Market-based assets. Building value through marketing investments

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Abstract

The goal of the company is to deliver value to investors. According to the resource-based view theory, companies need to develop a differential advantage in order to maintain earnings in excess of the cost of capital. Resources which are valuable, rare, inimitable and non-substitutable make it possible for businesses to develop and maintain competitive advantages. Companies may create differential advantages by building market-based assets. Emerging trends suggest that the purpose of marketing is creating and managing market-based assets in order to derive shareholder value. In these conditions, the resources allocated to marketing strategies should be viewed as investments which create assets. This paper highlights the way marketing activities and marketing expenditures contribute to creating market-based assets and, implicitly, to creating the value at the level of the companies.

Keywords: value, intangible, investment, market, brand, equity, customer, asset, expenditure

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1. Maximizing shareholder value, an important objective for any organization

The goal of the company is to deliver value to investors (Knight, 1998). The maximizing shareholder value is an important objective of any organization. This implies maximizing the difference between the organization's total market value and the amount of capital invested in the company. This difference is called market value added (MVA) and is determined like a difference between the total market value of the company and the value of invested
capital. Market value added is a useful operational indicator of long term economic performance of the company (Sveiby, 1997, Stewart 1997). Empirical studies indicate that MVA highlight the future earning potential of the company (Kallunki et.al. 1999).

A high value of market value reflects a high expectation of future return on companies' investments. The market value of company’s shares is driven by the ability of management to make profitable investments. Management create value when an investment generates an economic return greater than the cost of capital. The goal of the managers is to pursue strategies to maximize the value of cash-flows over time and to minimize the risk associated to company's investments. Shareholder value should be evaluated in relation with strategies and initiatives that could generate positive net present value.

According with the resource based view theory companies need to develop a differential advantage to maintain earnings in excess of the cost of capital. Resources that are valuable, rare, inimitable and no substitutable make it possible for businesses to develop and maintain competitive advantages (Barney, 1991). As pointed out by Srivastava et. al. (2001), Hogan and Armstrong (2001), and Hogan et. al. (2002), notions of market based assets and relational assets have a strong link to the resource based view of the firm. The companies may create differential advantage by building the market based assets. The marketers want to optimise marketing investments in purpose of increasing shareholder value. The emerging trend suggests that the purpose of marketing is creating and managing market based assets to derive shareholder value (Srivastava et. al. 1998, Doyle 2000). In these conditions, the resources allocated to marketing strategies should be viewed as investments that create assets. These assets can be leveraged to enhance future performance, to provide potential for growth or reduce risk (Srivastava et. al. 1998).

The working paper is organized as following:

In section number two the concept of market based assets is outlined and two of the most important market-based assets of the companies are presented, determinant for the value of these: Brand Equity and Customer Equity.

In section number three I try to highlight the importance of making the relation between marketing activities and marketing expenditures, on one side, and the market based assets, on the other side. It is important to make a distinction between the effort or input flow that goes into the creation of the asset and the nature of the value or capital stock generated. I highlight that a big part of marketing expenditures must be treated as marketing investments because these contribute to forming the market based assets and generating the long-term benefits.

2. The Concept and Components of Market Based Assets. Literature Review

Assets was defined as organizational attributes that an organization can acquire, develop, nurture, and leverage for both internal (organizational) and external (marketplace) purposes (Barney, 1991; Hunt & Morgan, 1995; Srivastava, Shervani & Fahey, 1998). The market based assets (known and as marketing based assets) was defined as assets that arise from the commingling of the firm with entities in its external environment (Srivastava et. al. 1998, Doyle 2000). Barney (1991) highlight that the market based assets can be any physical, organizational, or human attribute that enables the firm to improve its efficiency and effectiveness in the marketplace. Market-based assets include elements as brand, customer relationships, channel relationships, partner relationships, etc.

