Singapore Management University

Institutional Knowledge at Singapore Management University

Research Collection Lee Kong Chian School Of Business

Lee Kong Chian School of Business

11-2008

Marketing Strategy and Wall Street: Nailing Down Marketing's Impact

Dominique M. Hanssens
University of California, Los Angeles

Roland T. Rust
University of Maryland

Rajendra Kumar SRIVASTAVA
Singapore Management University, rajs@smu.edu.sg

Follow this and additional works at: https://ink.library.smu.edu.sg/lkcsb_research

Part of the Business Administration, Management, and Operations Commons, Management Sciences and Quantitative Methods Commons, and the Marketing Commons

Citation

Dominique M. Hanssens, Roland T. Rust, & Rajendra K. Srivastava

Marketing Strategy and Wall Street: Nailing Down Marketing's Impact

Stock prices are based in large part on corporate financial statements, augmented by analysis by stock analysts. The ultimate goal of any marketing expenditure should be to increase the value of the firm, but the road from marketing expenditure to stock price is usually circuitous. This is because marketing's path to financial impact is through revenues, and the road to revenues runs through the customer. Typically, a long chain of effects is involved to account for the impact of a marketing expenditure (Rust et al. 2004), and the effects of marketing investments play out over time. This special issue focuses on exploring relationships along this chain from marketing actions to marketplace outcomes and the creation of market-based assets and firm value.

In an effort to add greater clarity to and lend support to the exploration of these issues, the Marketing Science Institute (MSI) and Emory Marketing Institute (EMI) organized a gathering of manufacturers, investment companies, and academics from across marketing, finance, and accounting to identify key issues and research questions. This small group identified five key areas:

1. *Main drivers of market value*: How informed are stock prices relative to important customer, brand, and marketing developments? What is the relative importance of short-term versus long-term performance? Should market-based assets (brand, customer, and channel equity) be on the balance sheet? Does Wall Street recognize long-term importance of marketing assets?

2. *Understanding brand valuation*: What are defensible, rigorous methodological approaches to brand valuation? Can methods be developed that incorporate the impact of brands on the major drivers of shareholder value? What is the impact of brands on the level, growth, and risk (longevity, persistence, sustainability, and resilience) of cash flows and cost of risk capital?

3. *Challenging the efficient market hypothesis*: Many marketing assumptions and strategies are focused on segmentation and differentiation and, thus, on "making markets imperfect." The success of these actions is reflected in, for example, brand loyalty and customer retention. Is this value reflected in stock returns? If marketing resources are used well, will that trickle down to the capital markets?

4. *The investor community as a customer (investor relations)*: Are the right marketing metrics communicated to the investor community? Is the investor community more interested in some activities (e.g., innovation) than others (e.g., advertising, market development)? How can companies better market themselves to investors?

5. *Analyzing the analysts*: Are analysts' recommendations more positive or "sticky" for firms with higher corporate brand equity? How do analysts' interpretation of marketing events affect prices?

A call for proposals with funding from MSI and EMI led to the special interest conference Marketing Strategy Meets Wall Street, culminating in this special issue. The call resulted in the funding of 15 proposals and the presentation of 32 papers at the conference, a smaller set of which have emerged in this special issue. We propose a unifying framework for this research, discuss the major findings obtained so far, and identify important avenues for further research.

Marketing Drivers of Firm Value

The value of the firm is based on its current cash flows as well as growth and risks associated with future cash flows (Srivastava, Shervani, and Fahey 1998). These market performance measures can be linked to the following:

• *Market-based assets*: Examples of market-based assets are customers, brands, channels, and innovations. These assets are valuable on their own, but they deliver greater "value in use." Brands can be leveraged to launch extensions with higher returns and lower risk.

• *Marketing capabilities*: Market orientation and expertise are essential for efficient and effective use of resources in the marketplace.

Dominique M. Hanssens is Bud Knapp Professor of Marketing, Anderson School of Management, University of California, Los Angeles (e-mail: dominique.hanssens@anderson.ucla.edu). Roland T. Rust is Distinguished University Professor, David Bruce Smith Chair in Marketing, and Chair of the Department of Marketing, Robert H. Smith School of Business, University of Maryland (e-mail: rrust@rhsmith.umd.edu). Rajendra K. Srivastava is Provost and Deputy President, Singapore Management University, and Roberto C. Goizueta Chair in Marketing and e-Commerce, Goizueta Business School, Emory University (e-mail: rajs@smu.edu.sg).

