Branding and Firm's Financial Performance - Insights from the Consumer Goods Industry in India

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Existing literature documents that there are broadly two sets of strategies available to any business enterprise, viz., the quality leadership strategy, and the cost leadership strategy. The quality leadership strategy is concerned with creating competitive advantage for the firm in the market place, and manifests in premium pricing as a result of product differentiation attained through branding and advertising. On the other hand, the cost leadership strategy aims at benefiting from penetration pricing focusing on process differentiation leading to a low cost production system. However, against these blatant differences on the marketing front, economics postulates that, at the economic front, both the strategies would end up giving the same financial performance under perfect market conditions. Then, the question arises as to what actually is expected to happen in the perfect market condition that may nullify what otherwise could be a distinct strategic advantage under a given strategy. The answer lies in what is known as the Du Pont Framework in finance literature. It breaks down Return on Assets (ROA), which is the ultimate parameter of financial

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performance at the firm level into two components of Profit Margin (PM) and Asset Turnover Ratio (ATOR), and states that the ROA would be the same in the long run irrespective of the strategy used because the two components, PM and ATOR, would play against each other. To elaborate, the product differentiation strategy would have an advantage in margins (i.e. PM) but will be a loser in turnover (i.e. ATOR), and vice-a-versa for the process differentiation strategy. So, if this market based economic reasoning holds, there would hardly be any sense in going for the product differentiation strategy. However, in reality, leading marketers are found to be pursuing the product differentiation strategy. To understand and resolve this dichotomy, in this study we try to test this economic postulation in the context of the consumer goods industry in India.

Branding helps in differentiating the products and services of a firm from those of its competitors. The advertising expenditure depends on the branding strategy (Aaker, 1991) and has a long-term effect on brand equity (Rao, Agrawal & Dahlhoff, 2004). Brands possess financial value as they enhance future cash flows (Aaker & Jacobson, 1994) based on customer loyalty and high margins (Keller, Parameswaran & Jacob, 2011). The stock markets consider brand and brand equity in stock valuation (Rao *et al.*, 2004), and stock returns are found to be positively associated with perceived brand quality (Aaker & Jacobson, 1994). In the light of this, using the DuPont framework, this paper tries to find out whether higher ad intensity results in higher ROA.

How do brands contribute to the ROA? There have been interesting studies on this issue. The resource based view holds that strategic assets (both tangible and intangible) confer competitive advantage on firms and result in better financial performance owing to a positive relation between resources and firm performance (Wernerfelt, 1984; Canibano, Gracia-Ayuso & Sanchez, 2000). Intangible capital, also known as Intellectual Capital, plays an important role in the value creation process (CIMA, n.d.). IFAC (1998) classifies intellectual capital into three categories namely, human capital (employees, know-how, education, innovativeness, etc.), relational or customer capital (brand, customers, customer loyalty, distribution channels, etc.), and organizational or structural capital (patent, copyrights, trademarks, organizational procedures, culture, systems etc.) Customer capital is one of the most important components of intellectual capital. Riahi-Belkaoui (2003) defines it as "the firm's value of its franchise, its ongoing relationships with the people or organizations to which it sells, like market share, customer retention and defection rates, and per customer profitability." As a matter of fact, all the marketing activities are channelized to enhance customer capital, branding being one of them.

REVIEW OF LITERATURE

The literature relevant to this study has three dimensions. The first is the marketing dimension, focusing on branding and its importance. The second dimension is the interface between finance and marketing, which deals with the relationship between branding (advertising) and a firm's financial performance. The third dimension pertains to research methodology which focuses on the methodology used to study the relationship between branding/advertising and a firm's financial performance.

