Institute for Market-Oriented Management
Competence in Research & Management
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IMU Research Insights
012

The Impact of Marketing and HR on Firm Value

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Executive Summary

Research Insights

Relevance of Topic

- Most B2C companies state that their brands and their employees are their most important assets.
- However, research on their joint impact is scarce.
- Similarly, prior research neglects whether their performance implications differ between manufacturing and services industries.

Sample, Investigated Industries & Method

- Sample: Longitudinal data on approx. 200 companies publicly traded at the US stock exchange for 2002-2009.
- Industries: B2C-markets (fast-moving consumer goods, consumer durables, retail, and services)
- Method: Descriptive statistical analyses and regression models using STATA

Key Contributions

- Based on objective longitudinal data, this study demonstrates the complementary impact of a firm‘s two most important assets (i.e., brands and employees) on financial performance (Tobin‘s q, cash flow, cash flow volatility).
- In addition, we observe that brands and employees are relatively more valuable in a service setting.

Key Implications

- *Balancing investments:* Due to their complementary relationship, brands and employees unfold their full potential in conjunction. Therefore, firms should balance their asset-building efforts.
- *Cross-departmental coordination:* Investment decisions on brands and employees usually occur in different departments (marketing vs. HR); exploiting their benefits, however, requires cross-departmental coordination.
- *Nurturing intangibles in service industries:*
    - Service companies can use brands to make their offering more tangible.
    - For manufacturing companies that extend their portfolio to the inclusion of services (service transition strategies), nurturing brands and employees is of central importance.

Agenda

- Topic Relevance and Key Questions
- Study Characteristics
- Study Results
- Managerial Implications
- Contact and Further Information

Topic Relevance an Key Questions

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"The statement that "our brand is our most valuable asset" appears almost as frequently as the statement "our people are our most valuable asset."
But they cannot both be right, surely?"

Jonathan Knowles

Founder and CEO of Type 2 Consulting

- The widely accepted principle of firm value maximization pressures every functional area within a company to demonstrate the value relevance of their investments.
- However, since marketing and HR build long-term intangibles assets, their spendings are not immediately reflected in quarterly earning statements.
- Unfortunately, marketing and HR traditionally did not focus on financial outcomes but on non-monetary outcomes such as customer satisfaction and market share. However, to avoid a gradual loss of importance in the company, marketing and HR need to quantify their value impact and need to be able to communicate their contribution in financial language (e.g., cash flows).
- Furthermore, for optimal budget allocation, managers need to know which interdependencies between important intangible assets exist.

Topic Relevance an Key Questions

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In order to demonstrate the contribution of marketing and HR to value-added, our study examines the influence of a companies' two most important intangible assets: brands and employees.

Key Question 1: What is the joint contribution of brands and employees?
Do they…

a) …exhibit a **complementary** relationship (positive interaction)-that is, the value of one asset is leveraged in the presence of the other?
→ In the case of a complementary relationship the **joint effect** of brands and employees is **greater** than the sum of their individual effects.

b) …represent **independent** assets (no interaction)-that is, the contribution of one asset does not depend on investment in the other asset?
→ In the case of independence the **joint effect** of brands and employees **equals** the sum of their individual effects.

c) …exhibit a **substitutive** relationship (negative interaction)-that is, investment in one asset decrease the returns to the other resource?
→ In the case of a substitutive relationship the **joint effect** of brands and employees is **smaller** than the sum of their individual effects.

Key Question 2: Does the value of brands and employees depend on the type of industry (manufacturing vs. services)?

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Study Characteristics

Our recommendations are based on a broad sample of approx. 200 publicly-traded firms from all major business-to-consumer industries. They are generalizable across industries.

Study Design

Method

- We draw on multiple archival data sources to capture firm and industry level data:
  - **Firm level data**:
    - Financial performance : Tobin's q, cash flow, and cash flow volatility
    - Intangible assets: Employees' human capital and brand strength
    - Controls: ROA, market share, capital intensity, and firm size
  - **Industry level data**:
    - Industry characteristic: Industry concentration
    - Industry: Fast-moving consumer goods, consumer durables, retail, and services

Sample

- Cross-industry study
- Sample: In total, n_1 = 174 firms for Tobin's q and n_2 = 211 firms for cash flow and cash flow volatility
- Time span: 2002-2009

