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Organizational Debut on the Public Stage: Marketing Myopia and Initial Public Offerings

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Organizational Debut on the Public Stage: Marketing Myopia and Initial Public Offerings

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Successful initial public offerings (IPOs) provide firms with access to valuable resources, but also put pressure on firms to impress potential investors with evidence of their current well-being and prospects for future growth. To impress investors IPO firms might curtail their marketing budgets, which appears to inflate current earnings and provide evidence of current well-being. However, curtailing marketing budgets unexpectedly during an IPO may be a myopic practice, in that the immediate benefits of these budget cuts are offset by their longer-term adverse consequences on financial well-being. The extent of these adverse consequences in turn may be moderated by external firm factors, including strategic alliances and key customer relationships, and internal firm factors, such as the strategic emphasis on value creation versus value appropriation. A sample of 1,095 IPOs during 2000–2011 reveals evidence of myopic marketing practices in more than 37% of the sample. Investors seem misled during IPOs, but they correct their beliefs in the three years following the IPO and penalize these firms. The penalty for myopic marketing budgeting practices also increases with more strategic alliances and a strategic emphasis on value creation versus value appropriation, but it decreases in the presence (versus absence) of key customer relationships.

Data, as supplemental material, are available at http://dx.doi.org/10.1287/mksc.2015.0970.

1. Introduction

Scholars emphasize the importance of marketing by showing that as marketing investments increase, firm performance increases (e.g., McAlister et al. 2007, Moorman and Rust 1999). However, stock market pressures may encourage firms to reduce their marketing investments to improve their short-term performance (Chakravarty and Grewal 2011). This short-term emphasis is highlighted by Firepond, Inc., a provider of integrated e-business sales and marketing solutions that went public in 2000; to attract investor attention to its initial public offering (IPO), Firepond reduced its marketing investment (advertising and research and development (R&D)) to 69% of revenue (thus increasing earnings) in 2000 compared to 97% of revenue it consistently spent in years prior to and after the IPO.[1] Because their valuations are driven primarily by

earnings (Lowry and Schwert 2004, Ritter 2011), a firm that has decided to go public has incentives to try to boost its earnings to increase its IPO valuations.

Representing private firms' debut on the public stage, IPOs exert tremendous pressure on those firms to obtain favorable responses from investors (Ritter 2011). Successful IPOs increase organizational reputation (Brau and Fawcett 2006), improve access to funding (Chemmanur and Fulghieri 1999), provide exit routes for initial investors (Daily et al. 2003), and have significant imprinting effects that shape organizations' evolution (Fischer and Pollock 2004). The desire for a successful IPO thus can motivate firms to engage in myopic marketing, as the Firepond example shows, by temporarily reducing their marketing investments to boost their current earnings.[2]

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[1] We use the acronym "IPO" to refer to the actual "IPO event." For other uses of IPO we are more specific, such as we use "IPO firm," "IPO profits," "IPO process," etc.

[2] These expenditure cuts are myopic because they result in short-lived gains in current performance (Mizik and Jacobson 2007, Roychowdhury 2006). The long-term implications of such cuts during the IPO have not been studied; this question motivates our research.

Graham et al. (2005) find that more than 80% of chief financial officers decrease discretionary expenses (advertising and R&D) to meet capital market expectations, suggesting they are willing to sacrifice longer-term firm value for short-term gains. This reasoning aligns with emerging literature on marketing myopia that provides empirical evidence of how firms intentionally make unanticipated marketing cuts during seasoned equity offerings (Mizik and Jacobson 2007), at the end of financial quarters (Chapman and Steenburgh 2011), and at the end of financial years (Mizik 2010) to increase immediate earnings. Such cuts fail to consider that short-term gains can be more than offset by lower long-term shareholder returns. Thus, Firepond did exceedingly well during its IPO, but it significantly underperformed the market and its peers over time.[3] We seek to study the (potentially harmful) effects of these myopic cuts to marketing budgets during the IPO process, to gain a better understanding of their implications.

To study marketing myopia during the IPO process, we incorporate moderators that reflect firm-level heterogeneity. Because IPO firms by definition have limited track records, they create significant uncertainties, which IPO firms can address by providing more information about their resources and internal strategies (Chemmanur and Yan 2009, Xiong and Bharadwaj 2011). For example, an IPO firm can access external resources if it possesses interfirm relationships that allow it to integrate its strategies and processes with those of partners (e.g., Uzzi 1997), such as strategic alliances or key customer relationships. Firms' internal strategies instead reflect their strategic emphasis on fundamental value creation and value appropriation processes (March 1991). Value creation implies a focus on upstream marketing activities, such as R&D to create novel innovations, whereas value appropriation emphasizes downstream marketing activities, such as advertising new and existing products (Mizik and Jacobson 2003). Although firms can pursue several strategies, "choices must be made between gaining new information about alternatives and thus improving future returns [i.e., value creation], and using the information currently available to improve present returns [i.e., value appropriation]" (March 1991, p. 72). The extent to which firms emphasize value creation over value appropriation then may be critical for assessing organizational outcomes. Accordingly, our conceptual framework includes IPO firms' external relationships (i.e., strategic alliances and key customer relationships) and internal strategic emphasis.

To test this conceptual framework, we gather data from firms that went public during 2000–2011. This 12-year window is long enough to obtain a large sample (1,095 IPOs) and observe longer-term performance (i.e., three years after the IPO). With this unique data set, obtained from multiple sources, we apply robust econometric specifications to account for potential endogeneity of myopic marketing. We find that more than 37% of the firms in the sample engage in myopic marketing during their IPOs, in that they reduce their marketing investments to inflate their current earnings. Investors fail to discern this myopic behavior immediately and reward firms during their IPOs, which appears to justify such myopic marketing. However, firms that engage in myopic practices also have systematically lower longer-term performance. The extent to which investors penalize myopic firms depends on the external and internal moderators. The downside of myopic marketing increases with more strategic alliances and a strategic emphasis on value creation, but it decreases in the presence of key customer relationships.

