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How does marketing capability impact abnormal stock returns? The mediating role of growth

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ABSTRACT

Building on the frameworks of the resource-based view and value relevance, this study contributes to how the firms' marketing capabilities affect firm performance. More specifically, this research examines growth as a potential mechanism to explain how marketing capabilities impact stock returns. This study estimates empirical models using a merged data set comprising firms' marketing and financial information. Results indicate that asset growth mediates the relationship between marketing capability and abnormal stock returns. Marketing capabilities in general and marketing capabilities of retail firms specifically show direct significant effects on abnormal stock returns. This study contributes to resource-based view theory in marketing by demonstrating that it is not only the intangible characteristic of marketing capabilities, but also the growth potential that marketing capabilities exhibit that help explain higher stock returns. This study points to the need to account for mechanisms and mediating variables when building theoretical frameworks of the impact of marketing capabilities on firm performance.

1. Introduction

The questions of how firms deploy resources to serve customers better, how to more fully understand the effect and value of firms' marketing actions and how marketing capabilities affect firms' performance in the long run are key areas of concern for marketing academics and practitioners (e.g., Dutta, Narasimhan, & Rajiv, 1999; Marketing Science Institute, 2016). This interest could be even higher for retailing firms because, as Moore and Fairhurst (2003) recognize “as retail competition in consumer markets around the world continues to intensify, marketers are seeking strategies that will capture both the interest and loyalty of consumers” (p. 386). Surprisingly, given recent managerial and academic interest in marketing accountability (Marketing Science Institute, 2014), the role of *how* marketing capabilities generate higher stock returns remains largely unanswered (e.g., Orr, Bush, & Vorhies, 2011; Vorhies, Orr, & Bush, 2011). This article examines whether growth is a significant mechanism to explain the impact of marketing capabilities on retailing and non-retailing firms' stock returns (Fama & French, 1992; Lintner, 1965; Sharpe, 1964).

A key aspect of the impact of marketing capabilities is how stock markets seize marketing capability information—that is, how future earnings integrate marketing capability information. Research recognizes that growth prospects are critical information that stock markets value (Collins & Kothari, 1989; Rappaport, 1998). In the context of this study, business environment in the retailing industry is constantly changing, so firms must succeed in building and using capabilities that support marketing strategies that lead to growth and/or long-term survival (Moore & Fairhurst, 2003). In this line, this study argues that marketing capabilities provide firms' growth prospect information that enable firms to generate higher stock returns. This study uses financial models, in particular, the Fama–French (FF) model to estimate a measure of abnormal stock returns or stock returns adjusted by risk-free rate, market risk, stock size, and book-to-market ratios (Fama & French, 1993). This issue is important and timely for practitioners and researchers who are attempting to understand how marketing capabilities affect long-term financial performance (e.g., Agic, Činjarević, Kurtovic, & Cicic, 2016; Frösén & Tikkanen, 2016; Jaakkola et al., 2016).

In sum, the purpose of this paper is to study *how* marketing capabilities influence abnormal stock returns and we argue that growth is a potential mediator that connects marketing capabilities (independent variable) with firms' stock returns (dependent variable).

This research provides the following contributions. First, by studying the mechanisms that explain the impact of firms' marketing

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capabilities on firms' stock returns this research contributes to contemporary debates on resource-based view (RBV) theory. RBV research in marketing has added significantly to our understanding of the performance-enhancing role of marketing capabilities (e.g., Fang, Chang, Ou, & Chou, 2014; Morgan, Slotegraaf, & Vorhies, 2009; Nasution & Mavondo, 2008; Orr et al., 2011; Vorhies, Harker, & Rao, 1999) and extant research examines the *direct* effect of marketing capabilities on firm's performance arguing that the intangibility and complementarity of marketing capabilities explain the generation of sustained competitive advantage and therefore impact higher performance (Kozlenkova, Samaha, & Palmatier, 2014; Srivastava, Fahey, & Christensen, 2001). Building on extant research, this study contributes to RBV demonstrating that it is not only the intangibility of marketing capabilities, but also the growth potential marketing capabilities exhibit that help explain higher stock returns.

Second, this study recognizes the importance of integrating different resources when defining and measuring capabilities from a productivity or efficiency perspective. Using an input-output approach, Luo and Donthu (2006) study the impact of marketing capability—from a communication productivity perspective—on stock returns measured through market value of equity. Luo and Donthu (2006) employ a Malmquist productivity index to model marketing communication productivity. They use advertising expenditures and sales promotions as input measures, and sales level, sales growth, and corporate reputation as output measures. This study builds on Luo and Donthu's study and defines marketing capability from an input-output approach. However, in contrast to Luo and Donthu's (2006) research that do not include the role of competition and the industry in their modeling, this study models marketing capability using bootstrap data envelopment analysis (DEA) and build frontiers of companies competing in each two-digit standard industry classification under analysis. Modi and Mishra (2011), on the other hand, assess the relative influence of marketing capability—from an efficiency perspective—on stock returns measured by the Fama–French model. Modi and Mishra (2011) employ the ratio of sales to selling, general, and administrative expenses of a firm compared to other firms in its industry. In contrast, this study disentangles selling, general, and administrative expenses by using advertising and promotion marketing expenditures as input measures in the modeling. Rather than using only sales as an output measure in the model (Modi & Mishra, 2011), this study also includes sales growth and customer satisfaction as output measures. Therefore, this research adds to the current literature not only by integrating advertising, promotion and customer satisfaction but also by including the role of the industry and competitors when defining and measuring capabilities. Accordingly, this study is relevant for researchers and practitioners interested in answering the question of how to make an efficient use of resources to build capabilities, considering the role of industry competitors.

