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Brand Risk Management:

Why Brands are Becoming More Valuable and More Vulnerable

By George Jurkowich and David Abrahams

During the last three months of 1999, Internet-based companies spent more than a billion dollars on advertising in the United States alone. What were they doing? "Building their brands" is the usual reply. With a few exceptions, they will fail—building a brand that can deliver sustainable shareholder value takes much more than lavish spending on witty advertising. But for those companies that succeed, another question emerges: How should they protect their brands, in which they have invested so heavily?The costs of ignorance or muddled thinking about brand risk could come to weigh heavily on the financial performance of businesses of all types and sizes in the years ahead. Managing brand risk is likely to rise rapidly up the list of senior management concerns—and not just for Internet start-ups or consumer giants such as Coca-Cola and Procter & Gamble. For a variety of reasons, the importance of brand as a driver of shareholder value is growing (see sidebars: "Why Are Brands Becoming More Valuable? and Why Are Brands Becoming More Vulnerable?). The risks are growing proportionately. Effective brand risk management is essential.

Brand risk management can most effectively be conducted when all of a company's risks are identified, measured and managed in an integrated manner—in other words, within an enterprise risk management framework. The reason for this is simple: Brand risk is multifaceted. Financial, hazard, strategic and operational risks—most of which tend to be managed discretely in organizational "silos"—can all give rise to brand risk. Brand risk is no respecter of silos.

But what precisely is brand risk? It has been defined in various ways, most of them too narrow. Under many risk management approaches, brand risk has no definition of its own. It is merely the by-product of a variety of other risks, such as product liability lawsuits or adverse regulatory decisions. At most it is defined as threats to brand equity—in other words, to those differentiators that cause consumers to choose one product or service over another.

Neither of these approaches is satisfactory. At its broadest, brand risk can be defined as changes in stakeholder perceptions that threaten:

1. the sustainability of current and future demand for a company's products or services; and
2. in certain circumstances, the company's commercial freedom or "license to operate."

Brand risk could therefore be generated by:

- A company's own conduct, such as manufacturing defects in the company's products or poor customer service owing to badly trained or demotivated employees.
- The behavior of customers or competitors—regardless of the company's own conduct—that might suddenly or gradually depress demand for the company's wares.
- Political or community opposition to a company that might limit its ability to develop, or even transact, business in a particular region or product/ service category. (This is sometimes referred to as the company's "license to operate.") The value of approaching brand risk is this comprehensive manner is that it provides a useful framework for risk analysis. Brand risk has three dimensions (see Exhibit 1).

Exhibit 1: Dimensions of Brand Risk.*

Brand A Brand B Brand C

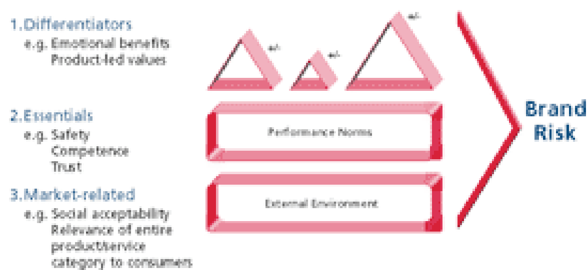
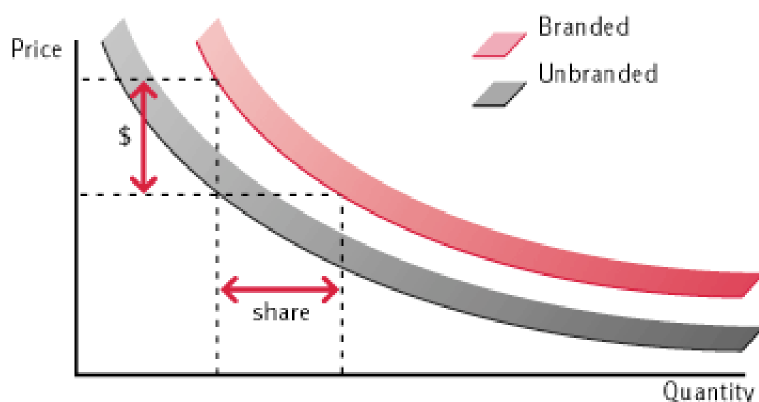


