

EXPLOITING THE VALUE OF IDIOSYNCRATIC INTANGIBLE RESOURCES: THE EFFECTS OF STRATEGY AND BRAND CAPITAL ON SHAREHOLDER VALUE

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This research examines the relationship among firm strategies, brand capital and shareholder value. Using a sample of single product manufacturing firms, results suggest that under certain conditions, the intangible value contained in a firm's brand capital is a valuable firm resource that can be measured and exploited to increase shareholder returns. However, firms with large amounts of brand capital realized negative shareholder returns when trying to exploit brand capital in new ways. Results suggest that managers should be cautious of efforts to use existing intangible resources (brand capital) in new ways if these resources are already highly valued.

INTRODUCTION

Scholars from both the marketing and strategic management disciplines have argued that idiosyncratic firm resources may lead to sustained competitive advantage. For example, Day (1992) noted that strategic management research has begun to focus on the sources of a firm's competitive advantage and that a firm's invisible assets (Itami 1987) are of particular interest because these resources offer the greatest potential for the development of distinctive competencies that are difficult or costly for competing firms to imitate. Some have suggested that a firm's brand awareness among consumers is one type of idiosyncratic intangible resource that can be exploited to increase shareholder value (Barney 1991; Simon and Sullivan 1993; Kerin and Sethuraman 1998). This is consistent with the view that marketing, specifically the promotion and sale of a firm's products, should be a key factor in the ability of a firm to use its strengths to exploit its opportunities in order to enhance shareholder value (Day 1992).

Kerin and Sethuraman (1998) have noted that while a positive relationship between brand value and

shareholder value is widely claimed, there was not a comprehensive theoretical basis to support this claim and no documented empirical support. Their study developed theoretical arguments in support of the intuitively appealing argument that brand value can have a positive effect on shareholder returns. Kerin and Sethuraman measured brand value using the values published in *Financial World* magazine and measured shareholder value using a firm's market to book ratio. They found that among consumer goods firms, those with higher accumulated brand values also had higher market to book ratios. However, they also found this relationship was concave with decreasing returns to scale.

While Kerin and Sethuraman's (1998) findings have important implications for managers who are interested in understanding ways in which firms might exploit brand value in order to increase shareholder value, questions of generalizability remain. For example, do their findings hold beyond consumer goods companies? Can their findings be replicated if other operationalizations are used for both brand value and shareholder value? For example, Simon and Sullivan (1993) developed a technique that estimates a firm's brand equity based on the firm's value in the equity capital market. Using this method to measure a firm's brand value offers the opportunity to validate Kerin and Sethuraman's findings using an operationalization

of brand value that is derived from the financial market value of the firm, which is also consistent with their theoretical arguments.

Simon and Sullivan (1993) defined brand equity as "the incremental cash flows which accrue to branded products over unbranded products (incremental cash flows are based on the value consumers place on branded products and on cost savings brand equity generates through competitive advantages)" (Simon and Sullivan 1993, p. 28). Their estimation technique separates the value of a firm's brand equity from the value of its other intangible assets and can be used to estimate brand equity for a broad sample of firms. Simon and Sullivan (1993) argued that brand equity is an appropriate means of evaluating the impact of long-run strategic decisions. Further, the creation of shareholder value should also be a key consideration when evaluating new strategic initiatives (Srivastava, Tasadduq and Fahey 1998).

It seems clear that firms should seek to exploit their existing stock of valuable resources in new ways that can enhance firm performance (Barney 1996). The marketing literature offers useful insights that suggest a firm's brand value is an intangible resource that may be exploited to increase firm performance (Simon and Sullivan 1993; Thomas 1996; Kerin and Sethuraman 1998). This study seeks to build upon the work of Kerin and Sethuraman (1998) and Simon and Sullivan (1993) to address the following research question: *What is the effect on shareholder value of firm strategies that exploit brand capital in new ways?*

BRAND CAPITAL, STRATEGY FORMULATION AND SUSTAINED COMPETITIVE ADVANTAGE

How should firms respond when formulating strategies that seek to use the firm's strengths to exploit its opportunities, especially if firm performance has suffered? Kerin (1992) argued that innovation and entrepreneurship within the firm can lead to successful organizational renewal and that the functional role of marketing can play a key role in strategy formulation. Varadarajan (1992, p. 340) also suggested that new product decisions and

"effective management of the present product mix" are central to the marketing function.

