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The impact of brand health on customer equity

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ABSTRACT

This paper aims at studying the interactions between brand and customer assets over the long-term. Through the application of a new behavioural measure called the brand health index (BHI) we examine the impact of brand health on customer equity, and its mediating impact on the advertising-customer equity relationship. Three services industries, department stores, airlines, and banking, were studied from 2001 to 2012. The results show that brand health has a positive impact on customer equity, although the magnitude of the BHI impact varies across different industries. Moreover it was demonstrated that brand health mediates the impact of advertising on customer equity.

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1. Introduction

Customers and brands are firms' primary intangible assets (Gupta and Lehmann, 2003). Firms spend their resources to acquire new customers and retain existing customers (Stahl, et al. 2012) in order to increase their current and future cash flows and ultimately firm value (Hanssens, Rust and Srivastava, 2009). A customer's contribution to firm value is not limited to the profit from just one single transaction, but also to the total profit gained from a customer throughout its relationship with the brand (Kumar and George, 2007). Therefore to maximize firm value, it is critical that managers can influence customers' decisions, and maximize customers' acquisition and retention rates, which are the two main drivers of customer lifetime value.

To capture all future margins generated by a customer, the concept of customer lifetime value (CLV) or in its aggregate level, customer equity (CE) (Kumar and Shah, 2009) has been proposed in recent years (Gupta and Lehmann, 2003). Previous research has shown a positive association between marketing actions (such as price, advertising, and promotion) and customer equity (see Blattberg et al., 2009 for a comprehensive review). In addition to marketing actions, customer lifetime value and customer equity can be affected by other intangible assets such as brand equity (Stahl et al., 2012). In theory it has been argued that a brand asset can affect customer equity through creating growth opportunities, and charging premium prices, thereby increasing customer loyalty. Therefore, in the current competitive marketplace, monitoring the short-term and long-term influences of brand and customer equity as a predictor of customers' future behaviour is crucial (Vogel et al., 2008). Despite the conceptual papers developed on the brand–customer asset relationship, little research has studied this interaction empirically. In other words, the scholarly research has established a theoretical link between brand and customer assets, but the specific link has not been tested empirically. Moreover whilst considerable prior research has examined the relationship between marketing actions and brand performance, marketing actions and customer lifetime value and customer equity, little work has been done on the interaction between brand and customer assets with and without accounting for marketing actions (Stahl et al., 2012).

In this paper, we operationalize the theoretical link and empirically examine the impact of building a healthy brand on customer equity over the long-term. In doing so, we apply a new measure of customer equity, a macro model proposed by Lim and Lusch (2011). We also use a new long-term based behavioural measure of brand asset, termed the brand health index (BHI) as proposed by Mirzaei et al. (2015). Crucially we study the impact of advertising spending, as one of the key marketing actions (Buil et al., 2013), on customer equity. Finally, since brand asset may have a mediating impact on the marketing action-customer equity relationship (Stahl et al., 2012) we examine the mediating role of a healthy brand in the advertising-customer equity relationship by applying the Sobel (1982) test. Fig. 1 captures the essence of this paper since it shows how we propose the mediating effect of brand health between advertising and customer equity. We study

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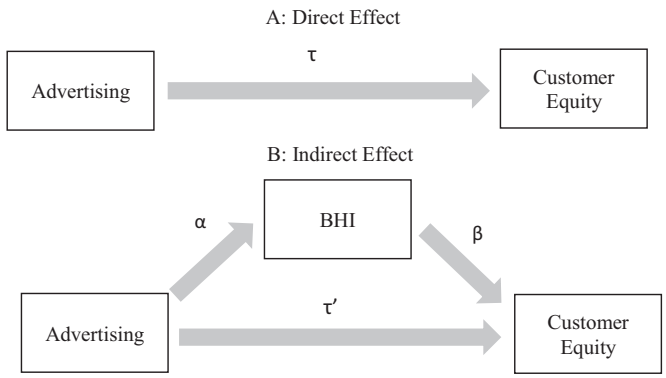

Fig. 1. Direct and indirect effects of advertising on customer equity via brand health. Note: the model specifications will be discussed in Section 6.2.

three industries, namely airlines, banking, and department stores in the U. S. market from 2001 to 2012.

This study contributes to the understanding of the relationship between brand oriented and customer oriented marketing actions. This is one of the first studies to empirically examine the interaction between two marketing assets, brand and customer assets, through studying the impact of brand health on customer equity. Managers in different industries can follow our approach in order to examine the contribution of brand building actions, namely advertising on customer equity, and the mediating role of healthy brands in the advertising-customer equity relationship.