These findings in turn advance literature on marketing resource allocation and IPOs. First, we show that myopic cuts in marketing spending, when unrelated to product market factors, exert a persistent, negative impact on shareholder value. Prior research demonstrates the existence and negative consequences of myopic marketing (e.g., Chapman and Steenburgh 2011, Mizik and Jacobson 2007); we provide evidence about contingencies associated with its effects, involving factors both external and internal to the IPO firms. Second, our research contributes to IPO literature as we provide some resolution to the long-standing question of why IPO firms underperform relative to benchmarks after their IPO (Ritter and Welch 2002). Myopic marketing has significant effects on post-IPO performance and should be explicitly accounted for in any study that aims to examine longer-term IPO outcomes.

In the next section, we present out conceptual framework and then develop our hypotheses in §3. After we present our data and measures in §4 and analysis approach in §5, we detail the results in §6. In §7, we conclude with a discussion of the implications of our findings for both literature and practice.
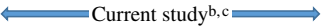
2. Conceptual Framework

2.1. Marketing Myopia and Initial Public Offerings

Marketing myopia refers to marketing actions motivated by immediate, tangible outcomes, such as growth in current earnings and stock prices, without regard to their longer-term implications. Such practices came to light after 2002, when the enactment of the Sarbanes–Oxley Act tightened accounting standards. In curtailing the use of accounting methods to inflate performance

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[3] Firepond's share price closed at $100.25 on the first day of trading, a 356% jump over the offer price of $22.00. Within a year, its stock was trading for $4.00.

Table 1   Extant Literature

	IPO	Marketing Myopia[a]
Short-term performance	• Luo (2008)[b] • Saboo and Grewal (2013)[b,c]	• Chakravarty and Grewal (2011)[c] • Moorman et al. (2012)[b]
Short- and long-term performance	• Kurt and Hulland (2013)[b]	• Mizik and Jacobson (2007)[d] • Gunny (2010) • Mizik (2010) • Chapman and Steenburgh (2011)
	←————— Current study[b,c] —————→	

[a]Regular public firm context.
[b]Includes moderators.
[c]Corrects for endogeneity of myopic marketing.
[d]Seasoned equity offering context.

measures (Cohen and Zarowin 2010), it also prompted an upsurge in manipulations of marketing activities to attain short-term performance objectives (Cohen et al. 2008). Myopic marketing practices include accelerating sales by offering unanticipated promotions or credit terms or reducing marketing budgets to inflate current-period earnings (Gunny 2010, Roychowdhury 2006). Although research on the longer-term effects of myopic marketing continues to emerge, some evidence (see Table 1 and the Web appendix (available as supplemental material at http://dx.doi.org/10.1287/mksc.2015.0970)) already indicates the harm of myopic marketing practices. Mizik and Jacobson (2007) show that myopic marketing actions during seasoned equity offerings result in stock underperformance by up to 39%, relative to matched counterparts, over four years. Chapman and Steenburgh (2011) find that price promotions that run for a week and offer a 33% discount increase current quarterly revenues but result in post-promotion dips of about 7.5% of net income. Yet, as Table 1 indicates, there is a general paucity of research that identifies the contexts that motivate myopic marketing actions or the conditions that influence their short- and long-term consequences. Although myopic marketing actions are strategic managerial choices, designed to influence IPO outcomes, existing empirical research fails to account for their nonrandom, endogenous nature.

Research that identifies contexts in which myopic marketing actions likely proliferate, as well as their consequences, can provide useful information to shareholders and regulators concerned with sustainable firm performance. For example, during an IPO, the short-term goal of attracting immediate investors is paramount (Lowry et al. 2010), and its success typically is quantified by immediate payoffs, such as initial stock valuations (Pollock and Rindova 2003). Such short-term goals may overshadow longer-term strategic concerns. An IPO also demands heavy resource commitments, as demonstrated by research across

business disciplines, including finance (Ritter 2011), accounting (Ball and Shivakumar 2008), economics (Daines and Klausner 2001), management (Chen et al. 2008), and marketing (Saboo and Grewal 2013). Overall, this research focuses on two broad domains: drivers of short-term performance measures (Ritter and Welch 2002) and the longer-term implications (Pástor et al. 2009). Tandem investigations of short- and longer-term IPO outcomes are scarce, even though such joint investigations are essential to determine if actions geared toward influencing short-term outcomes have unintended consequences on longer-term results; that is, because information about pre-IPO earnings largely drives IPO valuations (Ritter and Welch 2002), firms experience intense pressure to increase these earnings, which might lead them to engage in myopic marketing (Healy and Wahlen 1999). Lowering expenditures prior to an IPO is an easy way to increase earnings, because firms are not legally bound to justify changes in their discretionary spending to stakeholders. Therefore, we study marketing myopia in the IPO context, an appropriate research setting to investigate whether firms engage in myopic marketing around IPOs and, if they do, what short- and longer-term implications result.