Thomas (1996) suggests that *brand capital*, a firm's stock of well established brands, is a firm-specific asset that may be exploited in the marketplace. He also argues that firms possess *organizational capital*, which consists in part of organizational skills and superior market information that gives firms the ability to innovate and introduce new resources in the marketplace. Thus, *both* brand capital and organizational capital, which is the ability to formulate and implement new strategies, may be important determinants of the firm's ability to successfully develop and exploit new resources. Brand capital appears conceptually similar, if not identical to, brand value (Murphy 1989). Brand value may be defined as the incremental capitalized future earnings and cash flows that accrue to a firm by linking successful brand names to its products (Kerin and Sethuraman 1998). Brand value is essentially the capitalized value of brand equity, or the "incremental cash flows which accrue to branded products over unbranded products" (Simon and Sullivan 1993, p. 28). However, the term brand capital is used here because it is intended to be more comprehensive. Brand capital captures the value contained in all of the firm's idiosyncratic intangible resources that are used to produce and market the firm's products and is not limited just to the brand name itself.

Kerin and Sethuraman argued that in firms that produce multiple brands, the "accumulated incremental earnings and cash flows of all their brands . . . determine the overall brand value [capital] for the firm" (1998, p. 262). Thus, for single product firms, it seems reasonable to suggest that the value of the firm's brand equity (or the aggregated value in the case of multiple brands) should represent an excellent proxy for the firm's brand capital. Simply put, valuable strategies (which are the exploitation of valuable resources) are those that allow the firm to increase revenues and/or decrease costs. Manufacturing firms increase revenues through the sale of their products. Likewise, these firms may try to reduce costs by making improvements to the production processes associated with the manufacture of these products.

If the firm is conceptualized as a bundle of productive resources that are organized by an entrepreneur in order to make a profit (Penrose 1959), it seems reasonable to view the firm's product(s) as the culmination of the firm's activities. Thus, firms with better resources (brand capital) and organizational skills (organizational capital) should have better products than other firms. This suggests that an increase in brand capital accrues to firms that successfully exploit their resources. Consistent with the preceding arguments and the findings of Kerin and Sethuraman (1998), the following hypotheses suggest two main effects (for brand capital and strategy) and an interaction effect (brand capital*strategy).

- H₁: Brand capital will have a positive effect on shareholder value.
- H₂: Changes in a firm's strategy will have a positive effect on shareholder value if these changes create value that is difficult or costly for competing firms to imitate.
- H₃: The value of a firm's brand capital will moderate the effect of new strategies on shareholder value such that strategies that create new value by exploiting a firm's brand capital will have a positive effect on shareholder value.

METHODOLOGY

Sample

The population for this study included all single-product manufacturing companies from 1982 to 1994 identified in the COMPUSTAT database. A company was considered a single-product company if at least 95 percent of its sales came from one business segment (Rumelt 1974). A total of 980 firms were identified that met this criterion. Using only single-product manufacturing firms increased the homogeneity of the population and simplified the measurement of variables.

