PRICING OF BRAND EXTENSIONS BASED ON PERCEPTIONS OF BRAND EQUITY

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Abstract

The paper explores the role of brand equity when pricing hypothetical brand extensions. Companies tend to use different pricing techniques for their products, and their pricing decisions are based on many factors, including image and category fit of the product with the existing image and products of the company. Brand extensions are usually investigated from a consumer perspective, focusing on the extension attitude, however, it is essential to understand the corporate decision-making process regarding pricing. Exploring this matter using quantitative research methods, the study provides empirical evidence that companies that have invested heavily in marketing actions in the past and have built strong brand equity over-time, show flexibility in the mark-up during the cost decision-making process of a hypothetical brand extensions. Variations in mark-up percentages are also observed when there is a difference in image and category fit of the extension to the original brand. However, companies characterized by greater brand equity exhibited greater flexibility in the mark-up percentages, even for low fit extensions.

Keywords: Internal Control, Brand Equity, Electronics Sector, Goodwill Value

1. INTRODUCTION

Setting the "right" price when introducing a new product is significant. There are three main pricing methods: cost, competition, and marketing oriented pricing. However, as the price is the revenue earner, no matter how good the product, how creative the promotion and how efficient the distribution, the price needs to cover all costs, while avoiding overcharging (lost sales) and undercharging (lost margin) (Jobber, 2016, p. 422). Therefore, for competition and marketing oriented pricing to be calculated, all costs for the production of the product or service (full cost pricing & direct cost pricing) need to be considered (Jobber, 2016, p. 428). Thus, the mark-up for a product or service is decided by the company according to its financial goals and marketing strategy. Positioning the new product in the correct target market and at the right period of time is again very important for it to be accepted and favored over other similar products of competitors.

Nevertheless, when pricing brand extensions across sectors, pricing strategies consider additional information. Brand extensions are leveraging the current brand image of a company to enter a completely different market and/or product class.

This approach for growth is risky, as a company's most precious assets are its image, reputation, and the consumers' knowledge and experiences tied to the brand name (Song et al., 2010). These intangible assets, that have been created over time, are added to the company's existing tangible assets, creating an additional value for the company. This value gives the company the opportunity to 'use' the established brand name in order to gain the trust and preference of consumers in other unrelated markets to the one they originally operate.

Yet, this brand equity that has been created through investment in marketing activities over time, can be calculated as an intangible asset in the form of goodwill. It is important for a company to acknowledge its real market value, as this valuation can have positive effects on future opportunities, such as brand extensions (Stewart, 2009). If goodwill and customer valuation are relatively high, then, when brand extensions are introduced, this brand equity gives the flexibility to the mark-up, and consequently the total price, to be set at higher levels (Arslanagic-Kalajdzic & Zabkar, 2015).

This current study will focus on the exploration of the literature regarding brand extensions, brand equity, and pricing decisions. The methodological

approach and results will be presented, as well as the results. Finally, the discussion regarding the results will follow, and conclusions will be drawn.

2. LITERATURE REVIEW

2.1. Brand extensions

Brand extensions are leveraging the brand name and image, which are assessed and accepted according to the existing attitude of the consumers towards the original company (Aaker and Keller 1990; 1993; Bhat and Reddy, 2001, Keller 2003; Czellar, 2003; Kim et al., 2001, 2014; Hem et al., 2001; Martinez and Pina, 2010; Song et al., 2010; Salinas and Perez, 2009; Hem et al., 2014; Lopez et al., 2014; Park et al., 2015). The image of a company is created and exists in consumers' minds from their sociological environment. Brand specific associations make up the most important part of brand equity, the brand name (Aaker and Keller, 1990; Keller, 2003; Bhat and Reddy, 2001; Matzler et al., 2004; Kapoor and Heslop, 2009; Monga and John, 2010, Martinez and Pina, 2010). These unique associations differentiate one brand from the other and are used by companies when introducing new products or services to new markets. Studies suggest that there should be consistency through with the original brand's characteristics in order to reduce consumer uncertainty when expanding to dissimilar categories.

Furthermore, during the evaluation process of brand extensions, the brand name and the existing brand perceptions of consumers are significant (Aaker and Keller, 1990; Boush and Loken, 1991; Rangaswamy et al., 1992; Bhat and Reddy, 2001; Hem et al., 2001). If these are used wisely and kept consistent with the parent company's values and customer's associations through marketing communications (Keller, 2003; Kapoor and Heslop, 2009; Salinas and Perez, 2009; Goedertier et al., 2014; Kim et al., 2014;), then, brand extension launching costs are significantly reduced. According to Klink and Smith's (2001) findings, increased exposure through advertising may reduce the "distance" between original and extension category, consequently improving perceptions of fit.