•*Marketing actions*: These are based on strategy development and execution of business models that leverage marketing assets and capabilities.

These assets, capabilities, and accompanying actions not only affect market performance (profitability, growth, and risk) but also lead to key marketing metrics, such as customer satisfaction and retention, brand loyalty, and reputation.

How all these marketing assets, capabilities, and actions play out in determining market value remains somewhat of a mystery. There are two major paths. First, the valuation is likely to be linked to how these factors affect risk-adjusted discounted future expected cash flows. Second, key marketing metrics (e.g., customer or brand loyalty) as well as financial and accounting metrics (e.g., margins) themselves are likely to influence market valuation (e.g., price–earnings or market-to-book) ratios and, thus, a firm's market value.

Because firm securities are complex, intangible bundles of benefits, costs, and risks, it is necessary to examine how financial information intermediaries (stock market analysts) influence investor choices through buy, sell, or hold recommendations, just as channel intermediaries influence consumer choice. Srinivasan and Hanssens (2009) emphasize the importance of the investor community in the design and execution of marketing plans. Indeed, investors react to changes in important marketing assets and actions that are believed to change the outlook on the firms' cash flows.

What We Learned: Market-Based Assets Matter

Using the framework presented in the previous section, we confirmed some expectations. Others were left unaddressed and remain opportunities for further research.

Customer Equity

The value of the firm is based on its future cash flows, and almost all positive cash flows can ultimately be traced to customers (Srivastava, Shervani, and Fahey 1998). Thus, firms increasingly realize that the ultimate measure of their value is their customer equity, the sum of the lifetime values of the firm's current and future customers. Prior research has provided evidence of a correspondence between customer equity and the value of the firm (e.g., Gupta, Lehmann, and Stuart 2004; Libai, Muller, and Peres 2006; Rust, Lemon, and Zeithaml 2004), but Kumar and Shah (2009) conduct the most thorough study to date of this strategically important connection.

Kumar and Shah (2009) show that changes in market value track changes in customer equity and that the value of the firm can be predicted by customer equity, both for a business-to-business firm and for a business-to-consumer firm. This finding is important because it is possible for managers to link marketing actions to customer equity (e.g., Hanssens, Thorpe, and Finkbeiner 2008; Rust, Lemon, and Zeithaml 2004), meaning that marketing managers can now place a value on what changes in customer equity drivers resulting from marketing actions mean for the value of the firm. This reinforces recent calls for customer equity to be a

routine part of financial reporting (Wiesel, Skiera, and Villanueva 2008).

Brand Equity and Brand Metrics

Mizik and Jacobson (2009) analyze the value of branded businesses and find that brand metrics have statistically significant associations with valuation multipliers. These brand metrics add incremental explanatory power to accounting variables in explaining valuation multipliers. Their work supports the perspective that marketing metrics provide valuable information to investors, beyond pure accounting measures, such as margins and turnover. Similarly, Krasnikov, Mishra, and Orozco (2009) show that brand identification trademarks enhance the impact of brand association trademarks on cash flow growth and firm value.

In addition to information value, brand assets can be leveraged to enhance revenue and reduce risks while launching brand extensions in the context of motion pictures (Hennig-Thurau, Houston, and Heitjans 2009). This perspective is also supported by Tuli and Bharadwaj (2009), who demonstrate that investments in customer satisfaction insulate a firm's stock returns from market movements (overall and downside systematic risk) and lower the volatility of its stock returns (overall and downside idiosyncratic risk).

What We Still Do Not Know: How Marketing Actions Really Create Firm Value

Academic research in marketing is limited by data. Data linking marketing actions and their impact on firm value are difficult to obtain—thus the paucity of research in this domain. In some cases, the availability of data defines the problem that is being addressed rather than the other way around.

Such a case study approach leaves several important issues unexplored, including many of those we identified previously. Although Mizik and Jacobson (2009) provide valuable insights, key questions related to understanding brand valuation—namely, determining how to demonstrate the value of marketing actions and assets by challenging the efficient market hypothesis—remain to be addressed. Similarly, the carefully executed *Mad Money* case study by Karniouchina, Moore, and Cooney (2009) invites further examination of the role of financial information intermediaries and their impact on investor choice.

Marketing Actions

Luo and Bhattacharya (2009) advance the literature on the marketing–finance interface by drawing attention to the risk reduction potential of corporate social performance (CSP) and shed new light on some critical but neglected strategic marketing levers. On the negative side of CSP, Tipton, Bharadwaj, and Robertson (2009) find that deceptive marketing practices destroy firm value when they are exposed by regulatory agencies. For firms facing product recalls, Chen, Ganesan, and Liu (2009) find that, surprisingly, proactive recall strategies have a more negative effect on firm value than more passive strategies. This raises a possi-

ble dilemma for management. An explanation for this unexpected result is that the stock market may interpret proactive strategies as a signal for substantial financial losses to the firm.