Measures

Shareholder Value. Jensen's alpha (Jensen 1968, 1969) is a commonly used measure to assess firm performance in the equity capital market (Hoskisson, Johnson, and Moesel 1994). Specifically, it represents the average return for a particular firm's stock over (or under) that predicted by the capital asset pricing model (CAPM), given the firm's beta and the average market return. In other words, it indicates the extent to which a firm has met, failed to meet, or exceeded investors' expectations during the year, compared to a portfolio of firms having a similar risk profile (Lubatkin and Rogers 1989). Firms with positive alphas have exceeded the performance expectations of investors, firms with negative alphas have failed to meet investors' expectations, and firms with alphas of zero have met investors' expectations. Assuming that the equity capital market is efficient in semi-strong form (Fama 1970; Ross 1983), stock prices reflect both an individual firm's current performance and investors' expectations regarding a firm's future performance based on the market's evaluation of all currently available public information. Jensen's alpha was calculated as follows (Hoskisson et al. 1994, p. 1221):

Jensen's alpha may be estimated as $R_i - RFR = a_i + b_i(R_m - RFR)$, where R_i is firm returns, R_m is market returns (CRSP value - weighted index with distributions), RFR is the average risk-free rate from T-bill auctions, b_i is the estimated beta (firm stock price variance relative to market variance for all stocks listed on the same exchange as a firm's stock), and a_i is the estimated Jensen's alpha, or the intercept from the regression model.

Weekly firm returns and weekly market index returns were obtained from the Center for Research in Security Prices (CRSP) tapes. Missing data reduced the sample pool to 740 firms. The weekly Treasury Bill rates printed in the Thursday edition of *The Wall Street Journal* were used for the risk-free rate.

Because new strategic initiatives often follow a decline in firm performance (Alchian and Demsetz 1972), I identified the firms in the population that had failed to meet investors' expectations and thus would be motivated to formulate new strategies intended to increase shareholder value. Because the financial markets appear to be efficient in at least semi-strong form, one would expect that the number of firms that were found to have exceeded or failed to meet financial market expectations would be very small. There were a total of 4,352 firms in the population pool over the 13 year period of the study (1982-1994). The decision rule for firms to be included in the sample was at least two successful years (exceeding or meeting investors' expectations) followed by at least one year of decline. Using this criterion, a sample of 200 firms was identified, which represented an average of 4.6 percent of the firms in the population pool. Consistent with theoretical expectations, a relatively small number of firms were found to have failed to meet investors' expectations.

No empirical studies were found that addressed the time period between the occurrence of lower than expected firm performance and action taken by management aimed at improving the firm's performance. However, some have suggested that this time period is relatively short (less than one year) (Jain 1985; Hoskisson et al. 1994). Thus, the one year period following a decline in market expectations was considered the turnaround year and results were measured the following year.

Firm Strategies. The Wall Street Journal index and the Lexis/Nexis database were used to identify announcements by firms of changes that they intended to make during the turnaround year. Of the 200 firms in the sample, 114 firms made some type of announcement. A summary of these announcements, along with a description of the firm and its industry, were provided to an expert panel. The panel then used their judgement to identify those announcements that appeared to rely on the firms' existing stock of resources (brand capital) to create value (e.g., new products, processes or technologies) that would be difficult or costly for competing firms to imitate. Only new valuable strategies that are difficult or costly to imitate would be expected to

have a positive effect on Jensen's alpha, which is a measure of investors' long term expectations regarding a firm's performance. Interrater reliability was .78, which was considered an acceptable level of reliability. Based on the ratings provided by the expert panel, the type of strategy formulated in response to the decline in firm performance was dummy coded (1,0).

Brand Capital. The measure of brand equity developed by Simon and Sullivan (1993) was applied at the firm level as a measure of brand capital. Because the firms in the sample were all single product firms, this approach provides an excellent proxy of the value of brand capital that is available for exploitation by the firm. The technique developed by Simon and Sullivan (1993) to estimate the value of a firm's brand equity separates brand equity from the firm's other intangible assets. The market value of a firm is an unbiased estimate of the future cash flows that are expected to be generated from all of the firm's resources. Thus, a market approach to calculating brand equity has three important features:

- (1) Brand equity is treated as an asset of the firm and the methodology objectively separates brand equity from the other assets of the firm.
- (2) Brand equity is measured in a forward-looking perspective, since market value of the firm's traded securities reflect an unbiased estimate of future cash flows.
- (3) The value of a firm's brand changes as new information becomes available in the market (Simon and Sullivan 1993, p. 29).

