Brand equity and financial performance of Japanese banks: An industry case study

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ABSTRACT

The financial performance and stability of the banking sector plays a dominant role in the sustainable operations in Japan. This is because the debt-oriented framework in Japan reflects higher dependency of the private and the public sector corporations on Japanese banks. The large number of players in the banking industry intensifies competition and therefore, we believe that brand equity has become an important asset to differentiate themselves from their peers. In this paper, we aim to meet the following objectives: (1) determine the impact of financial performance on brand equity; (2) understand if financial performance affects brand equity positively; (3) and substantiate the financial variables affecting Japanese mega and local banks.

For the purposes of this research, we have purposively chosen a representative sample of the Japanese banking sector, which includes Mega banks (internationally and domestically operating) and local banks (domestically operating) of different regions of Japan. With a comparative period of 6 years (2005-2011), we perform a panel data regression with fixed effects on Oita bank, Okinawa bank, Iwate bank, Toho bank (Local banks), Mitsubishi UFJ Financial Group, Mizuho bank, Resona Bank, Sumitomo Mitsui Banking Corporation (Mega banks). This paper operationalizes brand equity as a construct using the Brand Perpetual Value because of its subjective nature. The financial performance measures used are: market value in terms of one year high stock price, one year low stock price, market capitalization and accounts from the statement of financial position and income statement.

Our findings revealed that financial performance affects brand equity, both positively and negatively. It also reveals that both Japanese mega and local banks behave homogeneously.

INTRODUCTION

Banks are an essential part of the economy. The financial performance and stability of the banking sector plays a dominant role in the sustainable operations of a country. Banks play a key role in promoting financial and economic resilience and facilitate efficient allocation of capital to support economic growth. Further, it enables payments and safeguards savings and the integrity of financial contracts while providing financial protection, risk transfer and diversification for the economic activities (Wyman, 2013). Evidently therefore, banks are of great significance in a country's economy.

For the purpose of this research, we limit our discussion to the Japanese Banking industry. The recent World Bank statistics for 2013 shows that Japan is ranked the third largest economy with a Gross Domestic Product (GDP) of 4,901,530 million US dollars. Japan, unlike other economies significantly relies on banks for credit. According to the Japanese Bankers' Association (2008), the banks' share of the total fund raising and loans market in the Japanese financial markets is 64.9% and 64.2%, respectively. The National Bureau of Asian Research (2011) indicates that Japan had a Gross Public Debt (GPD) of 220 per cent of its GDP, which is more than twice the size of its economy and is the highest GPD ratio that befell globally. Therefore, Japan is claimed to be a debt-oriented economy with banks as their chief suppliers of credit. In addition, Japan's banking system is unique in comparison to its American and European counterparts because after the financial crisis, the Financial Services Agency (FSA) of Japan introduced 100-odd local banks in the country to reduce over-reliance on the mega banks in Japan. The large number of players in the banking industry intensifies competition and therefore, we believe that brand equity has become an important asset to differentiate themselves from their peers. Unlike in most other countries, in Japan, the Automated Teller Machines (ATM) of respective banks do not operate twenty-four hours a day. Therefore, Japanese use the ATMs at the convenient stores to deposit or withdraw money. Currently, the Japanese banks are faced with a threat in terms of convenience of the services and the wide coverage provided by convenient stores. The situation worsened when recently the convenient stores in Japan, such the Seven Eleven, began to provide certain services of banks including the acceptance of deposits and issuance of credit cards, posing an enormous threat. *Convenience* has become the main focus of Japanese people considering the need for finance despite their busy lives and limited time. Therefore, it is of significant importance to invest on the quality of the services provided and the coverage, to maintain customer loyalty and to promote convenience.

Strong and positive brand equity in any organization will reflect the quality of the goods or services provided. In application to the Japanese banking industry, brand equity heavily relies on the convenience of the financial services provided and such investments highly depend on the financial performance of the banks. Thus, we aim to meet the following objectives: (1) determine the impact of financial performance on brand equity; (2) understand if financial performance affects brand equity positively; (3) and substantiate the financial variables affecting Japanese mega and local banks.