2.2.   Moderating Variables
The uncertainty surrounding IPO firms, because of their limited track records and resources (Daily et al. 2003), reduces investors' willingness to purchase an offering and lowers IPO valuations (Houge et al. 2001). To reduce this uncertainty, IPO firms can share information with prospective investors. In particular, they describe both their internal strategies and their access to external resources through their interfirm relationships. Strategic alliances and key customer relationships both constitute significant external ties. The firm's internal strategic emphasis on value creation or value appropriation also represents information that is valuable to investors. Because details about these external and internal factors help reduce uncertainty about the firms' inherent "worthiness" (Chemmanur and Yan 2009, Xiong and Bharadwaj 2011), IPO firms likely share this information during the IPO process, and the information in turn can influence managerial actions, including myopic actions. We accordingly consider strategic alliances, key customer relationships, and the internal strategic emphasis as critical moderators.

3.   Hypotheses

3.1.   Marketing Myopia
From an economic perspective, if firms are rational, forward-looking decision makers, myopic marketing makes little sense.[4] By definition, such practices provide immediate benefits that dissipate in the long run.

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[4] An exception is when the discount rates are so steep that only the current period matters. Because IPO firms seek to exist publicly and

However, the IPO context provides both an opportunity and a motivation for firms to be myopic. First, the scarcity of information about the IPO firm (Ritter 2011), limited media coverage (Rao 1993), and investors' tendency to overweight recent firm performance (Coval and Shumway 2005) make the IPO process particularly susceptible to inflation of current earnings. This inflation makes IPO firms "look good," appear less risky, and seem worth a higher offer price (Khokhar 2011). A myopic marketing approach implies that firms reduce their marketing investments (advertising and R&D budgets) to report higher cash flows and inflate current-period earnings. Because marketing investments are discretionary, any cuts can boost earnings without drawing much scrutiny. Second, Stein (1989) shows that incentives for myopic behavior increase with the importance of the current-period stock price. In an IPO, current-period performance largely determines the amount of capital raised. Because IPO firms seek high valuation from investors during their IPOs, we propose the following baseline hypothesis:[5]

HYPOTHESIS 1 (H1). *Firms going public seek to inflate their current-period earnings through myopic marketing actions* (*cutting advertising and R&D investments*).

Investments in market-based assets might make firms less vulnerable to environmental threats and challenges, because these assets reduce cash flow volatility (Srivastava et al. 1998). Budgeting for advertising and R&D activities thus is critical, because these investments create market-based assets such as innovative products and strong brands. Marketing investments can help the firm determine customers' current and potential needs; develop and execute sales, promotions, and service programs; design and develop superior products; and enhance customer trust and loyalty. Cutting these investments—when the cuts are unrelated to product market factors—instead might increase firms' vulnerability to environmental threats. It also could result in delayed product development cycles, slower product launches, increased price sensitivity, or unpredictable revenue streams (Kessler and Chakrabarti 1996). After the IPO is complete and the adverse effects of the myopic marketing actions on cash flows begin to emerge, investors likely start correcting their initial evaluations and penalize the myopic firms. Thus, we hypothesize:

HYPOTHESIS 2 (H2). *Firms that engage in myopic marketing during IPOs earn lower stock returns after the IPO than firms that do not engage in such actions*; *that is*, *the stock prices of myopic firms drop more than those of nonmyopic firms*.

3.2. Moderating Effect of Strategic Alliances

Strategic alliances are "characterized by the commitment of two or more firms to reach a common goal entailing the pooling of their resources and activities" (Teece 1992, p. 19). Such alliances are popular means to acquire knowledge and other resources. Firms thus use alliances to transfer and absorb their partners' knowledge and to exploit complementarities in their knowledge, without losing their own distinctive base of specialized knowledge (Grant and Baden-Fuller 2004). For example, firms enter into cooperative technological alliances for R&D and engineering to innovate; they join marketing alliances to undertake downstream activities such as sales, advertising, and distribution and stimulate demand (Fang et al. 2015, Swaminathan and Moorman 2009). Thus, alliances provide access to resources that the focal firm does not own and that are difficult to acquire otherwise. However, their benefits depend critically on the firm's ability to meet contractual obligations and nurture the goodwill of its alliance partners. Alliances demand maintenance, and working partnerships "have to be periodically renewed and reconfirmed or else they lose their efficacy" (Adler and Kwon 2002, p. 22). To make strategic alliances valuable and profitable, firms must proactively meet resource commitments and replenish their investments (Gundlach et al. 1995). Marketing investments provide explicit demonstrations of firms' efforts to nurture their partnerships. For example, advertising spending encourages market adoption of new alliance products, and R&D spending updates the available knowledge that can be used to advance technologies. Beyond their investments in developing and cultivating alliances, firms that invest in marketing activities should be better able to realize the potential benefits of those alliances.

However, when IPO firms engage in myopic marketing, they likely underinvest in activities that are important for alliance-based partnerships and then may not be able to realize the full benefits of the alliances. In turn, the opportunity costs of myopic marketing may increase when the firm has more alliances. Because strategic alliances seek to create joint value with partners, opportunistic actions, such as underinvestments, also might result in conflict (Gargiulo and Benassi 2000, Koka and Prescott 2002). If the IPO firm's underinvestment in the alliance is visible to current and potential alliance partners, its abilities to both benefit from current alliances and create new ones likely diminish (Gulati 1995, Kogut 1989). These risks also increase with more alliances. Therefore, the chances of being sanctioned for myopic behavior, and the resulting post-IPO decline in firm valuation, should increase with more alliances, and we hypothesize the following:

HYPOTHESIS 3 (H3). *As the number of strategic alliances increases*, *the effects of myopic marketing on post-IPO*

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thus create shareholder value (Saboo and Grewal 2013), it seems unlikely that discount rates would be steep.

[5] Although we do not formally hypothesize it, we expect myopic marketing to benefit short-term IPO outcomes.

stock corrections increases; that is, the negative effect of myopic marketing on post-IPO returns increases in magnitude with an increase in the number of strategic alliances.