The value of a firm in the equity capital market is based on the discounted value of future cash flows that are expected to accrue to a firm from the use of its assets, both tangible and intangible. From the perspective of the capital market, brand equity is the value of expected cash flows that result from associating a firm's brand name with a particular product or service. The difference between the financial market value of a firm and the replacement value of its tangible assets is equal to the value of the firm's intangible assets. Simon and Sullivan (1993, p. 32) argued that brand equity is a

"specialized, intangible asset which augments the cash flows of a firm." In addition to its brand equity, Simon and Sullivan (1993) contend that the other components of a firm's intangible assets are firm-specific factors not associated with brand equity and market-specific factors that lead to imperfect competition.

The Simon and Sullivan (1993) method extracts brand equity from the value of a firm's intangible assets.¹ The method relies on Tobin's *q* (Tobin 1969, 1978), which is a method for quantifying the value of a firm's intangible assets. Simon and Sullivan's reliance on Tobin's *q* is similar to other techniques in the economic and finance literatures that have been used to compute the expected value of returns that accrue from the exploitation of a variety of intangible assets (Smirlock, Gilligan, and Marshall 1984; Hirschey and Weygandt 1985). Research has found that the firm's market to book value is theoretically and empirically equivalent to Tobin's *q* (Varaiya, Kerin, and Weeks 1987; Chung and Pruitt 1994). Thus, the firm's market to book value was used in calculating a firm's brand capital instead of Tobin's *q*.

The measure used in this study to calculate a firm's brand capital differed from the method used by Simon and Sullivan (1993) in one other respect. Simon and Sullivan's measure requires the calculation of a firm's advertising share, defined as the firm's advertising expenditures divided by total expenditures by competitors in the same industry. Industry was defined at the 4-digit Standard Industrial Classification (SIC) code and each industry was required to contain at least five firms. COMPUSTAT business segment data were used to identify industries, but a problem arose because advertising is not reported among the business segment data. This did not pose a problem in determining advertising expense for the sample firms.

¹ The methodology described by Simon and Sullivan to measure a firm's brand equity was replicated in this study with two exceptions (discussed later). Only a brief theoretical discussion of the measure is provided in this paper. For a complete review of all the calculations and measures used to calculate brand equity, the reader is referred to Simon and Sullivan (1993). All of the data used in the calculations were obtained from the COMPUSTAT and CRSP databases.

Because these were single product firms, COMPUSTAT annual data, which do contain advertising expenses, could be used. However, for other firms in the industry that were part of a diversified firm, a method was needed to estimate the business segment's share of the parent's annual advertising expense. Advertising expense for these firms was proxied as segment sales divided by total company sales multiplied by total company advertising expense.

Testing the Hypotheses

Because the brand equity measure is "data intensive," there was missing data for many firms that reduced the final sample from 114 to 51. There were not statistically significant differences (*t* tests) between these two samples in terms of the dependent variable or firm size. Moderated hierarchical regression was used to test the hypotheses. In accordance with Aiken and West (1991), all continuous variables were standardized to reduce any ill-conditioned multicollinearity between *Brand Capital* and *Strategy* and their interaction term, *Brand Capital*Strategy* and to facilitate the plotting of the results in Figure 1. The natural log of the number of firm employees was used to control for firm size. The following moderated hierarchical regression model was used to test the hypotheses:

$$\text{Alpha} = \text{Brand Capital} + \text{Strategy} + \text{Brand Capital*Strategy} + \text{Size} + e \quad (1)$$

