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Glamour brands and glamour stocks☆

Matthew T. Billett[a,1], Zhan Jiang[b,*], Lopo L. Rego[a,2]

[a] Kelley School of Business, Indiana University, 1309 E 10th Street, Bloomington, IN 47405-1701, USA
[b] Shanghai Advanced Institute of Finance, Shanghai Jiaotong University, 211 West Huaihai Road, Datong Plaza, Shanghai 200030, China

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ABSTRACT

We explore the influence of customer perceptions from the product market on firms' return characteristics in the stock market. Using customers' opinions on over 1200 brands, we find that stocks of companies with prestigious brands have high market-to-book ratios and large negative loadings on the Fama-French HML factor. This relation is not explained by distress risk, asset irreversibility/growth, or information asymmetry. The HML loadings are most pronounced when retail investor ownership is high (when institutional ownership is low), when the brand is less familiar, and when market-wide investor sentiment is high. We conclude glamour in the product market is an important component of glamour in the stock market.

Numerous studies suggest that customer relationships in the product market influence investment decisions in financial markets. Grullon et al. (2004) find the breadth of ownership, in terms of the number of institutional and retail investors, increases in firm advertising expense. Frieder and Subrahmanyam (2005) find that firms with more familiar brands have greater retail investor bases. Keloharju et al. (2012) explore the stock holdings of retail investors and find that individuals invest a disproportionate amount of their portfolio in stocks where they have a significant product market relationship. Moreover, they find this product market bias does not reflect any information advantage and conclude that retail investors derive utility from such ownership "...just as a fan of a sports team could derive direct utility from her investment in the team." While these links establish that a firm's products influences its ownership structure, little evidence exists on how this ultimately influences firm value and stock returns.

Taking brand equity metrics from the marketing literature, we examine how customer perceptions of companies' brands associates with equity valuation and stock return characteristics. We measure customer perception using a brand equity

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* Corresponding author. Tel.: +86 21 6293 2079.
E-mail addresses: mbillett@indiana.edu (M.T. Billett), zjiang@saif.sjtu.edu.cn (Z. Jiang), lrego@indiana.edu (L.L. Rego).
[1] Tel.: +1 812 855 3366.
[2] Tel.: +1 812 855 1202.

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database containing information gathered annually from over 20,000 customers, and we label our primary measure *Prestige*. The marketing literature demonstrates that *Prestige* captures how attached and emotionally connected customers are to the brands.[1] While we empirically explore rational information based and risk channels, our primary focus is on discerning whether potential mispricing channels may link the product markets and financial markets.[2]

We begin by examining the relation between *Prestige* of the firms' brands and their financial characteristics. We find a strong positive relation between market-to-book and *Prestige*, consistent with findings in the marketing literature that stronger brands associate with greater firm value (Gruca and Rego, 2005). We further decompose firm value into fundamental value and a misvaluation measure proposed by Rhodes-Kropf et al. (2005). We find *Prestige* is significantly positively correlated to this measure of misvaluation, suggesting the influence of *Prestige* may not only influence fundamental value, but may also relate to potential misvaluation.

We next explore whether stock return characteristics relate to *Prestige*. Lakonishok et al. (1994) argue "glamour" stocks have overly enthusiastic investors which leads to overvalued stocks. They suggest the value premium, measured by the loading on the HML factor, reflects this mispricing rather than a fundamental risk. Similarly, Daniel et al. (2005) suggest overvaluation caused by investor overconfidence can result in a low loading on the HML factor.[3] Using this notion we ask whether glamour brands (high *Prestige*) contribute to glamour stocks. To test this we form portfolios stratified by whether customer perceptions place the firm's brands in the top, middle, or bottom third in *Prestige*. We find this is indeed the case. Namely, the portfolio of low *Prestige* firms has a positive and significant loading on the HML factor (0.263), while the loading on high *Prestige* brand firms is a significantly negative −0.370.