3.3. Moderating Effect of Key Customer Relationships

Customers are critical firm assets, especially for young firms subject to the liability of newness (Bruderl and Schussler 1990). Because they lack substantial resources and perceived legitimacy, new firms struggle to develop business relationships with new customers (Stinchcombe 1965). Strong ties with customers can alleviate risks, because close customers purchase large amounts regularly, are receptive to new products, and proactively offer product feedback, endorsements, referrals, and word of mouth to facilitate product adoption (Jones and Sasser 1995). Relationships with key customers also tend to be characterized by trust and intimacy (Heide 1994), so they can withstand relationship variations, such as those due to temporary lapses in internal marketing spending. Even if an IPO firm engages in marketing myopia, knowledge inputs (i.e., resources) from these key customers may remain readily accessible. As sources of both tacit and factual knowledge, key customers thus help increase the productivity of existing marketing investments of IPO firms and lower their resource requirements. Thus, the presence of key customers can compensate for underinvestments in marketing, enabling firms to deliver strong results with similar or lower marketing investments. Therefore, the post-IPO decline in the valuation of firms that engage in myopic marketing should be lower in the presence, versus the absence, of key customers. Formally:

HYPOTHESIS 4 (H4). *The effects of myopic marketing on post-IPO stock corrections are lower in the presence, as opposed to the absence, of key customer relationships.*

3.4. Moderating Effect of Strategic Emphasis

Finally, when the firm's strategic emphasis shifts toward value creation, relative to value appropriation, innovative activities, such as building technological proficiency, gain precedence over activities designed to create competitive barriers in the product market, such as image building (Swaminathan et al. 2008). As has been widely documented (Lavie 2007, Mizik and Jacobson 2003), value creation and appropriation activities both can produce firm value, but through different mechanisms. Value creation (emphasis on R&D) improves upstream activities, such as developing new products and improving existing products. With these activities, firms can extract rents by marketing products that meet changing market conditions and increase customer satisfaction through improved product quality. Value appropriation activities (emphasis on advertising) instead enhance downstream activities, such as creating entry barriers

or decreasing price sensitivity. These activities enable firms to extract rents by establishing brand loyalty and purchase intentions and obtaining real-time market knowledge about competitive products and customer needs. From another perspective, value creation activities represent an internal (supply side) focus; value appropriation represents an external (demand side) focus. Both can produce long-term firm value.[6] A priori, it is thus not apparent whether the negative performance consequences of marketing myopia will vary with the firm's strategic emphasis on value creation or value appropriation. We accordingly propose alternate hypotheses:

HYPOTHESIS 5 (H5). *When the firm's strategic emphasis on value creation, relative to value appropriation, increases, the negative effects of myopic marketing on post-IPO stock corrections diminish.*

HYPOTHESIS 5 (H5ALT). *When the firm's strategic emphasis on value creation, relative to value appropriation, increases, the negative effects of myopic marketing on post-IPO stock corrections increase.*

4. Data and Measures

Our sample consists of firms that went public during 2000–2011 and had no public presence before that point (i.e., excluding spinoffs and firms whose parent company was already publicly listed). The 12-year sample window provides a sufficiently large sample ($N = 1,095$) and allows us to observe longer-term (three years) post-IPO performance. We obtained a list of first-time IPO firms from the SDC Platinum New Issues Database. In line with extant research (e.g., Lowry and Murphy 2007, Luo 2008), we eliminated rights issues, leveraged buyouts, equity carveouts, issues with proceeds of less than $1.5 million, and firms with excessive missing information. Merging this IPO information obtained from SDC with accounting information obtained from Compustat, Factset, and Capital IQ and stock returns data from the University of Chicago's Center for Research in Security Prices (CRSP) data tapes, we derived a sample of 1,095 firms. For each firm, we manually collected pre-IPO financial information from its IPO prospectus and tracked its performance until 2014, resulting in an unbalanced panel data set with 10,926 firm-year observations.

4.1. Independent Variables

4.1.1. Detecting Myopic Marketing. To test our framework, we need to be able to identify firms that exhibit myopic behavior. In line with extant research,

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[6] We thank the anonymous reviewers for suggesting this line of argument.

we classify firms as myopic if they report higher-than-expected earnings along with lower-than-expected marketing expenses in the year of their IPO (e.g., Mizik and Jacobson 2007, Roychowdhury 2006).[7]

4.1.2. Measuring Earnings Surprise and Abnormal Marketing Expenses. We use return on assets (ROA) to assess earnings, and size-adjusted advertising and R&D expenses to assess marketing expenses. The ROA series can be approximated well with a two-way (firm and time), fixed-effect, first-order autoregressive model. By including a lagged dependent variable, we control for past levels of ROA and other factors, including inertia, persistence, and different initial conditions that can predict future ROA (Mizik and Jacobson 2007). Specifically,

$$ROA_{it} = \beta^{ROA} \times ROA_{it-1} + \delta_t^{ROA} + \phi_i^{ROA} + \varepsilon_{it}^{ROA}, \quad (1)$$

where ROA_{it} is the return on assets for firm i in period t, ROA_{it-1} is the lagged value of the ROA series, β^{ROA} is the first-order autoregressive coefficient that captures persistence in the ROA series, δ_t^{ROA} is the time-fixed effect, and ϕ_i^{ROA} is the firm-fixed effect that accounts for time-invariant unobserved factors. Equation (1) is superior to alternate specifications. Simpler models (e.g., without fixed effects, random walk) fail to depict the series well, because the fixed effects get (incorrectly) absorbed in the error term. More complex models (e.g., AR(2)) do not provide benefits over our proposed model (Kothari et al. 2015).[8]

The marketing series similarly can be approximated by:

$$MKT_{it} = \beta^{MKT} \times MKT_{it-1} + \delta_t^{MKT} + \phi_i^{MKT} + \varepsilon_{it}^{MKT}, \quad (2)$$

where MKT_{it} is the value of marketing investments for firm i in period t, MKT_{it-1} is the lagged value of the marketing investment series, β^{MKT} is the first-order autoregressive coefficient that captures the persistence of the MKT series, δ_t^{MKT} is the time-fixed effect, and ϕ_i^{MKT} is the firm-fixed effect (time-invariant unobservable factors).