Additionally, attracting new customers has proven to be more expensive than retaining existing customers. Thus, companies use the already existing consumer attachment in order to reduce purchase-related risks and increase motivation and positive attitude towards the extension (Tsai, 2014). Motivation to acquire additional information about new extensions, acceptance, and intentions of trying the new products are intensified when there is a strong brand-customer relationship (Kim et al., 2014). This relationship is used by companies as a platform when entering a new product class even when there is a low fit while keeping launching and introduction marketing costs to a minimum (Broniarczyk and Alba, 1994).

2.2. The significance of goodwill's valuation

Brand valuation may be conducted about merger and acquisition deliberations (Buchan and Brown, 1989; Jobber, 2016), or taxation determination (Brymer and Schiro, 1989). Additionally, brand valuation may be motivated by a managerial stance to enhance decision-making (Guilding and Pike, 1994). More specifically, in marketing management, during the introduction of new products/services, the accounting information falls short and more information is needed during the decision-making process (Foster and Gupta, 1994). The marketing literature indicates that companies with a strong brand name require more quantifiable information to assist with brand management (Aaker & Keller, 1992; Kapferer, 1992; Keller 1993), as they are more vulnerable to negative influence (Cravens & Guilding, 2001). Thus, managerial implications of brand valuation have received attention in both the accounting and marketing literature (Barwise, 1993; Guilding and Pike, 1994a).

Goodwill account occurs indirectly from the capitalization of brands, and even though this is calculated differently across different countries, the factor in common is the fact that goodwill represents an aggregated, composite figure covering all intangible assets, reflecting the market value. According to the IFRS IAS 38, "Intangible Assets," does not allow recognizing internally generated goodwill (Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance). The only accepted form of goodwill is the one that acquired externally, through business combinations or acquisitions. Only then, the value of the company can be shown on the balance sheet. Furthermore, according to IFRS 3, "Business Combinations," goodwill is calculated as the difference between the amount of consideration transferred from acquirer to acquiree and net identifiable assets acquired.

This goodwill value, according to Christodoulides (2009), can serve as a bridge that links brand's actions in the past and what will result from them in the future. Hence, Ambler's (2003) characterization of brand equity as a repository of future profits resulting from investing in marketing actions. Stewart's (2009) model, follows this concept where not only brand equity is recognized to have an impact on long-term investments but also acknowledges its impact on future opportunities, such as brand extensions.

2.3. Pricing brand extensions

In section 2.1. the literature on brand extensions was analyzed and discussed, pointing out the factors that play a role to consumers when they are introduced in order to be favored. However, the price is another very important factor of brand extensions. According to Jobber (2016), the inability of a brand to give economic justification of prices may make the customer reject the cost of a product or a service. As there is no empirical evidence of specifically pricing brand extensions across sectors, for that reason the literature of pricing new products is analyzed at this stage.

Firstly, Reichelstein & Rohlfing-Bastian (2015) mentions that product prices are equal to the levelised product cost (per unit revenue figure that an investor in a production facility would need to obtain to break even), plus a mark-up that varies according to competition in the industry. However, their research did not acknowledge the intangible assets that are also considered when setting prices. Cravens and Guilding (2001) focused more on brand value

accounting and how this adds value to companies, such as Quaker Oats, Coca-Cola, and Unilever. The corporate value of these companies derives from intangible, rather than tangible assets, and there is a stronger connection with consumers as a result of that. Consequently, the price of a new product to be accepted, it needs to be justified and to be considered as fair value by the customer, based on factors such as quality and benefits. These benefits can derive from the brand itself, through on-going past marketing activities, as brand loyalty and trust are strong decision-making factors, where price plays a minor role. Accordingly, prices of brand extensions introduced by strong brands, with high brand equity and external valuation, are expected to have a higher mark-up, and also accepted by consumers.

Moreover, as brand extensions mean moving to a different product class, it is important not only to take into consideration the cost of the product or service, and the mark-up based on consumers' perceptions of brand equity, but also the image and category fit between the original and the new sector. Using brand equity valuation solely to set a price could be damaging. Customer valuations of overpriced products from a strong brand and in an unrelated sector where the image is not coherent are negative and brands can lose prestige and customer's trust and admiration because of that.

