LINKING OWNERSHIP STRUCTURE AND BRANDING STRATEGY TO FINANCIAL PERFORMANCE AND STABILITY: CASE OF FRENCH WINE COOPERATIVES

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Abstract: This research explores the impact of branding on financial performance of a firm while taking into account its ownership structure. Using the decisional theory, we apply a normative approach to better explain the incentives and constraints of branding in two types of firms: Cooperatives and Investor Owned Firms (IOFs). We adopt a quantitative analysis, using a survey of 207 French firms in the wine sector, combing its data with financial information. We show that cooperatives are more constrained to brand, therefore, they invest more in collective branding whereas IOFs are more likely to invest in specific branding. Additionally, we find that branded firms have lower financial and commercial performance. Finally, we find that the main factor contributing to the stability of financial performance is the cooperative ownership structure rather than the creation of a brand.

Keywords: Cooperatives, Branding, Financial Performance, Decision Theory, Wine Industry

LER LA STRUCTURE DE PROPRIETE ET LA STRATEGIE DE MARQUE A LA PERFORMANCE FINANCIERE ET LA STABILITE FINANCIERE : LE CAS DES COOPERATIVES DE VINS FRANCAISES

Résumé : L’étude examine l’impact de la création d’une marque sur la performance financière d’une entreprise selon sa structure de propriété : coopérative ou capitaliste. Nous adoptons dans un premier temps une approche normative pour mieux étayer les contraintes et les incitations à la création d’une marque selon chaque type de structure. Ensuite, nous testons nos résultats via une étude quantitative du secteur viti-vinicole basée sur un questionnaire de 207 entreprises françaises en le combinant à des données financières. Nous trouvons que les coopératives sont plus contraintes à créer une marque propre, cependant elles investissent plus dans la création d’une marque collective. Nous trouvons aussi que les entreprises ayent des marques propres ont une sous performance financière. Finalement, nous trouvons que le facteur principal qui contribue à la stabilité de la financière de l’entreprise est la structure de propriété coopérative plutôt que la création d’une marque.

Mots clefs: Coopératives, Création d’une Marque, Performance Financière, Théorie de la décision, Secteur Viti-vinicole

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Introduction

Marketing departments are getting more importance in the modern firm and their budget allowances are significant and are required to create value for the firm. Therefore, the marketing discipline is interested in measuring the performance of its actions. Several studies have examined the relationship between marketing discipline and results such as branding (Madden 2006, Lane and Jacobson 1995), new product launching (Pauwels et al. 2004; Sorescu et al. 2007), communication and advertising (Buil et al. 2013; Oyinga et al. 2011), customer satisfaction (Anderson et al. 1994; Fornel et al. 2006) and perceived quality (Aaker and Jacobson 1994; Mizik and Jacobson 2003) and financial performance using various methodologies such as event studies, surveys, case studies and empirical research (Srinivasan and Hanssens 2009). These research studies prove the generation of value through these different marketing actions and their positive impact on stock returns.

Nevertheless, no studies test these relationships while considering the ownership structure. Ownership is a key factor that defines purposes of a firm and, therefore, the way of evaluating each strategy and performance is relative to its objectives (Hansmann 1996). In this research, we study cooperatives and compare them to investor-owned firms (IOFs). Cooperatives are democratically controlled (one member one vote rule) and are owned by an essential stakeholder that can be the producer, the consumer or the employee while investor-owned firms’ governance depend on the proportion of shares detained by each owner who is the capital provider. Cooperative shares are repaid to their member at exit time, to their nominal prices, unlike investor shares. As a consequence, investing in marketing, specifically, in branding which generates brand equity is less attractive for cooperatives. Consequently, we expect different marketing strategies for each type of firm with different financial outcomes. We are interested in branding of cooperatives and compare it to investor-owned firms. Branding is an expensive strategy, however, its advantage is to reduce the uncertainty in the product’s quality (Sappington and Wernerfelt 1985; Srinivasan et al. 2009) generating a higher demand for the firm's product, therefore, better financial and commercial performance and providing a stability of returns (decrease of the risk).

In this paper, we adopt a normative approach, to explore the marketing decisions undertaken by managers and how they maximize the utility of the owner of the firm, according to each type of entity. We then confront the analysis with results of a survey held in 2005 on 207 firms in the French wine industry sector on the branding strategies adopted while combining the financial performances between 2005 and 2009. We differentiate between collective and specific branding. Collective brands, in the case of wine businesses, are the protected geographical identification labeling (Mccluskey and Loureiro 2003). Specific brands are created internally within a firm allow a certainty for the products ‘quality while creating a brand equity. We find that collective branding is usually used in cooperatives whereas specific branding is the main strategy for IOFs. We confirm that branding has a negative impact on financial and commercial performance for IOFs and we also demonstrate this impact in the case of cooperatives. Also, we find that the ownership structure reduces the financial risk, more than the branding strategy: cooperatives’ financial returns are more stable than investor-owned firms. Our main contribution is to examine, in a transversal approach, the relationship between ownership structure, brand strategy and financial performance.

