

Market-Based Assets and Shareholder Value: A Framework for Analysis

The authors develop a conceptual framework of the marketing-finance interface and discuss its implications for the theory and practice of marketing. The framework proposes that marketing is concerned with the task of developing and managing market-based assets, or assets that arise from the commingling of the firm with entities in its external environment. Examples of market-based assets include customer relationships, channel relationships, and partner relationships. Market-based assets, in turn, increase shareholder value by accelerating and enhancing cash flows, lowering the volatility and vulnerability of cash flows, and increasing the residual value of cash flows.

Too often marketing tends to focus on sales growth and market share, and it fails to recognize the impact of marketing decisions on such variables as inventory levels, working capital needs, financing costs, debt-to-equity ratios, and stock prices. To assume such factors are *purely* the responsibility of finance is to be guilty of a kind of marketing myopia not less damaging than that originally envisioned by Levitt (1960).

—Paul Anderson, "The Marketing Management/
Finance Interface"

There is a quiet revolution in the positive way that marketing activities are being viewed by some marketing professionals, enlightened senior managers, and innovative managers in other functions, particularly finance. Old inviolable assumptions about the purpose, content, and execution of marketing slowly are giving way to assumptions that more accurately reflect how it is practiced in leading organizations. In this article, we identify the new assumptions pertaining to the marketing-finance interface and discuss their consequences for the theory and practice of marketing.

Although they often are unstated, assumptions underlie, shape, and constrain both theory and practice (Hunt 1983; Senge 1990). Therefore, it is imperative that marketers continually identify and articulate changes in the underlying assumptions regarding the field of marketing. In particular, as the movement to adopt shareholder value-based measures of firm performance continues, marketing's traditional assumptions must be extended to address the marketing-finance interface. These new assumptions about the relationship between marketing and finance do not replace the traditional assumptions; rather, they add to and incorporate them. Marketing's traditional assumptions and the addi-

tional assumptions regarding the marketing-finance interface are summarized in Table 1.

Traditionally, marketing activities focus on success in the product marketplace. Increasingly, however, top management requires that marketing view its ultimate purpose as contributing to the enhancement of shareholder returns (Day and Fahey 1988). This change has led to the recognition that the relationship between marketing and finance must be managed systematically; no longer can marketers afford to rely on the traditional assumption that positive product-market results will translate automatically into the best financial results. As a result, marketers are adopting the perspective that customers and channels are not simply the objects of marketing's actions; they are assets that must be cultivated and leveraged (cf. Hunt and Morgan 1995). These assets can be conceptualized as *market-based assets*, or assets that arise from the commingling of the firm with entities in its external environment. Leveraging such assets requires marketers to go beyond the traditional inputs to marketing analysis, such as marketplace and organizational knowledge, and to include an understanding of the financial consequences of marketing decisions. Indeed, it also expands the external stakeholders of marketing to include explicitly the shareholders and potential shareholders of the firm and requires broader input into marketing decision making by other functional managers.

Another shift in the mind-set of marketers is occurring in the direction of expanding the set of measures of the success or failure of marketing activities. Marketers are moving beyond traditional financial measures—such as sales volume, market share, and gross margin—to include additional financial measures, such as the net present value of cash flows and hence shareholder value (Anderson 1979; Day and Fahey 1988; Pessemier and Root 1973). Indeed, it is interesting to note that as marketers are moving to assess the impact of marketing activities on shareholder value, accountants and finance professionals are broadening their thinking to include nonfinancial measures of firm performance as a means to develop a more "balanced scorecard" (cf. Kaplan and Norton 1992, 1993).

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TABLE 1
Assumptions About the Marketing-Finance Interface

	Traditional Assumptions	Emerging Assumptions
Purpose of marketing	Create value for customers; win in the product marketplace	Create and manage market-based assets to deliver shareholder value
Relationship between marketing and finance	Positive product-market results translate into positive financial results	Marketing-finance interface must be managed systematically
Perspective on customers and channels	The object of marketing's actions	A relational asset that must be cultivated and leveraged
Input to marketing analysis	Understanding of the marketplace and organization	Financial consequences of marketing decisions
Conception of assets	Primarily specific to the organization	Result from the commingling of the organization and the environment
Marketing decision-making participants: internal	Principally marketing professionals; others if deemed necessary	All relevant managers irrespective of function or position
Marketing stakeholders: external	Customers, competitors, channels, regulators	Shareholders, potential investors
What is measured	Product-market results; assessments of customers, channels, and competitors	Financial results; configuration of market-based assets
Operational measures	Sales volume, market share, customer satisfaction, return on sales, assets, and equity	Net present value of cash flow; shareholder value

As the new marketing assumptions emerge, the question is not whether marketing activities are useful and valuable but why marketing has played such a limited role in the process of strategy formulation (cf. Anderson 1981, 1982; Day 1992; Webster 1981, 1992). In our view, an important reason is that the marketing community historically has found it difficult, if not nearly impossible, to identify, measure, and communicate to other disciplines and top management the financial value created by marketing activities. Almost a decade ago, Day and Fahey (1988, p. 45) highlighted the increasing importance of new measures of firm performance that are linked closely to shareholder value: "Managers of diversified companies are rapidly replacing their usual yardsticks of performance, such as market share, growth in sales, or return on investment, with approaches that judge market strategies by their abilities to enhance shareholder value."

Although Day and Fahey (1988) and Day (1992) hoped that increasing acceptance of shareholder value as a yardstick for judging market strategies would encourage a close integration of marketing and financial perspectives, this has happened only to a limited extent. Despite the growing importance of shareholder value creation as a criterion for evaluation of strategic initiatives, attention to the role of marketing strategies in the creation of shareholder value has been relatively sparse in the marketing literature. Among the notable exceptions are event studies that link "events," such as new product announcements, brand extension announce-

ments, celebrity endorsement announcements, and so on, to abnormal changes in the stock prices of firms (cf. Aaker and Jacobsen 1994; Agrawal and Kamakura 1995; Chaney, Devinney, and Winer 1991; Horsky and Swyngedouw 1987; Lane and Jacobsen 1995; Simon and Sullivan 1993).¹ At the same time, the finance literature has all but ignored the contribution of marketing activities to the creation of shareholder value. Consequently, financial appraisals of marketing strategy seldom involve trying to value long-term marketing strategies with uncertain outcomes (Barwise, Marsh, and Wensley 1989).

The purpose of this article is to develop a conceptual framework that makes explicit the contribution of marketing to shareholder value. To do so, we advance the notion of market-based assets as a principal bridge between marketing and shareholder value. Although internal processes, such as superior product development or customer intelligence, also can be leveraged to enhance shareholder value, our focus here is exclusively on external, market-based assets. As Constantin and Lusch (1994) point out, marketing activities

¹In addition, a substantial body of literature links marketing constructs, such as customer satisfaction, brand equity, and quality, to various accrual accounting measures of business performance, such as profits and return on investment (cf. Anderson, Fornell, and Lehmann 1994; Rust, Zatorik, and Keiningham 1995). However, these studies stop short of linking marketing variables to the creation of shareholder value.

are primarily external in their focus and are largely off the balance sheet.

The absence of a comprehensive conceptual framework that identifies and integrates the many linkages between marketing and finance has grave implications for the funding of marketing activities and the financial well-being of the firm. Aaker and Jacobsen (1994) note that assets that are harder to measure are more likely to be underfunded. In the absence of a strong understanding of the marketing-finance interface, marketing professionals cannot but have great difficulty in assessing the value of marketing activities. This, in turn, limits investment in marketing activities, which can restrict the ability of the firm to create shareholder value. Indeed, there is a growing recognition that a significant proportion of the market value of firms today lies in intangible, off-balance sheet assets, rather than in tangible book assets. "Market-to-book" ratios for the *Fortune* 500 are approximately 3.5, which suggests that more than 70% of the market value of the *Fortune* 500 lies in intangible assets (Capraro and Srivastava 1997). As Lusch and Harvey (1994, p. 101) note, "Organizational performance is increasingly tied to intangible assets such as corporate culture, customer relationships and brand equity. Yet controllers, who monitor and track firm performance, traditionally concentrate on tangible, balance-sheet assets such as cash, plants and equipment, and inventory." Furthermore, as Lusch and Harvey (1994) observe, little has been done in the past 20 years to project more accurately the "true" asset base of the corporation in the global marketplace. Thus, a failure to understand the contribution of marketing activities to shareholder value continues to diminish the role of marketing thought in corporate strategy.