Doyle (2000) divided marketing based assets into four types: marketing knowledge, brands, customer loyalty, strategic relationships (e.g. relationships with channels partners)

Srivastava, Shervani & Fahey (1998) identified two types of market-based assets: relational market-based assets and intellectual market-based assets.

Relational market-based assets are outcomes of the relationship between a firm and key external stakeholders, including distributors, retailers, end-customers, other strategic partners, community groups, and even governmental agencies.

Intellectual market-based assets are the types of knowledge a firm possesses about the environment, such as the emerging and potential state of market conditions, and the entities in it such as competitors, customers, channels and suppliers.

The market based assets, generally, are not recognized in the companies ‘balance sheets and are included in category of intangible assets.

From different types of market-based-assets, brand equity and customer equity have received most attention from researchers.
2.1. Brand Equity

Brand is considered as valuable, long-term corporate asset. The importance of the brand as the fundamental asset of any business is well recognized by managers. This is because of the economic impact that brands have. They influence the choices of customers, employees, investors and of other company’s stakeholders.

Branding has become a top management priority for many organizations as they have come to appreciate that one of their most valuable assets is the intangible asset that is their brand (Keller, 2002). It has been recognized the fact that a firm’s real value lies outside the business itself: in the minds of potential buyers. (Aaker 1996, Pearson 1996). Customers and other stakeholders integrate all they see, hear and read about a product with all their experiences using or consuming it to form a single, but often complex, mental image about both the physical product and the company that makes it (Keegan & Moriarty & Duncan, 1995).

In paying very high prices for companies with brands, buyers are actually purchasing a position in the minds of potential customers. Awareness, trust and reputation are the best guarantees of future earnings (Kapferer, 1992).

Brand has been used for many years to identify and differentiate goods and services from those of the competitors. In addition of their role of differentiation, brands can also been used to build a competitive advantage and financial return to the organization (Bick, 2009).

Brand Equity is the figure that reflects the inherent value of the brand. Brand Equity as a management concept arose in the 1980's when the high purchase prices paid, largely, reflected the value of the brands (Leone et. al. 2006). It was highlighted that brands are financial assets and should be recognized as such by top management and the financial markets.

Equity arises from customers' awareness about the brand and customers' knowledge about the brand. Customers have a set of associations of what the brand means, and what it delivers. They have ideas of what they can expect, in terms of the relationship, and in terms of the product's delivery (Campbell, 2002).

Brand equity was defined in several ways.

Aaker (1996) defined brand as a set of brand assets and liabilities linked to a brand, its name and symbol that add to or subtract from the value provided by a product or service to a firm and/or to that firm’s customer. According to Aaker the brand equity comprise four major asset categories such as brand loyalty, brand awareness, perceived quality, brand associations and, other proprietary assets such as patents, trademarks and channel relationships.

Keller (1998) focused on customer mind-set equity, which Keller refers to as “customer-based brand equity.” According to Keller (p. 48) “the power of a brand lies in what customers have learned, felt, seen, and heard about the brand”. Keller (2002) defines brand equity as "the differential effect of brand knowledge on the consumer response to the marketing of the brand". The sources of Brand Equity are derived from a high level of brand awareness and a positive brand image.

Rust, Zeithaml and Lemon (2004) suggest that brand equity is a product-focused concept and should be viewed as a component of a larger concept of customer equity. The brand equity was defined as "the customer's subjective and intangible assessment of the brand, above and beyond its objectively perceived value" (Rust et. al. 2005, p. 24). The Brand Equity was considered as a driver of Customer Equity. The role of brand in building Customer Equity is to build awareness and attract customers, to build emotional connections to customers, and to remind customers to repurchase (Rust et. al. 2000).

Managers have a deeper understanding of the elements of brand equity, of how brand equity affects customer behaviour, of how to measure brand equity, and of the influence of brand equity on corporate value (e.g., Aaker 1991; Keller 1998, 2002).