REVIEW OF LITERATURE

Studies on the banking industry of Japan

The private banking system of Japan is basically classified into two kinds; mega banks and local banks. The mega banks are usually large in size and have its headquarters usually based in Tokyo or Osaka. Its branches are often located in all major cities and also in their suburbs. Market share of mega banks in Japan as a percentage of total fundraising institutions in the year 2008 was 21.9 percent and 27.9 percent of total loan providing institutions. On the other hand, the local banks are usually based on the main cities of a prefecture and conduct most of their operations within that area. They also build a very strong relationship with the local government and businesses of the relevant prefecture. Market share of local banks as a percentage of total fundraising institutions in the year 2008 was 16.4 percent and 22 percent of total loan providing institutions (JBA, 2009).

The importance of the banking industry in Japan stems from the debt-oriented economic structure that the country encountered during the past two decades due to extensive government spending on public projects across the country since 1990s (CEPR, 2013). In 2013, Japan's gross public debt as a percentage of the GDP has risen to 228.3 percent (OECD, 2013) while the domestic credit to private sector as a percentage of GDP has reached 189 percent (World Bank, 2014) This is mainly due to the loss in government revenue and continuous budget deficit after 1990s with the collapse in stocks and housing bubble which has made the Japanese economy more dependent on its banks for credit. This reflects the higher dependency of private and public sector corporations on Japanese banks and it is clear that the financial performance and stability of the banking sector plays a dominant role in the sustainable operations in Japan.

Studies on Brand Equity

In an attempt to identify the most appropriate model of brand equity for this research, a number of perspectives were studied. One of the most commonly used perspectives of brand equity is the "customer-based perspective" which is also known as "perception perspective". This model takes a cognitive psychological approach in defining brand equity. It asserts that brand equity is created through consumer perceptions and that the customer's willingness to pay higher prices for brands with a favorable image. Further, it says that brand equity is an added value to the product and is an outcome of how customers respond

when a brand is being marketed (Keller, 1993). However this perspective is non-financial and fails to offer a financial value for brand equity.

Another perspective identifies brand equity as a variable that adds value or subtracts value from a product or service. This model recognizes brand loyalty, name awareness, perceived quality and associations as significant items that affect the brand value of a product (Aaker, 1991), which is known as the "premium perspective". This theory suggests that brand equity is reflected in the price or the revenue of the product. It is also assumed that the changes in the consumer behavior are reflected in the price differences and total revenue between the selected and the benchmarked goods/services (Anderson, 2011). However proposing benchmarks in determining price and revenue can be problematic.

Financial market value of a firm is also deemed as a possible determinant in valuing brand equity. This perspective takes a financial approach where it estimates the value of a brand based on the assets of the company. The value is the difference between the firm's tangible assets and its market capitalization. . Therefore, stock premium could be reflected as a component of brand equity (Sullivan, 1993). However in this perspective computing the value of individual product-level is problematic and it excludes certain macro-economic influences.

The "Perpetuity perspective" is another model, which takes the form of a financial approach in determining the value of brand equity. In this model, a financial value is assigned to brand equity, considering the total revenue that a business could generate, in response to marketing of its brand to its customers with the capital available in the business. As a result, *Brand Perpetual Value* (BPV), which is the name given to the financial value of brand equity, is calculated using a formula inclusive of the three variables: total revenue, total marketing cost and Weighted Average Cost of Capital (WACC). The equation is as follows:

$$\text{BPV} = \frac{\text{Total revenue- total marketing cost}}{\text{Weighted Average Cost of Capital (WACC)}}$$

The *total revenue* in the equation defines the total cash inflow a firm could receive from a particular brand and reflects the customer response for it. The *total marketing cost* is the amount the firm will have to spend on marketing the brand. The net value of the numerator expresses the profit a firm could make by its marketed brand. The firm's ability to market the brand depends on the amount it could invest through its capital and debt financing. Thus, the impact of that is taken into consideration by computing for the WACC of the firm in a given period (Anderson, 2011).

For the purpose of this study, we utilize the "perpetuity perspective" to give a financial value to brand equity, which in turn will allow us to generate quantitative statistics for more accurate comparisons when determining the impact of financial performance on brand equity. Further, we find this model to be the more appropriate model for our research because it removes the concern of brand equity as an absolute measure rather than a relative one, as with the premium perspective. BPV also captures the features of the perception

perspective where it recognizes brand equity as the brand image association that is in customers' minds which helps the firm to generate revenue by adding in the 'total revenue', as part of the equation when calculating BPV. In addition, financial market approach stated above is also captured in BPV by taking into consideration the WACC, which accounts for investment portfolio of the firm concerned. Hence, it could be comprehended that this model captures all the shortcomings of other three prospective while it defines brand equity in numerical values for the purpose of this comparative research, making it the most appropriate definition of brand equity for our study.

