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INGREDIENT BRANDING - A GROWTH OPPORTUNITY?

Review
Article

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Abstract

Co-branding is an increasingly used strategy, consisting of marketing products representing two brands or more. Ingredient branding fits in the scope of co-branding, consisting of the inclusion of key attributes of one brand into another brand as ingredients. Ingredient branding is one of the many brand strategies used in marketing to provide differentiation criteria for the customers. In recent years, its importance and incidence have dramatically increased. Extant research provides disparate and limited understanding of contexts in which such contracts pay off. Our paper provides an extensive review of literature and research streams in ingredient branding, adding knowledge to theory and help for companies that need to establish and maintain a competitive advantage, by differentiating their offer on the markets they act on, in a globalized economy.

INTRODUCTION

The ingredient branding strategies consist in an effort to create brand awareness for the ingredient brand to generate pull effects with the final customer through the value chain. The use of ingredient branding strategy involves both pull and push effects as consequences of marketing mix decisions, effects described in figures 1 and 2.

Success stories as Intel, Gore Tex, Dolby, TetraPak and Teflon conducted to the extended use of ingredient branding strategies by the component suppliers (Tiwari and Singh, 2012).

Research in this area showed both positive and negative effects for the brands using such a strategy, yet ingredient branding offers great potential for successful brand management and increased profits for companies along with value creation for their customers. The initiative for employing such a strategy may come from the supplier or from the OEM (Original Equipment Manufacturer). OEMs incorporate the purchased materials, parts or components into their final products. The most eloquent examples are the automotive industry, where many parts of a car are outsourced by the car producers and the computer industry, in which case the producers base on numerous different suppliers of a PC components.

We further carry out an analysis of the situations in which this strategy can bring potential brand equity growth for both the supplier and the host brand, based on an extensive literature review.

OPPORTUNITIES FOR SUPPLIERS

Suppliers strive for a significant competitive advantage, wanting to develop, strengthen and extend their market position. Thereby the component becomes the trigger for the buying decision of the consumer. Many brands sell their products separately, especially in the aftermarket for automobiles.

Kotler and Pfoertsch (2010) established four stages necessary for an unknown in-brand to run through in order to create and maintain its brand equity.

In the first stage, the component manufacturer signs a contract with an end product manufacturer. The supplier hopes to profit from the joint presentation of his new ingredient brand. As trade-off, the manufacturer benefits from certain incentives like price reductions or advertising expenditures subventions from the supplier. The ingredient brand profits from the association with the reputation of the end product (Pfoertsch and Chen, 2010).

The *second stage* is characterized by continual promotion to the end user and cooperation with partners.

In the *third stage*, the host brand is taking advantage from the supplier's increased brand value.

Lienland et al. (2013) confirmed these findings, observing that manufacturing firms of complex goods (buildings, machinery or automobiles) tend to focus on core competencies, strategy resulting in a greater dependence on suppliers and their management. They conducted a study for the automotive industry, finding that a supplier's prestige significantly influences the end user's perception of the host brand's overall reputation. They established that low-ranked ingredient brands often decrease the main producer's reputation.

The *fourth stage* is characterized by the fact that the brand value of the ingredient brand does not depend on the association with the host brand, as it has surpassed the brand value of the end product manufacturer. In this phase, the risk is that the much known ingredient brand is omnipresent and could not be used as a differentiator.

A component supplier could offer meaningful aspects of differentiation to multiple OEMs only when customization is the key to providing differentiation. For the cases of suppliers that possess a strong brand backed up with unique technology, but for which customization is relatively insignificant, there are available two attractive strategies. First, the supplier can present its innovative component to various OEM's and sign an exclusive contract for the best offer, in which case the OEM receives a unique differentiator. An exclusive agreement between an OEM and a supplier could be an advantage over competitors that are not able to access parts that are highly desired by end customers (Lienland et al., 2013). Second, the firm could supply multiple OEMs, in which case the component is not a very solid point of differentiation (Ghosh and John, 2009).