In both Equations (1) and (2), the fixed-effect terms (ϕ_i^{ROA} and ϕ_i^{MKT}) correlate with the lagged dependent variables (ROA_{it-1} and MKT_{it-1}), resulting in biased and inconsistent estimates (Greene 2003).[9] The bias for

the autoregressive coefficient is especially severe when the number of time periods T is low (Arellano and Bond 1991), as is the case here. Therefore, we follow a precedent from econometrics research and use a panel (internal) instrumental variable estimation (Anderson and Hsiao 1982) to recover the parameter estimates. We begin by first-differencing Equations (1) and (2) (i.e., subtracting their respective lagged values) to remove the fixed effects ϕ_i^{ROA} and ϕ_i^{MKT}:

$$\Delta ROA_{it} = \beta^{ROA} \times \Delta ROA_{it-1} + \Delta \delta_t^{ROA} + \Delta \varepsilon_{it}^{ROA}, \quad (3)$$

$$\Delta MKT_{it} = \beta^{MKT} \times \Delta MKT_{it-1} + \Delta \delta_t^{MKT} + \Delta \varepsilon_{it}^{MKT}, \quad (4)$$

where $\Delta ROA_{it} = ROA_{it} - ROA_{it-1}$, and the other terms use similar notations. The first-differenced lagged dependent variables, ΔROA_{it-1} and ΔMKT_{it-1}, in Equations (3) and (4) are correlated with the first-differenced error terms, $\Delta \varepsilon_{it}^{ROA}$ and $\Delta \varepsilon_{it}^{MKT}$, respectively, because the lagged error term ε_{it-1}^{ROA} appears in both $\Delta \varepsilon_{it}^{ROA}$ and ΔROA_{it-1}, as does ε_{it-1}^{MKT}. We therefore must account for the endogeneity of ΔROA_{it-1} and ΔMKT_{it-1} (Greene 2003). We create instruments to account for these correlations. Specifically, we use ROA_{it-2} and ROA_{it-3} to form instruments for ΔROA_{it-1}. Similarly, we use MKT_{it-2} and MKT_{it-3} to form instruments for ΔMKT_{it-1}. Lagged values are valid, with the assumption that error terms are serially uncorrelated, such that $E(\varepsilon_{it}^{ROA}, \varepsilon_{it-1}^{ROA}) = 0$ and $E(\varepsilon_{it}^{MKT}, \varepsilon_{it-1}^{MKT}) = 0$ (Arellano and Bond 1991). We use a test developed by Arellano and Bond (1991) to verify this assumption. Next, we apply a Hansen test to assess the validity of instruments, with the null hypothesis that the instruments are valid (Hansen 1982, Roodman 2009). We also consider a general method of moments estimation, which does not make any distributional assumptions and allows for consistent estimates of β^{ROA} and β^{MKT}. With the parameter estimates, we can use Equations (1) and (2) to estimate the forecast values for the series, $\widehat{ROA}_{it}$ and $\widehat{MKT}_{it}$, for each firm-year observation and thereby classify the firms as follows:

	$(MKT_{it} - \widehat{MKT}_{it}) > 0$	$(MKT_{it} - \widehat{MKT}_{it}) < 0$
$(ROA_{it} - \widehat{ROA}_{it}) > 0$	Group 1	Group 2
$(ROA_{it} - \widehat{ROA}_{it}) < 0$	Group 3	Group 4

4.1.3. Strategic Alliances. In line with extant literature, we anticipate that firms enter into various alliances to access external resources (Xiong and Bharadwaj 2011). We analyze the IPO prospectuses to count the total number of alliances in which each firm engages.

4.1.4. Key Customer Relationships. For their IPO, firms report "major customers" that account for more than 10% of their revenues. We use a dummy variable to

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[7] Our measure of myopic management is based on *actions*, not *intent*. Firms face the negative consequences of myopic marketing only if they actually engage in such activities.

[8] Fixed-effect AR(1) models are less data intensive than AR(2) models. Most IPO firms have a limited performance history, so an AR(2) model would severely restrict the sample available for analysis. When we applied AR(2) models to a subsample, we obtained substantively similar results.

[9] The fixed-effect terms appear in the equations for the lagged dependent variables, $ROA_{it-1} = \beta^{ROA} \times ROA_{it-2} + \delta_{t-1}^{ROA} + \phi_i^{ROA} + \varepsilon_{it-1}^{ROA}$ and $MKT_{it-1} = \beta^{MKT} \times MKT_{it-2} + \delta_{t-1}^{MKT} + \phi_i^{MKT} + \varepsilon_{it-1}^{MKT}$, so they refer to correlations between the error term at time t and the lag of the dependent variable.

indicate whether a firm has key customer relationships (Xiong and Bharadwaj 2011, Yli-Renko et al. 2001).

4.1.5. Strategic Emphasis. We collected information about advertising and R&D investments from Compustat, Factset, and Capital IQ. The ratio of R&D investments to advertising investments captures the firm's strategic emphasis (Mizik and Jacobson 2003). Table 2 contains a list of all of the independent and control variables.