Studies on Brand Equity and financial performance

Studies have validated the impact of brand equity on financial performance. Components of brand equity, which includes brand attitude, perceived quality, brand loyalty and brand awareness have been significant with changes to financial performance in firms. Studies prove that changes in brand attitude are closely associated with stock returns and that helps predict financial performance of firms (Jacobson, 2001). At the same time perceived quality, brand loyalty and brand awareness are predictors of firm performance, customer value and willingness to pay (Artur Baldauf Karen, 2003). The BPV model used in this paper denotes the above in terms of numerical value.

Research Design and Methodology

This industry case study aims to capture firm specific factors for the selected banks in our research. We generated secondary data using Business Insight Compustat and S & P Capital IQ for the comparative period of six years from 2005 to 2011 in the form of panel data.

We have purposively chosen four mega banks and four local banks which are regarded as giant players in the banking industry and are geographically well spread around Japan, for our sample. The selected mega banks are Mitsubishi UFJ Financial Corporation, Mizuho Bank, Resona Bank and Sumitomo Mitsui Banking Corporation. The local banks we chose for sample are Oita Bank, Bank of Okinawa, Bank of Iwate and Toho bank.

For the purpose of operationalizing brand equity as a construct, we used quantitative data to gather information on revenue, marketing cost and WACC to calculate BPV of the selected banks. Measures used for financial performance includes market value in terms of one year high stock price, one year low stock price, market capitalization and accounts from the statement of financial position and income statement.

In addition, we derived qualitative data from the notes to the consolidated financial statements in the annual financial reports of these banks. The level of disclosure and discussions on the selected financial variables were also influenced in the choice of the sample. Further, we used descriptive statistics with table and charts of comparative information to identify the significance of the banking industry.

Finally, brand equity was set as the independent variable and was compared with the financial variables using panel data regression with random

effects and firm specific factors to determine the impact of financial performance on brand equity for the selcted banks.

Hypothesis

The studies of Aaker and Jacobson (2001) on the value relevance of brand attitude suggest that it is closely associated with stock returns and helps predict financial performance of firms. Further, their study also states that brand equity, which includes brand attitude, perceived quality, brand loyalty and brand awareness have been significant with changes to financial performance in firms. Hence we hypothesis that

H1: Financial performance affects brand equity of Japanese banks

The BPV model uses 'total revenue' as a variable in its calculation. This variable reemphasizes the importance of consumer awareness and loyalty, which helps firm generate revenue (Sullivan, 1993). With the importance of customers, the perceived quality of a service is positively correlated with organizational performance indicators such as sales margin (Tvan der Wiele, 2002). Furthermore, customers as mediators or customer's satisfaction which is a major component of brand equity plays an important role in understanding financial performance in banking automated services which are an outcome of better financial performance of banks. (Al-Hawari, 2006). Hence, we hypothesize that:

H2: Financial performance positively affects brand equity of Japanese banks

One of the main differences between the mega and local banks is their size. This has an impact on the way they operate in the market and also their approach to customers and the size of the customer base itself. Firm size and financial performance is believed to affect the firm's Corporate Social Performance (CSP), which mainly consists of social issues, environmental concerns and stakeholder concerns where customers are greatly involved. Firms that are larger in size have higher levels of profitability and CSP. At the same time a positive relationship exist between CSP, sales and profitability (Stanwick, 1998). Customer's involvement in CSP and with the relationship between firm size and CSP, we could hypothesize that

H3: The brand equity of Japanese Local banks and Mega banks are affected by different financial variables

RESULTS AND DISCUSSION

Data Presentation

Although, brand equity is an intangible asset itself, in this research, we generate a financial result for it, to determine the impact of financial performance on brand equity for each of the chosen banks. Based on our literature review, we calculate the value of brand equity by using the BPV. This study considers BPV as the dependent variable and the chosen financial performance measures to be the

independent variables. BPV is placed against the independent variables, which are the other financial performance measures, to identify the impact of financial performance on brand equity of the Japanese mega and local banks. By carrying out both quantitative and qualitative analysis, we chose the significant variables with a p-value typically less than or equal to 0.05 (p value≤ 0.05). The coefficient result shows whether the selected financial variables are negatively or positively significant to brand equity. Then, the sample was tested for its statistical reliability and its accuracy using two statistical quality-checks, namely, Variance Inflation Factor (VIF smaller than 10) and Generalized Least Square method. The former was used as an indicator of multicollinearity to identify outliers in our data set, if any, and to ensure that the variables we used in our sample is rather consistent and do not significantly vary from one another. The latter was used as a measure of the statistical behavior of the selected banks based on the tested variables. If the generated result is *"homoscedastic"*, it implies that the selected banks behave consistently. In contrast, if the generated result is *"heteroscedastic"*, it infers that the selected banks behave inconsistently. All of the results with a high p-value (typically > 0.05) are considered to be insignificant against the financial performance measures used, and is therefore, not taken into consideration in our study.

