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Stock analysts' assessments of the shareholder value of intangible assets

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Abstract

Marketing decisions create intangible assets. In the absence of formal intangible asset value reporting structures, the stock analyst acts as an independent valuation source who provides seemingly objective assessments of the shareholder value of a firm's intangible assets. Drawing on qualitative data from in-depth interviews with stock analysts, the authors investigate a series of antecedent factors that affect the accuracy of the stock analyst's assessment of intangible assets. The study collates these observations into several propositions that may serve as a basis for further research.

Keywords: Marketing; Intangible assets; Stock analysts; Shareholder value

1. Introduction

Proponents of the resource-based view (RBV) of the firm point to the important role of assets in general and of intangible assets in particular (e.g., Barney, 1986, 1995; Conner and Prahalad, 1996; Grant, 1991; Hall, 1993). Intangible assets can comprise the majority of a firm's total assets (Doyle, 2000), are important contributors to shareholder value (Gupta et al., 2004), and provide a sustainable source of wealth creation (Riahi-Belkaoui, 2003). Intangible assets include brands, customer relationships, and market knowledge. The RBV suggests that intangible assets may be powerful sources of competitive advantage because rival firms cannot easily comprehend, evaluate, and imitate them. Intangible assets are also difficult to measure. The accounting profession struggles with the task of determining the financial value of intangible assets (Lev, 2001). Consequently, the more intangible-dominant the firm, the more likely its financial reports do not reflect the full potential of the firm's future returns on investment (see Choi et al., 2000).

Generally, each firm has the responsibility to measure and report upon the value of its intangibles. Because of the lack of regulated reporting controls (Guthrie and Petty, 2000), disclosure by firms of the perceived value of intangibles is irregular (Ambler et al., 2001), subjective (Backhuijs et al., 1999), selective (Wyatt, 2002), and informal (Stolowy and Jeny-Cazavan, 2001). Over-valuation of intangible assets was the principal cause of corporate crashes such as WorldCom and Enron in the USA, and HIH and One.Tel in Australia. Investor reaction to these unexpected crashes indicates an urgent need for investors to receive more accurate information about the nature and value of firms' intangible assets (Lim and Dallimore, 2002).

Because intangible assets are complex and difficult to measure (Srivastava et al., 1998), challenges exist not only for investors but also for the stock analysts who advise them. The role of stock analysts is a critical one: evaluating the tangible and intangible assets of firms and then making recommendations to investors based on their evaluations. The more accurately stock analysts evaluate a firm's intangible assets, the more likely they facilitate informed decision-making by investors by providing an accurate assessment of a key influencer of shareholder value.

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Stock analysts present themselves to investors as independent, impartial, and expert, yet little is known about how analysts deal with the challenge of assessing intangibles. This paper aims to understand the factors that can influence the accuracy of stock analysts' assessment of the shareholder value of intangible firm assets. On the basis of qualitative data derived from in-depth interviews with 63 stock analysts, the paper integrates these factors into five propositions.

This study is important for the marketing discipline because intangibles often relate to marketing (McLaughlin, 2003). A growing theoretical literature shows that marketing assets provide a substantial contribution to shareholder value. However, what is not known is how, whether, and to what extent, stock analysts understand the contribution of marketing intangibles to shareholder value. This issue is part of a broader question, namely, how do those external to the organization value the contribution of marketing, broadly defined, to the organization's future prosperity? This study also sheds light on the thought processes of stock analysts, and how they conceptualize intangibles and determine the relative contribution of intangibles to future shareholder value *vis a vis* tangibles.

This article begins by defining key terms, outlining the stock analyst's role, and presenting the methodology used. Subsequently, the article merges insights from the extant literature and from in-depth interviews with stock analysts to develop several propositions relating to analysts' assessments of intangible assets. Finally, the article provides guidelines for future research and discusses the implications of the propositional framework.

2. Key considerations

Intangibles, knowledge assets, and intellectual capital are interchangeable terms. Each term refers to a claim to future benefits that does not have a physical or financial embodiment, such as a stock or a bond (Lev, 2001).