Lastly, when setting prices in today's market environment, companies cannot price a product or a service according to what they believe is 'fair' and based on the internal valuation of the company. The European Commission and national bodies, such as the Competition Commission, operate in order to discourage anticompetitive practices that are against the public interest. Yet, prices tend to vary and change-over-time, according to the competitive conditions in the market.

From the literature review analyzed in the sections above, the following hypotheses were developed (Table 1.). The 2 hypotheses will be tested and conclusions based on the results will be made.

Table 1. Summary of hypotheses

H1	Perceptions of fit (image & category) affect the mark-up when pricing brand extensions	**Section 2.1**
H2	The percentage mark-up to the full cost of an extension will be higher for companies with greater brand equity	**Sections 2.2 & 2.3**

3. METHODOLOGY

This chapter explains the research methodology used for testing the proposed set of hypotheses concerning the pricing decisions regarding brand extensions of companies from the commerce to the service sector.

More specifically, a Pretest, a Pilot, and the Main study were designed to successfully address the aims of this study. All questionnaires for the Pretest, the Pilot, and the Main Study were designed on Google Forms, for compatibility reasons. The questionnaires were distributed online to businesses, via e-mail, prior to electronic or telephone contact.

3.1. Pretesting Process

This process was composed of a Pretest that served two purposes. First, the selection of the hypothetical brand extensions for the design of the pilot and main study, and second, the public's brand familiarity that would serve as a determinant of the companies' strength of the brand image and equity of 20 electronics companies, that would serve later in the study.

The Pretest was an online self-completed questionnaire, and it was administered by the research team via e-mail to the general public using snowball sampling (Saunders et al., 2016, p.303). Initial contact was made with some cases of the population, and these cases identified further cases. A sample of 40 people to determine the fit and perceived brand equity seemed appropriate. The participants rated on a 7-point Likert scale their familiarity with the company (1=Not at all familiar, 7=Very familiar)

The perceived fit distance for the brand extensions was determined in the following way. From a list consisting of eight preselected service categories, participants had to rate the extension categories based on fit with the category "Consumer electronics companies", using two 7-point Likert scales where both the category and image fit were considered (Bhat and Reddy, 2001). The services used for this pretest were carefully selected to be relevant to the main study sample that the questionnaire was destined to (Völckner et al., 2010). From the complete scales for both image and category fit (Aaker and Keller, 1990; Taylor and Bearden, 2002), only one item from each was selected, in order to reduce completion time and encourage participation (Bhat and Reddy, 2001).

The mean scores were again compared to select the high and low fit hypothetical extensions (Table 2).

Table 2. Descriptive analysis of Pretest II data (N=40)

Levels of fit	*Mean IF*	*Mean CF*	*Total Mean Score*
Cybersecurity services ↑	6.3	5.5	5.9
Photo editing application ↓	2.75	2.15	2.45
Online surveillance services	3.95	3.25	3.6
Online insurance services	6.2	5.3	5.75
Online language tutorials ↓	2.55	2.25	2.4
Subscription video on demand	5.5	4.5	5
Telecommunication provider ↑	6.2	6.35	6.275
Transportation booking service	5.2	4.2	4.7

Note: ↑=High fit, ↓=Low fit

3.2. Pilot and Main Study

This main study focuses on brand equity and how this influences the pricing of brand extensions moving from the commerce to the services sector. This study is conducted to explore the company's perception of their own brand equity and their beliefs on the impact of the brand name on pricing. As the structure of each company is different, the collection of qualitative data about the abstract theme of brand equity may pose a problem in the coding and analysis of the findings. Thus, this study follows a quantitative method.

A Pilot Study was conducted prior to the Main Study on a sample of 6 participants. Syntax and grammar errors, as well as incomprehensiveness due to phrasing, were identified and amended.

The online questionnaire for the Main Study was administered to the commercial managers of the 20 electronics companies used in the Pretest, using homogeneous purposive sampling. Electronic and telephone communication prior to completion, and a follow-up (Saunders et al., 2016, p. 475) had an impact on the period given to complete this study. Four weeks (November-December 2017) were needed in order to receive an acceptable amount of responses from companies.