Panel Data Regression Result

Table 1.1. Positively Significant Variables

Regression Result				Quality check for the sample
Variables	Coefficient	P value	VIF	Generalized Least Square
Revenue	30.19737	0.000	5.70	Homoskedastic
SG&A	76.55718	0.002	9.78	Homoskedastic
Common Equity	17341.99	0.000	5.93	Homoskedastic
Book Value of Debt	2.470391	0.000	5.74	Homoskedastic

*SG&A: selling general and administrative expenses
VIF: Variance Inflation Factor

Table 1.2. Negatively Significant Variables

Regression Result				Quality check for the sample
Variables	Coefficient	P value	VIF	Generalized Least Square
Interest Expense	-71.30164	0.000	2.48	Homoskedastic
1 Year Stock High Price	-5662.716	0.007	3.21	Homoskedastic
1 Year Stock Low Price	-5644.063	0.054	3.01	Homoskedastic
Market Capitalization	-5.404392	0.002	2.63	Homoskedastic

*SG&A: selling general and administrative expenses
VIF: Variance Inflation Factor

The regression results can be categorized into two groups, namely, positively significant and negatively significant variables.

The positively significant variables include revenue, SG&A (selling, general and administrative) expense, common equity and book value of debt (table 1.1). All of these four variables shared similar characteristics including a positive coefficient and a p-value smaller or equal to 0.05 featuring its significance. The banks with positively significant variables had a VIF of less than 10 and the generalized least square proved to be homoscedastic.

On the other hand, four financial variables, namely, the interest expense, the one-year stock high price, the one-year stock low price and market capitalization appeared to have a negatively significant correlation against brand equity (table 1.2). As it was with the positively significant variables, these other four negatively significant variables also share similar characteristics among them. They had a significant p-value, a negative coefficient, a VIF smaller than 10 and was homoscedastic in behavior.

The outline of these variables and its relationships for all of the banks in our statistical results suggests a valid outcome in which, financial performance and brand equity could be interrelated both positively and negatively.

DISCUSSION

As mentioned in the purposes of this study, researchers in the recent past have already identified the impacts of brand equity on an organization's financial performance. Hence, in our analysis, we aim to highlight the impact of financial performance variables that affects brand equity. The statistical results show that financial performance is both positively and negatively significant to brand equity.

Positively significant variables

Total revenue is defined as the total cash inflow from a brand (Anderson, 2011) as it is defined in the Premium Perspective of brand equity. It is stated that revenue has a positive effect on brand equity. High revenue at the end of the fiscal year is an indication of an increase in sales due to customer loyalty, increase in the number of new customers or a potential increase in price. Therefore, evidently, an increase in revenue leads to an increase in BPV, which in turn, uplifts the image of the brand and the company itself justifying the positive relationship between revenue and brand equity (See Diagram 1).

Next variable in this group is SG&A expense, which is defined as the sum of all direct and indirect selling expenses and all general and administrative expense of a company. According to Dowling (1998), Dacin and Smith (1994), marketing activities and advertising, in particular, have a positive impact on the perceptions over the organizational image. In addition, these activities facilitate in creating an efficient and an effective workforce to provide better services (Fombrun & Shanley, 1990; Gatewood et al., 1993). In the case of Japanese banking industry, SG&A expense is used to invest in employee training, maintaining new ATM machines and increase employee salaries. All of these actions are carried out to increase the service quality of the banks, which in turn would increase consumer satisfaction and convenience. This will make customers

loyal to the bank and hence, increase the brand equity value justifying the positive significant relationship (See Diagram 2).

The regression results also show a positive significant relationship between common equity and BPV. Common equity in our research refers to tangible common equity and it is explained clearly in Diagram 3.

According to Yates (1996), capital gains increase equity, which provides an opportunity for the bank to make new investments on projects that generate higher revenue. Reinvested gains are the engine of a growing portfolio. In other words, it suggests that the cash of the bank is effectively and efficiently used as investments to generate profit in the long run. As a result, common equity increases the quality of service, generates higher revenue, attracts more customers and in turn positively uplifts the BPV value (See Diagram 4).