Background and normative approach

A transversal study between marketing decisions and financial performance of the firm is needed to better understand incentives and results of each strategy (Wind and Robertson 1983).
Marketing theory uses the scientific approach into two models according to Massy and Webster (1964): behavioral relationships and normative decision rules. Behavioral relationships models are used to describe the behaviors of individuals or firms whereas decision models allow showing how economic units must behave using the optimization rule. Besides, corporate finance theory considers a firm’s cash flows as affected by stakeholders in the firm (insiders, outside investors, managers...), ignores interactions between different firms. To serve the objectives of our research we choose to explore the firms’ utility function concentrated on corporate finance theory’s and decision theory perspectives using an optimization analysis. We identify a theoretical framework using the utility function of each of cooperatives and investor-owned firms, how they decide to undertake branding and product strategies to serve the best interest of their owners.

Assumptions and model overview: We assume a simple framework without any agency problems; managers maximize the utility of the owner: the member of a cooperative and the investor. The firm produces two types of products, final elaborated products, and raw products. The manager has two options of a branding strategy: create a brand or not. Branding aims to create value allowing the firm to increase its price. Investing in brands creates a reputation of quality for the product. Customers value this reputation and, therefore, are willing to pay higher prices for this product. The price increase assumed depends on the type of product: A higher price increase is expected for final elaborated products and a lower one for raw products. Branding generates brand equity for the firm that can be sold in the case of investor-owned firms. Cooperative members cannot take advantage of this brand equity since the value of their shares is repaid at a nominal price. And, the choice of not creating a brand is a costless procedure that generates sales at the market price. The benefit of cooperating is a U-shaped quadratic function that relates to the economic benefit of cooperating. The cooperating advantage is provided in this case by the fact of getting better market prices or lower costs for the members of the cooperative (Kyriakopoulos et al. 2004). Cooperating is interesting until reaching a threshold where decisional costs and free riders problems reduce the benefit of cooperating. The firm generates an increasing concave profit function.

Results. The optimization of the utility function generating the branding decision under the branding costs; production and cooperation constraints show us that an investor-owned firm has incentives to brand when the brand equity and the price premium of branding of the product exceed its costs, whereas for cooperatives the increase of price premium is a unique advantage that must overcome its costs. Therefore, cooperatives are more constrained to brand. Consequently, the branding strategy is interesting for cooperatives only when the cooperation advantage exceeds the branding equity created within an IOF. Additionally, it is more likely to brand when the marginal financial profits are positive. Economies of scale imply better financial returns; consequently, it is more likely to have an extra financial endowment to invest in branding. Additionally, it is more likely to brand when the price premium of branding is positive. Therefore, the type of product sold is an important factor in the branding decision. In our case, the higher the propensity of the final product is within the firm, the higher the chances of branding are.

Within the normative framework, we understand better the incentives for the branding strategy. However, the decisional theory has its limits. Firstly it is unable to support behavioral models (Massy and Webster 1964), where we consider the interaction of customers. Secondly, it does not take into account the impact of competition on these behaviors. Finally, all of our assumptions do not always hold. Consequently, we confront our normative results to those emanating from a research in the French wine industry.
Empirical illustration in the French wine industry

We use data from a survey held in 2005 by Credit Agricole SA, completed with financial information from Diane database from 2005 till 2009. The survey was held on 214 firms; we removed outliers and missing data to get a database on 207 firms in the wine sector. The survey included firm’s information concerning their production, commercialization, and branding strategies (see Table 2 for descriptive statistics). We examine the relationship between ownership structure and marketing strategies from, and then the impact of ownership structure and marketing strategies on financial performance.

Table 2: Descriptive statistics

<table>
<thead>
<tr>
<th></th>
<th>No Brand</th>
<th>Collective Brand</th>
<th>Specific Brand</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>IOF</td>
<td>Number of firms</td>
<td>14</td>
<td>11</td>
<td>64</td>
</tr>
<tr>
<td></td>
<td>Number of firms with predominance of bottled wine</td>
<td>6</td>
<td>8</td>
<td>63</td>
</tr>
<tr>
<td></td>
<td>Number of firms with of wine in bulk</td>
<td>8</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Coop</td>
<td>Number of firms</td>
<td>29</td>
<td>55</td>
<td>34</td>
</tr>
<tr>
<td></td>
<td>Number of firms with predominance of bottled wine</td>
<td>9</td>
<td>15</td>
<td>25</td>
</tr>
<tr>
<td></td>
<td>Number of firms with of wine in bulk</td>
<td>20</td>
<td>40</td>
<td>9</td>
</tr>
</tbody>
</table>

The data shows that IOFs invest significantly more in specific branding and produce more bottled wine as compared to cooperatives, regardless of their maximal capacity of production. Cooperatives invest more in collective branding rather than specific branding. Moreover, the type of the product affects the branding choice; when cooperatives produce bottled wine; they are more likely to invest in specific branding and vice-versa. We also find that cooperatives are more likely to produce wine in bulk than bottled wine.