Research shows a significant and positive relationship between intangible assets and shareholder value, but this proposition rests primarily on an analysis of individual intangible assets. Studies include: brands and products (e.g., Ambler, 2002; Fernandez, 2002; Houston et al., 2002; Madden et al., 2002); customer satisfaction (e.g., Anderson et al., 2002; Fornell et al., 2006; Gruca and Rego, 2003; Ittner and Larcker, 1998; Wanganheim and Bayon, 2002); and alliances, partnerships, and distributorships (e.g., Anand and Khanna, 2000; Suarez, 2002; Swaminathan and Moorman, 2002). This research confirms that intangible assets are important generators of firm wealth and that their importance will increase in the future (see Carroll and Tansey, 2000; Klaila and Hall, 2000; McConnachie, 1997; Nickerson, 1998).

Work by scholars on the RBV shows that intangibles matter. The RBV demonstrates the importance of looking inside the firm and getting a deeper understanding of the firm's resources and capabilities as sources of competitive advantage (e.g., Amit and Schoemaker, 1993; Barney, 1995; Collis and Montgomery, 1995; Dutta et al., 2005; Peteraf, 1993). One of the RBV's key insights is that some intangibles matter more than others. Barney (1995) proposes a four-stage test to analyze the extent and nature of a resource's contribution to competitive advantage. The test involves four questions (Barney, 1995, pp. 50–57). The question of value: do a firm's resources and capabilities add value by allowing the firm to exploit opportunities and/or neutralize threats? The question of rareness: how many competing firms possess these valuable resources and capabilities? The question of imitability: how easy or difficult is it for other firms to imitate these valuable resources and capabilities? The question of organization: is the firm organized to exploit the full competitive potential of its valuable resources and capabilities? Analysts should consider these questions when determining which intangibles contribute most to competitive advantage.

Just as intangibles matter, so do analysts too. The analyst's role is similar to film critics and consumer advocates: the consumer hands over some of the decision-making process to those who are deemed to be more experienced, more informed, and more knowledgeable (Gershoff et al., 2001). In following the analyst's advice, an investor assumes that the analyst performs detailed research to develop a deep understanding of the drivers (and inhibitors) of a firm's wealth-generating capacity. Investors, either consciously or unconsciously, rely on analysts to carefully analyze both tangible and intangible assets (Bruce, 2002).

While stock analysts' assessments influence investor decisions (e.g., Lee, 2001; Ryan and Taffler, 2001), very few studies (notable exceptions are Barron et al., 2002; Barth et al., 2001) explore the things that have an impact on the assessments made by stock analysts, and none specify the effects in a propositional framework. Research shows, however, that recommendations by analysts about particular firms typically derive from current financials such as assets, immediate profits, and short-term cash flow, supplemented by the stock analyst's knowledge of the specific industry, judgment of the execution capabilities of a firm's management, and personal contact with the firms' executive management (Lev, 2000). Research also shows that the valuation of intangible assets tends to be based upon non-financial data (McLaughlin, 2003), such as brand audits and customer satisfaction surveys.

The stock analyst's role is two-fold: to make an assessment of a firm's future value and to provide a buy/sell/hold recommendation. Analysts perform these two tasks to varying degrees of accuracy. Because the second task relates to the first, accuracy of assessment by stock analysts is the key dependent variable in this study.

This point requires a precautionary note. The analyst's role is a classic instance of trying to exercise judgment under two aspects of decision uncertainty (Leblebici and Salancik, 1981). The first aspect has to do with environmental conditions, including diversity and turbulence, which provide the context in which a decision is made and which create uncertain outcomes. The second aspect is the challenge of determining cause–effect relationships and predicting how actions will affect outcomes. In valuing firms, the analyst has to deal with both of these aspects: trying to ascertain likely changes in the environment that the firm faces and, simultaneously, trying to predict how the firm's strategies and tangible and intangible assets will allow