Branding and its importance: Low cost (cost leadership strategy) and perceived uniqueness (quality leadership strategy) are the bases for strategic advantage (Porter, 1998). The cost leadership strategy aims at exploiting the advantage of possessing the lowest cost. However, every customer may not be convinced by a low cost offering. Some may look for functional performance, prestige, and higher perceived quality, which demands additional costs on the part of the company. Thus, an alternative to create customer value is through differentiation and distinctiveness (Pitt & Koufopoulos, 2012). Product differentiation is established by the brand as customers identify distinctive products/services by their brand names. A brand is further strengthened by suitable communication and advertising strategies (Aaker, 1991). According to the American Marketing Association (AMA, n.d.) a brand is "a name, term, sign, symbol or design or a combination of them intended to identify the goods and services of one seller or a group of sellers and to differentiate them from those of the competitors." A powerful brand is instrumental in realizing various benefits such as 'improved perceptions on product performance; greater customer loyalty; less vulnerability to competitive marketing actions and marketing crises; larger margins; more elastic customer response to price decreases and inelastic customer response to price increases; greater trade or intermediary cooperation and support; increased marketing communication effectiveness; additional licensing, and brand extension opportunities' (Keller, 2009). Thus, the capability of marketing activities lies in product differentiation and building strong brands (Kotabe, Srinivasan & Aulakh, 2002). Consequently, firms expend on advertising and promoting their products. Advertising, thus, represents investment in brand and goodwill (Bharadwaj, Bharadwaj & Konsynski, 1999). Moreover, advertising is considered both a symptom (indicates that product is differentiable) and a source (determinant of level of differentiation realized by established firms vs. new and potential entrants) of differentiation (Comanor & Wilson, 1967). Thus, product differentiation, branding, and advertising are related to each other.

Relationship between branding (advertising) and firm's financial performance: One of the most important determinants of a firm's profitability is the effective spending on intangibles. (Cheng & Chen, 1997). Expenditure on advertising and R&D is considered an investment in intangible assets, which is reflected in enhanced future cash flows. The information about advertising and R&D expenditures assists investors in predicting the size and variability of future cash flows (Chauvin & Hirschey, 1993). Thus, information about brand and advertising expenditures is considered value relevant (Chauvin & Hirschey, 1993; Aaker & Jacobson, 1994; Cheng & Chen, 1997) and are associated with market value proxies like Tobin's q or stock returns (Han & Manry, 2004). The extant literature has documented positive association between advertising expenditure and a firm's Tobin's q (proxy for the firm's financial performance). Morck & Yeung (1991), Chauvin & Hirschey (1993), Lu & Beamish (2004), Kotabe *et al.* (2002) and Hermalin & Weisbach (1991) find a positive association between advertising expenditure and a firm's financial performance. Lev & Sougiannis (1996) report that the coefficients of advertisement intensity range between 0.906 in the transportation vehicles, industry to 1.639 in the scientific instruments industry. Thus, a one-dollar advertising expenditure is associated with an operating income (before advertising) increase of roughly 1 to 1.6 dollars. Thus, the relevant literature consistently sets out that advertising expenditure has a positive impact on a firm's financial performance.

Research methodology for studying the relationship between branding (advertising) and a firm's financial performance: The research methodology applied in examining the relationship between advertising and a firm's financial performance has extensively used multivariate regression (Comanor & Wilson, 1967; Bharadwaj, Bharadwaj & Konsynski, 1999; Chauvin & Hirschey, 1993), panel regression (Kotabe, Srinivasan & Aulakh, 2002), regression models based on the earnings-valuation model, different scalars like sales, total book value, and lagged price (Cheng & Chen, 1997), and another regression based model called Ohlson Equity Valuation Framework (Han & Manry, 2004). There are only two notable papers wherein the DuPont Framework has been used (Little, Little & Coffee, 2009; Little, Mortimer, Keene & Henderson, 2011). The DuPont Framework decomposes financial performance of a firm measured as its ROA into two components of PM and ATOR. Such decomposition provides a great insight into the drivers of ROA. PM shows the operating efficiency and ATOR shows the asset use efficiency. As per the theoretical proposition, firms with high relative PM and low relative ATOR are assumed to be pursuing a differentiation strategy and those with high relative ATOR and low relative PM are assumed to be pursuing a cost leadership strategy. Little *et al.* (2009) examined this issue for retail firms using the DuPont Model (with some modification). Their results did not confirm the perfect market

axiom of no difference in ROA between the two categories of the firms. They found that retail firms pursuing a differentiation strategy were more likely to achieve a higher PM than those firms pursuing a cost leadership strategy. Little *et al.* (2011) did a similar study, but with a difference in terms of comparing the financial performance of the two categories of the firms under a non-recession period and a recession period. There again, the result for the non-recession period was the same as that derived by Little *et al.* (2009); however, for the recession period, they observed that the retail firms pursuing a differentiation strategy were not more likely to achieve a higher return on net operating assets than those firms pursuing a cost leadership strategy.