Finally, comparing the effect of marketing capabilities in retailing and non-retailing firms constitutes another contribution. Over the last 40 years a great deal of attention has been paid to the general concept and practice of marketing strategy. Unfortunately, as Moore and Fairhurst (2003) recognize, few researchers have focused on understanding the unique challenges that marketers face in developing and implementing strategy in dynamic retail markets.

In the next section, this study develops a conceptual framework and research hypothesis of how marketing capability affects stock returns. Next, this study elaborates models to measure stock returns and marketing capability and to capture the effect of marketing capability on performance. This study estimates empirical models using a merged data set comprising firms' marketing and financial information from *Advertising Age*, the American Customer Satisfaction Index (ACSI), COMPUSTAT, and the Center for Research in Security Prices (CRSP). This study applies the three-factor FF model to measure stock returns, DEA with bootstrap to estimate marketing capability, and panel data methods to estimate the effect of marketing capability on stock returns. This study also performs a robustness check of the findings. Finally, authors discuss implications for managers, researchers, and marketing theory.

2. Conceptual framework: the impact of marketing capability on stock returns

Both resource-based view and dynamic capability theories propose that capabilities enable firms to outperform competitors over time, which in turn lead to superior firms' financial performance (Barney, 1991; Day, 1994; Teece, Pisano, & Shuen, 1997; Winter, 2000). A capability is a combination of resources and is embedded in the organization and its processes (Makadok, 2001; Teece et al., 1997; Teece, 2007). Amit and Schoemaker (1993), Helfat and Peteraf (2003), and Zollo and Winter (2002) assert that a capability reflects the organization's ability to perform a coordinated set of tasks (with its organizational resources) to achieve a particular end result. In marketing, researchers have defined marketing capability as a way to sense markets and relate with customers (Day, 1994), to exhibit “superiority in identifying customers' needs and in understanding the factors that influence consumer choice behavior” (Dutta et al., 1999, p. 550), to understand and forecast customer needs better than competitors and to effectively link offerings to customers (Krasnikov & Jayachandran, 2008), “to transform resources into valuable outputs based on the classic marketing mix” (Vorhies and Morgan, 2005, p. 82), and "the process of combining marketing resources by leveraging relational and intellectual assets to satisfy customers and attain brand equity" (Angulo-Ruiz, Donthu, Prior, & Rialp, 2014, p.383).

Considering the tenets of resource-based view and dynamic capability theories (Teece, 2007) as well as research in marketing and input-output approaches, this study defines “marketing capability” as a firm's combination of marketing resources to generate sales and satisfy customers (Day, 1994; Keller & Lehmann, 2003; Rust, Ambler, Carpenter, Kumar, & Srivastava, 2004; Srivastava et al., 2001; Vorhies & Morgan, 2005; Winter, 2000). In this study, marketing resources refer to marketing actions that require marketing expenditure so that firms can deploy, allocate, and combine expenditures (Dutta, Narasimhan, & Rajiv, 2005; Narasimhan, Rajiv, & Dutta, 2006; Rust et al., 2004). Sales generation represents the customer response to a product or service. Customer satisfaction is the “overall evaluation of [the] whole purchase and consumption experience with a good or service” (Fornell, 1992, p. 11). Our view of marketing capability is similar to the notion of accumulation of asset stocks proposed by Dierickx and Cool (1989) that is “strategic asset stocks are accumulated by choosing appropriate time paths of flows over a period of time” (p. 1506). By making appropriate choices about strategic marketing expenditures, firms can accumulate stocks of positive customer responses to products or services and firms can also accumulate stocks of customer satisfaction. Implicitly, the fact that firms need to make appropriate choices about marketing expenditures to build strategic asset stocks creates a relevant market for marketing expenditures which is in line with the notion of strategic factor markets. Barney (1986) defines a strategic factor market as “a market where the resources necessary to implement a strategy are acquired” (p. 1231). One of the marketing expenditure choices firms need to do involves advertising and promotion. Firms need to buy—from advertising and promotion markets—advertising media (TV, radio, outdoor, internet, print, etc.), product placements in movies, television shows, videos, or commercials with other products, and participation in special events among others. In this sense, different authors (Dabholkar, Thorpe, & Rentz, 1996; Moore & Fairhurst, 2003; Sharma, Levy, & Kumar, 2000; Wileman & Jary, 1997) recognize that promotional capability, defined as the degree to which retailers are effective in differentiating through advertising and promotions, has been acknowledged as important to success in retailing. By acquiring appropriate resources from the advertising and promotion markets over time, firms can build stocks of positive customer responses to products or services as well as customer

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