We expect the framework developed in this article to advance both the conceptual understanding of the marketing-finance interface and the assessment and measurement of the value created by marketing activities. Following the example of Day and Fahey (1988), we discuss this framework partially in the language of finance, so that the communication of the value of marketing activities to other functions and top management is facilitated. To the best of our knowledge, this is the first attempt to develop a comprehensive framework of the impact of marketing activities on shareholder value.²

The rest of the article is organized as follows: We first define and describe what we mean by market-based assets. Next, in the context of discussing financial valuation approaches, we briefly discuss methods of asset valuation and identify the key drivers of shareholder value. Following this, we draw the linkages between market-based assets and the drivers of shareholder value and discuss how market-based assets can be leveraged to drive shareholder value. We conclude with a deliberation of the implications and potential applications of the framework.

²Our focus in the article is on marketing activities and not on the marketing department. This is consistent with the work on market orientation by Kohli and Jaworski (1990) and Narver and Slater (1990). As they do, we focus on marketing activities regardless of where in the organization they take place and who in the organization performs them.

Market-Based Assets

To define, categorize, and leverage market-based assets (Sharp 1995), it is essential first to clarify the meaning, importance, and principal characteristics of the base construct—assets. Although there is much debate in the management, marketing, finance, and economics literature as to what constitutes an asset or a resource (Mahoney and Pandian 1992), an *asset* can be defined broadly as any physical, organizational, or human attribute that enables the firm to generate and implement strategies that improve its efficiency and effectiveness in the marketplace (Barney 1991). Thus, assets can be tangible or intangible, on or off the balance sheet, and internal or external to the firm (cf. Constantin and Lusch 1994). However, regardless of the type of asset, the definition clearly emphasizes that the value of any asset ultimately is realized, directly or indirectly, in the external product marketplace.

But which assets contribute to winning strategies or real advantage in prolonged marketplace rivalry? Which assets create and sustain value for customers and shareholders? And how can those assets that contribute more to value generation be distinguished from others? Or, stated differently, what makes an asset valuable? These questions constitute fundamental theoretical and practical issues at the heart of research in finance (Fama and Miller 1972; Stein 1989), strategy (Grant 1991), organizational economics (Barney and Ouchi 1986), industrial organization (Conner 1991), and marketing (Glazer 1991).

The resource-based perspective on what accounts for competitive success (Amit and Schoemaker 1993; Hunt and Morgan 1995; Itami 1987; Peteraf 1993) suggests that an asset is more likely to contribute to value generation when it satisfies the following four tests:

1. It is convertible: If the firm can use the asset to exploit an opportunity and/or neutralize a threat in the external environment, then the potential to create and sustain value is enhanced.
2. It is rare: If the asset is possessed by multiple rivals, its potential to be a source of sustained value is diminished.
3. It is imperfectly imitable: If it is difficult for rivals to imitate the asset, the potential to sustain value is enhanced.
4. It does not have perfect substitutes: If rivals do not possess strategically equivalent convertible assets and it is difficult to develop them, then the potential to sustain value is enhanced.

Therefore, if market-based assets are to contribute to customer and financial value, they must satisfy these four tests to some extent. However, before considering whether they do, we must refine the notion of market-based assets.

Types of Market-Based Assets

Market-based assets are principally of two related types: relational and intellectual. Such assets are primarily external to the firm, generally do not appear on the balance sheet, and are largely intangible. Yet stocks of these assets can be developed, augmented, leveraged, and valued. And, as we discuss subsequently, because of their characteristics, they are suited particularly to meeting the resource value tests noted previously.

Relational market-based assets are outcomes of the relationship between a firm and key external stakeholders, including distributors, retailers, end customers, other strategic partners, community groups, and even governmental agencies. The bonds constituting these relationships and the sources of them can vary from one stakeholder type to another. For example, brand and channel equity reflect bonds between the firm and its customers and channels. Brand equity may be the result of extensive advertising and superior product functionality. Channel equity may be in part a result of long-standing and successful business relationships between the firm and key channel members.

Intellectual market-based assets are the types of knowledge a firm possesses about the environment, such as the emerging and potential state of market conditions and the entities in it, including competitors, customers, channels, suppliers, and social and political interest groups (cf. Nonaka and Takeuchi 1995). The content or elements of knowledge include facts, perceptions, beliefs, assumptions, and projections. The content of each type and its sources vary greatly from one to another. Thus, a firm may develop projections of the way its industry will evolve so that it knows how it will react when total industry sales decline by a particular percentage or when a substitute product might emerge. Or a firm may develop over time unique facts, beliefs, and assumptions about its customers' tastes, manufacturing processes, or proclivities to respond in certain ways to promotion, sales, and pricing moves (cf. Glazer 1991).

The development and evolution of relational and intellectual market-based assets intertwine in many ways. Both evolve in part out of the firm's unavoidable interaction with entities in its environment. Intimacy of relationships enables knowledge to be developed, tested, and refined. Knowledge of the environment guides the firm in choosing which entities to align with, how to do so, and when. Relationships with and knowledge of specific entities often are developed by the same set of individuals. Customer service personnel, because of the relationships they develop with multiple distinct sets of customers, often generate unique insight into customers' backgrounds, behaviors, and propensities. Relational and intellectual market-based assets also share several common characteristics. Both assets are intangible; they cannot be inventoried or divided physically into specific portions. Yet both can be assessed in terms of their stock and flow. *Stock* refers to a specific amount or extent of brand equity or knowledge of customers' purchasing criteria possessed by a firm. *Flow* refers to the extent to which a stock of a particular asset is augmenting or decaying. Thus, a firm can strive to augment its knowledge of a corporate customer's buying processes, the persons involved in it, and the organizational systems supporting them.

Market-Based Assets: Three Propositions

There are several interrelated research streams in the marketing literature that contribute to the concept of market-based assets: brand equity (cf. Aaker 1991; Keller 1993; Shocker, Srivastava, and Ruekert 1994), customer satisfaction (cf. Anderson and Sullivan 1993; Yi 1990), and the

management of strategic relationships (cf. Anderson and Narus 1996; Bucklin and Sengupta 1993). These research streams collectively demonstrate that stronger customer relationships are created when the firm uses knowledge about buyer needs and preferences to build long-term relational bonds between external entities and the firm. Our purpose is not to provide an extensive review of this literature but to summarize their implications in an integrative framework.

Three central propositions for market-based assets now can be stated. First, the greater the value that can be generated from market-based assets for external entities, the greater their satisfaction and willingness to be involved with the firm and, as a consequence, the greater the potential value of these marketplace entities to the firm. Second, the more market-based assets satisfy the asset tests noted previously, the greater the value they generate and sustain for external entities. Third, shareholder value is created to the extent that the firm taps or leverages these market-based assets to improve its cash flows.

Market-Based Assets: Generating Customer Value

The concept of market-based assets, as delineated previously, can be refined and extended through comparison with the more familiar notion of tangible, balance-sheet assets. Perhaps the distinguishing characteristic of internal, tangible, balance-sheet assets, such as plant and equipment, raw materials, supplies, inventory, and finished products, is that there is a market for them—they can be bought and sold (see Table 2). However, the value of such assets to any organization ultimately is not only their market or trade value, but also their value in use. Unless assets possess some value in use, they fail the critical initial test of potential contribution to competitive success noted previously; they are not convertible. In a nutshell, tangible assets can be leveraged by an organization to

1. Lower costs by enhancing productivity;
2. Enhance revenues through higher prices if, for example, the raw materials and equipment lead to superior product functionality, features, and durability;
3. Serve as a barrier to entry or mobility barrier because others must make similar investments;
4. Provide a competitive edge to the extent that they make other assets (e.g., employees) more valuable; and
5. Provide managers with options, for example, if the plant or equipment can be shared across products.

For these reasons, the value of many tangible assets, such as plant and equipment, raw materials, and finished products, historically has been measured and presented on balance sheets. Some tangible assets, such as plant and equipment, are capitalized and amortized over time. Unfortunately, compared with tangible assets, the value of market-based assets is harder to measure, does not appear on balance sheets, and therefore is less likely to be recognized. Furthermore, marketing expenditures to acquire and retain customers, develop brands, and create channel and other partnerships most often are "expensed"—that is, they cannot be depreciated over time. Therefore, as less visible assets that must be paid for immediately, it is not surprising

that market-based assets often are not valued and nurtured in the same way as assets that are important for, by way of example, supply-chain effectiveness and efficiencies. However, it is important to recognize that market-based assets can be utilized in the same manner as tangible, balance-sheet assets. They also can be leveraged by the firm to

1. Lower costs; superior relationships with and knowledge of channels and customers lead to lower sales and service costs;
2. Attain price premiums; brand and channel equity lead to higher perceived value;
3. Generate competitive barriers; customer loyalty and switching costs render channels and customers less inclined to purchase from rivals;
4. Provide a competitive edge by making other resources more productive (e.g., satisfied buyers are more responsive to marketing efforts); and
5. Provide managers with options—for example, by creating trial for brand and category extensions.