RESULTS

The means, standard deviations and correlations among the variables used in the study are reported in Table 1. The results of the moderated hierarchical regression analyses are reported in Table 2. All variables used in the study had variance inflation factors of less than two suggesting that multicollinearity was not a problem. The initial step included only the control variable, firm size. This model had an *F* statistic of 1.295 and an *R*² of .03 and was not statistically significant. In the second step, the two main effects, *Brand Capital* and *Strategy* were added. The *F* statistic was 6.595

which was statistically significant ($p < .001$) and the R^2 increased to .30, which was a statistically significant increase ($p < .001$). The main effects of

TABLE 1
Means, Standard Deviations
and Pearson Correlation Coefficients

Variable	N	Means	s.d	1	2	3	4
Alpha	51	-0.0046	0.0134				
Brand Capital	51	9.5569	32.0122	.219			
Strategy	51	0.1176	0.3254	.284*	-.083		
Brand Capital*							
Strategy	51	0.2723	6.4984	-.243†	.218	-.343*	
Size	51	0.5460	0.9549	.160	-.590***	-.042	-.062
† $p < .10$		* $p < .05$		** $p < .01$		*** $p < .001$	

TABLE 2
Results of Moderated Hierarchical Regression
Analysis of Strategy and Brand Capital
on Firm Performance

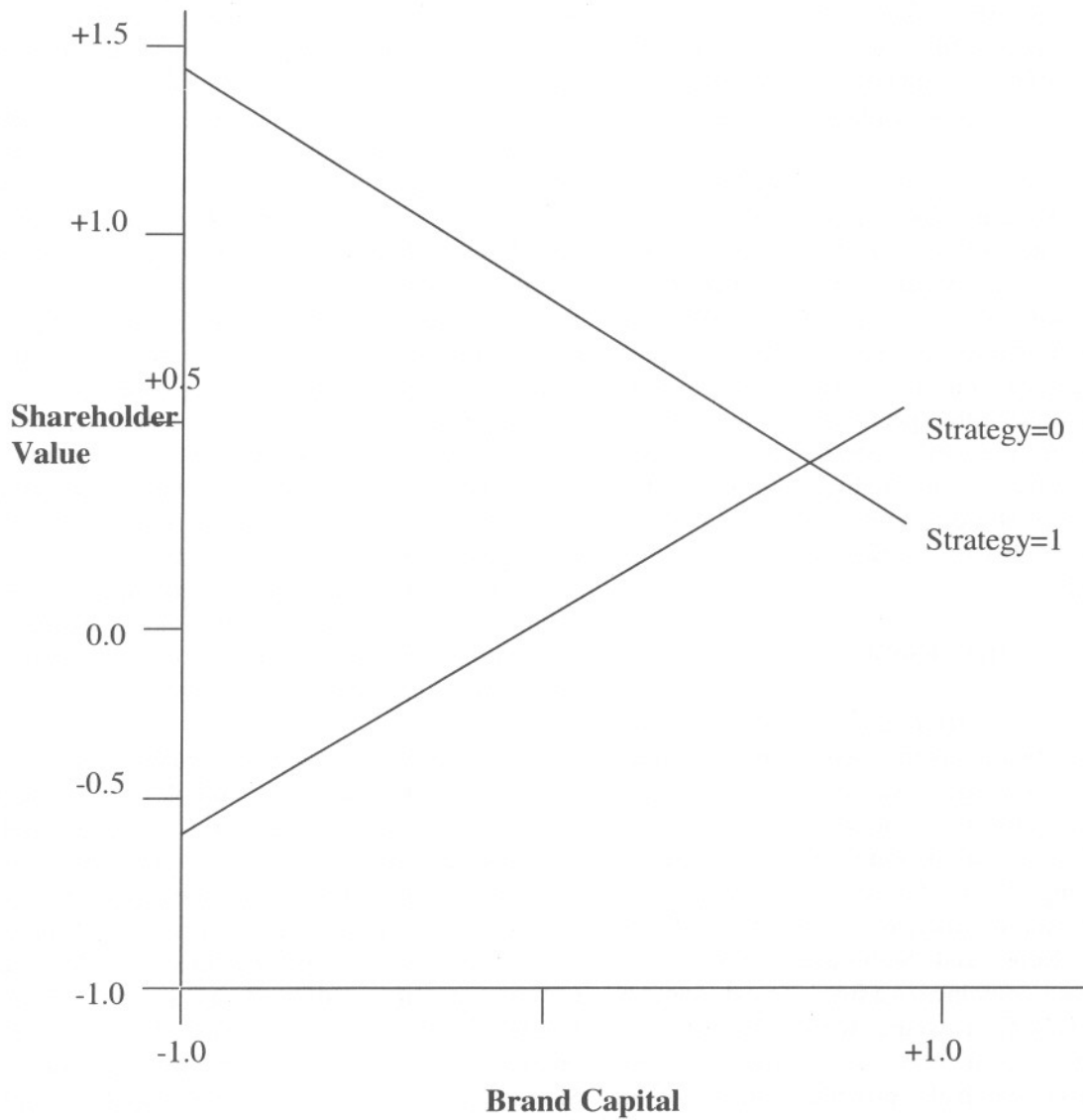
Independent Variable	Parameter Estimate
Size	0.160
F-Statistic	1.295
R^2	0.03
Adjusted R^2	0.02
N	51
Step 2	
Brand Capital	0.538***
Strategy	1.076**
Size	0.493**
F-Statistic	6.595***
R^2	0.30
Adjusted R^2	0.25
N	51
Step 3	
Brand Capital	0.594***
Strategy	0.830*
Size	0.507**
Brand Capital*Strategy	-1.160*
F-Statistic	6.153***
R^2	0.35
Adjusted R^2	0.29
N	51
* $p < .05$	** $p < .01$
	*** $p < .001$

