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The case for research on the marketing–finance interface

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Abstract

This article discusses five dominant themes and important empirical findings in the recent literature on the marketing-finance interface.

Keywords

digital economy, finance, investors, marketing, marketing decision making, value of the firm

A perennial challenge for the practice of marketing is that successful marketing is not easily distinguished from non-performing marketing. On the input side, marketing efforts take on many forms, conveniently summarized as the four Ps. On the output side, there are several possible key performance indicators (KPIs) for marketing which, unfortunately, tend not to correlate highly with each other. For example, across nearly 1000 published studies, Katsikeas et al. (2016) report the average correlation between accounting measures and customer mindset metrics is only 0.27, and the intercorrelation across customer-level metrics is only 0.13. However, since marketing inevitably consumes scarce firm resources of talent, time and money, the ultimate performance metric that is generally agreed upon is the financial value of the firm. This value is continuously measured as the stock price of publicly held firms, and occasionally assessed for public and private firms when mergers or acquisitions occur. From a research perspective, this consideration creates a major opportunity to connect the academic discipline of finance (both corporate finance and financial markets) with the field of marketing, an enterprise sometimes referred to as "research on the marketing-finance interface."

Scientific contributions on the marketing–finance interface began to surface around the turn of the current century. In 2006, two leading marketing research centers, the Emory Marketing Institute (EMI) and the Marketing Science Institute (MSI) combined resources to launch a research and conference initiative called "*Marketing Strategy meets Wall Street.*" Its objective was to broaden the scope of marketing to include *investors* as a relevant stakeholder. Do investors (and, therefore, the stock market) take notice when companies build brands, launch new products and engage in other activities that may not yield immediate cash-flow benefits, but strengthen the long-term viability of the enterprise? Conversely, are managers influenced by investor behavior, for example, does the recent evolution of stock prices impact the types of marketing activities the firm engages in? These and other questions are of interest to both academic disciplines, but also to their practice communities. Indeed, stock price is a recognized *consensus* metric of a firm's economic health and, as such,

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marketers are well served by knowing which of their actions, if any, either lift or depress stock prices. Second, the finance discipline relies heavily on the *efficient markets hypothesis*, which states that all unanticipated and value-relevant information about firms is incorporated immediately in their stock prices. When considering marketing actions, does the efficient markets hypothesis still hold, in particular when the marketing initiative does not produce immediate revenue and earnings impact?

The MSI/EMI initiative led to the funding of several research projects that were subsequently published in a special section of the *Journal of Marketing* (November 2009). It also spawned a series of biennial conferences on the marketing–finance interface, in Atlanta (2009), Boston (2011), Singapore (2013), Frankfurt (2015), and San Francisco (2017), with a sixth edition planned at INSEAD near Paris in June 2019. Leading journals in marketing and management have started to publish frequent contributions on the marketing–finance interface. The first review article on this material appeared in the *Journal of Marketing Research* (Srinivasan and Hanssens, 2009a), and was translated in French by *Recherche et Applications en Marketing* (Srinivasan and Hanssens, 2009b). The research has also been disseminated in books, notably the Handbook of Marketing and Finance (Ganesan, 2012).

This paper will discuss five dominant themes and insights that have resulted from this research stream and that invite further research in this area, thereby making the case for the importance of this interdisciplinary work. While a complete review of findings is beyond the scope of the paper, I will focus on insights that address big-picture questions about the role of investors and financial performance in marketing decision-making.

Insight #1: The stock market is long-run oriented

Despite the popular belief that stock prices react only to short-term earnings surprises, several findings in the marketing-finance literature support the notion that investors care about the long-run outlook of the firms they invest in. I focus here on two examples that illustrate investor patience as they involve marketing behaviors that are risky and/or yield benefits that only gradually materialize over time. The first is innovation, especially radical innovation. Sorescu and Spanjol (2008) report that the 1-year effect of innovation on shareholder value is significantly positive and is greater for radical than for incremental innovations. The second is investments in customer relationship quality. Fornell et al. (2016) report that, over a 15-year period (2000–2014), an investment portfolio based on firms' customer satisfaction scores would have yielded a cumulative return of 518%. By comparison, investing in the S&P500 would have yielded a cumulative return of 31% over the same time period.

This is particularly good news for marketing executives, especially those in charge of building marketing assets for their firms, including innovation, customer satisfaction, and brand strength. In essence, their actions, even if they are risky and/or involve discretionary spending that lowers short-term earnings, add value both to consumers and to investors, and are rewarded accordingly.

Insight #2: Investor reaction to marketing parallels consumer reaction, with one major exception

Some researchers have combined consumer response and investor response to marketing actions in a dynamic simultaneous-equation setting. In general, the two metrics react in the same direction, for example, effective advertising spending increases consumer demand, but also boosts stock prices (Joshi and Hanssens, 2010), so long as the spending levels are not excessive. As with the previous result, this suggests that "Main Street" and "Wall Street" are in sync with each other with respect to the value of these marketing investments.

The one exception to this pattern is with respect to temporary price cuts, that is, price promotions. Such promotions are widely acknowledged to have strong positive, though short-lived, effects on consumer demand (both at the category level and the brand level). Investor response, on the other hand,

has been found to be negative in the automotive sector (Pauwels et al., 2004): investors are concerned that sales promotions reduce profit margins and, therefore, earnings. They may also infer that the firm will become dependent on these promotions in order to meet their revenue quota, whence the negative reaction.

