/investment perspective on brand. Even with the increasing emphasis on valuing and managing brands, the various methodologies now in vogue confound rather than effectively reconcile these two perspectives. This conclusion was confirmed by our assessment of four leading brand valuation methodologies. The methodologies we reviewed are *Brand Asset Valuator* (Young & Rubicam), *Equitrend* (Total Research), *Brand Equity 10* (David Aaker), and *Brand Valuation* (Interbrand).

A New Vision

We believe that the following nine key principles are vital to understanding, valuing, and managing brand equity.

- 1) *Brand equity is a dynamic reservoir of customer perceptions that influence the stream of customer choices over time.* By considering brand equity as a stock (store) with dynamic properties, we can track how interventions (decisions) and uncertainties influence the growth (inflows) and decrease (outflows) of this stock over time. The systems dynamics approach to brand equity is a conceptual departure from the current approaches to understanding brand equity. Specifically, this approach operationalizes our descriptive understanding that brand equity is an accumulation of relevant customer and market perceptions and expectations.

Figure 1 is a stylized illustration of how this dynamic system might work for an existing durable good. Each stock is denoted by a rectangle; rectangles and circles depict the connections between flows and stocks. (Think of this as “bathtubs and plumbing.”) Four stocks (and their connected flows) are relevant here:

1. Installed Base,
2. Brand Equity,
3. Brand Expectation, and
4. Perceived Brand Reality.

The installed base is important because it generates a flow of credible experiences with the product. The number of product experiences by the installed base and the equity per experience together determine inflows to brand equity stock. The equity per experience is a function of the expectation gap—i.e., the difference between the brand expectation and the brand reality as perceived by the installed base of customers. Changes in the attributes associated with the product are important because these directly change the perceived brand reality, and eventually, also change the brand expectations. For instance, if the attributes (such as quality, style) delivered by a product improve significantly, the perceived brand reality will also change—and so will the brand expectation in the market. This stylized model was elegantly crafted at the workshop by Nick Pudar and Mark Paich with input from participants.

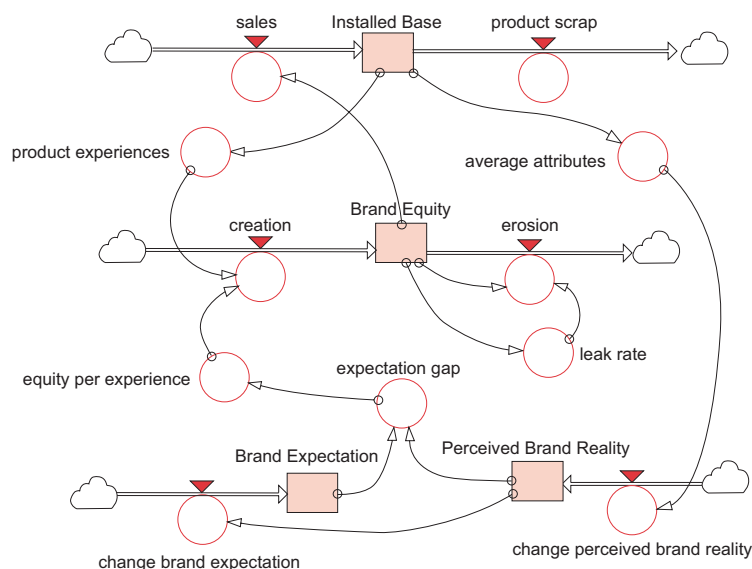


Figure 1. Attribute-based brand equity: a dynamic model

(continued)