4.2. Dependent Variables: IPO Outcomes
We measure short-term IPO outcomes using initial returns, which is a dominant measure in the IPO literature (e.g., Ljungqvist 2007, Ritter 2011) and has been used in prior marketing studies (e.g., Saboo and Grewal 2013). To evaluate longer-term consequences, we must compute abnormal stock returns over the longer term (e.g., Jain and Kini 1994, Teoh et al. 1998b). Traditional metrics (e.g., income, sales) are not appropriate for IPO firms, because balance sheet measures cannot capture their potential growth.[10] In line with extant literature, we instead use stock market–based measures to evaluate longer-term performance (e.g., Aggarwal et al. 2009). However, statistical tests based on commonly used benchmarks, such as market, three-factor, or four-factor models, suffer from severe misspecifications, because of the biases associated with new listings, rebalancing, and skewness (Barber and Lyon 1997, Kothari and Warner 1997).[11]

To account for this "bad model problem," we apply a procedure outlined by Barber and Lyon (1997). We compute the buy-and-hold abnormal returns of a sample firm, relative to a control firm with a similar size and book-to-market ratio. This matched-pair buy-and-hold abnormal return (MPBHAR) approach offers several advantages: It is less susceptible to the new listing, rebalancing, and skewness biases, and long-horizon

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[10] Balance sheet measures (e.g., Tobin's Q, revenues, profits) are backward looking and do not capture the long-term value of organizational strategies (Sheth and Sharma 2001, Srinivasan et al. 2012). We argue that the effects of myopic actions become evident only over multiple periods, so they cannot be captured effectively with balance sheet measures. Scholars in this domain use matched-pair buy-and-hold abnormal returns (or related) measures almost exclusively to assess the long-term influence of myopic actions (Mizik and Jacobson 2007, Shivakumar 2000, Teoh et al. 1998b), which supports our choice.

[11] A *new listing bias* arises because sampled firms generally have a long postevent history of returns, whereas firms that constitute the index (or reference portfolio) are new firms that begin trading only subsequent to the event month. A *rebalancing bias* arises because the compound returns of a reference portfolio, such as an equally weighted market index, are typically calculated with an assumption of periodic (generally monthly) rebalancing, but the returns of sample firms are compounded without rebalancing. A *skewness bias* arises because long-run abnormal returns are positively skewed (Barber and Lyon 1997, Kothari and Warner 1997).

tests based on this approach are well specified (Mizik and Jacobson 2007, Shivakumar 2000). As Barber and Lyon (1997) recommend, the control firm for each sample firm comes from the same two-digit Standard Industrial Classification (SIC) code and has a market value between 70% and 130% of that of the sample firm, as well as a book-to-market ratio that is closest to that of the sample firm. We calculate abnormal returns as the difference in returns between the sample firm and the control firm over a period of up to three years after the IPO (Kothari and Warner 2008, Mizik and Jacobson 2007). A three-year window is common in studies investigating longer-term IPO outcomes (Teoh et al. 1998a). Teoh et al. (1998a) argue that the incentives to maintain a high stock price likely persist in the years immediately after the IPO, because entrepreneurs cannot dispose of their personal holdings immediately, and firms face significant legal and reputational scrutiny, so any significant drop in earnings might trigger lawsuits. Moreover, underwriters engage in significant price-influencing activities after the IPO, to *stabilize* prices by stimulating demand or restricting supply (Aggarwal 2000). Thus, the consequences of myopic marketing likely are not visible immediately after the IPO. A three-year window is both short enough for the effects to be attributed to IPO-related actions and long enough for the consequences of these actions to manifest (Rajan and Servaes 1997). In addition, after a three-year period, IPO firms are "seasoned" (Rajan and Servaes 1997), so extending the analysis could introduce significant survivorship biases (Jain and Kini 1994). We specify the MPBHAR as

$$MPBHAR_{it+K} = \prod_{k=1}^{K}[1 + R_{ik}] - \prod_{k=1}^{K}[1 + R_{\text{Control},k}],$$
$$\text{where } 0 < k \leq 3 \text{ years}, \quad (5)$$

where R_{ik} is the holding period return for firm i at time period k, and $R_{\text{Control},k}$ is the k-period holding return for the control firm identified for firm i.

4.3. Control Variables
On the basis of our systematic review of the IPO literature (Daily et al. 2003; Kennedy et al. 2006; Ljungqvist 2007; Ritter 2003, 2011; Yong 2007), we include several IPO-specific controls that influence IPO outcomes. *Percentage width of offer range* is the offer width divided by the lowest offer price; underwriters who are uncertain about the price of an issue tend to set a wider offer range to provide greater pricing flexibility (Hanley 1993). We include the amount of equity stake that managers relinquish during an IPO, or *ownership dilution*, which provides important information about owner-managers' valuations (Leland and Pyle 1977). Investors are willing to pay a higher price if owners relinquish