Data Availability

Academic research on the topic of relating marketing actions to the value of the firm is often opportunistic, in that it searches for the rare cases in which appropriate longitudinal data are available. For example, Hennig-Thurau, Houston, and Heitjans (2009) investigate the value of brand extensions. However, the research is possible only because extensive longitudinal information about the industry under study (motion pictures) is readily available. Such an analysis could not generally be done for typical brand extension applications.

In general, the key issue in data availability is the time required to assemble a data set. The most promising solution in such a case is to substitute cross-sectional data, which can be gathered quickly, for the longitudinal data that might be ideal. This can work if the unit of data analysis is changed from the aggregate expenditure at time t to a customer measure. For example, consider the problem of figuring out the relationship between marketing actions M_t on market value V_t over time. In such a case, the standard approach is to gather a large number of data points over time t. The unit of analysis is the time period, and the number of data points is the number of periods for which data have been collected. If the company has not already collected these data, it must wait until some time in the future when the required data are available.

An alternative approach is to consider the problem using the individual customer as the unit of analysis. Instead of aggregate expenditures or aggregate actions, consider the effect on each customer at a particular time. Let C_i refer to the customer-specific measure that monitors the effectiveness of marketing action M, where i refers to an individual customer, and let B_i be the behavior (or intention or attitude) that can be linked to financial outcomes. Then, the natural variation across customers provides information about the effectiveness of the marketing action. That is, if customers with a high C_i show higher levels of B_i, this is evidence that the marketing action that produces higher levels of C_i is effective.

For example, customer equity models can be based on easily gathered cross-sectional data if the appropriate longitudinal data are not available (Rust, Lemon, and Zeithaml 2004). In such a model, customer data are obtained by survey, and perceptions of customer equity drivers are then statistically linked to purchase intention (calibrated to reflect aggregate market behavior). Such an approach can provide viable methods for addressing marketing impact, even when the ideal longitudinal data are not available.

Directions for Further Research

Investigating Reverse Causality

A key element of making marketing financially relevant is relating marketing actions to market value. Several articles

in this special issue address aspects of this, such as the impact on market value of customer satisfaction changes (Tuli and Bharadwaj 2009), brand equity (Mizik and Jacobson 2009), responses to product-harm crises (Chen, Ganesan, and Yiu 2009) and deceptive marketing exposure (Tipton, Bharadwaj, and Robertson 2009), social responsibility (Luo and Bhattacharya 2009), brand extensions (Hennig-Thurau, Houston, and Heitjans 2009), and trademarks (Krasnikov, Mishra, and Orozco 2009).

One of the biggest concerns about any model that relates marketing actions to market value is the possibility of reverse causality. Researchers want to show that marketing action → change in market value, but a reasonable competing hypothesis is often that market value → marketing action, meaning that the marketing action is endogenous. Several of the articles test for endogeneity econometrically, but statistical methods alone may only partially solve the problem. This is a well-known problem in econometrics but a central problem in relating marketing actions to market value. A sometimes-neglected approach to addressing this problem is to posit links that are plausible only in one direction. For example, it is reasonable to anticipate that changes in attribute perceptions can drive changes in choice, but the reverse causal direction (choice → attribute perceptions) is likely to be much weaker, even if it is statistically significant. Thus, careful model formulation can often ameliorate any difficulties with reverse causality, even without resorting to complicated econometric techniques.

Designing Simple Metrics

One of the best things about balance sheets and financial statements is that everybody understands what most of the numbers mean. Analysts can interpret the numbers without too much difficulty and produce many useful ratios and secondary analyses. However, in the realm of marketing, things are different. The effect of marketing actions is often reflected by changed customer attitudes or intentions, which may not be reflected in "concrete" numbers for some time. Thus, a challenge for marketers is how to bridge the gap between marketing reality (e.g., brand image, brand equity, customer equity) and financial value in a way that analysts can easily understand. Can simple metrics, based on information readily available in the standard financial statements, that will be reasonable proxies for important marketing measures be devised? If not, are there standard data that should be collected by all companies so that key marketing metrics (e.g., customer equity) can be evaluated in a uniform way across companies?