Not only can market-based assets be used for much the same purposes as tangible, balance-sheet assets, but they also are more likely to serve as a basis of long-term, sustained customer value for three specific though related reasons. First, market-based assets are more likely to satisfy the four resource-based tests noted previously. Second, they add to the value-generating capability of physical assets. Third, they are suited ideally to exploit the benefits of organizational networks. We discuss each separately.

Satisfy resource-based tests. Unless relational and intellectual assets are convertible into customer value, the remaining resource-based tests are irrelevant (Barney 1991). Knowledge is perhaps the ultimate source of opportunity (Drucker 1993; Leonard-Barton 1995): It is embedded in research and development; it guides product innovation; it energizes marketing and sales. Relationships now are so widely viewed as essential to opportunity creation that they are encapsulated in what has become known as “relationship marketing” (Sheth and Parvatiyar 1995). Furthermore, relationships with end users can be exploited in building relationships with other entities (e.g., distributors).

Knowledge and relationships are often rare and in some cases may be unique. For example, some firms’ ability to project the future evolution of market sectors using scenarios and related tools provides a unique insight into emerging opportunities, how best to exploit these opportunities, what contingent strategies should be developed, and how to monitor which “future” is emerging (Van der Hijden 1996). Such knowledge enables firms to exploit first-mover advantages, respond appropriately to the moves of competitors, and avoid the penalties associated with brash market moves (Kerin, Varadarajan, and Peterson 1992).

The intangible nature of market-based assets renders relational and intellectual assets extremely difficult to imitate (Hall 1992, 1993). Knowledge and relationships are socially complex and tacit phenomena. The intimacy of relationships with channels and customers attained by such

TABLE 2
Attributes of Balance-Sheet and Off-Balance Sheet Assets

Property	Balance-Sheet Assets	Off-Balance-Sheet Assets
Type of asset	Largely tangible	Largely intangible
Examples	Plant and equipment	Market-based assets such as customer/brand and channel relationships
Can they be bought and sold?	Yes. Tangible property has salvage value.	Yes. For example, AT&T's acquisition of McCaw Cellular.
Can they be leveraged to lower costs?	Yes, by enhancing productivity.	Yes. They can result in lower sales and service costs due to superior knowledge of customers and channels.
Can they be leveraged to command higher prices or share?	Yes. Superior product quality or functionality can be used to justify higher prices.	Yes. Brand and channel equity lead to higher perceived value that may be tapped through price or share premiums.
Can they generate entry barriers?	Yes. Others must make similar investments to be competitive.	Yes. Customer switching costs and loyalty reduce competitive vulnerability.
Can they provide a competitive edge?	Yes. They can make other assets, such as employees, more productive.	Yes, by making other resources more productive (e.g., satisfied buyers are more responsive to marketing efforts).
Can they create options for managers?	Yes, if plant and equipment can be shared across products.	Yes. Satisfied customers are more likely to try brand and category extensions.
Are asset acquisition costs capitalized?	Yes. Plant and equipment can be paid for over several years.	No. Marketing costs are “expensed” and must be justified in the short run.

firms as Home Depot, Nordstrom, and Johnson Controls has proved almost impenetrable by many rivals (Treacy and Wiersema 1995). Moreover, efforts to replicate these assets often necessitate extensive investments in marketing, sales, service, and human resources development with little, if any, guarantee of success.

Finally, knowledge and relationships present profound difficulties to rivals seeking to develop direct substitutes, that is, assets that enable them to pursue similar strategies. If a firm possesses truly unique knowledge of its customers, then a competitor must develop either another form of knowledge (such as technology knowledge) or another type of asset (perhaps a one-of-a-kind manufacturing process) that will enable it to achieve the same marketing outcomes. If, for example, the firm is using its distinct customer knowledge to customize its solutions (Pine 1993), it might be extremely difficult for rivals to develop substitute equivalent assets that will enable them to customize their solutions.

Add value to tangible assets. The role and importance of market-based assets is augmented further when the frequency with which they add to the value-generating capability of physical assets is recognized (Lane and Jacobsen 1995). For example, knowledge of customers' changing tastes and buying criteria enables a firm to adapt its manufacturing and engineering processes to produce products with the functionality and features demanded by customers. Strong customer relationships, manifested in channel and brand equity, enable a firm to commit human resources to entrepreneurial activity such as developing new products, extending existing product lines (Leonard-Barton 1995), and customizing existing solutions (Pine 1993). A firm's market-based assets can create value by exploiting not only the firm's own tangible assets, but also the tangible assets of partner firms. Thus, a manufacturing firm's relationship with a retailer (a market-based asset) can be used to leverage the retailer's physical asset (e.g., shelf space) to create value for the manufacturing firm.

Indeed, a strong argument can be made that relational and intellectual assets are necessary to invigorate and unleash the customer value-generating potential embedded in tangible assets such as plant and machinery and products. Without knowledge of and relationships with external entities, such as customers, channels, suppliers, and other strategic partners, marketing capabilities inherent in organizational processes, such as new product development, order fulfillment, and speed to market (Day 1994), can be neither created nor leveraged. Knowledge and relationships are essential sources of these capabilities and, in turn, are extended and augmented by the successful execution of these capabilities. Recent research (e.g., Badaracco 1991; Quinn 1992) has provided evidence of conceptual quagmires and managerial conundrums that ensue when researchers and managers fail to recognize that knowledge and relationships not only undergird every form of distinctive customer advantage but also are the essential building blocks of every form of competence or capability.

Exploit the benefits of networks. Finally, market-based assets underlie benefits that can be derived from "networks"

or product ecosystems. As individual firms increasingly become the nodes in an interconnected web of formal and informal relationships with external entities (Quinn 1992), including suppliers, channels, end customers, industry and trade associations, technology sources, advertising agencies, universities, and in many instances even competitors, their capacity to generate, integrate, and leverage knowledge and relationships extends considerably beyond the resources they own and control. For example, Intel's Pentium microprocessor's successful defense against both Digital Equipment Corporation's Alpha and the IBM/Motorola/Apple PowerPC chips is in part related to its network of users, original equipment manufacturers, and software vendors. Each network link enables customer value generation beyond what could be created by the nodal firm alone or any other network entity operating on its own. Therefore, a network can be viewed as a coordinated set of knowledge sources and cooperative relationships.

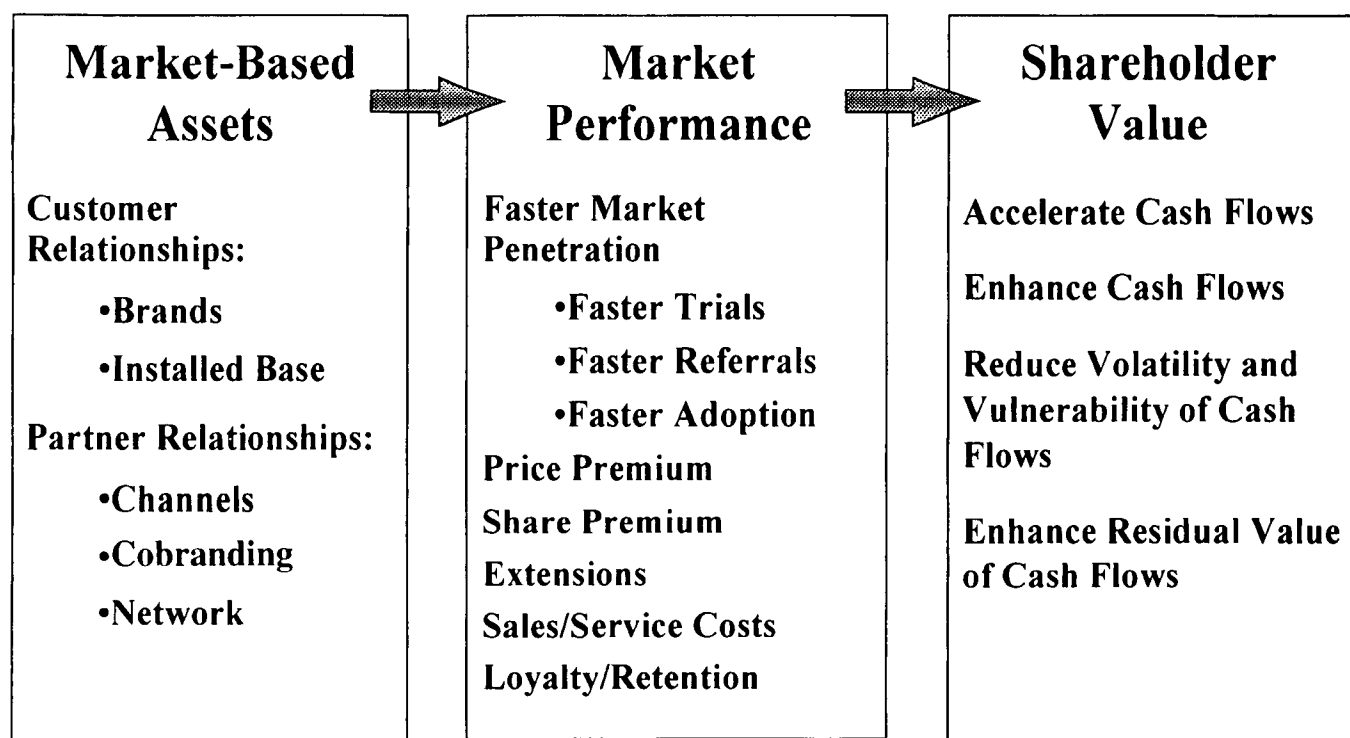
Illustrations of the role and importance of networked market-based assets are widely evident. A firm's offerings to customers become stronger when bolstered with superior service by members of the network. A car manufacturer can provide superior products that become even more valuable when accompanied by outstanding service provided by its dealers. A software publisher is likely to be more attentive to a hardware manufacturer with a dominant buyer installed base. Collectively, networked producers of complementary products are more valuable to buyers. Consequently, networked market-based assets help a firm create value over and above that created by market-based assets individually. Thus, the value of a network of market-based assets can be greater than the sum of its individual components.