Exhibit 1 shows how risks to a company's brand or brands can derive from various sources, many of them outside the direct control of the company. The broad areas of vulnerability are:

- *Market-related changes.* These are external to the management of the company. For example, social values may change, making products that once commanded premium prices (e.g. designer label jeans) seem less attractive.
- *Essentials.* These are the foundations of corporate, or product, reputation—the "entry tickets" to the business. Cars that have a reputation for being unsafe will not sell. Banks that have a reputation for stealing, losing or gambling their clients' money will not prosper.
- *Differentiators.* These are the constituents of what is termed brand equity: the set of image elements that have the ability to shift economic demand in favor of (or against—brand equity can be negative) the company or its products (see Exhibit 2).

Exhibit 2: Demand curve shift attributable to brand equity (all else being equal).



The relationship between essentials and differentiators varies according to the way in which the brand is positioned. For example, safety is normally simply an essential for cars, but Volvo has made it into a differentiator that has helped the company thrive in the family sedan market. Customer trust is widely regarded as a essential for banks, but Britain's Coop Bank has broadened its application. Coop customers not only trust the bank not to play fast and loose with their money; they also trust it not to invest their money in ways that would embarrass or offend them.

The relationship between essentials and differentiators can make a big difference to brand risk. Consider the relationship between soft drinks and customer health. A drink that poisoned its consumers could not be expected to sell: safety is an essential.

But some drinks promote healthiness far more than others: mineral water for example. Purity—and thus healthiness—is a core component of the brand equity of mineral waters—particularly given that different brands are hard if not impossible to distinguish by taste. Thus the contamination of Perrier water with benzene in 1990 had significant long-term impact on worldwide sales. By contrast, sales of Coca-Cola in Europe have not been nearly so severely affected by the contamination of its products in Belgium last year.

Why Are Brands Becoming More Valuable?

The value proposition glut. At a time when consumer choices are growing rapidly (at least in the developed world), brand appeal is an increasingly important criterion for consumers to apply. How else should one distinguish among 200 brands of salsa? (For further perspectives on the value of brands in this context, see the latest issue of *The Mercer Management Journal*—No. 12, 2000—at www.mercermc.com.)

Brand consolidation. As a response to the value proposition glut, many companies have pruned the number of brands they will support. In February 2000, the Anglo-Dutch consumer goods company Unilever announced plans to "focus on fewer, stronger brands to promote faster growth." The company will focus its marketing efforts on just 400 of its 1600 brands.

Growing price competition. Strong brand values—particularly emotional values—can protect a brand from intensifying price competition. Brand can thus serve as a bulwark against the substitution and commoditization risks presented by web-based "bargain hunting engines," which present consumers with lowest price options.

"Brand stretching" into new products or services. An extreme example is the Virgin brand (strongly supported by the personality of Richard Branson), which has been stretched, at different times, to encompass music production and retailing, airline and rail travel, and soft and hard drinks (Virgin Cola and Virgin Vodka).

Channel switching. Brand equity built through one sales channel can sometimes be transferred to another. It was partly for this reason that Sotheby's share price responded so strongly last year to the company's decision to conduct auctions on line. The combination of the Sotheby's name and web technology excited investors.

Outsourcing. One widely observed effect of the Internet is the opportunity it gives companies to unbundle their activities, refocusing their efforts and their assets on whatever they determine to be their core competence—and outsourcing everything else. In many cases this will concentrate the value of a firm into intangible assets, such as intellectual capital or brand.

Relationship-building. New technologies, particularly the Internet, enable companies to build brands faster than ever before by providing customers with highly customized information and services. The meteoric rise of Amazon.com is a good example of such relationship-building.

Brand alliances. By teaming up with other well-respected companies, a company can sometimes enhance its brand equity in the eyes of customers. An example is the OneWorld airline alliance, currently comprising six major airlines.

Why Are Brands Becoming More Vulnerable?