Understanding and Marketing Market-Based Assets and Capabilities

Although much is known about consumer behavior, marketers have stayed away from understanding and influencing investors. Yet many of the same theoretical underpinnings of consumer behavior, such as prospect theory, have had a major impact on behavioral finance. Therefore, the study of investor relations represents a major research opportunity in marketing.

In their review article, Srinivasan and Hanssens (2009) emphasize the importance of the investor community in the design and execution of marketing plans. Investors do react to changes in important marketing assets and actions that are believed to change the outlook on the firms' cash flows. Several econometric models have been developed to parameterize these relationships, and several empirical propositions have been generated to date. These can be put to use to answer important investor behavior and related policy questions: First, does the current practice of firm performance disclosure provide adequate information to investors, and if not, what sources of information should be added or deleted? Second, how can investor response to new marketing information be improved, if at all? Finally, what is the role of information intermediaries, such as stock analysts?

REFERENCES

Chen, Yubo, Shankar Ganesan, and Yong Liu (2009), "Does a Firm's Product-Recall Strategy Affect Its Financial Value? An Examination of Strategic Alternatives During Product-Harm Crises," *Journal of Marketing*, 73 (November), 214–26.

Gupta, Sunil, Donald R. Lehmann, and Jennifer A. Stuart (2004), "Valuing Customers," *Journal of Marketing Research*, 41 (February), 7–18.

Hanssens, Dominique M., Daniel Thorpe, and Carl Finkbeiner (2008), "Marketing When Customer Equity Matters," *Harvard Business Review*, 86 (5), 117–23.

Hennig-Thurau, Thorsten, Mark B. Houston, and Torsten Heitjans (2009), "Conceptualizing and Measuring the Monetary Value of Brand Extensions: The Case of Motion Pictures," *Journal of Marketing*, 73 (November), 167–83.

Karniouchina, Ekaterina V., William L. Moore, and Kevin J. Cooney (2009), "Impact of *Mad Money* Stock Recommendations: Merging Financial and Marketing Perspectives," *Journal of Marketing*, 73 (November), 244–66.

Krasnikov, Alexander, Saurabh Mishra, and David Orozco (2009), "Evaluating the Financial Impact of Branding Using Trademarks: A Framework and Empirical Evidence," *Journal of Marketing*, 73 (November), 154–66.

Kumar, V. and Denish Shah (2009), "Expanding the Role of Marketing: From Customer Equity to Market Capitalization," *Journal of Marketing*, 73 (November), 119–36.

Libai, Barak, Eitan Muller, and Renana Peres (2009), "The Diffusion of Services," *Journal of Marketing Research*, 46 (April), 163–75.

Luo, Xueming and C.B. Bhattacharya (2009), "The Debate over Doing Good: Corporate Social Performance, Strategic Marketing Levers, and Firm-Idiosyncratic Risk," *Journal of Marketing*, 73 (November), 198–213.

Mizik, Natalie and Robert Jacobson (2009), "Valuing Branded Businesses," *Journal of Marketing*, 73 (November), 137–53.

Rust, Roland T., Tim Ambler, Gregory S. Carpenter, V. Kumar, and Rajendra K. Srivastava (2004), "Measuring Marketing Productivity: Current Knowledge and Future Directions," *Journal of Marketing*, 68 (October), 76–89.

———, Katherine N. Lemon, and Valarie A. Zeithaml (2004), "Return on Marketing: Using Customer Equity to Focus Marketing Strategy," *Journal of Marketing*, 68 (January), 109–127.

Srinivasan, Shuba and Dominique M. Hanssens (2009), "Marketing and Firm Value: Metrics, Methods, Findings, and Future Directions," *Journal of Marketing Research*, 73 (June), 293–312.

Srivastava, Rajendra K., Tasadduq A. Shervani, and Liam Fahey (1998), "Market-Based Assets and Shareholder Value: A Framework for Analysis," *Journal of Marketing*, 62 (January), 2–18.

Tipton, Martha M., Sundar G. Bharadwaj, and Diana C. Robertson (2009), "Regulatory Exposure of Deceptive Marketing and Its Impact on Firm Value," *Journal of Marketing*, 73 (November), 227–43.

Tuli, Kapil R. and Sundar G. Bharadwaj (2009), "Customer Satisfaction and Stock Returns Risk," *Journal of Marketing*, 73 (November), 184–97.

Wiesel Thorsten, Bernd Skiera, and Julian Villanueva (2008), "Customer Equity: An Integral Part of Financial Reporting," *Journal of Marketing*, 72 (March), 1–14.