The valuation literature highlight that the brand equity can be determined on the base of incremental cash flows generated from the sale of a set of products or services, as a result of the brand being associated with those products or services (e.g., Keller 1998). Brand reputation (equity) has been shown to be a durable asset that can help reduce the risk of future cash flows for its owners (Deephouse, 2000).

2.2. The Customer Equity

It is a known the fact that a firm’s financial value depends on off -balance sheet intangible assets like the brand. Another intangible asset that has recently emerged as a critical aspect of a firm is its customers.
The customers are considered important intangible assets of the company. Forbes (2008) considers that the customers are the most important intangible assets of the company. This is due to the fact that without customers a business would not exist. The customers are the reason for a business ‘existence. They are behind the existing activity and create new business opportunities.

The notion that a firm’s relationships with a customer can be viewed as an asset is grounded in, both, the resource-based view of the firm (Barney, 1991) and, the relationship marketing paradigm (Hunt & Morgan, 1995). Customer Equity has received an increasing amount of interest among the marketing researchers since 1990 (Blattberg & Deighton, 1996; Hogan et al. 2002; Rust et al. 2004; Kumar & George 2007). It was highlighted that firms can achieve superior performance by changing their focus from delivering competitive products to building good customer relationships (Blattberg et al., 2001; Rust et al., 2000). Marketing managers and researchers recognize that long-term, quality customer-company relationships can be a major source of the company’s profitability. Bauer et al. (2005) highlight that each organization has to find the factors motivating its customers to start a transaction with the firm, and proceed doing business with that firm, in the future.

Customers are seen as the intangible assets a firm should wisely acquire, maintain, and maximize just like other financial assets (Blattberg et al., 2001). They are viewed as risky assets that may produce cash flow for the firm over time (Hogan, et al., 2002).

Customer equity is simply a measure of the value of the customers’ relationships that are managed (Blattberg and Deighton, 1996; Hogan et al., 2002; Kumar and George, 2007; Rust et al., 2004). The term customer equity refers to a figure, the amount of money that can be generated from the current and prospective customer relationships. This concept imply that management of a company should be able to calculate the value added to the company by its current and future customers.

Hogan et.al (2002) suggests that customer equity is a means of growing shareholder value. The long-term value of the firm is largely determined by the value of the company’s customer relationship.

The customers and the value that they bring to a company have enjoyed increased attention lately. Customer equity was first identified as a measure of the marketing asset by Blattberg and Deighton (1996). They defined customer equity as the sum of the lifetime values of the firm’s customers.

Dwyer (1997) defined Customer Equity as “the present value of the expected benefits (e.g., gross margin) less the burdens (e.g., direct costs of servicing and communicating) from customers”.

Hogan et.al. (2002) expanded the definition made by Blattberg and Deighton (1996) by stating that a company’s customer equity is derivative of both the existing and potential customer assets. He defined customer equity as the sum of all discounted profits from both existing and potential customers of the firms and, highlighted that, customer equity is a combination of the value of a firm’s current and potential customer assets.

The concept of Customer Equity is closely linked to the concept of Customer Lifetime Value (CLV). The measurement of Customer Equity depends on the determination of Customer Lifetime Value (CLTV). The CLV method allows computation of the value of a customer to the firm.

The term of Customer Lifetime Value (CLV) was introduced by Dwyer (1989) and it is most commonly defined as the present value of its expected revenues less the costs from a particular customer.

Bell, et al. (2002) noted that CLV is the value of the customer relationship to the firm in monetary terms. Gupta & Lehmann (2005) defined CLTV as „the (net) present value of all current and future profits generated from a customer over the life of his or her business with a firm. Customer Equity is then the sum of customer lifetime values of the firm’s current and future customers.

It measures the value of all present and future customers given a firm’s marketing actions (Dreze & Bonfrer, 2009).