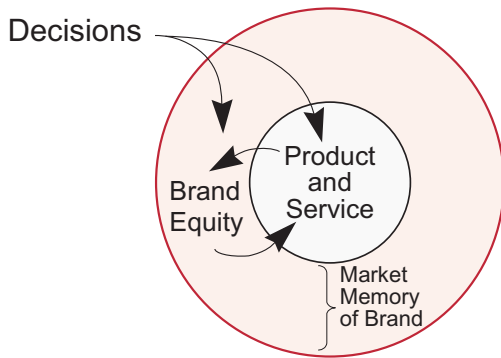


Figure 2. Economic Value of Brand = Product and Service + Brand Equity

- 2) The total economic value of the brand is the sum of the value of the product/service and its equity. Brand equity, while an asset, is not tangible. Brand equity is resident in the minds of the actual or potential consumers and their network of influences and influencers. One way to think of brand equity is to consider it the collective “market memory” of the brand that influences purchase choices. Decisions made by companies can impact the brand value through changes in products and services or in their associated market memory (see Figure 2).
 - 3) Brand equity has positive value only if it has the potential to influence customer choice behaviors *in the future*. Past performance does not guarantee future sales, especially if there is a discontinuous shift in the competitive environment. Successful brands help create the future preferences of customers.
- 4) “Loyalty” (repeat purchases) is often suggestive but not necessarily a definitive indicator of brand equity. Contrary to prevailing perspectives, market dominance does *not* always equate with high brand equity. Many consumers purchase a product or service due to the absence of reasonable alternatives. Our own perspective is that any robust measure of brand equity should estimate preference for a brand against credible alternatives. Otherwise, companies grow complacent, misperceiving long-term hostages as loyal customers.
- 5) Brand equity is highly sensitive to trust. The rates of growth and decline of trust are asymmetric. Trust grows slowly, but can erode rapidly. If the trust in a brand is violated with any degree of consistency, it can be much more expensive (and often impossible) to restore the brand equity. The profound understanding of the fragility and asymmetry of brand trust (and the conditions of forgiveness) is absent among many brand managers, leading to disturbing cycles of over-promise and under-delivery.
- 6) While brand equity is an intangible, its economic value can be estimated with far greater rigor and confidence than is currently practiced. For individual customers, brand equity can be measured by the willingness to pay for the difference in brand, assuming identical products. For the marketplace, brand equity can be measured by the distribution and aggregation of individual customers’ future willingness to pay and their belief in the brand promise.
- 7) The shareholder value of corporate brand equity is the perceived (expected or projected) present equivalent value of the additional cash flow that can be generated due to the brand equity over time.
- 8) To be useful to brand managers and financial analysts, any robust valuation method for brand equity needs to account for both the decisions taken by the firm and the uncertainties of outcomes in the market.
- 9) For multi-brand companies, this valuation needs to explicitly account for potential synergies and conflicts within the brand portfolio. An explicit understanding of interactions and feedback is needed because there can be significant unintended effects on brand equity in a multi-brand environment. *A decision focus is critical because investments ultimately*

involve allocating resources among competing demands, and such investments should be conscious, explicit, and tied to the highest value potential. Decisions need to be sorted out at the level of individual brands and across the portfolio. At SDG, we have found that this effort is best guided by a “brand decision hierarchy” that defines the relative scope, importance, and immediacy of different decisions. A generic example is provided in Figure 3, though brand decision hierarchies should be highly customized for each company.

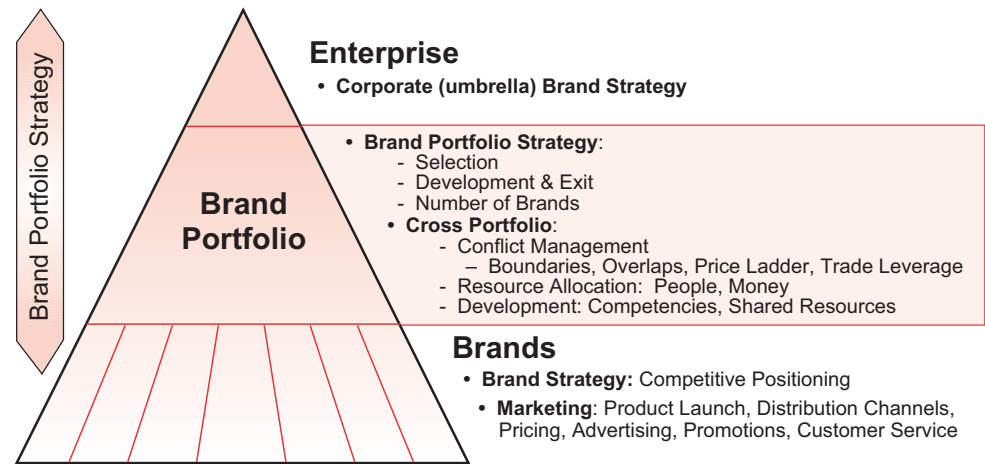


Figure 3. A brand portfolio perspective helps highlight the decisions and interdependencies up, down, and across the brand hierarchy.

Conclusions

The synthesis of systems dynamics and decision perspectives offers a promising and analytically powerful framework for valuing brands and designing brand strategies. By explicitly taking into account future uncertainties and the impact of feedback, this emerging methodology can help brand stewards measure the true value of their brands and more optimally allocate limited resources. Such undertakings are analytically and organizationally complex but well worth the effort.

We invite you to explore with us how you might apply these perspectives in improving your own brand strategies. May your decisions be wise, your equity flows positive, and your brand portfolio highly valuable.

Strategic Decisions Group
 Chanin Building
 122 East 42nd Street
 Suite 1910
 New York, New York 10168
 646 487.2500 PHONE
 646 487.9972 FAX
 nahmad@sdg.com
 SDG Office Locations:
 Boston
 Houston
 London
 Menlo Park, CA
 New Delhi
 New York

Forum Participants

Nazir Ahmad SDG ■ Val Akana SDG ■ Vince Barabba General Motors Corporation
 Steve Barrager SDG ■ Cathy Clift McCann-Erickson West
 Stephani Cook Lowe & Partners/SMS ■ Julie Curtis Wirthlin Worldwide
 Eva Freund Miranda Sony Pictures Entertainment (on leave from SDG)
 Nancye Green Donovan & Green ■ Patricia Hawkins Quest Futures Group
 Professor Ron Howard Engineering-Economic Systems, Stanford University
 Kenton Low Disney Imagineering ■ Mark Paich Burgundy Group
 Nick Pudar General Motors Corporation ■ John Rotondo AT&T
 Mary Beth Rymers Nestle USA ■ Dick Smallwood Applied Decision Analysis (ADA)
 Kent Smith US Postal Service ■ Michael Smith The Coca-Cola Company
 Carl Spetzler SDG ■ Steve Tani SDG ■ Steven Weiss Quest Futures Group
 Gunnar Wilmot McCann-Erickson