Brand Capital ($p < .001$) and *Strategy* ($p < .01$) were statistically significant and both coefficients had positive signs. These results offer strong support for Hypotheses 1 and 2. The interaction term *Brand Capital*Strategy* was added in the third step. The F statistic was 6.153 which was statistically significant ($p < .001$) and the interaction term increased the R^2 to .35, which was also a statistically significant increase ($p < .01$). The coefficient for the interaction term was statistically significant ($p < .05$) but had a negative sign. This suggests that the effect of the firm's strategy on shareholder value is moderated by the level of brand capital within the firm such that as the value of brand capital increases, strategies that exploit this resource in new ways have a negative effect on shareholder value.

Figure 1 clearly illustrates the moderating effect that brand capital has on the relationship between the firm's strategy and shareholder value, as measured by Jensen's alpha. Because the continuous variables were standardized as recommended by Aiken and West (1991), the values in Figure 1 refer to the number of standard deviations above, at and below the mean values for brand capital and Jensen's alpha. For example, firms with brand capital valued at one standard deviation below the mean that formulated valuable new strategies that should be difficult or costly to imitate ($\text{Strategy}=1$) achieved shareholder value equal to 1.4 standard deviations above the mean. However, firms with brand capital valued one standard deviation below the mean that did not follow this strategy ($\text{Strategy}=0$) realized shareholder value that was .6 standard deviations below the mean. Stated another way, firms with brand capital that is one standard deviation below the mean achieve substantially higher performance results by following a strategy that uses their existing resources to create new products, processes or technologies that are difficult or costly for competing firms to imitate.

Now consider firms with brand capital that is valued one standard deviation above the mean. If these firms followed the new strategy ($\text{Strategy}=1$), shareholder value is .3 standard deviations above the mean. However, firms with brand capital valued

FIGURE 1
The Moderating Effect of Brand Capital on
Shareholder Value Using Two Different Strategies



one standard deviation above the mean that did not follow this strategy (Strategy=0) achieved shareholder value .6 standard deviations above the mean. Stated another way, firms with brand capital that was one standard deviation above the mean realized higher shareholder value by *not* following a strategy that used existing firm resources (brand capital) to create new value that was difficult or costly for competing firms to imitate. While the performance differences are rather small (.3 standard deviations), they are statistically significant.