The questionnaire comprised of two main sections focusing on "Brand Equity and Pricing Decisions", where the importance of the brand equity was rated on a 7-point Likert scale, in terms of the consumer perception and decision making when pricing new service extensions. Following those questions, the type of pricing strategy used when deciding on prices (Cost, competition and marketing-oriented) was again rated on a 7-point Likert frequency scale (Vagias, 2006). The following section uses Aaker and Keller's (1990) and Taylor and Bearden's (2002) category and image fit scales for the hypothetical brand extensions. However, due to time constraints and to free the participants from similar and long questions, only one item from each scale was used to establish the image and category fit (Bhat and Reddy, 2001). Lastly, for each of the four hypothetical brand extensions, the participants were asked to give an approximately mark-up percentage (5% increments) to the full cost of development of the service, based on brand equity and fit, which will help us explore the differences between the most and least known companies in the Greek electronics market.

As mentioned above, the online questionnaire was administered to 20 companies international specializing in consumer electronics and are located in Greece and it was answered by the commercial managers of each company. The sample of this study was relatively low, yet acceptable since it was addressed to companies and there was a >40% response rate (Dillman, 2007). Table 3 includes data regarding the sample. The total number of companies that responded to the questionnaire was classified into 2 main categories, high and low perceived brand equity, based on the mean scores from the Pretest, which determined the familiarity of the general public with the companies used.

Table 3. Summary of Main Study sample

Sample (N=16)	Gender:	Age:	Education:	Years at current position:	Company's number of employees:
	87.5% male *12.5% female*	*35.5 years mean age* *28 years min* *46 years max*	*25% undergraduate degree* *68.8% postgraduate degree* *6.8% Ph.D.*	*31.3% 0 – 2 years* *37.5% 2 – 5 years* *31.2% 5 – 10 years*	*25% 50 – 100* *56.2% 100 – 250* *12.5% 250 – 500* *6.3% 500 – 1000*

4. RESULTS

A series of independent t-tests were performed to test whether the perceived brand equity (IV) has a significant effect on the percentage mark-up (DV) when pricing brand extensions. The results of the tests indicated significant variations between high and low perceived brand equity. The mean scores (Table 4.3.) indicated that electronics companies that were perceived to have higher brand equity were significantly more likely to have higher mark-up percentage for the hypothetical brand extensions. Hence, H2 is supported.

Table 4. Means and SD for the percentage mark-up, based on brand equity by extension (N=16)

Variables		Mean	SD	df	t	p-value
Telecommunication provider↑	High brand equity companies (N=8)	26.88	7.039	14	4.811	**.000**
	Low brand equity companies(N=8)	13.63	3.335			
Cybersecurity services↑	High brand equity companies (N=8)	26.25	6.409	14	4.943	**.000**
	Low brand equity companies(N=8)	13.63	3.335			
On-line language tutorials↓	High brand equity companies (N=8)	22.50	3.780	14	6.091	**.000**
	Low brand equity companies(N=8)	12.75	2.493			
Photo editing application ↓	High brand equity companies (N=8)	23.13	3.720	14	6.963	**.000**
	Low brand equity companies(N=8)	12.13	2.475			

Note: p<0.001, p<0.05
Note: ↑=High fit, ↓=Low fit

It is also interesting to note the difference in mean scores of the percentage mark-up between the high and low fit hypothetical brand extensions. This difference in mean scores is also getting smaller moving from the high equity to the low equity companies, indicating that fit does indeed have an effect on pricing decisions. This evidence supports H1, however, the value used for this analysis was a combined score derived from both image and category fit.

Table 5 presents the results from the additional correlations between image and category fit and the percentage mark-up for brand extensions. For low fit extensions (on-line language tutorials and photo editing application) the results are fairly consistent for both hypothetical service extensions being close for both image and category fit. For high fit extensions (telecommunication provider and cyber security services) means and SD indicate that there is a difference between the two kinds of fit. However, in one case (telecommunication provider) category fit is higher, whereas, for cybersecurity services image seems to have a higher effect.

Table 5. Correlations between fit (image and category) and percentage mark-up (N=16)

Variables		*Mean*	*SD*	*Sig. (2-tailed)*
Telecommunication provider↑	Image fit	5.06	.998	.248
	Category fit	5.19	.911	.356
Cyber security services↑	Image fit	4.5	.894	.933
	Category fit	4.25	1	.713
On-line language tutorials↓	Image fit	1.06	.250	.693
	Category fit	1.06	.250	.693
Photo editing application ↓	Image fit	1.38	.719	.623
	Category fit	1.31	.602	.663

Note: Note: p<0.001, p<0.05

Furthermore, even though there was no hypothesis for the specific data collected, as it was just an informative item, the pricing strategies used by companies were further analyzed. Table 6 demonstrates the scores regarding the pricing orientation of the electronics companies selected for this study. It is apparent that competitor-oriented pricing is generally more significant in both high and low brand equity companies. Cost-oriented, as well as marketing-oriented pricing, seems to play a more important role for companies of lower brand equity. We would expect cost-oriented pricing to be more dominant, at least among low brand equity companies. Interestingly, cost-oriented pricing seems to play a minor role, compared to the other two strategies.