The last variable that is positively significant is the book value of debt. It is commonly known as the total debt on the balance sheet. Generally, it is the sum of Notes Payable, Current Portion of Long-term Debt and other non-current liabilities (business.fullerton.edu, 2014). As Japan is a debt-oriented economy, the book value of debt in Japanese banks is often bigger than the banks in other countries. When banks do not have enough common equity to generate higher revenue, they will usually loan out from other banks in Japan or from the Japanese central bank. The amount loaned out will be used by the banks to reinvest in projects that generate higher revenue and increases in quality in the service provided. Therefore, it is clear that the book value of debt also positively affects the BPV (See Diagram 5).

Negatively significant variables

Negatively significant variables include interest expense, one-year stock high price, one-year stock low price and market capitalization. Interest Expense, is the cost incurred by an entity for borrowed funds. With the debt-oriented economy, Japanese banks provide a low interest rate to make easier way of borrowing money for individual/entrepreneurs and to boost their economies (Mariko Oi, 2012). However, more borrowings will increase the interest expense that a bank has to pay. The money that could have otherwise been spent on investments on marketing the brand would be used to pay for interest expenses, hence, there is an opportunity cost involved. Further, as interest expenses are deducted from revenue, lesser profits will be available for the banks for reinvestments to improve customer satisfaction and convenience. As a result, there would be a drop or no improvement in the quality of the services provided and the banks would be left at stake of losing its competitive advantage over other banks in terms of holding a favorable brand image. This will bring down the brand perpetual value and therefore the brand image of the bank. Hence, it is clear that a negative relationship exist between interest expense and brand equity (See Diagram 6).

Further, one-year stock high price and one-year stock low price are also negatively significant to BPV. In the case of one-year stock high price, a higher price of stock causes an over-valuation of stocks. As stocks are valued more than what it is supposed to be, equity issuance and total financing by firms increase with equity overvaluation in order to avoid sudden fall in the stock prices (Dong et

al., 2012). On the contrary, a low stock price can cause an under-valuation of stocks. According to the National Bureau of Asia Research (2011), during periods of economic booms in Japan, rapid growth of both the economy and tax revenues means that those regions or sectors that were relative losers could be easily compensated through transfers, public works spending, and subsidized lending through policy banks. It includes financial institutions oriented towards farmers, housing, small or medium-sized enterprises and under-developed regions. In other words, even if stocks of banks are under-valued, the banks still have the two options of either making an equity issuance or debt financing. Given that Japan is a debt-oriented economy, Japanese banks opt for debt financing rather than equity issuance. As a result, this decision causes an increase in interest expense and as explained above, the interest expense has a negative impact on the BPV. Therefore, all in all, both one-year stock high and low prices will negatively impact BPV (See Diagram 7).

The last negatively significant financial performance variable is Market Capitalization. A firm's market capitalization is calculated by multiplying the company's outstanding shares by its current market stock price. One year stock high/low price is also at one point in time the current stock price of the company. Given that, in the case of Japanese banks, one-year stock high/low price have a negative impact on brand equity, it could be concluded that market capitalization also negatively effects brand equity as it reflects the overall market condition of the Japanese banks in terms of stock price (See Diagram 8).

However, the recent marketing studies show that, brand equity is promoted using the marketing mix (Wood, 2000). Marketing activities such as advertisement, promotion and public relations can add more value into a brand and creates a price premium compared to other brands. Hence, these activities will be calculated as marketing expense. In general, marketing expense has a positive impact on brand equity. In fact, our regression results depict a positive significant correlation of marketing expenses with brand equity. However, in the BPV formula that we used in our study, the marketing cost is subtracted from the total revenue to generate brand equity. Therefore, evidently, it is quite contradictory as to whether the marketing expenses affect brand equity positively or negatively in reality. Nonetheless, this controversial topic has been already studied and discussed by other researches. According to Touminen (1999), brand equity is measured by using incremental cash flows of a brand, which comes from the premium price and also the reduction of expense related to the product over time. Therefore, in order to maximize the brand equity, he suggests that expenses should be reduced, which includes marketing cost as well. Furthermore, according to MARKSURE method (The Marketing Surplus & Efficiency), an increase in brand equity occurs when the firm can reduce marketing costs at present due to the cost incurred in the past, which in turn will increase revenue. This also means that the increased revenue without an associated increase in marketing costs could have a positive impact on brand equity (Park, Deborah, Xavier & Jonathan, 2008). These studies support our model where marketing cost is reduced from the total revenue to derive BPV and further supports that these costs do not have a negative impact on BPV, thus, helps to increase brand equity in the long run as

these costs starts providing benefits through increased revenue which may not be visible at the moment when the cost is incurred in the bank.