Research Gap and Research Problem: As a matter of fact, studies conducted on the relationship between branding/advertising and a firm's financial performance have clearly shown that branding results in better performance, at least during normal market conditions. However, since all those studies were conducted in advanced economies, there is a possibility of an inherent favourability towards quality products as affluent societies may not mind giving away a more than justified premium price for good quality. The Indian market may be a different ballgame altogether, where Nirma Detergent Powder can beat Surf! It is possible that the price may be a more influential factor over quality in countries like India. Since there have not been any studies in India in our knowledge that examine the financial performance of the two opposite strategic orientations, we have made an attempt to bridge that void. We prefer to use the DuPont Framework as it can address (i) whether the two strategic orientations result in the same financial performance more or less, and (ii) what happens to margins (i.e. PM) and volumes (i.e. ATOR). We preferred to examine these research issues in the context of the consumer goods industry because, obviously, it is supposed to be the most reflective on these issues.

RESEARCH DESIGN

1.1 The Sample

Besides the reason given above for selecting the consumer goods industry, there is another merit in it, too. Branding and advertising are more prominent in case of the consumer goods industries, so data availability gets assured. Since it is a very big industry encompassing a broad range of products in India, we have chosen to focus on the subset — consumer foods and household products. The data is sourced from AceEquity Database. It contains 166 listed companies in the consumer foods industry and 34 listed companies in the household products industry.

Criteria for Selecting Companies

- The advertisement expenditure data is available for at least 8 years during the period of 2000–01 to 2015–16.
- The data on other counts like sales, PM, ATOR, ROA and Market Value to Book Value Ratio (MV/BV Ratio) is available for the respective years.

Table–1 gives a description of the sample, along with the reasons for eliminating certain companies from the sample.

Table–1

Table 1: Description of Sample		
Reason for Elimination	**No. of Companies**	
	Consumer Foods	**Household Products**
Total no. of companies available in the database	166	34
Less: No data available on advertisement	56	5
Less: Data on advertisement available for less than 8 years	37	6
Less: Data not available on other parameters	34	2
Final Sample	**39**	**21**

1.2 Time Frame and Data Collection

The study is based on secondary data that has been sourced from the AceEquity database as shown above. Since the database captures the data from published financial statements of the companies without regrouping the data, there is no fear of any distortions in it. The time frame of the study is a period of 16 years from 2000–01 to 2015–16.

1.3 Research Approach/ Data Analysis Method

Branding is considered to be a differentiator between successful firms and unsuccessful firms from a marketing perspective (Comanor & Wilson, 1967; Kotabe, Srinivasan & Aulakh, 2002). However, there can be issues at a larger level, whether branding contributes effectively to the overriding financial goal of the enterprise or not. Towards that, we want to understand two things: (i) whether higher ad intensity results in higher ROA or not, and (ii)

if higher ad intensity results in higher ROA, then we would like to understand the chemistry of ROA by using the DuPont framework.

The DuPont framework is presented below:

Return on Assets (ROA) = Profit Margin (PM) * Asset Turnover Ratio (ATOR)

It was pioneered by the DuPont Company, a US based corporation. It has received widespread recognition and acceptance for the purpose of financial analysis. It is based on important interrelationships between operating efficiency (PM) and asset use efficiency (ATOR), and explains how ROA is influenced by PM and ATOR. The classical view believes that a firm cannot excel at both the components of return over a long period of time. It believes that firms focusing on product differentiation will have higher PM, but lower ATOR, whereas the firms that focus on process differentiation would have higher ATOR but lower PM. So, taking ad intensity as a measure of the level of product differentiation, we want to examine whether or not the classical view under the DuPont Framework holds in the contemporary period in case of the consumer goods industry in India. Towards that, first of all, we present the definitions of variables used in our research.

1.4 Definitions

1. **Ad Intensity:** Advertising intensity is defined as advertising expenditure in terms of percentage of sales. It is the measure of advertising assets such as brand names and goodwill (Lu & Beamish, 2004).

2. **Return on Assets (ROA):** ROA is calculated as net income divided by total assets. It is a measure of profit for every 100 rupees of assets.