Impact of Market-Based Assets

To assess the value of market-based assets, we present a conceptual framework that links the contribution of these assets to the financial performance of the firm and begins to suggest ways in which the value of marketing activities can be identified, measured, and communicated. Figure 1 depicts the proposed framework.

In the first column in Figure 1, we present the two types of market-based assets—customer and partner relationships—that we focus on in this article. These relationships are formed on the basis of value delivered to customers through enhanced product functionality, such as superior performance, greater reliability and durability, unique features, better product and service quality, wider availability, greater ease of use, lower levels of perceived risks, higher levels of trust and confidence, and better reputation and image. This value is the basis for customer satisfaction and its surrogates. If customers are end consumers, customer satisfaction is linked directly to brand equity. For each brand, there are those who like and buy that brand and those who do not. Hence, it is important to note that brand equity is linked to the installed base of users. If customers are channel members, the same concepts apply, but the specific attributes might be different. For example, whereas automobile buyers might focus on manufacturer-provided leasing programs, dealers might be responsive to inventory financing programs.

FIGURE 1
Linking Market-Based Assets to Shareholder Value



The entries in the first column of Figure 1 represent outcomes of activities designed to deliver value to customers, and those in the second column summarize the consequences of customer behavior that are considered desirable by firms. That is, the second column deals with outcomes of customer satisfaction or brand equity and represents various measures of market performance. For example, research over the past decade shows that marketing activities such as advertising can lead to more differentiated and therefore more monopolistic products characterized by lower own-price elasticity (Boulding, Lee, and Staelin 1994). Brand equity can be tapped in a variety of ways. It enables firms to charge higher prices (Farquhar 1989), attain greater market shares (Boulding, Lee, and Staelin 1994), develop more efficient communications programs because well-differentiated brands are more responsive to advertising and promotions (Keller 1993; Smith and Park 1992), command greater buyer loyalty and distribution clout in the marketplace (Kamakura and Russell 1994), deflect competitive initiatives (Srivastava and Shocker 1991), stimulate earlier trial and referrals of products (Zandan 1992), and develop and extend product lines (Keller 1993; Keller and Aaker 1992). These conclusions are similar to findings from research on the effects of customer satisfaction and relationship marketing. The consequences of customer satisfaction include pay-offs, such as buyer willingness to pay a price premium, use more of the product, and provide referrals, as well as lower sales and service costs and greater customer retention and loyalty (Reichheld 1996; Reichheld and Sasser 1990).

Although market-based assets can be expected to boost market performance and lower risks, little is known about how the stock market values the capability of market-based assets to enhance current and potential market performance. In the next section, we attempt to alleviate this shortcoming by examining asset valuation approaches to identify key drivers of shareholder value. These drivers—acceleration and enhancement of cash flows, reduction in the volatility and vulnerability of cash flows, and growth of residual value—are listed in the last column in Figure 1.

Asset Valuation Methods and Drivers of Shareholder Value

The valuation of assets is controversial. A variety of financial and accounting approaches has been proposed, each with its own set of problems. One way to value assets is on the basis of their costs. For example, the *book value* of a firm is based on the accounting value (costs less depreciation) associated with creating the firm's assets. But historical costs associated with creating businesses do not reflect true costs today, leading some financial accountants to argue that the value of a firm should be based on the *replacement value* of the assets it owns. Unfortunately, replacement costs are notoriously hard to estimate, especially for intangible assets, such as intellectual property, brand names, and customer relationships. Consequently, book values and replacement values typically ignore the value of intangibles.

In recent years, it has become accepted widely that the difference between the book value and the market value of

the firm is accounted for by intangible assets that are not recognized by today's standard accounting practices (Lowenstein 1996; Rappaport 1986). To the extent that the market value of a firm is greater than the book or replacement values, the differences can be attributed to intangible assets not captured by current accounting practices (Lane and Jacobsen 1995; Simon and Sullivan 1993). With "market-to-book" ratios averaging 3.5 and "market-to-replacement cost" ratios (or Q-ratios) averaging approximately 1.9 for the *Fortune* 500, it is clear that a substantial portion of a firm's market value is in intangible assets (Capraro and Srivastava 1997).

That financial markets are willing to pay price premiums in excess of book values for most firms leads to the question of how intangible assets are valued. According to Lane and Jacobsen (1995), intangible assets, such as brand names, enhance the ability of the firm to create earnings beyond those generated by tangible assets alone. In the paradigm of financial valuation based on present value of future earnings, firms with intangible strengths, such as well-known brand names, channel dominance, or an ability to innovate, should have higher net present values because of incremental earnings beyond those associated with tangible assets alone. The need to value intangible assets and the difficulties of doing so is reflected in the plethora of approaches that have been advocated in the past few years. These approaches include price premium, earnings valuation, and royalty payments (cf. Tollington 1995); determining the value of intangible assets as part of the value of intellectual capital (Simon and Sullivan 1993; Smith and Parr 1997); cost, market, and income approach methodologies (Reilly 1994); determination of brand "multiples" (Murphy 1990); and the use of momentum accounting to measure brand assets (Farquhar, Han, and Ijiri 1991).

Perhaps the most widely used basis for a brand-valuation approach is the "Price-Earnings (PE) Multiple" approach used by the InterBrand Group (Penrose 1989), in which the value of brands is estimated on the basis of incremental earnings associated with brand names multiplied by a PE multiple based on brand strength and product category attractiveness (higher for strong brands in more desirable categories). Intuitively, PE multiples and thus valuation of today's earnings increase with mitigation of risk and enhancement of future growth potential.

Although the PE Multiple is an often-quoted valuation measure, it has the problems associated with a reliance on earnings—an accrual accounting measure of firm performance (Fisher and McGowan 1983). Although the literature has yet to resolve which is the best measure of firm performance, there is a shift in recent years to use cash flows (Kerin, Mahajan, and Varadarajan 1990). Scholars in the finance area have argued that the market value of a firm is the net present value of all future cash flows expected to accrue to the firm (cf. Rappaport 1986). Thus, the "shareholder value" approach, based on discounted cash flow analysis, is becoming increasingly important in strategic decision making for purposes of resource allocation among options that offer growth but are inherently risky. The importance of this perspective is underscored by the fact

that a large proportion of the value of firms is based on perceived growth potential and associated risks, that is, value is based on expectations of future performance. The implications of this for the marketing profession are immense. If resources allocated to marketing strategies are not viewed as investments that create assets that can be leveraged to enhance future performance, provide potential for growth, or reduce risk, then contributions by marketers are likely to be perceived as marginal by corporate decision makers. The challenge then is to demonstrate and measure the value created or driven by marketing investments and strategies.

The shareholder value-planning approach proposed by Rappaport (1986) is based on several "value drivers" (Kim, Mahajan, and Srivastava 1995). Because shareholder value is composed of the present value of (1) cash flows during the value growth period and (2) the long-term, residual value of the product/business at the end of the value growth period (for a detailed description of the approach, see Day and Fahey 1988), the value of any strategy is inherently driven by³

1. An acceleration of cash flows (earlier cash flows are preferred because risk and time adjustments reduce the value of later cash flows);
2. An increase in the level of cash flows (e.g., higher revenues and/or lower costs, working capital, and fixed investments);
3. A reduction in risk associated with cash flows (e.g., through reduction in both volatility and vulnerability of future cash flows) and hence, indirectly, the firm's cost of capital; and
4. The residual value of the business (long-term value can be enhanced, for example, by increasing the size of the customer base).