Where brands are stretched across a number of products or services, brand failure in one area can taint perceptions of the brand in other areas. An obvious example is in the convergence between banks and insurance companies, where poor claims service in the insurance part of the business

might damage customer perceptions of the banking part of the business.

Brand stretching can be dangerous when it takes the brand beyond its natural boundaries. The brand then loses its power. This was what happened to Gucci in the 1980s, when the company's aura of exclusivity—critical in a luxury brand—was dissipated. It has since been recovered.

Value Concentration. As value is concentrated in fewer brands, the threat posed by risks to these brands will correspondingly grow in severity. To take one obvious example, the recall of a product accounting for 30% of a company's profits will be more damaging than the recall of a product accounting for 10% of profits.

Product Substitution. Greater ease of product and service substitution. If a brand takes a hit, the consumer will not have to look very far—increasingly no further than the Internet—to find a substitute.

Outsourcing. The stampede to outsource, encouraged by the price transparency afforded by the Internet, poses considerable brand risk—particularly where the outsourcing relates to customer service and other functions that may contribute significantly to a company's brand equity.

Brand alliances expose companies to the risk that their partners' performance may fail to meet customer expectations, thus damaging the brands of the other alliance members. For example, airline alliances make each participating airline vulnerable to poor service standards on the part of its alliance partners.

Information travels faster than ever before, supporting the formation of consumer or environmental advocacy groups to protest corporate behavior that they find objectionable. Large corporations can rapidly find themselves wrong-footed.

Customers and other audiences

Brand risk is commonly thought of in relation to customers. But an approach to brand risk management that focused exclusively on customers' perceptions would be seriously flawed. The company would risk being blindsided by the development of negative perceptions among other critical audiences. If allowed to fester, such perceptions can prove just as damaging to shareholder value as negative customer perceptions.

Audience perceptions of a company will commonly overlap but they will rarely coincide. (Exhibit 3 provides a graphic representation of the ways in which, in our experience, audience perceptions frequently overlap. The situation will vary, however, from company to company.) Brand risk management needs to take into account the dynamic relationship among the perceptions of different audiences. For example, U.S. companies that promote themselves to customers as embodying a set of "American" values (freedom, individuality, a can-do attitude) can easily find themselves perceived by foreign regulators, politicians and communities as arrogant, insensitive "cultural imperialists." It therefore makes sense for such companies to counteract such an impression through targeted investments in community and government relations outside the United States.

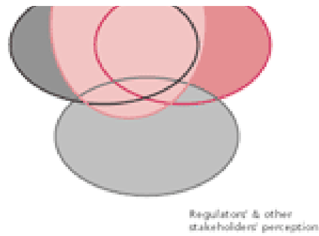
Exhibit 3: How is your brand perceived? Typical perception overlap among key.

time being, its stock soars.

Employees and potential employees can see the company differently from customers, focusing on the company as employer. Yet employees are essential contributors to sustaining the company's brand promise to customers and others.

Investors should, theoretically, enjoy an overarching perspective on the company, reflected in the price they will pay for its shares. In practice, their perspective is likely to converge most with that of customers.

Regulators. Includes governmental and non-governmental regulators and other stakeholders (e.g. local communities, environmental lobbies and others) whose actions might affect the company's "license to operate."



So how might a company draw up a risk management strategy that addressed all the threats to its brand considered above? We would recommend the following steps:

1. Understand and—more specifically—**evaluate** your brand: assess its strengths and weaknesses in the context of its risk environment. A variety of tools exist to achieve this. A Brand Vulnerability Analysis, which considers both brand catastrophic events and brand erosion, is often appropriate (see sidebar: Brand Catastrophies and Brand Erosion). In determining the economic power of brands, one of the most powerful tools is Strategic Choice Analysis TM, which uses quantitative analysis to reveal how a brand shifts demand among different customer segments. (For a description of SCA, see Eric Almquist, "Deconstructing Brand Equity," from *The Mercer Management Journal* at www.mercermc.com.) Other, simpler methodologies are also available—the insights they offer are less rich but still useful.
2. Do not confine your brand evaluation to customer perceptions. The perspective of your employees is also critical, both to help you gauge their willingness and ability to sustain your brand promise and to provide further insights into customers. As Andy Grove, the former Intel CEO, has observed, most CEOs are located "in the center of a fortified palace, and news from the outside has to percolate through layers of people from the periphery where the action is... We need to expose ourselves to lower-level employees who, when encouraged, will tell us a lot that we need to know."[1]
3. Quantify threats to your brand by incorporating brand risk into a broader "risk mapping" exercise covering all the major strategic, operational, hazard and financial risks affecting the company. A risk map ranks risks by frequency and severity. Some risks, such as adverse interest rate or exchange rate fluctuations, may have little or no attendant brand risk. Others, such as a major product liability lawsuit, may pose a brand risk that far outweighs the potential loss from the suit.
4. Also using external and internal research, evaluate the positive value of your corporate and product/service brands as a form of "insurance" protecting you against other risks. How trusted is management in the eyes of stakeholders such as consumers, investors and regulators? A high level of trust could enable the company to weather a crisis that would sink a less well-regarded firm. This dimension of brand risk analysis could help companies identify steps that should be taken to enhance their reputation with particular audiences.
5. Implement an integrated risk management strategy that a) protects your brand or brands from the major risks you have identified; and b) strengthens your brand in those areas where a strong brand can help mitigate other risks. Many of the components of this risk management strategy will be organizational. Most brand risks cannot at present be transferred because, although the risks can be huge, they are difficult to price to the satisfaction of both insurer and insured. (An exception is product recall insurance in the event of accidental or malicious contamination. But even this can do little to address a long-term decline in market share deriving from loss of consumer confidence in a product, particularly if that product is readily substitutable.)

Opportunities for risk transfer may begin to grow as insurers come to feel more comfortable with the workings of market research and as brand evaluation models become more sophisticated. But however the market evolves, insurers will need to be assured that their clients retain sufficient

incentive to protect their own reputations. Insurers will want to insulate themselves from moral hazard and will thus expect their clients to continue to shoulder a large measure of risk.

Whether brand risk is to be retained or transferred, the foundation of a successful risk management approach will remain the same—a clear-sighted appreciation of how stakeholders view your company and its products. For companies seeking to value and thus protect their brands, the words of Robert Burns remain as pertinent as ever:

"Oh wad some power the giftie gie us To see oursels as others see us! It wad frae monie a blunder free us, An' foolish notion."

[1] *Only the Paranoid Survive*, Andy Grove, Doubleday 1999

Brand Catastrophies and Brand Erosion

Brand risk is often thought of in relation to catastrophe—an oil spill, a plane crash, food or drink contamination, a defective car component that threatens driver safety. The brand risks posed by such events are immediate, public and, usually, severe.

But brand risk can also take the form of brand erosion. The effects of brand erosion are much harder to discern, at least in the short term. They are slow to develop and do not provoke news headlines—until and unless the firm's shareholder value collapses toward the end of the process. Brand erosion often escapes the notice of the company itself, unless brand management practices are regularly evaluated and brand value periodically measured.

There are non-catastrophic events in the life of every enterprise that should raise brand risk concerns, and which should be considered as elements of a Brand Vulnerability Analysis. (A Brand Vulnerability Analysis examines both catastrophic event and brand erosion risks in relation to value creation and value destruction.)

These non-catastrophic events include:

- A proposed merger or acquisition
- A spin-off or recapitalization
- A major enterprise restructuring
- Outsourcing of a brand relevant activity, such as technology or customer support
- A catastrophic, brand-impact event to a competitor
- A major change in brand-related efforts by a current or new competitor

This list is not exhaustive. Each enterprise should look to its own environment to identify brand risk challenges. For each event there are questions to be asked: What impact will the event have on customers, employees, investors, the community? What steps could be taken to take advantage of positive brand impact and to mitigate potential negative effects? Brand risk can thus be addressed, either in advance (which is preferable) or when the brand-related event takes place.

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