



Myopic (Marketing) Management: the Phenomenon and Its Performance Consequences

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Do Managers Give Appropriate Attention to Long-term Assets?



The Concern Over Myopic Management:

- Managers may unduly emphasize current-term financial performance

(i.e., have a discount rate higher than justified by cost of capital considerations)



Earnings Inflation Methods:

- **Accounting-Based Earnings Management (aka Earnings Management through accrual manipulation)**
 - using judgment in financial reporting to mislead stakeholders about the underlying performance
 - does not alter either the amount or the temporal flow of the true economic returns
- **Myopic Management (aka Earnings Management through real activity manipulation)**
 - selecting strategic options with immediate benefits at the expense of future profits
 - affects both the amount and the pattern of cash flows over time

The Theory of Myopic Management



- **Hidden Action Models**
 - Narayanan (1985), Stein (1989)
- **Hidden Information Models**
 - **Signaling** (e.g., Trueman 1986, Hirshleifer and Chordia 1992, Bizjak et al. 1993)
 - **Lemons** problem if no tools to send credible signals (e.g., Myers and Majluf 1984)
 - **Information Neglect** (e.g., Brandenburger and Polak 1992)

Evidence of Myopic Management



- Most research has been theoretical or based on anecdotal evidence
- Recent Survey of CFOs:
 - **80%** say they would cut spending on R&D and Advertising and **55%** would delay start of new projects to meet earnings goals, and only **40%** would book revenues sooner and **27%** draw reserve (Graham et al. 2005)
- Few empirical studies:
 - executives reduce R&D expenditures in their final year of tenure (Dechow and Sloan 1991)
 - firms issuing SEOs cut marketing spending to inflate earnings (Mizik and Jacobson 2007)
 - firms try to increase earnings beyond zero by giving price discounts to temporarily boost sales (Roychowdhury 2006)
 - at the end of the fiscal year price discounts are offered on non-perishable groceries to promote stockpiling (Chapman and Steenburgh 2007)

Consequences of Myopic Management



- **Consequences of Accounting-Based Earnings Manipulation studied extensively in Accounting Literature**
- **Consequences of Myopic Marketing Management for firms issuing seasoned equity (Mizik and Jacobson 2007)**
 - Myopic marketing management is defined as cutting marketing spending to inflate earnings at the time of an SEO
 - Myopic firms issuing SEO are able to temporarily fool the stock market and realize higher stock returns
 - The stock market corrects the mis-valuation of the myopic firms over time and the total long-term consequences of myopic marketing management are negative

The Total Financial Returns to Myopic Marketing Management Over the Long-Term



← myopic firms: Mktg Expenditure(-), Earnings(+)

$$\text{Abnormal StkR}_{i\tau+j|\tau} = \gamma_1 j * d^{ME(+), ROA(+)}_{i\tau} + \gamma_2 j * d^{ME(-), ROA(+)}_{i\tau} + \gamma_3 j * d^{ME(+), ROA(-)}_{i\tau} + \gamma_4 j * d^{ME(-), ROA(-)}_{i\tau} + \eta_{i\tau+j}$$