We then examine the impact of the marketing strategy and ownership structure on financial and commercial performance. We use multiple regression with financial and commercial performance as dependent variables and firm-related characteristics and marketing strategies as independent variables. The retained characteristics of the firm are ownership structure, the number of employees, and volume of production, pricing policy (price per hectoliter of wine), type of product (proportion of wine in bulk sold) and branding (No brand, collective brand, and specific brand). Financial and commercial performance are measured using return on assets (ROA) and return on sales (ROS). We use a measure of these variables at t+1 of the survey and then we use the average between 2005 and 2009. To measure the volatility of performance we use the standard deviation of firms’ financial performance between 2005 and 2009. The results of the multiple regressions ‘standardized coefficients and their significance are exposed in table 3.

We find that cooperatives underperform financially investor-owned firms, even though having higher commercial performance. This is due to the higher voluntary costs paid by cooperatives to their suppliers who are their members in this case. We also find a significant negative relationship between financial and commercial performance on one hand and the branding strategy on the other. This relationship is significant for financial performance; nevertheless, it is only significant for collective branding strategy while examining commercial performance. Generally, investing in branding activity aims to create a brand equity and generate better future cash flows for the firms. Hence, branding is a costly procedure; either it is specific or collective. Specific branding costs remain on the definition of the brand strategy, create a brand image and make the firm appropriate it. Collective branding has important costs of compliance with the requirements. Therefore, the financial underperformance is observed. Analyzing the results of the multiple regressions regarding
the volatility of financial performance, the ownership structure is the only significant variable: cooperatives performances are less volatile compared to IOFs. Additionally, we find that collective and specific branding imply a more important stability of performance which may be virtues of branding creating less volatile financial returns due to the certainty about the products quality generated by the brand image created.

Table 3: Results of the multiple regressions (with * p < 0.1, ** p < 0.05, *** p < 0.01)

<table>
<thead>
<tr>
<th>Variables</th>
<th>Financial Performance</th>
<th>Commercial Performance</th>
<th>Volatility of Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Numb_Empl 2005</td>
<td>,062</td>
<td>,094</td>
<td>,034</td>
</tr>
<tr>
<td>Total volume produced Q</td>
<td>,122</td>
<td>,121</td>
<td>,121</td>
</tr>
<tr>
<td>Proportion of wine in bulk (1-Z)</td>
<td>,076</td>
<td>,087</td>
<td>,175</td>
</tr>
<tr>
<td>Price per hectoliter 2006</td>
<td>,079</td>
<td>,121</td>
<td>,148</td>
</tr>
<tr>
<td>Coop1_IOF0</td>
<td>,005</td>
<td>,042</td>
<td>,092</td>
</tr>
<tr>
<td>Collective branding strategy</td>
<td>,231 **</td>
<td>,340 ***</td>
<td>,183 *</td>
</tr>
<tr>
<td>Specific branding strategy</td>
<td>,117</td>
<td>,334 ***</td>
<td>,034</td>
</tr>
<tr>
<td>R²</td>
<td>,086</td>
<td>,134</td>
<td>,145</td>
</tr>
</tbody>
</table>

Conclusion and limits

In this research, we explore the link between ownership structure, branding strategies and financial and commercial performance and the volatility of financial performance. The ownership structure dimension was not studied in the previous literature relating marketing to finance; even if it is an important factor in determining marketing strategies and governance of a firm. We compare cooperatives and investor-owned firms using a normative approach, and then we illustrate with an empirical application in the French wine sector.

In the wine industry, three main branding strategies are identified: collective branding, a specific branding, and no branding. We find that cooperatives sell more wine in bulk rather than bottled final product and use more the collective branding strategy, compared to IOFs. These results confirm the expectations of the normative framework; cooperatives are more constrained to create a specific brand; they prefer to invest in collective branding. It is a less costly procedure which provides customers, a level of certainty about the product’s quality while the firm is constrained to comply with a list of requirements to be part of this brand. This intermediary level of branding seems to be dominating cooperatives in this sector. And since the uncertainty of the level of production is an essential problem facing cooperatives (M. B. Beverland 2007; M. Beverland 2001), the use of a collective branding strategy seems as an optimal alternative for cooperatives. While IOFs, by creating a specific brand, generate a brand equity that can be resold on the secondary market, whereas members of cooperatives do not benefit from the residual value generated by a specific branding. We also find that branding impacts negatively financial and commercial performance whereas it contributes to decrease the volatility of performances. However, the direct impact of ownership structure appears as the main factor decreasing the volatility, cooperatives financial performance has a lower level of volatility as compared to investor-owned firms. This result is congruent with the previous literature on cooperatives and their risk-averse strategies. Branding is a costly strategy, nevertheless, it helps to enhance the financial stability of firms.

This paper suffers several limits. First, in our proposed decisional model, not all of the assumptions are verified in reality and does not take into account the behavioral models and the
effect of competition. Second, the quantitative application considers only the wine industry with a limited number of firms in each case; and the branding strategy considered is the one adopted by the firms’ main product, it could be more interesting to examine a bigger sample and different sectors. Third, we were unable to measure the brand equity created in our framework due to lack of market information. Finally, in this paper, we are focused on the branding strategy decision; it should be interesting to consider other types of marketing actions within each type of firm.

References