An example is the Intel Inside initiative, the most famous of all ingredient brand programs, launched in 1991. Intel Inside followed a model that chemical companies had successfully used to promote their patented products further along the value chain. DuPont was a pioneer of this idea and had used it to establish the Lycra, Kevlar, Teflon, and rayon ingredient brands. These brands provided enhanced equity for the host companies.

Intel negotiated contracts with all the leading original equipment manufacturers (OEMs) and supported the Intel Inside campaign with significant budgets both directly to the consumer and indirectly through advertising subsidies to its OEM partners.

Intel was transformed from a component supplier to a marketing and branding powerhouse. The OEMs were addicted to the contract, and consumers had been trained to look for the Intel mark as the most important sign of quality.

Intel's brand value grew constantly (it consistently ranks as a top 10 global brand) while the OEMs gave up important ground on differentiation because they were all using the same Intel chips (www.brandingstrategyinsider.com, 2016).

But not all the brand relationships have to end with this effect. Gore-Tex, for example, developed a distinct set of criteria for partnership, limiting partners to certain applications (cycling, sailing etc.) and specific industries or regions, succeeding to keep their partners' possibilities to differentiate.

An extension of the ingredient branding is the component supplier branding, strategy consisting of using co-branding contracts between suppliers selling their components to OEMs that further market their products to B2B clients.

Worm and Shrivastava (2014) studied the contexts in which the strategy of component supplier branding has a positive role on the profitability of supplier companies - more specifically, the situations in which the investments made to create a strong brand pay off. They analyzed the conditions under which component suppliers must increase their brand equity in order to maintain or grow their profitability.

Previous research (Dyer and Singh, 1998) showed that component suppliers' profitability growth can be positively influenced by their brand image when these suppliers can capitalize on OEM's dependence on strong component supplier brand image in their negotiations. Such dependence emerges when a component supplier controls important and critical resources that an OEM need in order to attain its goals (according to resource based theory). Component supplier's brand image is such a resource that the OEM has access to by signing a contract of ingredient branding.

More specifically, a first characteristic of the industry in which component suppliers operate, conducting to higher profits by leveraging their brand asset successfully, is the existence of differentiated products. In the opposite situation, when product differentiation is low in the supplier industry, a strong supplier brand image (correlated with high branding expenses) reduces its profitability. A product differentiation in the component supplier industry increases the importance of strong supplier brands while making it more difficult for OEMs to replace them with an alternative supplier. Product differentiation exists in an industry if various suppliers' components have meaningful differences. Replacing a strong supplier brand would add the effort of integrating a different component.

Another situation in which a component supplier's profitability is increased by its brand image is a high R&D intensity in the supplier's industry. R&D intensity depends on the degree to which suppliers emphasize R&D activity. High-

technology products are impacted by B2B brand image, because technology-intensive components evolve more rapidly, making them inherently risky for end customers and more complex to evaluate. End customers also need component suppliers brands to guarantee availability of upgrades for such components. Thus, suppliers' brand image becomes more important to OEMs that purchase technology-intensive components. Suppliers that possess strong research & development competences can establish innovative benefits as a point of difference of their brand, creating a co-specialized asset bundle that is more difficult to imitate by competitors (Van Ossellar and Janiszewski, 2001) thus becoming a business partner difficult to replace for the OEMs.

Another influential factor is the competition intensity. If component suppliers operate in a very competitive environment, where strategies based on cost advantages prevail over differentiation (based on innovation and quality) strategies, using an ingredient branding strategy would be risky. Otherwise, if a supplier evolves on a less competitive market, characterized by a small number of suppliers and a large number of OEMs, an ingredient branding strategy would be more suitable. Examples of successful component brands are Intel (microprocessors), antimicrobial cloth Microban, textile laminate Gore-Tex, gears for bicycles Shimano (Kotler and Pfoertsch, 2010).