Market-Based Assets and Shareholder Value

We turn now to a discussion of how market-based assets influence the four drivers of shareholder value identified in the previous section. We first discuss the influence of market-based assets on the acceleration of cash flows or the receipt of cash flows sooner than otherwise. We then examine how market-based assets enhance the level of cash flows. Next, we discuss how market-based assets lower the volatility and vulnerability of cash flows. Finally, we assess how market-based assets influence the residual value of cash flows. Although each market-based asset potentially

³Prior attempts in the marketing literature to develop a conceptual framework of the value of intangible assets such as information typically have stopped short of shareholder value. Glazer's (1991) influential work on the value of information describes value as arising from the capability of the information to (1) generate revenues from transactions higher than otherwise, (2) make cost of future transactions lower than otherwise, and (3) generate revenues from the information itself. The present framework extends Glazer's work in three ways. First, it adds new components of value, such as the capability to accelerate cash flows and lower their vulnerability and volatility. Second, it describes the four components of higher cash flow (i.e., higher revenues, lower costs, lower working capital levels, and lower levels of fixed investment). Third, it includes the value of relationships, or relational assets, and not just the value of information and knowledge.

can influence every driver of shareholder value, for reasons of brevity we discuss a select few of all the possible linkages. The goal is to illustrate rather than provide an exhaustive assessment of the influence of market-based assets on the drivers of shareholder value.

It also should be noted that there may be trade-offs or synergies involved in the influence of market-based assets on the four drivers of shareholder value. For example, it is possible that marketing activities to speed up cash flows also could have the effect of increasing the volatility of cash flows. Conversely, it is also possible that marketing activities to speed up cash flows simultaneously could increase the residual value of cash flows. Therefore, the criteria for choosing between investment opportunities in market-based assets must include the impact of the proposed marketing investments on all the drivers of shareholder value.

Market-Based Assets: Influence on Accelerating Cash Flows

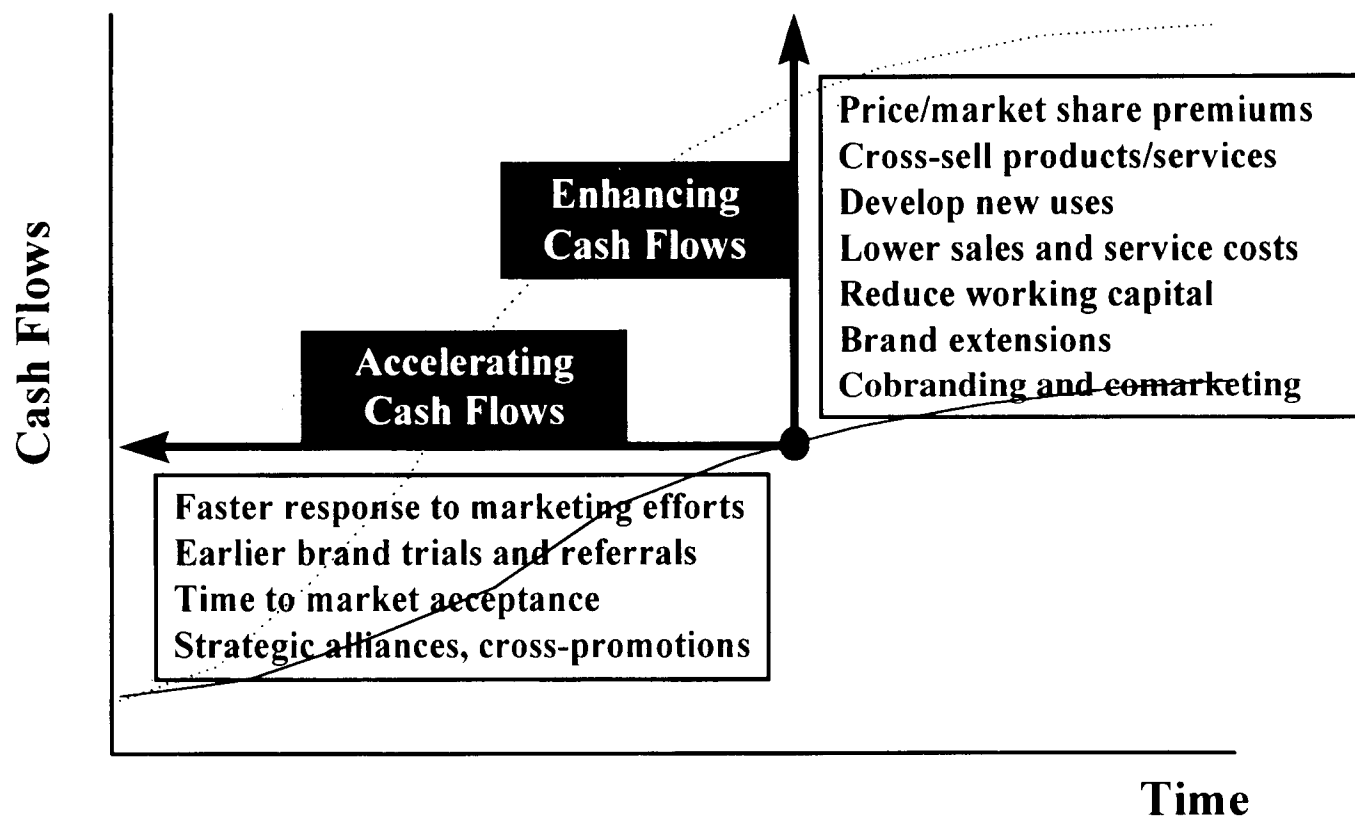
Market-based assets can enhance shareholder value by enabling the firm to accelerate the receipt of cash flows or generating cash flows sooner than otherwise. As depicted in Figure 2, the faster the receipt of cash flows, the higher their net present value. To the extent that market-based assets can help accelerate the receipt of cash flows, such assets can influence positively the shareholder value of the firm.

There is considerable evidence in the marketing literature that market-based assets can accelerate cash flows by

increasing the responsiveness of the marketplace to marketing activity. For example, Keller (1993) argues that brand equity can be captured in the differential effects of brand knowledge on consumer response to how the brand is marketed. Thus, if brand awareness and brand attitude are positive, customers are likely to respond with greater speed to the marketing efforts of the brand. Therefore, when exposed to a brand of which they are aware and to which they are disposed positively, customers are more likely to try the brand, adopt the brand, and begin to refer the brand to others sooner than otherwise.

Empirical evidence from industry studies also suggests that the more positive the brand attitude, the quicker the response of customers to new products. Zandan (1992) finds that brands with the strongest images in the personal computer industry, such as IBM, Compaq, and Hewlett-Packard, typically can expect customers to adopt their next-generation products three to six months sooner than brands with weaker images. Furthermore, his study also suggests that customers generally are willing to refer these brands to others three to six months sooner than they are for weaker brands. Therefore, customers with whom the firm has developed stronger long-term relational bonds through brand- and loyalty-building investments are likely to respond faster to marketing programs designed to stimulate earlier purchases and faster referrals, which leads to the acceleration of cash flows and thus greater shareholder value.

FIGURE 2
Accelerating and Enhancing Cash Flows



There is increasing recognition in the marketing and new product development literature that speed to market is a crucial variable. However, Robertson (1993) highlights that though there is a tremendous focus on speeding the new product development cycle, relatively little attention has been paid to achieving reductions in time-to-market acceptance for new products. Consequently, Robertson (1993) argues that being quick to market with a new product is only half the battle, the other half being the ability of the firm to penetrate the market quickly with the new product or reduce the market penetration cycle time. Jain, Mahajan, and Muller (1995) demonstrate that "seeding" the market (i.e., using promotions to establish an installed base) and then leveraging these early adopters to facilitate word-of-mouth advertising can speed up product life cycles and therefore cash flows. Recent research on network externalities demonstrates the importance of the installed base (and buyers' expectations of the future installed base) in driving the adoption process. Network externalities lead to "increasing returns" with the growth of the installed base and have been used to justify marketing activities that focus on licensing and standardization as a way of developing and leveraging the buyer installed base (Besen and Farrell 1994; Conner 1995). In the framework of network externalities, both clones and unauthorized (pirated) copies lead to the development of de facto standards (Conner and Rumelt 1991; Takeyama 1994). To the extent that market-based assets help reduce market penetration cycle time, the receipt of cash flows will be accelerated, and the net present value of cash flows will increase.

In addition, market-based assets also have network-level effects on market penetration cycle times. Strategic partnerships can help a firm reduce the speed with which products are able to penetrate the marketplace. Robertson (1993) points out that few firms have the capability to penetrate all markets around the world before a new product loses its innovative advantage. If so, alliances with partners can accelerate cash flows by penetrating a greater portion of the global market in the same time frame. Although the firm will need to part with the margins that are needed to create partnerships, the lower margins could be more than compensated for by the increase in the net present value of cash flows due to the acceleration of cash flows. In particular, this is more likely to be the case if the pace of technology development is rapid or the technology pioneer has a short window in which to establish the product.