CONCLUSION

We have identified that financial performance impacts brand equity. Hence, our first hypothesis was proved to be right. However, it is noteworthy that only certain financial variables affect brand equity and not all the selected financial variables. Although initially we developed a hypothesis based on the assumption that financial performance affects positively, our study ascertained that financial performance affects brand equity both positively and negatively. Among the financial variables that affect brand equity positively are revenue, SG&A (selling, general and administrative) expense, common equity and book value of debt. On the other hand, it was attested that financial variables such as interest Expense, one-year stock high price, one-year stock low price and market capitalization affects brand equity negatively. Hence, the second hypothesis was rejected. In addition to that, considering the large differences in the size and scope of operations of both mega and local banks, we developed our third hypothesis; assuming that both mega and local banks are affected by different variables, thus behave differently from each other. However, interestingly, based on the statistical quality check measures that we used in our study, we found out that both local and mega banks behave homogeneously and that its brand equity is affected by the same variables regardless of the large differences in the size and scope of operations rejecting our third hypothesis as well. The VIF factors of each financial variable that we tested against BPV for the selected local and mega banks were less than 10 suggesting co-linearity. Further, the generalized least square of each financial variable that was tested against BPV was demonstrated as homoscedastic result. In other words, it suggests that both mega and local banks act alike and that the selected financial variables affect these banks in the similar way. Nevertheless, we understood that the size of the bank is less significant to the brand equity in terms of financial performance.

For further studies, we would like to focus on measures other than financial performance affecting branding equity of the Japanese mega and local banks to uplift the qualitative revision of this research. We also hope to advance our research into a cross-country comparison study with that of the mega and local banks currently in operation in the United States of America. We find the banking system in the United States of America to be the exclusively contradictory with that of Japan, as US is not a debt-oriented economy and is significantly dependent on mega banks unlike Japan (Baily, 2013). Hence, we would like to see what different variables cause this and to see if the financial variables affecting brand equity of banks in both countries differ.

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APPENDIX

$$\text{Common Equity} = \text{Company Book Value} - \left[\text{Intangible Assets} + \text{Goodwill} + \text{Preferred stock}\right]$$
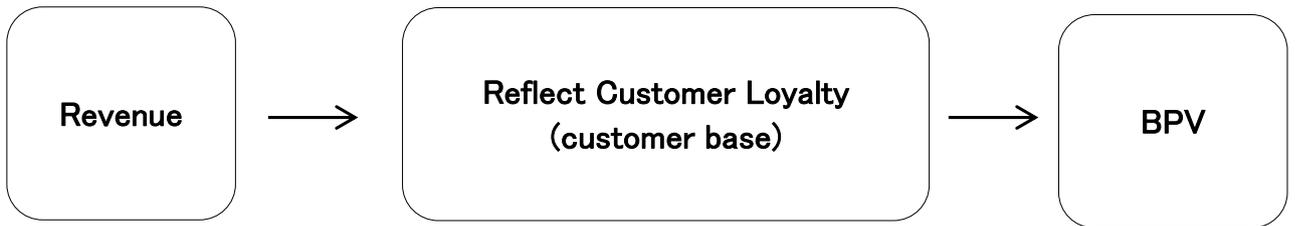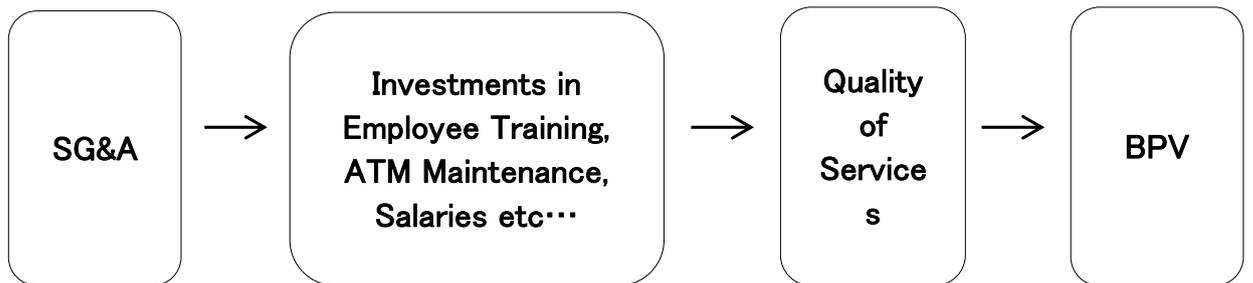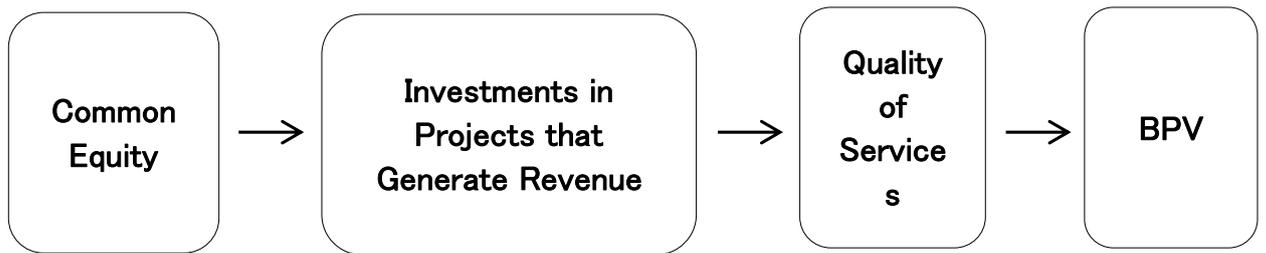
Figure 1: Common equity formula

