

## Can Marketing Expenditures Directly Affect Shareholder Value?



Advertising may legitimately claim some credit for market value increases of your firm, but incontrovertible proof remains elusive.

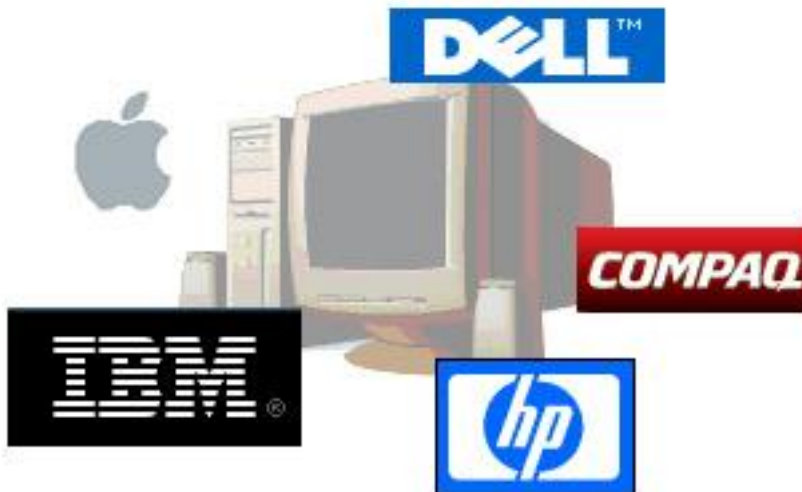
The most recent academic research to attack the question is "Advertising Spending and Marketing Capitalization," a working paper from the Marketing Science Institute by Amit Joshi and Dominique Hanssens. In it, the authors study 10 years of data for five PC manufacturers — Apple, Compaq, Dell, HP, and IBM — and look for correlations between advertising and market capitalization. They conclude that, in the long run, it's smart and consistent marketing spending that makes a company value rise. But their methodology, while sound, will likely not convince CEOs.

The pair start out with some simple reasoning that because advertising affects revenue and profit, and revenue and profit affect market capitalization, advertising at the very least indirectly affects market capitalization. So far, no news.

Then they test to see whether advertising has a positive impact on sales revenue; whether research and development spending has a positive long-run impact on sales revenue; and whether advertising has a positive long-run effect on market capitalization.

Advertising, they argue, seeks to differentiate a firm's products from those of its competitors, typically building a brand that represents the differences. Advertising investments create brand equity, an intangible asset of the company. Joshi and Hanssens argue that not only do consumers pay attention to advertising; investors do as well. And it makes some sense that they would. Previous research already established that investors favor stocks with strong brand names even when the brands do not generate superior short-run returns. Still other studies point out that ad and R&D spending figures help investors form expectations about the size and variability of future cash flows.

For example, when a celebrity endorses a brand by appearing in its advertising and visits retail locations and special events, investors may see advertising as a signal of future earnings potential. Michael Jordan's endorsements of products from McDonald's fast food to Hanes underwear increased market-adjusted values of these and other brands.



The pair are practical, however. They note that the direct relationship between advertising and valuation is ambiguous, in part because not all advertising is effective and even effective advertising can reduce profit in the short run because the advertising budget is a direct expenditure against current revenue. Company value, sales, profits, and advertising expenditures all have feedback effects on one another.

After the application of some serious marketing mathematics, for Apple, Compaq, and IBM, advertising spending had a persistent and positive impact on sales revenue. Additionally, R&D expenditures had a long-term impact on sales revenue. So did advertising spending have a positive long-run impact on market capitalization? Apple, Compaq, and HP data pointed to "yes."

Advertising expenditures, the researchers report, initially have a small impact on market capitalization. However, advertising's effect increases over time and may grow firm value beyond what's expected when looking at advertising's effect on revenues and profits. Overall, the five PC makers that Joshi and Hanssens' study looked at realized a net gain in market value by doubling their advertising spending in 10 of the 12 years projected by the pair. Advertising can change market capitalization by hundreds of millions of dollars, they found.

Unfortunately, research like this often has the effect of further separating science from marketing by caveating its conclusion in subtle ways that undermine the search for the simple proof. Granted, nothing is simple these days. That said, you — especially those of you in the technology development industry — might want to have someone in your analytical department read the article at [www.msi.org](http://www.msi.org) to see if the proposed science relates to your marketing efforts. You may be able to cut the theoretical leap made by the researchers to a more pragmatic conclusion.



For the whole story, search on [www.msi.org](http://www.msi.org) for "Advertising Spending and Market Capitalization" by Amit Joshi, doctoral student at Anderson School of Management of the University of California — Los Angeles; and Dominique M. Hanssens, the Bud Knapp professor of marketing at the same.