The appropriate use of partnerships also enables firms to respond more quickly to market needs by taking advantage of existing networks. For example, a recent trend in the fast-food industry is to seek new locations in institutional markets, such as airports, gas stations, retail stores, and universities. Thus, McDonald's has an arrangement with Wal-Mart to place restaurants in the new Wal-Mart Supercenters, which enables McDonald's to penetrate new markets with greater speed, albeit at the cost of sharing margins with Wal-Mart.

Marketers traditionally have focused on financial metrics such as sales volume, market share, gross margin, and so forth. As such, marketing expenditures that are aimed at accelerating cash flows by shortening the market penetra-

tion cycle time are difficult to justify in the context of resource allocation within a firm. To the extent that the impact of marketing investments on shareholder value can include the additional value created by the acceleration of cash flows, the value of marketing activities such as brand building, product sampling, and comarketing alliances will be understood better and valued more appropriately by senior management and other functional executives.

Market-Based Assets: Influence on Enhancing Cash Flows

Market-based assets can increase shareholder value by enhancing the level of cash flows or generating cash flows that are higher than otherwise. As shown in Figure 2, higher cash flows translate into higher shareholder value. Cash flows can be enhanced by (1) generating higher revenues, (2) lowering costs, (3) lowering working capital requirements, and (4) lowering fixed capital requirements. Although the first two have been discussed in the marketing literature (Glazer 1991), the impact of marketing activities on the fixed and working capital requirements of the firm, though it has received some attention lately, generally is not well understood.

Although great care must be taken not to overextend brands, a great deal of evidence in the marketing literature suggests that brand extensions are important mechanisms for enhancing revenues (cf. Aaker 1991; Srivastava and Shocker 1991). Well-established and differentiated brands can charge a price premium on the basis of their monopolistic power attributable to customer switching costs and loyalty (Boulding, Lee, and Staelin 1994; Farquhar 1989). Brand equity also is associated with a customer base that is more responsive to advertising and promotions (Keller 1993). Therefore, the marginal costs of sales and marketing are lower for higher equity brands. Brand extensions enable firms to fill out their product lines, expand into related markets, and increase revenues by licensing brand names for use in other product categories. Furthermore, Smith and Park (1992) demonstrate the positive impact of brand extensions on market share and advertising efficiency and present evidence for how brand extensions help lower costs. Although brand extensions give rise to the danger of diluting brand equity, Dacin and Smith (1994) show that the number of products associated with a brand can even strengthen the brand, provided a consistency in quality is maintained across all products associated with the brand. Indeed, Wernerfelt (1988) argues that brand extensions can be interpreted as a firm's use of its accumulated investment in the brand, and future cash flows from other products affiliated with the brand as a "bond" or collateral for the quality of the extension, which signals to customers the firm's faith in the brand extension.

There is a growing recognition in the literature that customer relationships enhance cash flows by reducing the level of working capital and fixed investments. The trend toward relationship marketing has created, in many instances, closer relationships between suppliers and customers (cf. Sheth and Parvatiyar 1995; Weitz and Jap 1995). These relationships have enabled both parties to achieve efficiencies by linking their supply chains. For example, the

relationship between Procter & Gamble and Wal-Mart has resulted in efficiencies in managing order placement, order processing, cross-docking, and inventory holding that have provided both firms with cost savings. In the absence of strong supplier-customer relationships, the ability of either party to create partnerships that lead to the more efficient use of working capital and fixed assets, such as manufacturing capacity and warehouses, is extremely limited. Thus, strong relationships make it possible for firms to conceive and implement new policies and programs that otherwise would be nearly impossible.

Networked market-based assets also influence shareholder value by positively affecting cash flows. Anderson and Narus (1996) highlight how channel members can collaborate to help provide superior service to customers that otherwise would not have been possible. Thus, by pooling inventories at the network level, each member of the channel can promise and deliver improved customer service levels while lowering the investment required in inventories by each member of the network. Anderson and Narus (1996) cite inventory reductions of 15%–20% and improved customer service as a result of better utilization of channel relationships.

In addition, cooperative ventures, such as cobranding and comarketing alliances, also enable firms to enhance cash flows (Bucklin and Sengupta 1993). The essence of cobranding and component branding is that both partners gain access to the other's customer base. Cooperation that involves sharing brands and customer relationships enables firms to (1) lower the cost of doing business by leveraging others' already existing resources, (2) increase revenues by reaching new markets or making available others' products, and (3) avoid the fixed investment of creating a new brand altogether or of establishing or extending the customer base.

Although researchers in marketing have addressed the issue of how marketing activities lower costs and enhance revenues, they have paid little attention to how market-based assets help reduce working capital and fixed investment needs. A notable exception is the recent literature on relationship marketing, which has brought to the fore issues such as the ability of partnerships to create efficiencies in the use of capital. If such a recognition has occurred, the willingness to invest in customer and partner relationship-building activities is apparent. However, the vast majority of marketing practitioners and top managers have yet to develop an appreciation for the role of marketing in influencing the capital needs of the business.

Market-Based Assets: Influence on the Vulnerability and Volatility of Cash Flows

Market-based assets also can increase shareholder value by lowering the vulnerability and volatility of cash flows. Lower volatility and vulnerability reduce the risk associated with cash flows, which results in a lower cost of capital or discount rate. Thus, cash flows that are more stable and predictable will have a higher net present value and consequently create more shareholder value. Therefore, the capability of market-based assets to reduce the volatility and

vulnerability of cash flows has a strong influence on the creation of shareholder value (see Figure 3).

The vulnerability of cash flows is reduced when customer satisfaction, loyalty, and retention are increased. When the firm has a satisfied and loyal base of customers, the cash flow from these customers is less susceptible to competitive activity. As a relatively rare and inimitable asset, the loyalty of the installed base represents a significant entry barrier to competition and makes the firm's cash flow less vulnerable. A variety of marketing programs are geared toward increasing customer loyalty and switching costs by increasing benefits (e.g., American Airlines' AAdvantage program) and reducing risks (e.g., through unconditional money-back guarantees) to more loyal customers. Furthermore, research from the services industry demonstrates that customer switching behavior is attributable more often to inadequate and indifferent customer service than to better products or prices (Reichheld 1996). This suggests that experiential as opposed to search attributes are more important for facilitating customer retention and loyalty. In addition, cross-selling of multiple products and services—and therefore increasing the number of bonds between firms and their customers—can increase switching costs.

Although marketers do focus on how to generate customer loyalty, they often fail to communicate its value. One way to do this could be by looking at the consequences of disloyalty. For example, the average retention rate in the automobile insurance industry is 80%. San Antonio-based USAA has a retention rate of more than 99%. So whereas the average insurance company must replace approximately 50% of its customers after three years, USAA must replace less than 3%. With customer acquisition costs running at least five times retention costs, the mathematical justification of a marketing focus on customer loyalty and retention is not difficult (for detailed analyses and arguments, see Reichheld 1996).

The volatility of cash flows is reduced when the firm's relationship with customers and channel partners is arranged in a manner that promotes stability in operations. This is, in part, the motivation for packaged goods manufacturers as they attempt to forge relationships with retailers that create operations that result in fewer and smaller peaks and valleys in sales. Customer and partner relationships enable firms to coordinate activities across the value chain, which enhances the ability of all members of the value chain to make their cash flows more stable. Thus, customer and channel partnerships that lead to greater sharing of information, automatic ordering and replenishment, and lower inventories can help reduce the unpredictability of cash flows. Volatility also is reduced when the firm is able to retain a large proportion of customers, as the cost of retaining customers is likely to be more predictable than the cost of acquiring new customers. Finally, companies such as General Electric and Kodak have followed the approach pioneered by Xerox—leasing imaging and medical equipment and generating stable cash flows from consumables and services that are then less vulnerable to competitive actions.

Although marketing activities can be structured to reduce the volatility and vulnerability of cash flows, such assessments of market strategy are rare. Indeed, traditional

marketing activities often can be faulted for increasing the volatility and vulnerability of cash flows by using promotion and pricing strategies that encourage customers and channel partners to buy more unevenly than they otherwise would. Only in the past few years, as is so aptly illustrated by the current problems of America Online, have marketers begun to recognize the impact of their actions on the level of volatility in their businesses. As this recognition has grown, marketers have begun to look at measures beyond the level of sales and market share, such as the volatility and vulnerability of sales volume and market share.

