How disclosing advertising spending can reduce investor and analyst uncertainty and possibly enhance firms' valuations

September 20 2022, by Marilyn Stone

Credit: Pixabay/CC0 Public Domain

Researchers from Bocconi University, Singapore Management University, and INSEAD published a new article in the *Journal of*

Marketing that shows that disclosure of advertising spending significantly lowers investor and analyst uncertainty and allows them to better understand how a firm is achieving its financial performance.

The study is authored by Sungkyun Moon, Kapil R. Tuli, and Anirban Mukherjee.

Apple Inc. increased its advertising spending from $933 million to $1.8 billion in the period from 2011 to 2015, but in 2016 the company stopped disclosing details of this spending to investors. Analysts and investors bemoaned this decision since information about advertising spending allows them to better understand how a firm is achieving its financial performance.

Apple is one of several publicly listed firms that does not disclose advertising spending. Other prominent examples include Campbell Soup Company that did not disclose advertising spending for 1997-2009 and Eli Lilly and Company that did not disclose its advertising spending until 2018.

Current Securities and Exchange Commission (SEC) regulations allow firms the discretion to disclose (or not) advertising spending—even though both the SEC and Financial Accounting Standards Board (FASB) mandate that firms provide disclosures that lower investor uncertainty about the future financial performance of the firm due to idiosyncratic risk. The term idiosyncratic risk reflects investor uncertainty about future cash flows due to firm-specific factors and not due to stock market returns and systematic risk factors.

Moon says that "disclosure of advertising spending is useful for investors and analysts because it gives a more complete picture of advertising expenses incurred by the firm even if estimates of this metric are available from data providers."

The research team's analysis of 2,285 publicly listed firms over 25 years shows that disclosure of advertising spending lowers idiosyncratic risk by about 7%. It also finds that the negative effect of advertising spending disclosure on idiosyncratic risk is partially mediated by its effect on lowering the uncertainty about the firm's future financial performance among financial analysts.

"We also find that firms' financial structure, overall disclosure quality, and competitive intensity moderate the negative effect of disclosure of advertising spending on analyst uncertainty," adds Tuli.

The negative effects of disclosure of advertising spending on analyst uncertainty are 41% greater for firms with high (vs. low) liquidity and 34% greater for firms in more (vs. less) competitive industries. Additionally, the negative effects of disclosure of advertising spending are 28% greater for firms with low (vs. high) disclosure quality and 20% greater for firms with low (vs. high) leverage.

The impact of disclosure of advertising spending on idiosyncratic risk and analyst uncertainty supports recent calls by researchers for greater disclosure of this metric. A potential concern is that disclosure can reveal proprietary information and have an adverse effect on firm valuation.

The study's additional analyses, however, find no support for this argument. Results show that the disclosure of advertising spending enhances firm valuation for firms across industries such as manufacturing and business services, hi-tech, and healthcare. Given the increasing relevance of communications with investors and analysts, these findings are of direct relevance for Chief Marketing Officers who face increasing calls to play a more prominent role in investor relations.

"Our findings support calls by the Marketing Accountability Standards

Board for more disclosures of marketing actions of publicly listed firms," claims Mukherjee.

From a regulatory perspective, this study suggests that there is strong merit for the Securities and Exchange Commission and the Financial Accounting Standards Board to reconsider current regulations that allow publicly listed firms the discretion to disclose (or not) their advertising spending.

More information: Sungkyun Moon et al, EXPRESS: Does Disclosure of Advertising Spending Help Investors and Analysts?, *Journal of Marketing* (2022). DOI: 10.1177/00222429221123013

Provided by American Marketing Association