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Full Length Article

The financial brand value chain: How brand investments contribute to the financial health of firms

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ABSTRACT

Marketing and finance executives follow different objectives and focus on different stakeholder groups. Marketers want to create sales impact. Finance executives are concerned about the financial health of the firm. As a result, both worlds tend to be rather disconnected in their daily business. We argue that this does not reflect the dynamics of the firm where important marketing and financial metrics in fact interact. As long as marketing and finance officers do not fully appreciate the interplay of their key metrics, their decisions are likely to be suboptimal.
This article proposes a simultaneous equation model that reflects the interaction of marketing and finance-domain variables in the value creation process. We focus on brand-building activities and the attraction of capital as major tasks of marketing and finance officers. Our model shows how advertising and other investments increase customer-based brand equity (CBBE) that in turn impacts financial leverage and credit spread and ultimately elevates the level of financial resources.
Based on a broad sample of 155 firms covering various B2C industries, we test for the empirical relevance of our model. We also assess the practical significance of our results by transforming them into elasticities. Our results suggest that marketing and finance executives need to consider the dynamic interaction of their decision and performance variables to fully evaluate the effects of their decisions on the firm's financial health.
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1. Introduction

Roberto Goizueta, the former CEO of The Coca Cola Company, once noted in an interview with *Financial World* (Badenhausen, 1997, 48): "[W]hat would happen if tomorrow we woke up and every single asset that Coke has was wiped out. I could walk into any bank and borrow the money to restart operations, just based on the strength of the Coke brand name." This quote suggests that the brand can be a strong signal for the creditworthiness of a firm and thus facilitate access to fresh capital. Attracting capital, be it from equity or debt investors, however, is a typical task of a finance manager but not on the radar of marketing managers.

Indeed, at the surface, there is not much connection between the fields of activity of marketing and finance departments. Marketers focus on customers, products, and distributors. The primary objective of their decisions is to maximize sales impact. Since the immediate impact on sales is often hard to measure important intermediate performance variables have been

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established. Mindset metrics such as advertising awareness or customer-based brand equity are such variables and often used as key performance indicators (KPI) in the marketing department (e.g., Hanssens, Pauwels, Srinivasan, Vanhuele, & Yildirim, 2014).

Finance officers focus on investors, creditors, and financial analysts. Without doubt, they also value sales growth. But they are primarily concerned about the financial health of the firm and need to guarantee there is sufficient capital available to finance the business. The capital structure or financial leverage, respectively, is a key decision variable. It measures the amount of debt over equity. The creditworthiness is an important intermediate performance variable that is reflected in the credit rating or cost of debt, respectively. Ultimately, the finance department strives for a sustainable, high level of financial resources including both fresh capital from the outside and internally generated cash flow. Financial resources are crucial for at least two reasons. They protect the firm against becoming insolvent, and they help in lowering capital constraints to enable firm growth. Lowering the idiosyncratic capital constraint is highly value-relevant as it allows the firm to undertake profitable investments that it would otherwise have to bypass (e.g., Cheng, Ioannou, & Serafeim, 2014; Hennessy & Whited, 2007).

Since marketing and finance departments focus on different decision variables and objectives, their monitoring and controlling systems are also very different. This results into two systems of marketing and finance KPIs that are managed separately from each other. But if marketing and finance managers are not aware of the potential interconnections between their objectives and KPIs, they are likely to arrive at suboptimal decisions. For example, finance is swift to cut back brand expenditures for bypassing a tight liquidity position. But this behavior may backfire in the near future as it reduces the potential of the firm to raise capital and generate cash flows to fight the next, maybe even tougher cash situation.

Given that both marketing and finance share the common goal to grow the value of the firm, we argue that marketing and finance objectives and KPIs are closely connected. Prior research produced ample evidence that marketing indeed contributes to firm value (e.g., Edeling & Fischer, in press; Srinivasan & Hanssens, 2009). The vast majority of these studies directly model the relation between a marketing variable and a shareholder metric. While the results from these studies are important to establish the value relevance of marketing, their informative value is also limited for management. Firms do not manage stock returns but marketing assets such as brands and the activities and expenditures that contribute to build this asset. Especially, a firm's idiosyncratic capital constraints determine how much a firm is able to invest into its marketing activities. Hence, we need a deeper understanding of the relationships between marketing and financing as well as investment activities. Our study contributes to filling this gap. We focus on brand-building activities and their contribution to the financial health of the firm. Our study attempts to provide the following contributions:

First, we propose a dynamic simultaneous equation system, which shows how advertising and other investments increase customer-based brand equity (CBBE) that in turn impacts financial leverage and credit spread and ultimately elevates the level of financial resources. The model includes a feedback loop from financial resources to our focal marketing variables advertising spend and CBBE since higher financial resources should permit larger marketing investments in future periods. We minimize the danger of inconsistent and biased estimates by treating the focal constructs as endogenous variables in a simultaneous equation system with instrumental variables.

A second contribution is that we investigate underresearched variables such as financial leverage and financial resources that include external financing sources. We develop hypotheses that explain why CBBE drives these finance-domain variables.

Third, we provide empirical evidence for our model and hypotheses with annual data that cover 155 companies across diverse B2C industries over the period 2005–2012. We use Harris EquiTrend data for measuring CBBE. This sample enables us to derive generalizable results, which is important to demonstrate that the proposed model does not only apply to selected industries or firms. We also transform the estimated coefficients into elasticity estimates, which help to assess the practical relevance of the effects. Thus, this study is among the first to compute elasticities for the effects of advertising and brand equity on financial performance variables (i.e., cost of debt, financial leverage, and financial resources).

Our results are valuable to both marketing scholars and marketing/finance practitioners. We extend marketing–finance theory building by explicitly modeling and demonstrating the value generation processes at the firm level and via the exchange processes with the equity and debt capital markets. Finance and marketing executives benefit from an improved understanding of the role brands play for the financial health of the company above and beyond the well-known customer-level and product market effects. We show that investing in brands may have important indirect effects that help gain access to capital markets for raising new capital. Such a potential value of marketing has not been demonstrated so far and may change the decision making of marketing and finance executives.

We organize the article as follows. In the next section, we provide a brief overview of the literature on the impact of advertising and brand equity on financial and stock-market outcome measures. We then develop our conceptual framework of the dynamic equation system and derive hypotheses. Next, we describe the model followed by the data, measures, and estimation results. Finally, we conclude with a discussion of the study's contributions and implications, its limitations, and opportunities for future research.

2. Literature review

2.1. Research on advertising and brand effects on financial performance

Our study focuses on advertising and brand equity and their importance for the cost of debt, the firm's capital structure, and the generation of financial resources. Table 1 gives an overview of prior empirical research that has examined the impact of

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