Market-Based Assets: Influence on the Residual Value of Cash Flows

Residual value is the present value of a business attributable to the period beyond a reasonable forecast period and generally accounts for a significant proportion of the net present value of a business (Rappaport 1986). As such, it reflects the expected value of the business beyond the planning horizon. Naturally, this expectation is linked to sources of expected cash flow in the future. As Figure 4 depicts, a strong case can be made for the link between market-based assets and residual value. For example, users of earlier versions of products and/or services not only can buy later versions but also can buy related products and services and brand extensions. More important, they contribute to growth by also referring these products and services to other potential users and therefore aid the adoption process. In many industries in

which cash flows can be linked directly to customers (e.g., magazine subscriptions, cable television, cellular telephone services), the residual value of the business is linked closely to the size and quality of the customer base (Kim, Mahajan, and Srivastava 1995).

Some of the same factors that contribute to enhancing cash flows and reducing volatility and vulnerability also lead to higher residual values. For example, the larger the customer base and the higher the quality of the customer base (as measured by usage volume, willingness to pay a price premium, lower sales and service costs, and so on), the higher the loyalty (and therefore the lower the risk or vulnerability) and the residual value. This understanding is important because to create shareholder value, companies not only must grow the customer base but also must refine it (i.e., eliminate less profitable customers). Furthermore, a long-term goal of less vulnerable cash flows suggests a higher priority for customer retention versus acquisition, because customer loyalty is associated with higher revenue, lower sales and service costs, and lower risk. Finally, it is important to recognize that sustained, long-term customer loyalty results in more stable businesses and therefore a lower cost of capital. This further enhances the residual value of businesses.

Research on customer satisfaction, retention, and loyalty demonstrates the impact of marketing on the size and quality of the customer base of a business (cf. Anderson and Sullivan 1993; Johnson, Anderson, and Fornell 1995; Oliver

FIGURE 3
Reducing Volatility in Cash Flows

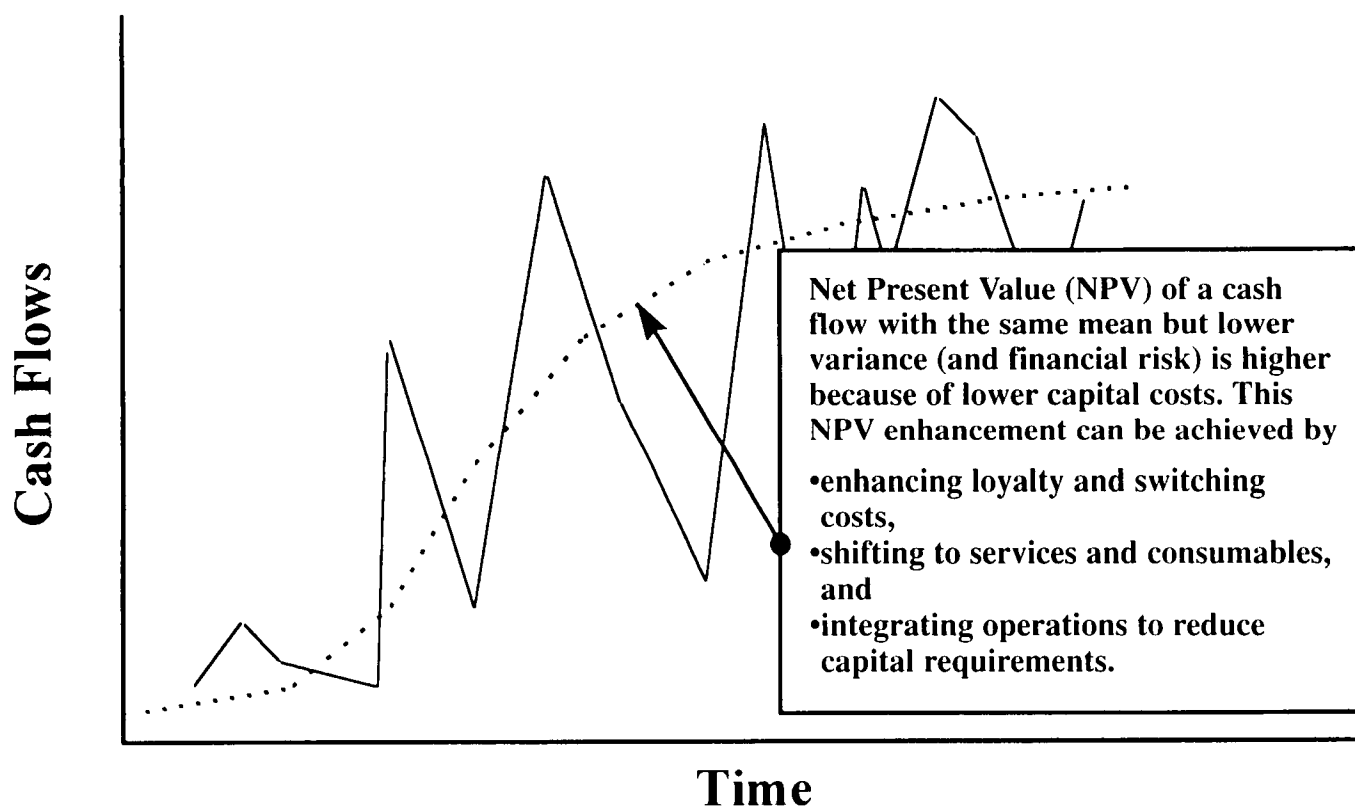
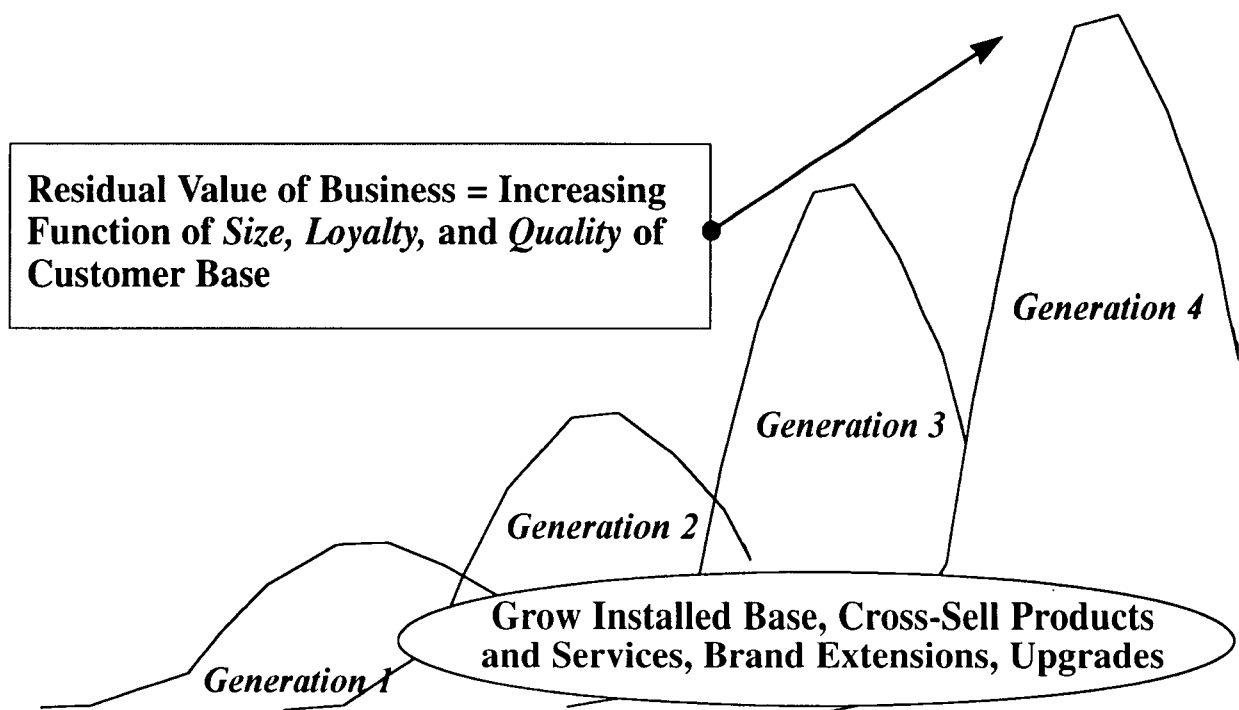


FIGURE 4
Enhancing the Residual Value of Cash Flows



1980; Yi 1990). Satisfied customers are more loyal. Satisfied customers also extend their relationships with vendors to include other products and services. Finally, satisfied customers also are willing to pay higher prices. Furthermore, the possession of a large and loyal customer base confers a degree of legitimacy on the organization that is difficult for competitors to emulate. As a socially complex, difficult-to-imitate, and relatively rare asset, the customer base creates barriers for competition and thus increases the residual value of a business.