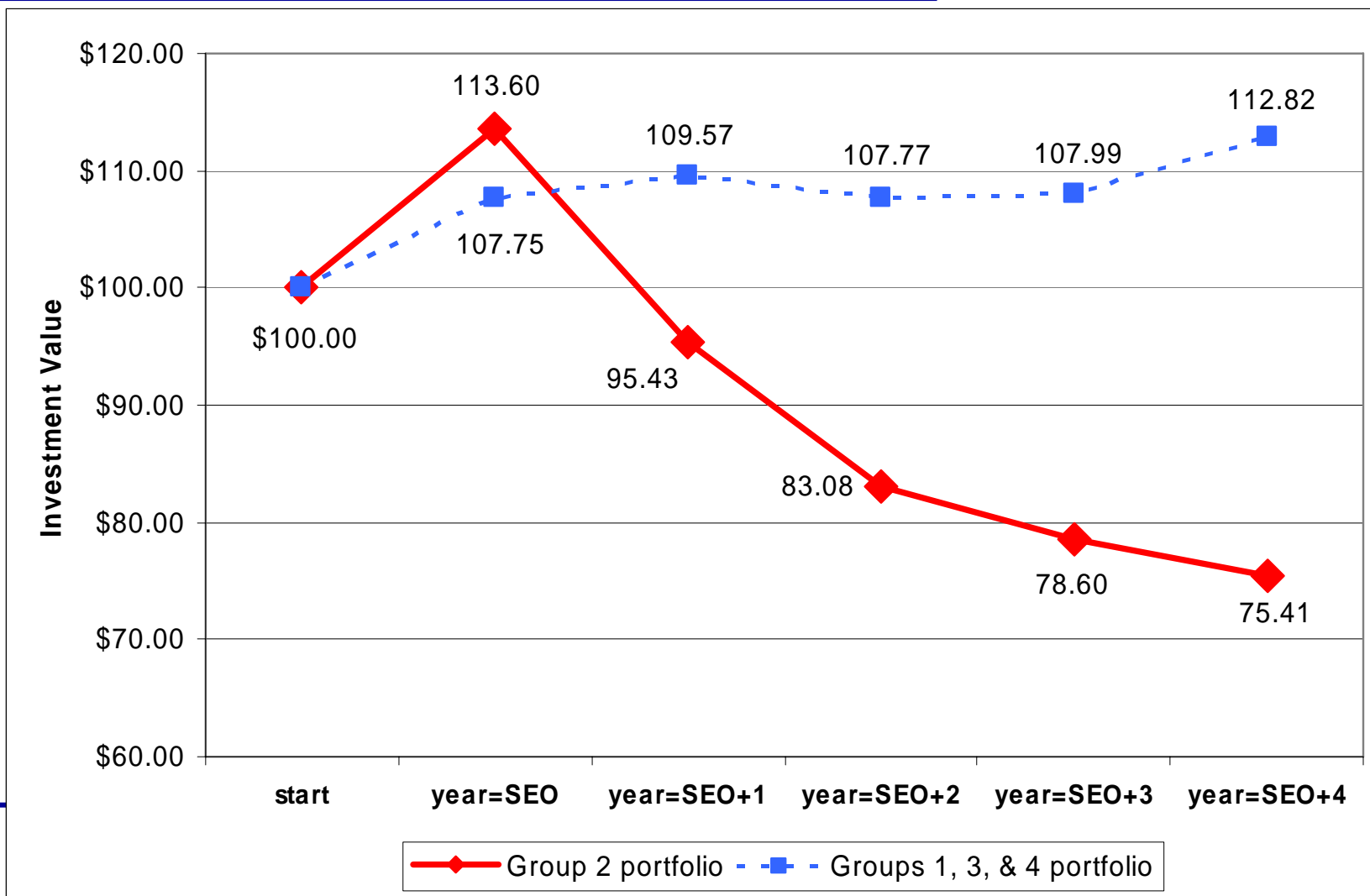
where $j=0, 1, 2, 3,$ and $4.$ t-statistics in brackets, Significance levels: ** $p < .01$

	The year of an SEO: current-year abnormal stock return $j=0$	One year after an SEO: cumulative two-year abnormal stock return $j=1$	Two years after an SEO: cumulative three-year abnormal stock return $j=2$	Three years after an SEO: cumulative four-year abnormal stock return $j=3$	Four years after an SEO: cumulative five-year abnormal stock return $j=4$
γ_1	0.131** [4.34]	0.188** [3.67]	0.129* [1.98]	0.126 [1.64]	0.160 [1.82]
γ_2	0.136** [6.13]	-0.046 [-1.22]	-0.169** [-3.57]	-0.214** [-3.90]	-0.246** [-3.89]
γ_3	-0.004 [-0.10]	0.002 [0.04]	-0.002 [-0.02]	0.103 [1.11]	0.190 [1.78]
γ_4	0.081** [3.34]	0.079 [1.92]	0.079 [1.50]	0.042 [0.69]	0.081 [1.17]
# obs.	1,837	1,774	1,669	1,553	1,365
F-stat	16.88	4.66	4.74	4.89	5.74



Performance of SEO Firm Portfolios:

Myopic Firms Portfolio vs. Non-Myopic Firms Portfolio



Earnings Management vs. Myopic Management: Performance of Firm Groupings Based on ROI Shocks, R&D Shocks, and Discretionary Accruals