However, as pointed out by Daniel et al. (2005), misvaluation as well as priced risk give rise to HML loadings. In attempts to distinguish the risk and mispricing channels we conduct additional tests using commonly accepted risk interpretations of HML loadings. For example, Chen and Zhang (1998) suggest the HML factor may capture distress risk, and Zhang (2005) and Cooper (2006) argue the degree to which a firm has growth opportunities versus assets in place may be an important risk factor that explains the value premium. In this case the difference in HML loadings between high *Prestige* and low *Prestige* portfolios could just capture underlying risks associated with *Prestige*. To see if this is the case we use double sorts where we first sort on distress risk (asset growth) and then on *Prestige*. We continue to find significant HML loading differences across *Prestige* terciles after controlling for distress risk (asset growth).

We ask whether *Prestige* relates to HML simply as a proxy for financial characteristics known to associate with HML loadings. In the spirit of Lemmon and Portniaguina (2006), we orthogonalize *Prestige* to firm financial characteristics including market-to-book, firm size, profitability, asset growth, analyst coverage and other controls. We then re-sort the firms and form portfolios based on the residuals from this regression. Portfolios based on high *residual Prestige* continue to have significantly negative HML loadings while low *residual Prestige* firms have positive loadings.

Our third set of tests exploits the idea that mispricing should attenuate as information costs and arbitrage costs decline. Theoretically, mispricing is caused by misguided investors who overestimate the precision of their private information, and therefore hold incorrect beliefs about the fundamental value of an asset. We hypothesize that less information asymmetry should reduce the incorrect belief and reduce the impact of sentiment on overvaluation. In simple terms, if customer familiarity increases investor awareness and information, then we expect *Prestige* effects due to misvaluation to diminish as the brands familiarity increases. Our test supports this prediction. We first sort firms into portfolios based on *Familiarity* (a measure from our customer database) and then on *Prestige*, and we find that the influence of *Prestige* on HML loadings is pronounced in the unfamiliar brands and diminishes as brands become more familiar. Moreover, *Prestige* has no effect on HML loadings for the most familiar brands.

We conjecture that if the effect of *Prestige* on HML reflects mispricing, then this effect will be pronounced when overall market-wide sentiment is high. In other words, when market-wide investor sentiment is high we would expect to see the product-market channel fueling sentiment for particular stocks. Using the market-wide sentiment index of Baker and Wurgler (2006), we find that the loading on HML for the high-*Prestige* low-*Familiarity* is only significantly negative during periods where market-wide sentiment is high. This suggests that, while brand *Prestige* may be relatively stable, its' influence is confined to periods of high overall market sentiment.

Our last set of HML based tests examine whether the HML factor loadings vary with institutional ownership. Presumably, institutional investors should be less affected by *Prestige* than retail investors if it is indeed indicative of misvaluation. In this case we would expect to see the relation between *Prestige* and HML loadings to dissipate as institutional ownership increases. This is precisely what we find. Forming portfolios on double sorts where we sort firms into high, medium and low institutional holdings and then by *Prestige* we find that the HML loading for the high *Prestige* portfolio is −0.754 for the low

[1] We measure brand perceptions using a unique dataset, EquiTrend©. The marketing literature shows brands can create unique images and memory associations in the eyes and minds of customers. Moreover, brands can create emotional ties between customers and products (Berthon et al., 1999; Chaudhuri and Holbrook, 2001; Keller, 2003). This dimension is captured by our *prestige* measure. We also discuss results using consumer awareness, labelled *Familiarity*. It is important to note that *Prestige* does not equate to luxury or other price point definitions of goods. The Marketing literature also refers to this brand dimension (*Prestige*) as brand identity or brand emotional connection (Keller, 1993).

[2] We also document that a firm's systematic risk (Beta) decreases in *Familiarity* as well as *prestige*, consistent with Rego et al. (2009). This relation is consistent with the notion that brand equity lowers firm risk by delivering more stable and less volatile profits.

[3] They point out that overvaluation as well as priced risk factors can lead to significant HML loadings. This suggests that HML loadings alone cannot distinguish between misevaluation and risk. We conduct additional tests below in attempts to distinguish these two sources of HML loadings.

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