3. **Profit Margin (PM):** PM is calculated as net income divided by sales. It is a measure of profit for every 100 rupees of sales.

4. **Asset Turnover Ratio (ATOR):** ATOR is calculated as sales divided by total assets. It indicates the sales generated for every rupee invested in assets.

5. **Market Value to Book Value Ratio (MV/BV Ratio):** It is an adapted form of Tobin's q. It is worked out as the market value of a company's equity divided by the book value of the shareholders' net worth. It is a measure of value creation for shareholders. Value creation being the prime goal of any enterprise, higher the ratio (over unity value), the better it is.

We categorize all the companies in both industries into two categories. The basis for categorization is median Ad Intensity. Thus, there are two categories of companies: one, having ad intensity above median, and the other, having ad intensity below median. The companies falling in the 'above median' category are believed to follow a quality leadership strategy (product differentiation). The companies falling in the below median category are believed to follow a cost leadership strategy, assuming that some ad expense will have to be made even if the company is not being promoted as a brand. Table–2 gives an idea of the companies covered in the study, and Table–3 compiles the summary statistics.

Table–2

Table 2: Categorization of Sample		
Category	**Consumer Foods**	**Household Products**
Median Value of Ad Intensity	0.1698	2.8990
Above Median Category	11	10
Below Median Category	28	11
Total	**39**	**21**

Table–3

Table 3: Descriptive Statistics/ Summary Measures						
Variables	**Consumer Foods**			**Household Products**		
	Mean	**Median**	**SD**	**Mean**	**Median**	**SD**
Sales	670.4150	142.89	1972.0148	1685.3725	162.0212	5050.7566
Ad Intensity	1.4524	0.1697	2.5321	5.6590	2.8990	5.6199
PM	2.4813	1.5112	4.9598	5.2172	4.8693	6.3910
ATOR	1.9415	1.9136	1.2177	1.3959	1.1262	0.5926
ROA	4.8269	4.0290	4.5235	8.9295	6.89	9.6576
MV/BV Ratio	1.8823	0.8461	2.4210	5.8358	1.4868	8.7306

1.5 Hypotheses

To make it a systematic inquiry, first we examine whether some essential conditions are met, or not, before inquiring into the research problem. Since we are using the DuPont Framework as the basis of investigation, we examine for the pooled data for each of the two industries whether the ROA is explained by PM and ATOR as envisaged or not (Ho_1). Then, as ad intensity is supposed to be a differentiator between the two categories of the companies in each industry, we examine whether it commands significantly different values for the two categories of companies or not (Ho_2), if they are discriminated on the median value of ad intensity. With that, we turn to examining our research problems. Towards that, first we would like to see whether the two categories of the companies end up with more or less the same ROA or not (Ho_3). Then the two drivers of ROA are examined with the next two hypotheses (H04 & H05). Subsequently, we look at another measure of financial performance to substantiate our observations on the parameters used in the DuPont Framework (Ho_6). The null hypotheses are spelt out below.

Ho_1: ROA is not explained by PM and ATOR.

Ho_2: There is no significant difference in the ad intensity between the two categories of companies.

Ho_3: There is no significant difference in the ROA between the two categories of companies.

Ho_4: There is no significant difference in the PM between the two categories of companies.

Ho_5: There is no significant difference in the ATOR between the two categories of companies.

Ho_6: There is no significant difference in the MV/BV ratio between the two categories of companies.

1.6 Techniques of Analysis

Regression Analysis: In order to know the impact of PM and ATOR on ROA, regression analysis is conducted. The regression model has ROA as a dependent variable and PM and ATOR as independent variables.

t-Test: We conduct an independent two sample t-Test assuming unequal variances for examining whether there are significant differences among the two classes of companies (i.e.

those that are into differentiation, and those that are not into differentiation), on parameters of interest such as ROA, PM, ATOR, Ad Intensity, and MV/BV ratio.

ANALYSIS AND FINDINGS

Hypothesis–1: For a business enterprise, return is measured as return generated on the investment made in assets. As per the DuPont Framework, the return on assets is decomposed into two major ratios, namely, PM and ATOR. So the relationship of ROA with PM and ATOR is examined by first conducting regression analysis separately for each of the two industries. The results depicted in Table–4 uphold the contention of the DuPont Framework. Moreover, both the ratios, PM and ATOR are statistically significant. Thus, the use of the DuPont Framework for further investigation is justified.