Group 1: ROA _{it} >0, rR&D _{it} >0, DAcc>0	-0.02804 (0.04813) [-0.58]	-0.11690 (0.07359) [-1.59]	-0.12219 (0.09532) [-1.28]	-0.10002 (0.11462) [-0.87]	-0.09584 (0.13018) [-0.74]
Group 2: ROA _{it} >0, rR&D _{it} >0, DAcc<0	0.00383 (0.04950) [0.08]	0.06809 (0.07484) [0.91]	0.01395 (0.09728) [0.14]	-0.02079 (0.11347) [-0.18]	0.02362 (0.13119) [0.18]
Group 3: Myopic Firms with Positive Accruals ROA _{it} >0, rR&D _{it} <0, DAcc<0	-0.12031 (0.03698) [-3.25]	-0.22320 (0.05730) [-3.90]	-0.25697 (0.07549) [-3.40]	-0.27792 (0.09244) [-3.01]	-0.34496 (0.11002) [-3.14]
Group 4: Myopic Firms with Negative Accruals ROA _{it} >0, rR&D _{it} <0, DAcc<0	-0.10532 (0.03828) [-2.75]	-0.14678 (0.05831) [-2.52]	-0.23033 (0.07604) [-3.03]	-0.27523 (0.09244) [-2.98]	-0.32080 (0.10712) [-2.99]
Group 5: ROA _{it} <0, rR&D _{it} >0, DAcc>0	-0.06292 (0.05013) [-1.26]	-0.07725 (0.07755) [-1.00]	-0.05742 (0.10031) [-0.57]	-0.07696 (0.11830) [-0.65]	-0.18272 (0.13664) [-1.34]
Group 6: ROA _{it} <0, rR&D _{it} >0, DAcc<0	0.01859 (0.05462) [0.34]	0.02168 (0.08372) [0.26]	-0.04494 (0.10695) [-0.42]	0.12654 (0.12582) [1.01]	0.13958 (0.14349) [0.97]
Group 7: ROA _{it} <0, rR&D _{it} <0, DAcc>0	-0.05816 (0.04568) [-1.27]	-0.00276 (0.06885) [-0.04]	0.03889 (0.08828) [0.44]	-0.02799 (0.10819) [-0.26]	-0.03458 (0.12968) [-0.27]
Group 8: ROA _{it} <0, rR&D _{it} <0, DAcc<0	0.01918 (0.04910) [0.39]	0.11664 (0.07502) [1.55]	0.08410 (0.09757) [0.86]	0.29963 (0.11917) [2.51]	0.16280 (0.14283) [1.14]

