University of Kentucky

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Institute for the Study of Free Enterprise

Study analyzes the buffering effect of strong brands for companies in the face of legislative change

- **Brands can enhance the impact of investments in marketing, but also protect firms from experiencing the full effect of a negative market shock**
- **Previous studies have documented these effects for firm-specific events, this study analyzes this buffering effect in the face of a market-wide event, the passing of the Sarbanes-Oxley Act of 2002**
- **Study finds that firms experience a change in incentives that induces firms to emphasize value appropriation strategies over value creation strategies, this results in a reduction in marketing efficiency, this reduction is smaller in firms with stronger brands**

The Sarbanes-Oxley Act was passed in 2002 in response to the large accounting scandals at companies such as Enron, WorldCom, and Adelphia. The law required evaluation and disclosure of the effectiveness of firms' internal control systems and made firms' CEOs and CFOs potentially criminally responsible for corporate misdeeds. This resulted in decreased incentives for investment and risk-taking, which may stunt long-term innovation and growth, and increased incentives to increase market share of existing products over the development of new products. Felipe Thomaz of the University of South Carolina, John Hulland of the University of Georgia, Chad Zutter of the University of Pittsburgh, and ISFE affiliate Leonce Bargeron of the University of Kentucky use the introduction of this rule to examine if a strong brand can buffer a firm from the negative consequences that can come as a result of government-driven market shocks.

The study has several key findings. First, firms rapidly comply and adjust their strategy in the face of new environmental and cost structures. Second, firms display homogeneity in their competitive response to market-wide shocks. In the case of Sarbanes-Oxley, this resulted in a shift towards marketing activities that decreased marketing efficiency across firms. Third, the existence of strong brands before the market-level shock buffered firms from the effects of the shock. Firms with stronger brands had smaller decreases in marketing efficiency than firms with weaker brands.

The authors note, “we have focused on how firms have responded to one such legislative imposition, the introduction of the Sarbanes-Oxley Act of 2002. SOX has influenced how boards evaluate and respond to the perceived risks of various business options, resulting in a systematic shift across firms away from value creation in favor of more value appropriation. This happened in a homogenous manner, thereby reducing firms’ marketing efficiency, with the exception of those firms having the strongest of brands.”

They continue, “what the legislation means exactly for everyday marketing practice (e.g., pricing, advertising) is not yet clear, but it seems likely that marketers will prefer to support and promote well-established brands over radical new products.”