A factor that also has to be analyzed when a supplier decides to invest in creating a strong brand is the importance of the OEM-end customer relationship. It reflects the degree to which end customers enter long-term customer relationships with OEMs, relationships that facilitate flow of information to end customers, reducing their perceived risk (for example, end customers will trust that an OEM will not put the relationship at risk by using unsuitable components). These close relationships also give end customers assurance that OEMs will respond flexibly to resolve unpredictable problems arising from any unknown component. Both factors decrease the importance of using a supplier's strong brand to reduce information cost and perceived risk. Therefore, when the importance of the relationship between end customer and the OEM is high, a strong supplier's brand image will be less important for the market performance of that OEM and these brands will be easier to replace, decreasing the supplier's ability to leverage its brand image to sustain or enhance prices and profitability.

OPPORTUNITIES FOR ORIGINAL EQUIPMENT MANUFACTURERS

Studying the advantages of ingredient branding for the OEMs, Helmig et al. (2008) confirmed the

results presented in the previous section and concluded that branded ingredients consistently and positively affect moderate-quality host brands, but only occasionally have positive effects on higher-quality host brands. The positive evaluation of the co-branded product can be improved therefore by the high-quality of the brand partner.

Nevertheless, Ghosh and John (2009), observing practices in several industries, found cases that did not comply with the leveraging supplier brand pattern - the OEM's brand was much more prominent than its supplier brand.

Thereby, they studied the motivators of OEMs for choosing branded component contracts, by examining contracting practices in engineering-intensive industry sectors. They found that a main trigger of such contracts, beside the differentiation by taking advantage of the suppliers' brand reputation, is the diminishing of the hazards associated with the investments necessary to develop engineering designs, manufacturing processes, specialized tools and equipment and employee training. Such investments generate low salvage value across different clients (OEMs), making them hazardous to the supplier. Thus, the utility of a branded contract is higher at higher levels of customization investments made by the supplier, this way the OEMs managing to motivate their suppliers and to establish long period relations with them.

OEMs could also use the ingredient branding strategy not only to leverage a supplier's strong reputation, but also to create *ex post* differentiation created by the component vendor. This approach could be valuable when creating business relations with small entrepreneurial companies that poses high innovative capabilities in niche technologies, especially in IT. This strategy would have the role to incentivize the small company to undertake the development efforts necessary to ensure a successful innovative component embedded in the OEM's products (Ghosh and John, 2009).

Kotler and Pfoertsch (2010) confirmed the findings of Ghosh and John, systematizing the business types in the B2B markets that could choose a successful ingredient branding strategy. The ingredient branding contracts differ from other commercial business relations by the next characteristics:

- there is a stronger emphasis on the continuity of business relationship between the supplier and the customer;
- the business relations are based on customized performances;
- another condition is the high complexity of the component in relation to the final product and its importance for the functionality of the final product.

Also, the quality of the relationship between the component supplier and the OEM positively

influences relational behaviors, promoting value creation in the relationship. In this case, using an ingredient strategy would help bracing the long term relations between the two actors in the value chain. For example, OEMs could be more willing to give the supplier access to private internal information, enabling it to identify and develop more effective customized solutions that create superior value (Tuli et al., 2007).

Ghosh and John (2009) demonstrated the utility of branded component contracts as governance devices that secure the supplier's noncontractible investments to customize the component to the OEM's benefit. Farsighted OEMs that stand to benefit more from a branded contract are more likely to choose that contract form.

They also found out that using a co-branding strategy with a highly respected supplier brand will not automatically translate into benefits for the host brand when customized engineering activities are important for value creation.

Many suppliers sell the same basic component in the automotive industry under branded and non-branded contracts. Components with enhanced performance are offered under branded contracts, while standard performance components are sold under white box contracts. OEMs could purchase non-customized branded components from different suppliers to serve different customer markets and performance requirements.

CONCLUSIONS

An outward review of industrial practices shows that co-branding and its included strategy, ingredient branding, are popular in practice, but the situations in which such strategies pay off (as sources of increased profits) are not always well understood. Our study provides a thorough review of the advantages for both suppliers and OEMs that follow such a strategy, emphasizing the prior conditions necessary to be accomplished in order to create benefits translated in increased brand equity and supplementary profits. Table no.1 presents a synthetic review of the triggers influencing the selection of an ingredient branding strategy and the actual situations in which this strategy could pay off in terms of market success.

