Brands, patents can protect firms from bankruptcy

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If a firm faces troubled times during a stable market, strong advertising can carry it through. But when the market is turbulent, a firm's Research and Development is more likely to help save it from bankruptcy. A new study published in the Articles in Advance section of *Marketing Science*, a journal of the Institute for Operations Research and the Management Sciences (INFORMS), shows that "intangible assets" built with advertising (such as brands) and R&D (such as patents) can help protect firms from bankruptcy, but the effectiveness of each depends on the market climate.

The study, The Impacts of Advertising Assets and R&D Assets on Reducing Bankruptcy Risk by Niket Jindal of Indiana University's Kelley School of Business and Leigh McAlister of the University of Texas's McCombs School of Business, is based on data from more than 1,000 firms covering three decades.

"While it is widely recognized that intangible assets, such as brands and patents, contribute to a firm's stock price, until now there has been limited research on whether and how these same intangible assets protect firms from bankruptcy," says Jindal.

The research provides new insight for managers of distressed firms by showing the conditions under which a firm's brands and patents can protect the firm from bankruptcy. This research also has important implications for stakeholders external to distressed firms, such as creditors, suppliers, and investors. It shows that bankruptcy prediction can be substantially improved by considering a distressed firm's brands and patents, in addition to the usual financial predictors, such as profit and leverage.

"What's particularly interesting is that the manner in which these intangible assets protect firms from bankruptcy differs from the manner in which they increase stock prices," says McAlister.

Unlike stock prices, which are based on investors' expectations of the firm's performance over a long-term horizon, bankruptcy risk is based on the firm's ability to generate enough cash to survive in the near-term. Consequently, the authors say, market turbulence impacts the effectiveness of brands and patents on bankruptcy protection but not stock prices.

The authors say this is why brands protect firms from bankruptcy more when the market is stable than when the market is turbulent. For example, Blockbuster's brand protected it from bankruptcy when the market was stable, but when the video rental market became turbulent and consumer preferences switched away from DVD's to online media, the brand was unable to protect the firm from bankruptcy.

In contrast, patents protect firms from bankruptcy more when the market is turbulent than when the market is stable. For example, when the computer market became turbulent and consumer preferences switched away from stand-alone word processor systems to more general-purpose personal computers, Wang Laboratories' patent portfolio allowed it to make the switch to personal computers and protected it from bankruptcy. However, when the computer market became stable in the early 1990s, price wars ensued and Wang's patents were no longer able to protect the firm.

More information: pubsonline.informs.org/doi/abs …

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