CLV is driven by estimates that are based on certain assumptions about future revenue, movement in customer numbers, and future costs implied by acquisition and retaining the customers. It is also dependent on the appropriate allocation (Bell, et al. 2002) of costs to customers. It is outlined that it is not always easy to forecast cash flow (revenue and costs) and customer movements for the future.

The vast majority of the evaluation literature uses customer lifetime value (CLV) as the main method for valuation of Customer Equity. The majority of existing CVL models are built around three basic elements: revenue from customer, costs of servicing the customer, customer retention rate.

The concept of customer value represents the link between, the customer, as the external factor with regard to a company’s revenue and, the internal processes, representing the costs of a company (Bauer & Hammerschmidt & Braehler, 2004).
Rust et al. (2000) highlighted existence of three key drivers of customer equity: value equity, brand equity and relationship equity. Value equity is defined as "the customer’s objective assessment of the utility of a brand, based on perceptions of what is given up for what is received". Brand equity is "the customer’s subjective and intangible assessment of the brand, above and beyond its objectively perceived value". Retention/relationship equity is defined as "the tendency of the customer to stick with the brand, above and beyond the customer’s objective and subjective assessments of the brand".

Stahl et al. (2003) propose that customers have to be treated as assets that increase shareholder value by processes that accelerate (earlier cash flows produce a higher present value of money) and enhance (increasing revenues and/or reducing costs, working capital and investments) cash flows, reducing cash flow volatility and vulnerability (lowering the cost of capital) and increasing the residual value of the firm (through processes).

3. Building Value through Marketing Investments

In the present exist many concerns for measurement the return on marketing spend, for linking marketing activities and investments to financial performance of the company and its value. As Doyle (2000) highlighted marketing practitioners and scholars are under increased pressure to be more accountable for and to show how marketing expenditure adds to shareholder value. The market based assets are considered appropriate means to measure the impact of marketing activity on the financial outcomes and value of the company.

Firms are concern with actions (marketing actions) that seek to position the brand in the mind of consumers, to attract and retain the customers. Marketing Activities include activities such market research, advertising, personal selling, sales promotions, public relations, direct marketing, other forms of communications (Keller, 2009).

The marketing activities generate marketing expenses. These have been defined as all costs made to start and maintain a customer relationship (Webster, 1992).

An important question is if marketing expenditures should be regarded as capital investments. For marketing expenditures to be considered as capital investments the products of these expenditures should satisfy the definition of fixed assets.

Fixed assets are assets that are used repeatedly or continuously in production processes for more than one year. Vosselman (1992) highlighted that, the main characteristic of an investment product, is its ability to contribute to more than one production cycle.

The studies that have analysed the impact of marketing activities on companies' market share and level of sales highlighted that these effects can be divided in two categories: short term and long term effects. And that the long-term impact is very different from short-term impact (Dekimpe & Hanssens, 1995).

These studies highlight that some marketing actions (e.g., sales promotions) produce effects quickly but have influence on the short time periods comparative with other marketing actions (e.g., service quality improvements, advertising) that have influence on the long time periods (Rust, et al. 2004).

The marketing expenses that have long-term effects on company's sales, profits, cash-flows, risk and value, must be perceived as marketing investments. Vosselman (1992) highlights that “there are severe problems in strictly defining which (part of an) marketing outlay should be considered as an investment and which (part) is an operational cost”.

The market-based assets are long-term assets. These contribute to profits in the short run and, provide potential for growth and sustained profits in the long run. (Rust et. al. 2004).

The expenditures on market research and advertising are important parts of investment in brand equity.

It is obvious that the expenditures on market research have an investment character. Firms that spend money on market research obtain knowledge about consumers’ preferences which can be utilized for obtaining benefits during long periods of time. Corrado, Hulten and Sichel (2005) highlight that, although the properties of markets tend to change consistently over time, it is reasonable to assume that the knowledge of certain market segments and consumer attitudes holds benefits for more than one year, because the information gathered tends to be valid for several years. The expenditure on market research contributes to the value of the brand and to generating the long-term benefits for the investor.