Table 6. Means and SD for the pricing strategy, based on brand equity

Variables		*Mean*	*SD*	*df*	*t*	*p-value*
Cost-oriented pricing	High brand equity companies (N=8)	4.63	.518	14	-.306	.764
	Low brand equity companies(N=8)	4.75	1.035			
Competitor-oriented pricing	High brand equity companies (N=8)	6.88	.354	14	2.898	.012
	Low brand equity companies(N=8)	6.13	.641			
Marketing-oriented pricing	High brand equity companies (N=8)	5.13	1.126	14	.914	.376
	Low brand equity companies(N=8)	6.63	1.061			

Note: p<0.001, p<0.05

5. DISCUSSION AND CONCLUSIONS

The aim of the current study was to examine 1) whether the perceptions of fit, both image, and category, have an influence on the mark-up when pricing brand extensions, and 2) whether the percentage mark-up will be higher from companies that have greater brand equity.

Results indicate that there is a variance in the mark-up percentage when pricing brand extensions according to the fit of the hypothetical brand extensions and the original brand. This observation is in line with the literature and previous empirical evidence indicating that if the perceived fit is high, the more successful the brand extension (Aaker and Keller, 1990, 1992; Sunde and Brodie, 1993). Thus, since the fit is higher, flexibility in pricing is indeed suitable for companies. Further, from a significance point of view, category fit seems to have less influence on pricing decisions. Again, this is partially in accord with the literature, as for low brand equity companies, category fit is more important since the trust that the image inspires is less than that of higher ones. Thus, low equity companies should be focusing on quality, as well as physical characteristics, in order to aspire higher credibility (Chun et al., 2015).

Furthermore, electronic companies operating in Greece with higher perceived brand equity demonstrated a higher flexibility in selecting a higher mark-up for extensions, even when the fit was low. As advertising and exposure to marketing communication messages reinforce the relationships between companies and consumers (Egan, 2015, p. 162) and reduce the fit distance of extensions (Czellar, 2003), higher brand equity companies have an advantage, over smaller ones, who do not have the resources. In addition, innovative companies and highly reputable companies, especially the ones involved in technology, motivate the self-categorized

in the innovation cluster consumers to learn more and unconsciously accept unfitting extensions (Tsai, 2014). This is considered by high brand equity companies, who maintain high prices and preserve their image. Therefore, since stronger companies have stronger reputation and influence in the market, extension failure and overpricing unfitting extensions will not have the same negative impact as if low brand equity companies took that risk (Pina et al., 2013).

To sum up, the main purpose of this paper was to examine whether the percentages of the mark-up of brand extensions are influenced by perceptions of fit between the new product and the original company, and the difference of mark-up flexibility between companies with high and low perceived brand equity. The results indeed demonstrate that companies with higher perceived brand equity have higher mark-up when pricing brand extensions. Additionally, perceptions of fit, and more specifically image and category fit, also affect pricing decisions. High fit extensions are added a higher percentage mark-up, whereas percentages are reduced for lower fit extensions.

5.1 Limitations and future research

There were quite a few limitations to this study. First, due to lack of resources, the hypotheses were tested on a very small sample, focusing on one small sector of the market. Due to globalization and free trade, the selected initial sample of companies was limited to the number of electronics companies that are physically located in Greece, since it would be very difficult to contact international electronics companies for the purposes of this study.

Replications of this study could be tested on other sectors of the market, and on larger samples so that generalizations can be made. The sample may also consist of cases with different roles within a company, to also compare the difference in views within departments. However, even if the sample is larger and more sectors are tested, the difference in location could restrict generalizations, as the consumers' perceived brand equity may vary across different countries. Additionally, this was a study that focused on brand extensions from products to services. More studies with cross-sector brand extensions would provide more insight into the research of pricing brand extensions. Furthermore, it would be interesting to test the percentage mark-up for the same hypothetical brand extensions from various companies, in combination with its acceptance from consumers.

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