# Research finds reason advertising boosts stock prices for some companies and not others

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By 2017, total advertising spending is expected to approach $136 billion, placing more pressure on management to demonstrate its impact on sales and stock prices. It's the age-old question of advertising effectiveness.

While nearly every research study has found that advertising has a positive impact on sales, the results are mixed regarding its effectiveness on stock price, which can be seen as an indicator of future sales.

New research from professors at the Kelley School of Business at Indiana University, the McCombs School of Business at the University of Texas and the W. P. Carey School of Business at Arizona State University found the reason advertising boosts stock prices for some companies and not others.

They found that companies that set out to differentiate themselves through brand equity and thus create intangible firm value benefit more from advertising than firms that simply set out to become cost leaders.

"They're both very valid strategies. Different companies choose different approaches. They both can be very successful for companies," said Niket Jindal, an assistant professor of marketing at Kelley.

"Advertising can increase awareness; it can increase sales regardless," he added. "But it's only for those companies that have a differentiation strategy where advertising's going to build up brand equity ... and shareholder value.

"That's not to say that it's wasteful spending for those cost leaders; there's still value in that it's increasing their sales. But those kinds of companies shouldn't expect to see an impact beyond the current year's sales."

The paper, "Advertising Effectiveness: The Moderating Effect of Firm Strategy," has been accepted for publication by the *Journal of Marketing Research*. Co-authors are Leigh McAlister and Raji Srinivasan, marketing professors at the McCombs School, and Albert Cannella Jr., a management professor at the Carey School.

Chances are you've heard of companies that have a differentiation strategy; they are popular brands. It makes sense to suggest that companies which are cost leaders are far less visible in consumers' minds and may include commodities firms, manufacturers and budget retailers that focus on squeezing out costs.

Beginning in 1994, publicly traded companies were required by the Securities and Exchange Commission to report advertising expenditures that are considered "material," something under the law that is significant to users of a registrant's financial statements. Before then, all firms had to report advertising expenditures.

McAlister, Srinivasan, Jindal and Cannella decided to review financial statements before and after the implementation of accounting regulation FRR44 (SEC Financial Reporting Release No. 44), when over half of the companies stopped disclosing advertising expenses.

The researchers looked at reports for S&P 500 companies in 1990-94 and 1996-2009

The researchers predicted that companies with a differentiation strategy would disclose costs associated with marketing, because it was "fundamentally central to their strategy." Obviously, shareholders would be interested in this information as well.

They predicted and found that for firms operating with a cost leadership strategy, shareholders would build their intangible market-based assets through mechanisms other than advertising.

"These are not inferior firms by any means. They are really healthy firms, but the role of marketing in these firms is a very different thing," Jindal said.

For example, business-to-business firms such as aircraft maker Boeing develop such assets through their selling organizations, not advertising. Tech firms develop assets through research and development rather than through advertising.

"We're not saying that cost leaders are the poor stock performers," Jindal said. "They can add great stock price. What we're saying is advertising isn't going to have any impact on that stock price."

Their paper also has important application for those evaluating marketing offers at various firms and for consultants wishing to target firms with a strong marketing emphasis. It also has ramifications for marketing education.

"Most marketing textbooks, when introducing the marketing career path, overlook the implications of a firm's business strategy," the authors wrote. "The marketing function is frequently presented as the growth driver, with budgetary authority and a clear path to general management that one might expect in a firm that differentiates.

"If, in fact, marketing is only cast in the role of a growth driver in that 40 percent of publicly traded firms that differentiate, some students may find themselves in firms that are cost leaders where marketing responsibilities and career opportunities of the marketing job that they accept differ significantly from the responsibilities and career opportunities that their marketing textbooks lead them to expect."

Provided by Indiana University

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