Table 2 Variable Descriptions

Variable	Definition	Operationalization	Indicative references
Dependent variables			
Matched-pair buy-and-hold abnormal returns	Abnormal returns of the IPO firm up to three years after IPO relative to a control firm	Difference in returns between the sample firm and a control firm over a period of up to three years after the IPO; the control firm has the same two-digit SIC code, between 70%–130% of the market value (from Compustat), and the closest book-to-market ratio (from Compustat) relative to the sample firm	Barber and Lyon (1997)
Initial returns	Also referred to as underpricing; the percentage difference between the offer price at which the stock was offered to investors and the first-day closing price	Ratio of the first-day closing price obtained from CRSP and the offer price obtained from SDC Platinum New Issues Database, adjusted by market movements	Daily et al. (2003), Ritter and Welch (2002)
Independent variable			
Myopic marketing	Marketing actions motivated by immediate, tangible outcomes, such as growth in current earnings or stock prices, without regard to long-term implications	Firms are myopic if they report higher-than-expected earnings along with lower-than-expected marketing expenses in the year of their IPO	Mizik and Jacobson (2007), Roychowdhury (2006)
Moderators			
Strategic alliances	Sources of external resources	Number of alliances (new product and marketing), provided in the IPO prospectus	Xiong and Bharadwaj (2011)
Key customer relationships	Sources of external resources	"Major customers" that account for more than 10% of the firm's revenues, provided in the IPO prospectus; we include a dummy variable to indicate whether the firm has key customer relationships	Xiong and Bharadwaj (2011), Yli-Renko et al. (2001)
Strategic emphasis	Relative focus on value creation versus value appropriation for resource deployments within the firm	Ratio of advertising and R&D expenses, obtained from Compustat, Factset, and Capital IQ	Mizik and Jacobson (2007)
Control variables			
Percentage width of offer range	IPO pricing flexibility	Offer width divided by lowest offer price (SDC)	Hanley (1993)
Ownership dilution	Information about owner-managers' valuations	Amount of equity stake that managers relinquish at the time of an IPO (SDC)	Leland and Pyle (1977)
Price adjustment	Upward or downward revisions in offer price relative to the file price range	Revision in offer price from the midpoint of the original file price range (SDC)	Benveniste and Spindt (1989)
Venture capital funding	Quality of monitoring	Dummy variable that equals 1 if the firm has been funded by venture capital and 0 otherwise (IPO prospectus)	Pollock and Rindova (2003)
Underwriter reputation	Quality of monitoring	Carter and Manaster (1990) score, with update provided by Loughran and Ritter (2004)	Bhabra and Pettway (2003)
Run-up	Short-term market sentiment	Weighted market index 15 days prior to IPO	Chemmanur and Yan (2009)

less ownership. We also note *price adjustment*, or the revision in the offer price from the midpoint of the original file price range. Ritter (2011) argues this variable has the greatest explanatory power for short-term IPO outcomes. After setting the initial offer price range, underwriters gather investors' private information during road shows and incorporate it in the final offer price. According to information acquisition models, IPOs for which the final offer price is revised upward (versus downward) relative to the file price range should experience greater initial returns (Benveniste

and Spindt 1989). We control for *underwriter reputation* in line with extant research (Bhabra and Pettway 2003), using the Carter and Manaster (1990) score and the update provided by Loughran and Ritter (2004). We use a dummy variable to assess *venture capital funding* (Pollock and Rindova 2003).

Because market conditions may affect short-term IPO outcomes, we control for *run-up*, or the compounded return of an equally weighted market index 15 days prior to the IPO, to capture short-term market sentiments (e.g., Chemmanur and Yan 2009). A dummy

Table 2   (Continued)

Variable	Definition	Operationalization	Indicative references
		Control variables	
Bubble	Investor euphoria around the dot.com boom	Dummy variable to indicate if the firm went public before August 2000	Lowry et al. (2010)
Firm size	Stability and formalization	Sales and total assets at time of IPO (IPO prospectus, Compustat, Capital IQ)	Bhabra and Pettway (2003)
Firm age	Stability and formalization	Years in existence at time of IPO (IPO prospectus)	Lowry et al. (2010)
Net income	Profitability of the firm	Net income obtained from Compustat, Capital IQ, and Factset	Teoh et al. (1998a)
Functional background of CEO	CEO's experiential understanding of the marketing function	Dummy variable to capture CEO's marketing background (IPO prospectus)	Barker and Mueller (2002)
Total buzz	Market enthusiasm prior to IPO	Number of articles about the firm on Lexis–Nexis prior to the IPO	Pollock and Rindova (2003)
Competitive intensity	Industry competitiveness	Herfindahl index	Lee and Grewal (2004)
Market turbulence	Pace of market change	Ratio of sales and general administrative expenses to sales of firms in the same SIC code (Compustat)	Segarra and Callejón (2002)
Technological turbulence	Represents pace of technological change	Ratio of R&D investments to sales of the firms in the same SIC code (Compustat)	Osborn and Baughn (1990)

variable, *bubble*, indicates whether the firm went public before August 2000 (Lowry et al. 2010).

We also include firm-level variables related to unobserved firm quality. As firms grow larger and older, they establish and formalize relationships and standardize routines, which increase their structural stability and efficiency (Stinchcombe 1965). Thus, we control for firm size and age. To measure size, we use *sales* and *total assets* (book value of assets; Bhabra and Pettway 2003); for age, we consider the firm's *age* in years at the time of its IPO (Lowry et al. 2010). We also control for firm profitability (*net income*) because profitability should influence both organizational actions and their outcomes (Teoh et al. 1998a). In line with an upper echelons perspective (e.g., Hambrick and Mason 1984), we also include top management team information, because this team can provide access to resources. We thus note the number of board executives. The functional background of the CEO also influences firm strategies and outcomes (Barker and Mueller 2002), so we coded the CEO profiles contained in the IPO prospectus by their functional backgrounds, specifically, whether the CEO has a marketing background (*CEOMark*). We also include *total buzz*, measured as the number of articles about the firm on Lexis–Nexis prior to its IPO, because such chatter can influence IPO outcomes (Pollock and Rindova 2003).