Table–4

Table 4: Regression Results				
	Consumer Foods		**Household Products**	
DV	**IV1**	**IV2**	**IV1**	**IV2**
ROA	**PM**	**ATOR**	**PM**	**ATOR**
Beta Coefficient	0.6709	0.9679	1.1926	4.2540
t-Statistic	6.8592	2.3625	7.4883	2.4768
p-value	5.02645E-08	0.0236	6.1997E-07	0.0234
F-statistic	24.2846		40.8530	
p-value	2.1068E-07		2.03685E-07	
R squared	0.5743		0.8194	
Adjusted R Squared	0.5506		0.7994	

Hypothesis–2: It aims at examining the difference in the ad intensity between two categories of companies in each of the two industries. The two categories of 'above median' and 'below median' are formed using the median of ad intensity as a differentiator. In both the

industries there is a significant difference between the 'above median' and 'below median' categories of companies as shown in Table–5. Thus, the categorization based on median ad intensity is justified.

Table–5

Table 5: t-Test for Ad Intensity [Independent Samples Assuming Unequal Variances]				
	Consumer Foods		**Household Products**	
	Above Median Category	**Below Median Category**	**Above Median Category**	**Below Median Category**
Observations	11	28	10	11
Mean	4.8047	0.1355	10.6148	1.1536
Variance	7.7453	0.0162	20.4244	1.0550
t-statistic	5.5620		6.4700	
t-critical value	1.8124		1.8124	
p-value	0.0001		3.58157E-05	

Hypothesis–3: It examines the difference in ROA between the two categories of companies in each of the two industries. As shown in Table–6, for both the industries there is a significant difference between ROA of the two categories of companies viz., those that are into product differentiation vs. those that are not into product differentiation. The firms that are into differentiation have a higher ROA than firms that are not into differentiation. This indicates that branding has a favourable impact on the financial performance of a firm. Thus, the DuPont contention that there would not be any difference in the returns of the firms under the quality leadership strategy and the cost leadership strategy does not hold.

Table–6

Table 6: t-Test for Return on Assets (ROA) [Independent Samples Assuming Unequal Variances]				
	Consumer Foods		**Household Products**	
	Above Median Category	**Below Median Category**	**Above Median Category**	**Below Median Category**
Observations	11	28	10	11
Mean	7.4598	3.7925	15.5654	2.8969
Variance	39.6244	10.9467	106.7060	15.7640
t-statistic	1.8352		3.6414	
t-critical value	1.7822		1.7958	
p-value	0.0456		0.0019	

Hypothesis–4: It focuses on PM which is one of the drivers of ROA, and examines whether there is any significant difference in PM between the 'above median' and 'below median' categories of the companies in both the industries. In both the industries there is a significant difference between the PM as shown in Table–7. The firms that are into differentiation have a higher PM than the firms that are not into differentiation. This indicates that branding has a favourable impact on profit margins of the firm. Thus, the DuPont contention that a quality leadership strategy earns higher margins than a cost leadership strategy does hold for PM as a driver of profitability.

Table–7

Table 7: t-Test for Profit Margin (PM) [Independent Samples Assuming Unequal Variances]				
	Consumer Foods		**Household Products**	
	Above Median Category	**Below Median Category**	**Above Median Category**	**Below Median Category**
Observations	11	28	10	11
Mean	5.6589	0.8924	9.4220	1.3946
Variance	35.8727	13.6406	27.4980	27.2725
t-statistic	2.4194		3.5104	
t-critical value	1.7613		1.7291	
p-value	0.0148		0.0011	

Hypothesis–5: It focuses on another driver of ROA, viz., the ATOR, and examines whether there is any significant difference between the 'above median' and 'below median' categories of the companies in both the industries. In both the industries, the mean values of ATOR are higher for the 'above median' category; however, the difference between the two categories is not significant as found in Table–8. This negates the DuPont contention that a quality leadership strategy suffers on the count of ATOR.