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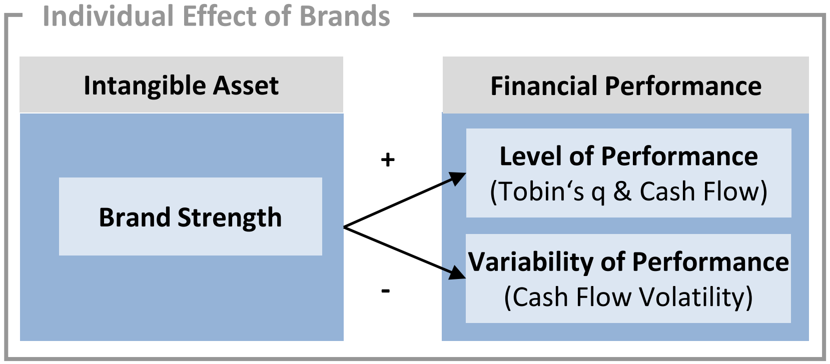
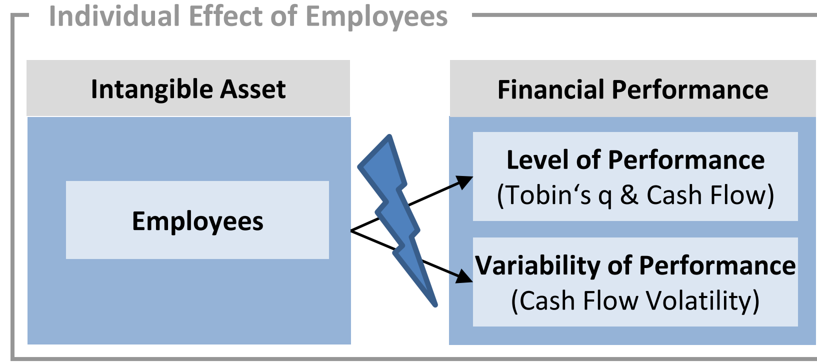
Study Results Key Question 1

Brands and employees exhibit a complementary relationship





On an individual basis, we observe…

- …a ***positive* influence** of brands on the level of performance and
- …a ***negative* influence** of brands on the variability of performance

On an individual basis, we observe…

- …***no* influence** of employees on the level of performance and
- …***no* influence** of employees on the variability of performance

Two reasons explain why **skilled employees do not automatically lead to higher financial performance**:

1. The mere presence of skilled employees is not sufficient to increase performance. It is important that employees are **motivated to use** their skills in accordance with the company's goals.
2. Company performance is the outcome of a two stage process of **rent generation** followed by **rent appropriation**. Skilled employees lead to higher rents (rent generation), but can use their bargain power to negotiate higher wages (rent appropriation). From a company perspective, the positive effect of skilled employees on financial performance diminishes owing to higher labor costs .

Study Results Key Question 1
Brands and employees exhibit a complementary relationship

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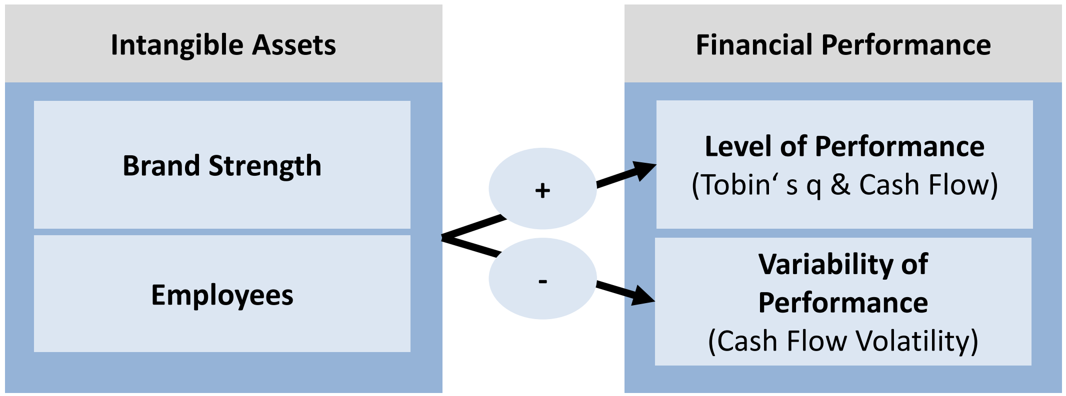
Joint Effect of Brands and Employees



- The joint effect of brands and employees is **greater than the sum of the individual effects** (complementary relationship).
- **Jointly**, they exert the **strongest impact** on the level of performance (higher Tobin's q and higher cash flows) and on the variability of performance (less cash flow volatility).