Natalie Mizik
of Myopic Management
F-statistic

AMA Consortium, ASU, May 2007
2,292
2.75

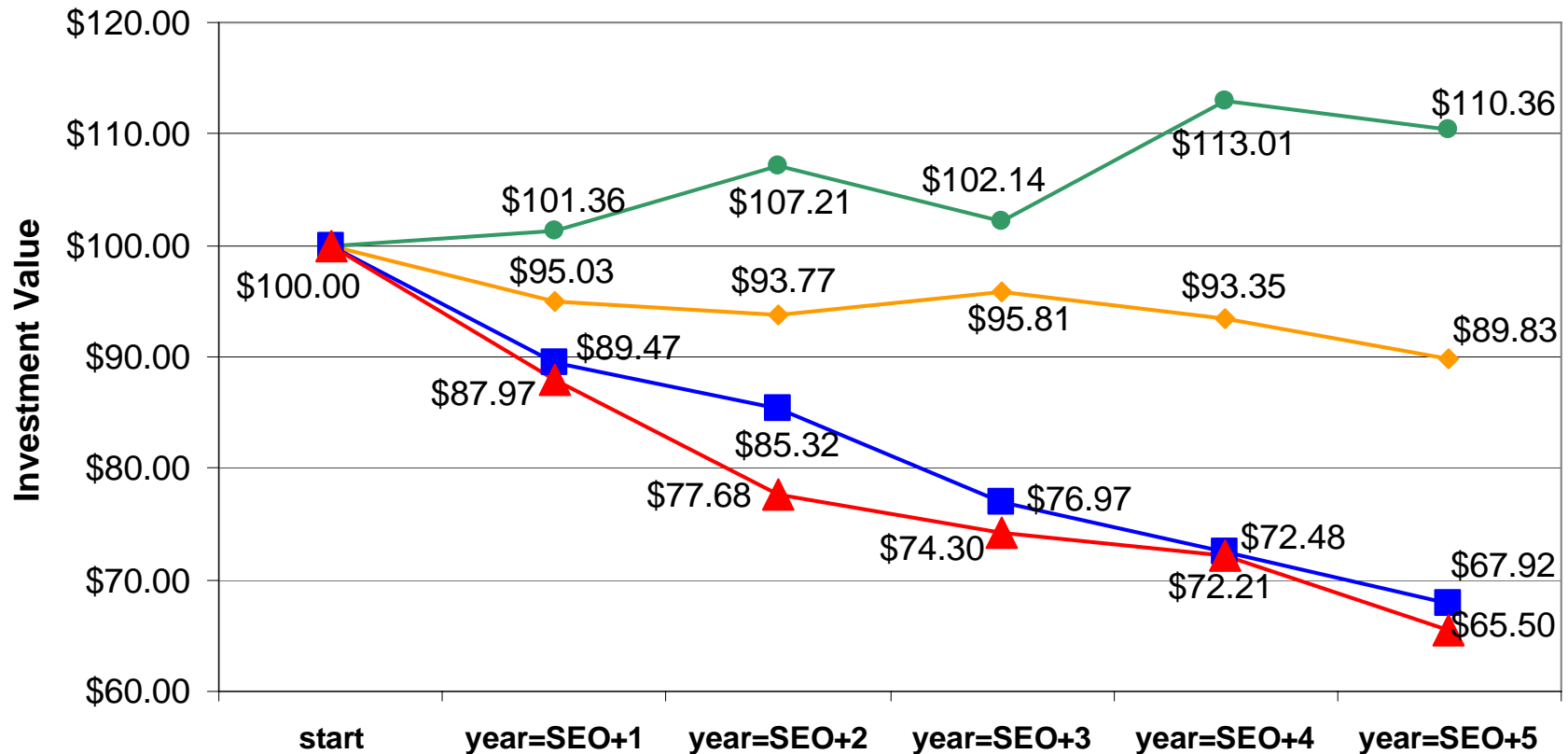
1,896
3.54

1,565
2.98

1,310
3.32

9
1,096
2.93

Earnings Management vs. Myopic Management: Performance of Firm Groupings Based on Earnings, R&D, and Discretionary Accruals



- Firms not engaging in Earnings Management and no Myopic Management (Group 2,6,8 portfolio)
- ◆ Firms engaging in Earnings Management and no Myopic Management (Group 1,5,7 portfolio)
- Firms engaging only in Myopic Management (Group 4 portfolio)
- ▲ Firms engaging in both Earnings Management and Myopic Management (Group 3 portfolio)

What can Owners (Shareholders) do to Diminish Incentives for Myopic Behavior and Its Negative Effects?



- Realign managerial incentives to focus the management team on the long-term horizon
 - Introduce **metrics** reflecting long-term intangible assets (customer satisfaction, loyalty, churn, new product success, brand perceptions, etc.)
into the managers' evaluation and compensation schemes

What can Managers do to Diminish Incentives for Myopic Behavior and Its Negative Effects?



- Managers need to improve their information disclosure strategies:
 - Send **credible** and **meaningful** signals to the market about the firm health and future prospects

Marketing Metrics (quantifiable and verifiable) can play a key role

Two roles of Marketing Metrics in limiting Myopic Behavior:



- To the extent that **Marketing Metrics** are monitored and reported, managers are less likely to sacrifice **Marketing Assets** for a short-term gain
- **Marketing Metrics** can provide signals about future firm performance (incremental to current accounting performance numbers) and/or earnings quality

What can Marketing Academics do to Diminish Incentives for Myopic Behavior and Its Negative Effects?



- Marketing researchers need to focus on extending our knowledge of how marketing assets affect the amount, timing, and the variability of financial performance
 - **customer equity, brand equity, new products, innovation, quality...**
(e.g., Aaker & Jacobson 1994, 2001, Anderson et al. 2004, Fornell et al. 2006, Geyskens et al. 2002, Golder & Tellis 1997, Gupta et al. 2004, 2006, Ittner and Larker 1998, Lehmann 2004, McAlister et al. 2007, Mittal et al. 2005, Mizik & Jacobson 2003, 2007, Moorman & Rust 1999, Morgan & Rego 2006, Pauwels et al. 2004, Rust et al. 2002, Sorescu et al. 2003, 2007, Srivastava et al. 1998 ...)

but ...we still know relatively little about the impact of marketing assets and strategies on financial performance (Rust et al. 2004)

MSI 2007 call for research proposals