In the next section, we provide a review and discussion of customer equity, its definition and measurement approaches. We then discuss the need for a behavioural measure of brand health, which captures the long-term dynamics of a brand. The Brand Health Index (BHI) is a new behavioural long-term based metric, and its theoretical grounding and methodology is discussed. We then discuss the customer–brand asset interactions and marketing actions–customer assets interactions before moving to the research methodology and findings.

2. Customer equity

One of the early papers on customer equity was Blattberg and Deighton's (1996) seminal paper on creating and maximizing customer equity. Since then it has been enriched by extensive research efforts (Bick, 2009). The core concept of customer equity is customer lifetime value (CLV) which is defined as "the present value of all future profits generated from a customer" (Gupta and Lehmann, 2003, p.10). It has also been defined as "the discounted future income stream derived from acquisition, retention, and expansion projections and their associated costs" (Gupta et al., 2004, p. 7). Simply stated, customer equity is the aggregate value of the customer lifetime value of all current and future customers (Blattberg and Deighton, 1996). Since not all customers are equally profitable for a firm, it is critical to allocate different resources to different customers (Gupta, et al. 2006). Customer lifetime value and customer equity as marketing assets (Hanssens et al., 2009) enable managers to find the profitable customers and manage the marketing actions for different groups of customers (Kumar and Reinartz, 2006). A wide range of tactics such as telemarketing, door-to-door selling, and direct mail have been used to engage more with customers and increase their lifetime value (Nguyen et al., 2014).

Customer lifetime value is driven by three major sources: customer acquisition, customer retention, and customer expansion (or cross-selling) (Gupta et al., 2006). A brand can spend on marketing actions such as advertising to acquire new customers, or to maintain current customers (Hanssens et al., 2008). A brand can also develop relationship with its customers to introduce them its other products, and brands (cross selling) (Rust et al., 2004b). This is important especially when customers lose their interest in a brand. Instead of phasing out the brand and losing the customers, customers can be shifted to another brand of that company that is a better match for them (Rust et al., 2004b).

To measure the concept of customer lifetime value and customer equity, several models have been developed over the last three decades. Blattberg and Deighton (1996) proposed a mathematical framework of calculating customer equity based on acquisition and retention rates. In an effort to find the optimum acquisition and retention rate to maximize customer equity, Blattberg and Deighton (1996) suggested as guidelines a list of considerations such as investing in highest-value customers first. Their proposed measure has two main shortcomings. First, they haven't taken the expansion (cross-selling) rate into account, and second, their approach is only applicable in the direct marketing field (Bick, 2009).

Rust et al. (2000, 2004a) proposed a model of customer equity which is built on three main pillars, namely, value equity, brand equity and relational equity. Gupta and Lehmann (2003) and Gupta et al. (2004) tried to simplify the measurement of customer equity and CLV, and provided a simple model which measures customer lifetime value based on publicly available data. Although their proposed measure enables managers to calculate CLV with minimal and general information, their model is subject to several assumptions such as constant margin rates over time, constant retention rates over time, and infinite length of project.

Recently Kumar and his colleagues in a series of studies shed light on customer lifetime value, and customer equity (Reinartz and Kumar, 2003; Kumar and George 2007; Kumar and Shah 2009). Kumar and Shah (2009), applying what they called the *always-a-share* approach, proposed a framework to measure customer lifetime value. According to Kumar and Shah (2009), the always-a-share approach assumes that customers are always associated with the firm and never terminate their relationship.

Considering all the approaches discussed above as micro models of CLV and customer equity measurement, Lim and Lusch (2011) propose a new framework for measuring customer equity at the macro level. While all the micro models of customer equity are based on individual level customer data, the macro model of customer equity is a process model based on the entire firm readily available data in the standard financial statements. To compute customer equity based on micro level models, accessing customers' transactional records and purchase behaviour is required which is not publicly available.[1] Moreover, in some industries such as fastfood, where individual customers' information and purchase history is not recorded, individual level data does not exist. Tirenni et al. (2007) argue that managers in industries such as airlines continue to guess their customers' value, or inaccurately value them. In practice there are attempts to estimate customer equity through loyalty programs. Banking is clearly a "subscription-type" business (Baumann, Elliott and Burton, 2012, p. 149) where the service provider has a very clear idea of the value of the relationship even without the loyalty program. However in the other two industries we study here (airlines, and department stores) transactions are not always easily identified to a particular customer. Loyalty programs have been introduced to move these

[1] Customer equity is a relatively new construct with only emerging understandings, conceptualisations and subsequent measurements. Admittedly, customer equity may ideally be measured at the actual individual customer level, calculated based on customer lifetime value (CLV). For practical reasons, however, and in order to move the discussion on customer equity research forward, we have decided to apply the macro level Lim and Lusch (2011) model as the closest proxy to empirically capture customer equity for 24 firms, in three industries, over 12 years.

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