Besides their positive effects on customers, **strong brands exert a positive effect on employees**:

1. Strong brands may **foster employees' identification** with the company which **motivates** them deploy their skills in the service of the company's goals.
2. Employees who strongly identify with the company are **willing to accept lower wages**. From a company perspective, this leads to beneficial rent appropriation owing to lower labor costs.

Study Results Key Question 2

Brands and employees matter most in a service setting

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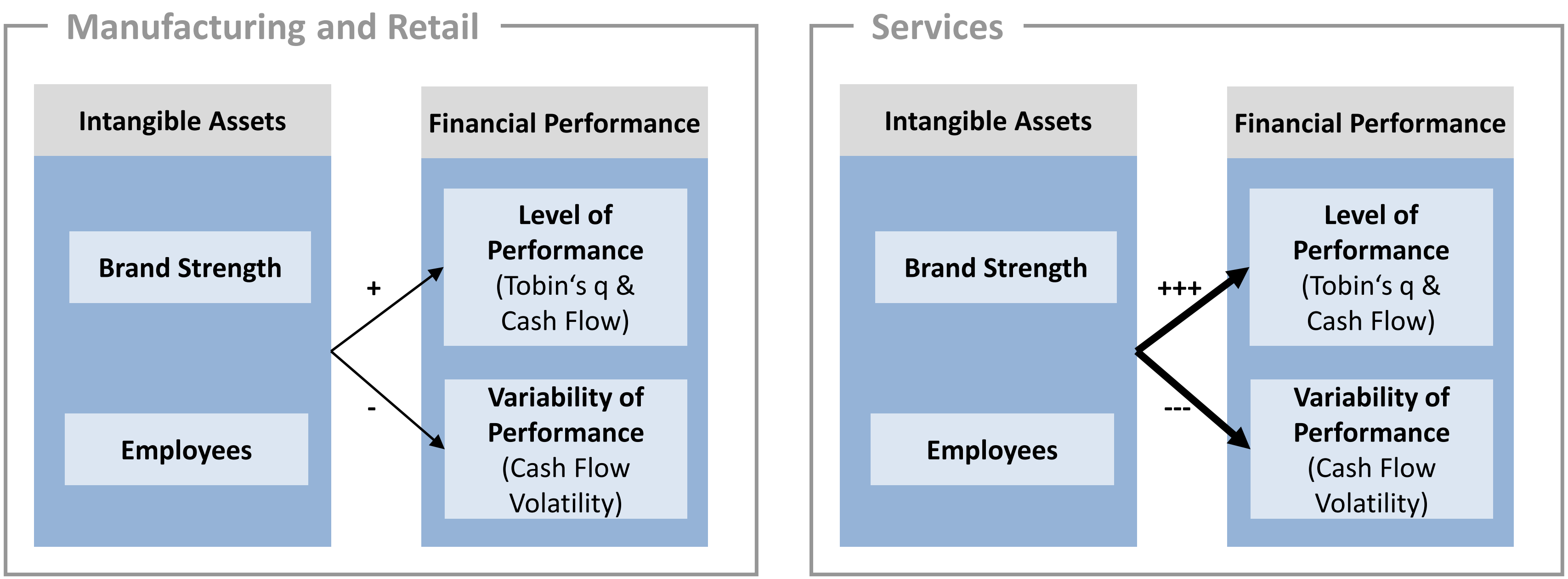

Implication

As compared to manufacturing (FMCG and consumer durables) and retail, brands and employees are more valuable in a service setting. Individually, they lead to higher performance (higher Tobin’s q and higher cash flows) and less variability of performance (less cash flow volatility).

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Managerial Implications

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1. You should be able to quantify the value relevance of your investments. The results of our study indicate that a one-unit increase in brand strength leads to additional $610 million in a company's market value.
2. You should balance your asset-building efforts, since brands and employees unfold their full potential in conjunction.
3. Synchronize the marketing and HR department to ensure maximal return to your investments.
4. Recognize that the value creating potential of brands is not restricted to manufacturing industries, but is even more pronounced in service industries.
5. Nurture intangibles when competing in service industries.

Contact and Further Information: Institute for Market-Oriented Management at the University of Mannheim

The **Institute for Market-Oriented Management** (**IMU**) at the University of Mannheim (Germany) considers itself to be a forum for dialogue between scientific theory and practice. The high scientific and academic standard is guaranteed by the close networking of the IMU with the two Chairs of Marketing at the University of Mannheim, which are highly renowned on a national and international level. The Academic Directors of the IMU are Prof. Dr. Dr. h.c. mult. Christian Homburg and Prof. Dr. Sabine Kuester.

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