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Will eChannel additions increase the financial performance of the firm?—The evidence from Taiwan

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Abstract

The emergence of the Internet has forced firms to add eChannels to their existing channel system. Nevertheless, empirical studies failed to provide direct evidence on whether eChannel addition could enhance the financial performance of the firm. In this research, an attempt was made to fill in this literature gap from three financial measure perspectives, i.e., Event Study methodology, Economic Value Added (EVA) measure and Market Value Added (MVA) measure. Empirical data were collected from Taiwan's financial service sector. The finding revealed that eChannel addition announcement could increase a firm's accumulative abnormal returns, EVA value and MVA value. We therefore concluded that eChannel addition could help increase the financial performance of the firm.

Keywords: eChannel; Internet channel; Event study; Economic value added; Market value added

1. Introduction

The emergence of the World Wide Web (WWW hereafter) has forced a large number of firms, both in B2B and B2C environments, to explore Internet-based channels of distribution, i.e., eChannels, to market their products. The purpose of adding eChannels to their existing channel systems is to increase and sustain their competitive advantage, and to eventually enhance their financial performance. However, addition of an eChannel system into existing channel systems (eChannel addition hereafter) can be met with opportunities as well as threats (Geyskens, Gielens & Dekimpe, 2002). Therefore, the use of eChannel addition could potentially undermine the firm's financial performance and further jeopardize their overall operations.

In spite of the uncertainty surrounding the financial performance of eChannel addition, countless firms have rushed to build eChannels to access millions of potential online customers directly. This leads to the question: "will eChannel addition increase the financial performance of the firm?"

Through a review on the literature, only one pioneer work, which devoted efforts to providing a clearer picture on how eChannel addition increased a firm's financial performance, has been identified. Nevertheless, this work, conducted by Geyskens et al. (2002), failed to provide direct evidence on whether eChannel addition could enhance the financial performance of the firm.

This research looked to investigate the financial performance of the eChannel addition strategy for firms through research from financial measure perspectives. Of the two financial measures, economic measures were used to compute a firm's performance as accounting measures were considered to be less appropriate in evaluating eChannel values (cf. Anderson, Fornell & Mazvanchery, 2004). In view of its popularity and effectiveness, Abnormal Returns (AR hereafter), a kind of economic measures, was identified and further computed to assess the impact of eChannel addition on the market value (a kind of financial performance indicator) when such a strategy was announced by the firm. This would be implemented by using Event Study methodology.

The short-term oriented Even Study methodology brought about the consideration that observation in the short term might

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not accurately reflect the true value of a firm over longer periods of time. In order to overcome this limitation, the research also introduced alternative long-term economic measures of a firm's financial performance: the Economic Value Added[3] (EVA hereafter) and Market Value Added (MVA hereafter) measures (Yook & McCabe, 2001), for the purpose of eChannel addition assessment. Popularity and application suitability for strategic planning and performance evaluation (Bhalla, 2004; Chen & Dodd, 1997; Ehrbar, 1999) were further considerations in employing these two measures.

In the following sections, related literature including performance evaluations of eChannel addition, Even Study, and EVA and MVA will be reviewed. Research methodology will then be reported, followed by data analysis. Research conclusion will be in the final section.

2. Performance Evaluation of an eChannel Addition

Due to intensified market competition and the emergence of the WWW, the channel system context is changing (Stewart & Zhao, 2000). The Internet as an addition to the modern channel system, i.e., the use of physical as well as virtual channels, has become critical (cf. Coelho & Easingwood, 2003), and a large number of firms have increasingly utilized such a dual channel system to market their products (Reda, 1999). It is believed that the adoption of the Internet as channel addition can achieve high level of Customer Lifetime Value (CLV) (Rajkumar & Kumar, 2004), and enhance a firm's competitive advantages (Reda, 1999). These competitive advantages include extended market coverage, increased sales, low transaction costs, and service delivery and communication. Nevertheless, potential disadvantages can occur, such as consumer confusion, conflicts with original intermediaries and increased organizational complexity (Alba et al. 1997; Coelho & Easingwood, 2003; Geyskens et al., 2002; Park & Kim, 2003; Rosenfield, 1999; Rowley, 2004).

Because eChannel addition potentially has both beneficial and detrimental consequences, the net profit of such an action is unclear. A solution to support the value of eChannel addition in guiding business processes is to link it to financial performance (Bolton, 2004). Performance measures provide information to managers and investors about the value creation process within the firm. On one hand, managers rely upon performance measures to provide information on both current performance and to track the underlying value creation process over time. On the other hand, performance measures provide investors a benchmark for comparison across firms and as indicators of likely future performance.

Financial measures are valuable as they reflect the assets and cash flows at different levels of the organization. The primary distinction among the many alternative financial measures of a firm's performance is between accounting measures and economic measures (Hirsch, 1991). The majority of financial performance research have concentrated on studying accounting measures which result from historical financial data, such as sales, cost, Return On Investments (ROI) and Return On Assets (ROA) (see, among others, Boulding & Staelin, 1993; Dekimpe & Hanssens, 1995; Hanssens, Parsons & Schultz, 2001; Jacobson, 1990; Werner, Manfred & Wayne, 2004). Economic measures are forward-looking and reflect the stock market's perception of both current and potential profitability. A number of research have assessed a firm's financial performance in terms of economic measures. Examples include stock price, stock return and Tobin's Q (see, among others, Anderson et al., 2004; Huselid, 1995; Jensen & Murphy, 1990; Lewellen & Badrinath, 1997; Pardue, Higgins & Biggart, 2000).

Financial performance evaluation of eChannel addition using traditional accounting measures may be inappropriate. Reflecting upon Copeland and Weston's (1983) opinion, accounting measures can only provide a limited reflection of true shareholder values generated by eChannel addition investments. This statement can be verified by Anderson et al. (2004) who state that "Commonly used accounting measures are found to be less appropriate indicators of an Internet channel's value, because such measures typically contain little or no information about the true value of the firm". As suggested by Mandel (2000), more intangible factors such as brand names and R&D should be considered as evaluation indices. Stock prices, a kind of economic measure which also reflects such intangible factors, are therefore deemed by Milbourn (1996) to be the best financial performance measure. However, a recent article (Anderson et al., 2004) argued that stock prices may not be an efficient benchmark for evaluation purposes because stock prices can be affected by uncontrolled factors without any common baselines. Accordingly, Event Study which incorporates the AR value of stocks based on a particular event to the capital market into stock prices is considered a better means for performance evaluation. A pioneer work conducted by Geyskens et al. (2002) attempted to introduce Event Study methodology to evaluate the financial performance of eChannel addition. Unfortunately, the research failed to provide direct evidence that eChannel addition could enhance the financial performance of the firm. In this study, an attempt was therefore initiated to explore the relationship between eChannel additions and a firm's financial performance by measuring its AR value using Event Study methodology. However, the inherent short-term nature of such a process/methodology lead us to apply another two "value-added" economic measures of a firm's financial performance, i.e., EVA and MVA, for the assessment to show a more long-term perspective (Yook & McCabe, 2001) and to verify the results of Event Study methodology.

3. Event Study

Event Study draws on the efficient market hypothesis that financial markets will process publicly available information to assess the impact of a firm's financial performance and to adjust expectations of its future achievements (Fama, Fisher, Jensen, & Roll, 1969). The logic underlying the hypothesis is the belief that investors will react rapidly to any additional public information regarding a firm (that is, when an event occurs) and the extent to which they adjust their expectations of the

[3] EVA, being a tool for measuring business performance at the firm level, is a trademark of a New York consulting firm, Stern Stewart Management Services.