In a post hoc analysis, the operationalization of *strategy* was changed to include those strategies that raters felt created value that should be *easy* for competing firms to imitate. Theoretically, these strategies should not have a positive effect on Jensen's alpha, because investors would not expect cash flows gained from these strategies to be long lasting. Consistent with expectations, these strategies had no effect on investors' expectations as measured by Jensen's alpha. This finding strengthens the validity of the strategy construct by providing evidence of predictive validity and face validity (Schwab 1980).

DISCUSSION

These results provide strong support for Hypotheses 1 and 2. Specifically, as the value of brand capital increased, shareholder value also increased. Likewise, in firms that announced strategies that created new value that should be difficult or costly for competing firms to imitate (Strategy=1), shareholder value also increased. Consistent with the findings of Kerin and Sethuraman (1998), the intangible value contained in a firm's brand capital is indeed a valuable firm resource that can be measured and exploited to increase shareholder returns. However, this research also provides evidence of the generalizability of Kerin and Sethuraman's findings by using different operationalizations for brand value (Simon and Sullivan's 1993 measure of brand equity) and shareholder value (measured using Jensen's alpha). Further, the sample consisted of single product manufacturing firms rather than consumer products firms.

Counter to Hypothesis 3, the results suggest that the interaction between the value of a firm's brand capital and strategies designed to use the firm's resources in new ways has a negative effect on shareholder value. This means that as the value of a firm's brand capital increases, exploiting these resources in new ways has a negative effect on shareholder value. On the other hand, if a firm's brand capital is less valuable, strategies that exploit these resources in new ways have a positive effect on shareholder value. This finding seems to suggest that managers should be cautious of efforts to use existing resources in new ways if these resources are already highly valued. The Coca-Cola company's introduction of New Coke in the mid-1980s offers anecdotal evidence to support this conclusion. Kerin and Sethuraman (1998) also found that the relationship between brand value and shareholder value was concave with decreasing returns to scale. This suggests that there is a point beyond which additional increases in brand value may not produce a corresponding return to shareholders. Together, the findings from these studies offer interesting opportunities for new theoretical development. At what point, and under what conditions, is brand capital too much of a good thing? This is indeed an interesting research question for future theoretical development and empirical exploration.

Previous studies that have examined the relationship between brand value and shareholder value have relied on consumer goods firms. This sample provides additional evidence of this relationship based on a sample of publicly traded single product manufacturing firms. The market-based brand equity measure developed by Simon and Sullivan (1993) was also validated using this sample. Finally, it should also be noted that this study provided a very conservative test of the hypotheses. Strategy was coded 1 only for those announcements that the raters agreed created new value that would be difficult or costly for competing firms to imitate. The choice of Jensen's alpha for the dependent variable also provides a very conservative test. It was not enough for shareholder value to be increased, it had to be increased beyond investors' expectations. Finding significant results using a relatively small sample size and very conservative

operationalizations would seem to add additional support for the model as well as offer evidence of validity for the methodology that was used.

CONCLUSION

This study appears to both validate and strengthen early research on the relationship between brand value and shareholder value (Simon and Sullivan 1993; Kerin and Sethuraman 1998) and should serve to motivate additional research in this area. These findings also suggest that academics outside of marketing should give increased attention to the marketing literature (Day 1992). Scholars from marketing and strategic management should be intrigued by some of the implications found in this study. For marketing, brand capital is an idiosyncratic firm resource that can be measured and exploited by firms in order to increase shareholder value. For strategic management, strategies that exploit a firm's existing resources by creating new value that is difficult or costly for competing firms to imitate can have a positive effect on shareholder value. Researchers from both disciplines should explore the apparent negative reaction by the financial markets to efforts by firms that try and create even more value by using resources that are already highly valued. Scholars from these and other disciplines should strive to develop multidisciplinary approaches in future research that will adequately address these issues.

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