Advertising is an important activity with which the companies are concerned. These spent large amounts in communication. Expenditure on advertising should be viewed as an investment in intangible asset because it is intended to create a reputation, a perceived image of these entities in the minds of potential consumers. The created
reputation can have an important impact on the profits and on the value of the companies during long periods of the time.

As was highlighted customers are considered valuable assets for the firm. The companies make efforts for acquisition, development and retention of their customers. These activities imply important marketing investments.

Kamakura et al. 2005 highlight that a firm's customer relationships initiatives can be organized along the customer life cycle as customer acquisition, development, and retention. The goal of acquisition is to obtain profitable customers.

The goal of development is to grow revenues from existing customers. And the goal of retention is to minimize “churn” of customers (Kamakura et al. 2005).

The aim of marketing expenses is to generate returns in terms of customer attraction (producing cash flows from new customers), customer retention (increasing the length of the customer lifetime), and/or customer development (increasing cash flows from existing customers) (Rust et al., 2004; Kamakura et al., 2005).

The new marketing divided itself into the work of acquiring customers and the work of retaining them (Villanueva, 2007). One of the important challenges of management is the allocation of resources across acquisition and retention activities. Setting a marketing budget becomes the task of balancing what is spent on customer acquisition and what is spent on retention (Villanueva, 2007).

In order to grow their business, companies try to acquire customers. Firms use various types of marketing activities to acquire new customers which include: mass media (TV, advertising) and more personalized contacts (emails, promotion calls). Marketing spending on acquiring customers represents for many firms one of the most important expenses.

In the same time, the companies are concerned with developing the loyalty programs that give them the competitive advantages. The result of these loyalty programs is customer retention. Customer loyalty plays an important role in the success of the organization. Loyal customers provide firms a consistent source of revenue (repeat and increased purchases) and for cost reduction (less promotional expenses) (Mei-Lien Li, 2007).

Villanueva (2007) highlights the modality in which the managers articulate marketing goal: they talk not about selling products but about keeping customers. A senior executive offers the general rule that it is “easier to get current customers to use you more often than it is to get a new customer” (Villanueva, 2007).

Kotler & Keller (2006) and Wills (2009) highlighted that firms spend more than five times as much to obtain a new customer than to retaining an existing one.

Advertising plays an important role in the acquisition of new customers, but it may also affect the behaviour of existing customers. By creating favourable brand associations and brand preference, advertising will strengthen the relationship between the customer and the firm (Ambler et al. 2002; Keller 1993).

4. Conclusions

The goal of the company is to deliver value to investors. The maximizing shareholder value is an important objective of any organization. The goal of the managers is to pursue strategies to maximize the value of cash-flows over time and to minimize the risk associated to company's investments.

According with the resource based view theory companies need to develop a differential advantage to maintain earnings in excess of the cost of capital. Resources that are valuable, rare, inimitable and no substitutable make it possible for businesses to develop and maintain competitive advantages.

The companies may create differential advantage by building the market based assets. These include elements as brand, customer relationships, channel relationships, partner relationships, etc. The market based assets are not recognized in the companies’ balance sheets and are included in category of intangible assets.

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The marketing activities generate marketing expenses. An important question is if marketing expenditures should be regarded as capital investments.

In this paper I outlined the fact that the marketing expenses that have long-term effects on company's sales, profits, cash-flows, risk and, value, must be perceived as marketing investments. These are investments related by
building the marketing assets. The creation the brand and solid customers’ relationships imply important marketing investments.

The expenditures on market research and advertising are important parts of investment in brand equity. These types of expenditures provide future benefits at the level of the companies.

Customers are valuable assets for the firm. The acquisition and retaining the customers imply important marketing investments. The companies make efforts for acquisition, development and retention of their customers.

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