Table–8

Table 8: t-Test for Asset Turnover Ratio (ATOR) [Independent Samples Assuming Unequal Variances]				
	Consumer Foods		**Household Products**	
	Above Median Category	**Below Median Category**	**Above Median Category**	**Below Median Category**
Observations	11	28	10	11
Mean	2.0008	1.9182	1.5536	1.2526
Variance	1.3278	1.6482	0.2939	0.4256
t-statistic	0.1949		1.1532	
t-critical value	1.7247		1.7291	
p-value	0.4237		0.1315	

Hypothesis–6: Going a step forward, we want to bring in another parameter of financial performance, namely the MV/BV ratio that captures the response of the capital market, and so, is hailed as the ultimate test of value creation for shareholders. Accordingly, here we examine whether there is any significant difference in MV/BV ratios between the 'above median' and 'below median' categories of the companies in both the industries. The results are captured in Table–9. The firms that are into differentiation have a higher MV/BV ratio than the firms that are not into differentiation. This indicates that shareholders' response to branding and promoting is also favourable.

Table–9

Table 9: t-Test for Market Value to Book Value Ratio (MV/BV Ratio) [Independent Samples Assuming Unequal Variances]				
	Consumer Foods		**Household Products**	
	Above Median Category	**Below Median Category**	**Above Median Category**	**Below Median Category**
Observations	11	28	10	11
Mean	3.9587	0.8441	11.1016	1.0488
Variance	11.1743	0.5021	117.4008	1.4741
t-statistic	3.0560		2.9173	
t-critical value	1.8124		1.8331	
p-value	0.0060		0.0085	

CONCLUSION AND DISCUSSION

Marketing professionals tend to prefer differentiation over 'me too' (Smith, 1956). To them, branding and promotion are the success mantras for customer value creation. However, all that is done by all concerned in a business enterprise has to ultimately contribute to shareholder value. It is in this context that we have tried to study the association between customer value creation and shareholder value creation. Prima facie, the two may look like two sides of the same coin; however, the economic theory of 'perfect market' does not approve of it. So, we have investigated with empirical evidences whether the differentiation strategy results into a better performance over the 'me too' in pursuing the ultimate goal of shareholder value creation of a business enterprise, or not.

Taking the median value of 'ad intensity' as a discriminating score, we divide the companies into two categories of 'above median' and 'below median'. The former is supposed to be following a product differentiation strategy, and the latter, manifesting absence of product differentiation (i.e. process differentiation). Our results clearly show that firms which are into product differentiation through branding and advertising report better financial results than the firms into 'me too'. We have examined the financial results from both the angles; ROA representing the internal (organizational) perspective, and MV/BV Ratio capturing the

external (capital market's) outlook. On both of these parameters, the companies with 'above median' ad intensity outsmarted the 'below median' group. Thus, the economic postulation of no difference in profits of the two opposite strategic orientations does not hold. In fact, the economic logic is based on quite a convincing argument that ROA, which is the firm level measure of financial performance is a function of two opposingly behaving performance drivers of PM and ATOR. If one is higher, the other would be lower. The DuPont Framework hypothesizes that product differentiation would result in higher PM but lower ATOR, whereas process differentiation would result in higher ATOR but lower PM. However, our study reveals that firms which are into branding and differentiation do have an advantage in PM, but do not have any disadvantage in ATOR. In other words, they do exhibit higher operational efficiency, but do not suffer on the front of asset use efficiency. Thus, branding and advertising not only result in higher customer value creation, but also result in higher shareholder value. Put in another way, investment in brand building resulting into creation of brand equity earns relatively higher returns than the investment in tangible assets. This result is consistent with our finding in another study, which brought out that the creation of intangible assets in terms of R&D investments by pharma companies resulted in higher profitability (Danak & Rajpurohit, 2017).

Prima facie, one may be tempted to interpret these results as being against the economic theory of 'perfect market'. However, it is not so. One basic requirement of a perfect market is that it must be a free market; however, a free market may not necessarily be a perfect market. Though the markets in which the consumer foods industry, household products industry, pharma industry, etc. operate are practically categorised as free markets, they are not perfect markets. Innovative approaches to target marketing inhibit a free market from translating into a perfect market. In fact, in modern times, governments try to make any market as perfect as possible, but marketers are likely to always try to make it as imperfect as possible through product differentiation. As a matter of fact, the economic postulation that in a perfect market all firms would tend to earn only a normal profit in the long-run is not wrong; rather, the firms with innovations do not allow any market to become perfect, and thereby enjoy super normal profits.

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