The managerial implication is that, when it comes to price promotions, the occasional and unexpected promotion is unlikely to be harmful and, in fact, boosts short-term revenue. However, repetitive price promotion campaigns, however effective they may be in generating consumer demand, send the wrong signal about financial health to the investor community.

Insight #3: Investors are reasonably efficient, but not totally efficient, in incorporating value-relevant marketing information

Research on the marketing–finance interface has shown that product innovation *announcements* influence investors, as these announcements are associated with positive abnormal returns (Sood and Tellis, 2009). However, the total returns to innovation are much greater than this announcement effect. The product life cycle concept in marketing provides a good testing ground for our understanding of how these total returns materialize over time. In the automotive industry, for example, new models typically have a 6-year life before a major redesign is launched. In the United States, unit sales and average prices of automobile models are tracked and communicated to stock analysts on a weekly basis, which allows us to examine how long it takes for the stock market to incorporate the incremental earnings effect of new-product introductions. Pauwels et al. (2004) studied that question empirically and estimated that the full impact of the innovation is realized in about 8 weeks. So, while the product life cycle typically spans several years, the investor community incorporates the financial implications of a new-product launch for the firm in a matter of weeks.

In conclusion, while the investor community does not immediately and fully incorporate the innovation effect, it does not take very long for the effect to be absorbed. Similar analyses for other product categories in which product innovation is an essential marketing activity need to be conducted. In particular, we need to better understand the conditions under which the absorption time is longer or shorter.

Insight #4: The digital age is enhancing the importance of factual product performance, at the expense of overall brand image

Consumers have always sought quality at a commensurate price in their purchases; however, the explosion in digital information availability makes quality assessment easier and less costly. As such the quality information provided by third-party online reviews has become an important driver of consumer demand, with a reported meta-elasticity of 0.69 (valence of review) and 0.35 (quantity of reviews; Floyd et al., 2014). By comparison, the meta-advertising elasticity is only around 0.12 (Sethuraman et al., 2011), which demonstrates that factual product information (reviews) now dominates – by a wide margin – persuasive information (advertising) in buyer impact.

This has important ramifications for the economic relevance of brand strength and customer relationship strength of firms. This relationship was quantified by Edeling and Fischer (2016). On the basis of nearly 500 estimates from 83 different scientific studies, they derive that the average brand strength→firm value elasticity is 0.33, while the customer relationship→firm value elasticity is 0.72. Thus, brand image is still relevant for firm value, but customer experience quality is more important.

An excellent illustration of this phenomenon has been provided in the hospitality industry (Hollenbeck, 2018). Using a large database of hotel revenues and customer satisfaction ratings in Texas, the author reports that the relative importance of brand affiliation as a revenue driver has gone down over time, in favor of the perceived quality of an individual hotel. Indeed, travelers now find it much easier to collect quality ratings from individual

hotels (say, the Hilton in San Antonio), and these have become stronger determinants of hotel choices than the hotel's mere brand affiliation (e.g. the attractiveness of the Hilton brand name).

A careful test of this premise is provided by examining the role of "brand strength" versus "customer relationship quality" in the prices paid for *mergers and acquisitions*. Indeed, the occurrence of a merger or acquisition is the only instance where *enterprise value* is assessed with real market data. When a merger or acquisition takes place, accounting specialists in "purchase price allocation" determine the fractions of the purchase price that are attributed to "brand" and "customer relations," respectively. Binder and Hanssens (2015) examined the relative importance of brand and customer relationship value for over 5000 mergers and acquisitions between 2003 and 2013. The results demonstrate the inverse movement of these two metrics over time. Brand value declined from about 19% of purchase price to around 9%, whereas customer relationship value increased from about 8% to 17% over the same time period. The authors' interpretation of these trends is that the recent abundance of high-quality customer data enables companies to maintain stronger customer relationships than in the past.

Insight #5: Stock prices influence marketing resource allocations

The final reason why marketing-finance research is important is centered on the reverse relationship, that is, capital market actions influence marketing behavior. This has been demonstrated mainly in the areas of *marketing budget setting* and *innovation*. A major finding, due to Mizik (2010), is that managers have a tendency to engage in *myopic marketing management* and cut marketing and R&D spending to inflate earnings in the short term, to the detriment of long-term performance. This is an interesting finding, in light of the earlier Insight #1 that the stock market is fundamentally long-run oriented. Thus the question arises to what extent managers' fundamental misinterpretation of investor behavior undermines their companies' performance.

In the area of innovation, Markovitch et al. (2005) find that, when their stock prices underperform relative to competition, pharmaceutical firms implement more high-risk innovation strategies than their peers. Another important insight, due to Wies and Moorman (2015), is that, after going public, firms introduce more new products but fewer breakthrough innovations. While more research is needed on the financial performance→marketing behavior connection, we can already conclude that the relationship does not necessarily serve the best interest of the firm. There may be a disconnect between investor behavior and managers' *perception* of investor behavior.

In conclusion, the first two decades or so of research on the marketing–finance interface have produced several insights that are of importance to both academic disciplines and to their practice communities. Of particular interest is the mounting evidence that financial markets are not fully efficient with respect to firms' marketing behaviors, and that the executives in charge of these behaviors do not always act in their firms' best economic interests. In the words of Fornell et al. (2006), "The tacit link between buyer utility and the allocation of investment capital is a fundamental principle on which the economic system of free market capitalism rests." Research on the marketing–finance interface is ideally positioned to test this premise in a marketing context and to point to areas that are in need of improvement.

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