Discussion

Although the assertion that marketing activities create financial value is well accepted, marketing practitioners historically have found it difficult to measure and communicate to other functional executives and top management the value created by investments in marketing activity. Prior frameworks that assess the value of marketing activities typically have addressed the issue of customer value, but relatively little has been said about how marketing creates shareholder value. It is this gap that we hope to address by developing a conceptual framework that links marketing activities to the creation of shareholder value. In this discussion, we focus on the potential impact of the framework on marketing theory development, empirical research, and the teaching and practice of marketing.

Implications for Marketing Theory

As a multifaceted discipline, marketing lacks a single, integrating theory (cf. Hunt 1983). What is clear is that as the practice of marketing evolves, as the influence of market-

ing increases within organizations, and as the need for greater integration of marketing with other disciplines such as finance and manufacturing becomes necessary, marketing theory has not kept pace. In the absence of development of its underlying theory, marketing as an academic field of inquiry cannot avoid further intellectual disintegration (cf. Day 1992), and as a field of practice, it is likely to lose influence within organizations in the battle for managerial attention.

Although it is not offered as a solution to these ills, a significant contribution of the framework presented in this article is its potential to influence the development of theory in marketing. Fundamentally, the framework is a powerful tool to help understand the changing contours of marketing: what it is and what it is not, how and why it is evolving in specific directions (as suggested by the changing assumptions about marketing noted at the beginning of the article), and the role of marketing in broader business issues and contexts. Specific to this article is the contention that theories of marketing must be extended and broadened to include developments in finance, as indeed, theories of finance must be extended and broadened to include recent developments in marketing.

In at least one respect, the framework presented here represents a paradigm shift of modest proportions in the domain of marketing theory. If theory is the stipulation of cause and effect, given particular conditions, then marketing theory must incorporate more explicitly market-based assets as an input to marketing strategy choices that affects financial performance measures such as cash flows. Although we have made an attempt to define and delineate carefully the concept of market-based assets, we are far

from developing a theory that refines the concept of market-based assets, identifies the range and extent of such assets, and develops sets of indicators to measure their stock and flow. Moreover, theory development in this area must address the trade-offs and synergies involved in accelerating cash flows, increasing cash flows, lowering the volatility and vulnerability of cash flows, and increasing the residual value of cash flows. Without such theory development, critical distinctions among types of market-based assets are likely to remain far too coarse-grained. We hope this article stimulates such theorizing.

Implications for Empirical Research in Marketing

By adding shareholder value-based criteria to assess the effectiveness of marketing activities, the framework has the potential to influence empirical research on the value of marketing by (1) highlighting under-researched variables in marketing and (2) examining hitherto unexplored paths among existing variables.

Under-researched variables. Cash flow is a relatively underutilized variable in marketing theory and research. Prior research has examined the impact of marketing on variables such as brand loyalty and customer satisfaction. Many studies also have examined the influence of marketing activities on financial measures, such as return on sales, return on assets, and return on equity. However, these are accrual accounting variables and as such are not always the most appropriate measures of firm performance (Rappaport 1983, 1986). Among the problems with accrual accounting measures of firm performance are that (1) they reflect previous performance and are not forward looking, (2) they are not adjusted for risk, and (3) they can be distorted by accounting laws and conventions (Bharadwaj and Bharadwaj 1997; Fisher and McGowan 1983; Montgomery and Wernerfelt 1988). Although the debate on the pros and cons of alternative measures of firm performance is far from resolved, cash flow is viewed increasingly as less susceptible to the problems associated with accrual accounting measures (Day and Fahey 1988). Thus, the inclusion of cash flow as a variable in marketing studies will help marketers better understand the influence of marketing activities on shareholder value.

Yet another variable that has received limited attention in marketing is speed. With the exception of the new product development literature, speed has not been a popular variable in marketing research. A focus on speed as a variable of interest undoubtedly will alter the focus of marketing activities and reframe research questions around the influence of marketing variables in attaining more rapid market penetration and hence greater shareholder value. In particular, the effect of speed on the capability of a firm to increase the net present value of cash flows is an interesting area that remains unexplored.

Unexplored relationships. The framework also has the potential to highlight some relationships that remain unexplored in the marketing literature. For example, the link between customer loyalty and the reduction of the vulnerability and volatility of cash flows as of yet has not been understood adequately. Likewise, the linkage between mar-

keting strategies and the capital requirements of the firm remains relatively less understood. Further research in these areas will help sharpen marketers' understanding of the impact of marketing activities on shareholder value.

By considering hitherto underutilized variables and understanding these unexplored relationships, the current framework has the potential to influence the nature, content, and tone of the marketing conversation. Traditionally, studied variables, such as market share, market orientation, customer satisfaction and loyalty, and brand equity, must be linked to their influence on cash flows as research in marketing increasingly focuses on the creation of shareholder value.

Implications for Teaching Marketing

The framework also has implications for how marketing is taught. First, it enables marketing academics to provide a coordinated treatment of concepts from the marketing, finance, and accounting disciplines. Second, it also allows for the development of course materials to aid in the team teaching of courses that integrate marketing, finance, and accounting perspectives. Given the demands placed on business schools to develop integrated courses that prepare students to work more effectively in cross-functional environments, this framework and others like it can serve a valuable role in guiding the way the nature, scope, and value of marketing activities are taught in the future.

Implications for Marketing Practice

A critical implication of this article is that both the input and output dimensions of many practitioners' mental models of what marketing is might need to be amended radically. An appreciation of market-based assets, shareholder value parameters, and, more important, the linkages between them could lead to nothing short of a paradigm shift in how many marketing managers understand the scope and content of marketing, its role in the organization, and how to communicate with managers in the top echelon and other functional areas. Although the change in marketing assumptions enumerated at the beginning of this article suggests that this paradigm shift is at least in the early stages in some organizations, the thrust of the managerial implications suggested here is that it must occur on a grander scale and at a considerably more rapid rate.

A fundamentally new challenge for many marketing managers at the strategy input end is the identification of the market-based assets they now possess. This involves nothing short of cataloging each relational and intellectual asset. In the spirit of the marketing-finance framework presented here, cross-functional teams can aid in both listing such assets and affording an opportunity to begin the necessary dialogue across organizational boundaries about market-based assets and their impact on financial performance.

The market-based assets an organization possesses may not be those it needs. Using current and potential marketing strategies as a guide, managers should ask what relational and intellectual assets would be required ideally to attract, win, and retain customers. Such judgments would compel managers to think in terms of market-based assets. Man-

agers then must make assessments about asset stocks (that is, how much of each asset they possess) and flows (that is, whether each asset is augmenting or atrophying). The challenge here is to determine relevant stock and flow parameters. Some organizations might be unaware of market-based asset parameters they already possess, such as customer and channel surveys, third-party reports, and managers' own judgments that are contained in their reports of visits to customers, channels, and other strategic partners. Articulating and measuring such parameters, however crude they may be, will familiarize managers with the notion of market-based assets.

The central managerial challenge is how to leverage market-based assets for marketplace success. Consideration of how intellectual and relational assets might be leveraged in developing new products or solutions, reaching new customer sets, and establishing new modes of differentiation could lead managers to identify new opportunities or ways to exploit existing opportunities better. Managers can ask whether the stock of each asset is being exploited fully. For example, some organizations will discover that their strong relationships with specific channels are underutilized, the channel could take more throughput, or they could do a better job of detailing and pushing the firm's products to customers. At a minimum, assessing how such assets can be leveraged will give managers a greater appreciation of their role and importance in developing and executing marketing strategy.

At the output end, managers must assess, even if they only do so crudely to begin with, how leveraging these assets affects cash flows. Again, learning both the analysis methodology and the underlying thought process, as articulated here, is essential. For example, marketing managers must assimilate and use the concepts and vocabulary now

second nature to financial and accounting managers. In many organizations, it also will necessitate reconfiguring the core of marketing decision analysis: The output or performance measures now will include financial as well as marketplace parameters. Managers can begin by carefully identifying how a marketing strategy or individual marketing programs, such as a sales promotion program or a new advertising campaign, might affect cash flows. Indeed, the few organizations that do leverage their market-based assets well provide excellent guidelines for how other firms also can create and use market-based assets. At a minimum, additional marketing decision levers will be added to the arsenal of marketing managers.

Conclusion

The focus of this article is to enhance the understanding of the marketing-finance interface by developing a framework that captures the linkages between marketing activities and the creation of shareholder value. The framework proposes that marketing is concerned with the task of developing and managing market-based assets, or assets that arise from the commingling of the firm with entities in its external environment. Examples of market-based assets include customer relationships, channel relationships, and partner relationships. Market-based assets, in turn, influence shareholder value by accelerating and enhancing cash flows, lowering the volatility and vulnerability of cash flows, and increasing the residual value of cash flows. It is our hope that this framework will influence the nature, content, and tone of the marketing conversation and enable marketing professionals to assess and communicate the value of marketing activities to other disciplines.

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