| Revenue | → | Reflect Customer Loyalty (customer base) | → | BPV |

Diagram 1

| SG&A | → | Investments in Employee Training, ATM Maintenance, Salaries etc… | → | Quality of Services | → | BPV |

Diagram 2

| Common Equity | → | Investments in Projects that Generate Revenue | → | Quality of Services | → | BPV |

Diagram 3

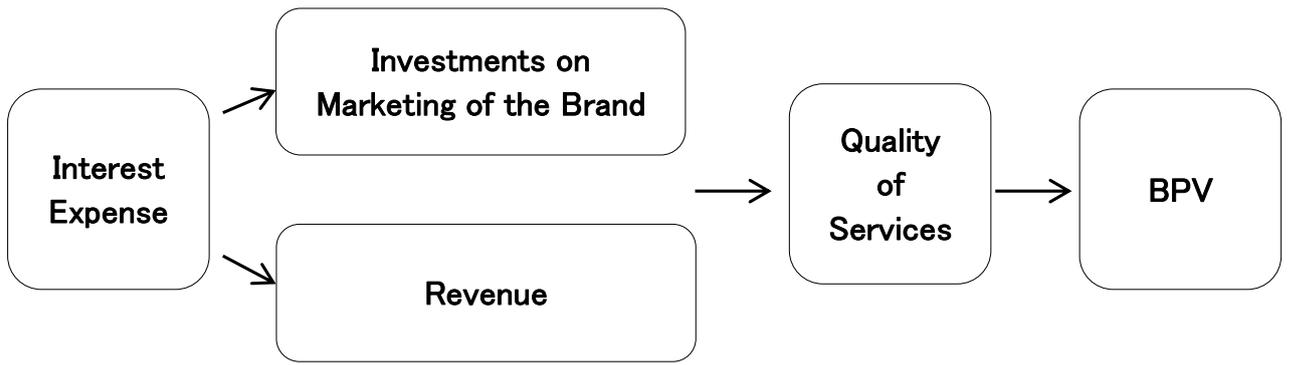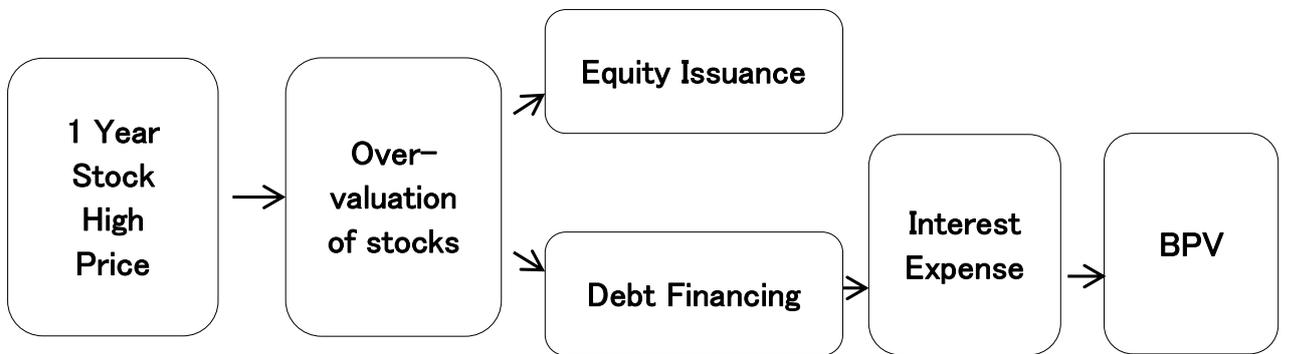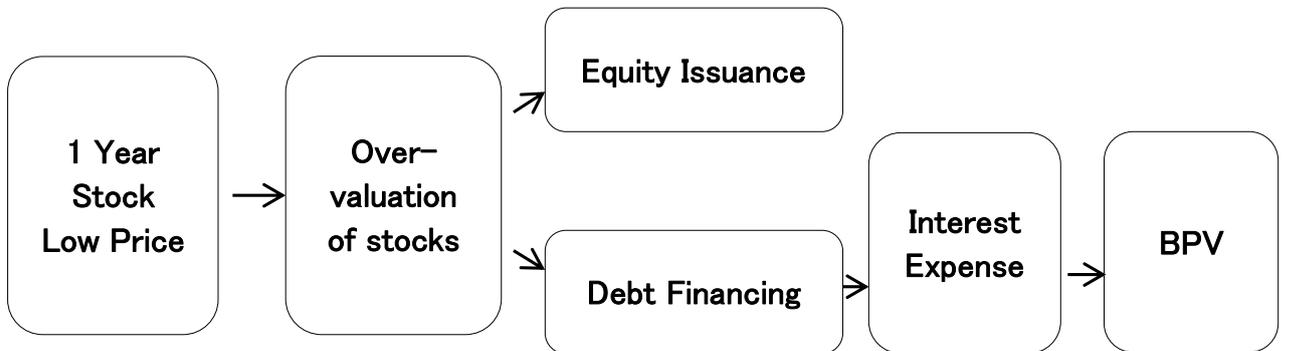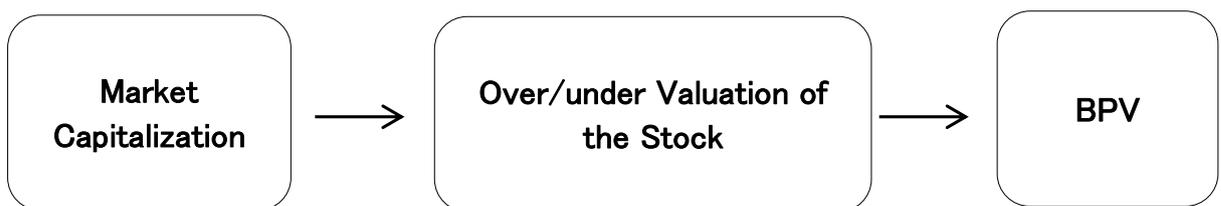| Book Value of Debt | → | Investments in Projects that Generate Revenue | → | Quality of Services | → | BPV |
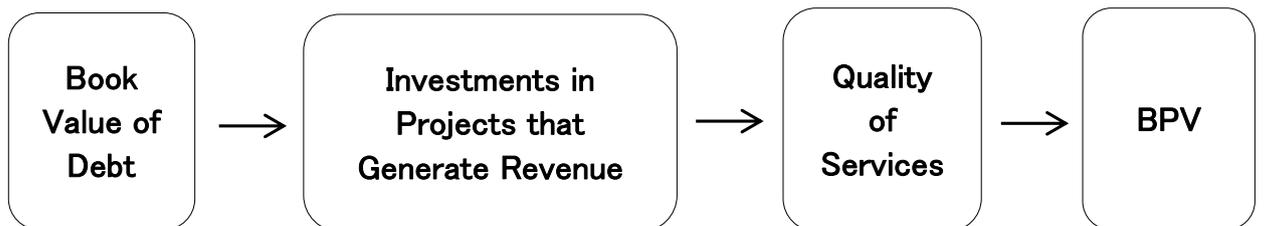
Diagram 4

Diagram 5

Diagram 6

Diagram 7

Diagram 8

Contributors

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