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ANNEXES

Table No.1 *Triggers for using an ingredient branding strategy*

Differentiation for the host brand by adding a branded component	Safeguarding the customization investments of the component supplier
High brand awareness of constituent brands	The components are designed exclusively for the OEM
High perceived quality of the constituent brands	The supplier possesses a high ability to customize engineering activities
High brand equity of the constituent brand	The supplier possesses a high entrepreneurial capability in innovative niche technologies
Signing an exclusive contract for the best offer, in which case the OEM receives a unique differentiator or developing a distinct set of criteria for partnership, limiting partners to certain applications and specific industries or regions, succeeding to keep the OEMs' possibilities to differentiate	There is a stronger emphasis on the continuity of business relationship between the supplier and the customer
High R&D intensity in the supplier's industry. R&D intensity depends on the degree to which suppliers emphasize R&D activity. High-technology products are impacted by B2B brand image, because technology-intensive components evolve more rapidly.	A high complexity of the component in relation to the final product and a high importance for the functionality of the final product.
The existence of differentiated products in the supplier industry and a low competition intensity	A high quality of the relationship between the component supplier and the OEM, which positively influences relational behaviors, promoting value creation in the relationship
A low importance of the OEM-end customer relationship (the degree to which end customers enter long-term customer relationships with OEMs, relationships that facilitate flow of information to end customers, reducing their perceived risk)	

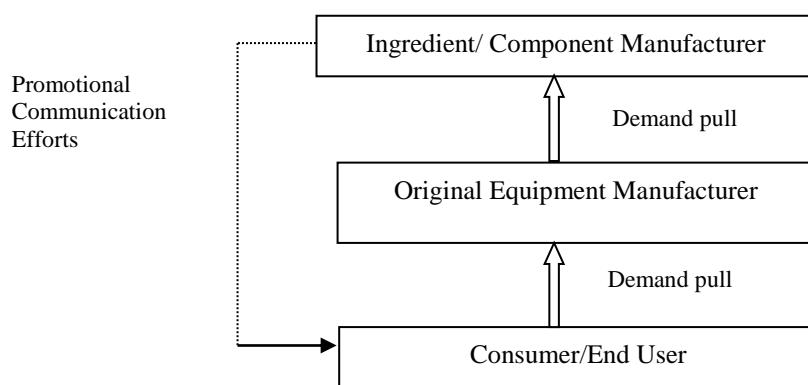


Figure No. 1 Market stimulation pull principle of ingredient branding (Hermeier and Friedrich, 2007)

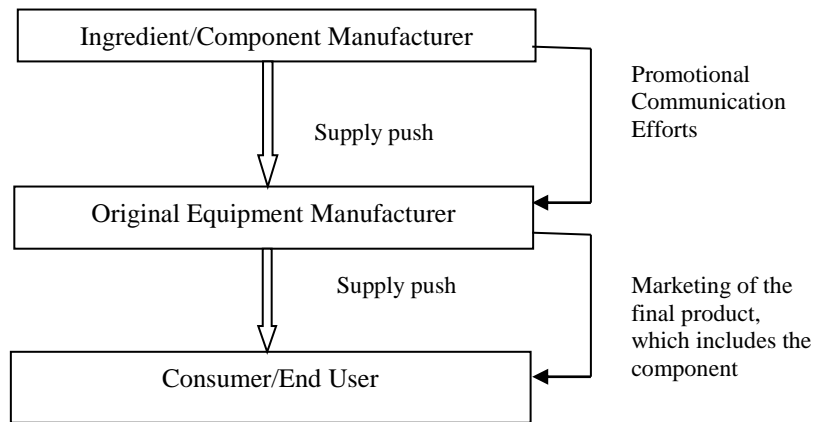


Figure No. 2 Market stimulation push principle of ingredient branding (Hermeier and Friedrich, 2007)