Finally, we control for environmental variables. We include *market turbulence* as the ratio of sales and general administrative expenses to firm sales in the same SIC code as the focal firm (Segarra and Callejón 2002). For *competitive intensity*, we use the well-known Herfindahl index and square the market shares of the top four firms in the same SIC code (Lee and Grewal 2004). For *technological turbulence*, we take the ratio of

R&D investments to sales by firms in the same SIC code (Osborn and Baughn 1990).[12]

5.   Model Specification and Estimation

5.1.   Model Specification

To test H1, in line with Mizik and Jacobson (2007), we measure abnormal marketing expenses ($MKT_{it} - \widehat{MKT}_{it}$) and earnings surprises ($ROA_{it} - \widehat{ROA}_{it}$), as in Equations (3) and (4). We then categorize the firms into four groups, depending on whether they report marketing and earnings that are higher or lower than expected. According to H1, the proportion of firms that simultaneously report higher expected earnings and lower expected marketing investments should increase in their IPO year, relative to firms in other groups. In addition, H2 suggests that firms that engage in myopic marketing during their IPO suffer inferior performance in the future and are penalized more than those that do not engage in such activities. Consistent with Mizik and Jacobson (2007), we estimate the following equation to test this hypothesis:

$$
\begin{aligned}
MPBHAR_{ik} = {} & \lambda_k^1 I(Group\ 1) + \lambda_k^2 I(Group\ 2) \\
& + \lambda_k^3 I(Group\ 3) + \lambda_k^4 I(Group\ 4) \\
& + \varepsilon_{ik}^{MPBHAR},
\end{aligned}
\tag{6}
$$

where $MPBHAR_{ik}$ is the k-period matched-pair buy-and-hold abnormal return; $I(\cdot)$ is the indicator function, $k = 1$, 2, and 3 years after IPO; and estimates of λ_k

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[12] Some variables may not be relevant in a particular model specification. We list all of the control variables, their definitions, and their operationalization here, then indicate which variables we used in a particular analysis in their respective sections.

provide measures of the returns associated with each group.

From H2, our null hypothesis would be $\lambda_k^1 = \lambda_k^2 = \lambda_k^3 = \lambda_k^4 = 0$, where $k = 1, 2$, and 3. To test the moderating effects of strategic alliances, key customer relationships, and strategic emphasis (H3–H5), we also estimate the following model:

$$
\begin{aligned}
MPBHAR_{ik} = {} & \beta_{ik}^{MM} MM + \beta_{ik}^{SA} SA + \beta_{ik}^{MMSA} MM \times SA \\
& + \beta_{ik}^{CR} CR + \beta_{ik}^{MMCR} MM \times CR + \beta_{ik}^{SE} SE \\
& + \beta_{ik}^{MMSE} MM \times SE \\
& + \sum \beta_{ik}^{CTRL} \times CTRL + \varepsilon_{ik},
\end{aligned} \tag{7}
$$

where $MPBHAR_{it}$ is the matched-pair buy-and-hold abnormal returns for firm $i = 1, \ldots, N$ in year $k = 1, 2$, and 3 after the IPO; *SA, CR,* and *SE* refer to strategic alliances, customer relationships, and strategic emphasis, respectively; and *CTRL* are the other control variables. With H3–H5, we predict that $\beta_{ik}^{MMSA} < 0$ and $\beta_{ik}^{MMCR} > 0$, but we are unsure about β_{ik}^{MMSE}. The specification of Equation (7) includes industry-quarter and year fixed effects, which means our estimates are "within industry"; that is, they control explicitly for unobserved variables that do not vary across firms in a given industry and quarter, such as seasonality, broad macroeconomic conditions, recessions, hot IPO periods, industry attractiveness, or business cycles.

5.2. Endogeneity of Marketing Myopia
Our theoretical framework is based on the notion that firms want to enhance their IPO outcomes and therefore choose strategically to behave myopically, with the goal of enhancing their immediate IPO valuations. Unobservable factors (e.g., resources, capabilities) could influence both the decision to behave myopically and IPO outcomes, which would make myopia endogenous. To correct for this potential bias, we use a dummy endogenous variable model (Vella and Verbeek 1999), also known as a treatment effects model (Heckman 1978, Maddala 1983). It is a special case of the Heckman selection model, in which the outcome is observed for the entire sample, not just entities that received the "treatment," as in the case of a selection model (Madureira and Underwood 2008). This model has been widely used in finance (Madureira and Underwood 2008), economics (Vella and Verbeek 1999), and marketing (Ghosh and John 2009).[13]

To implement the model, we used a two-step procedure. The first stage involves a probit model of the incidence of myopic marketing, and z_i^{MM} captures exogenous variables that influence the organizational choice to engage in myopic management during the IPO. Therefore, we include firm-level variables (ROA, total assets, marketing intensity, technological intensity, number of alliances, total employees, number of patents, firm age, number of board executives), market conditions (short-term, whether the firm went public during a bubble), IPO-specific factors (underwriter reputation, venture funding), and industry variables (market turbulence, technological turbulence, competitive intensity) to predict the firm's decision to engage in myopic marketing. The first-stage probit model specification is:

$$
MM_i^* = z_i^{MM} \lambda^{MM} + \eta_i^{MM}, \tag{8}
$$

where MM_i^* denotes a latent measurement with an observed binary response indicator $MM_i = I\{MM_i^* > 0\}$, λ^{MM} is the unknown parameter vector, and the random error η_i^{MM} is assumed to be normally distributed.

In a second step, we use the estimates of λ^{MM} from Equation (8) and the resultant estimates of $z_i^{MM} \lambda^{MM}$ to compute the inverse Mills ratio (correction term, *IMR*) for each observation as follows:

$$
IMR = \begin{cases} \dfrac{\phi(z_i^{MM} \lambda^{MM})}{\Phi(z_i^{MM} \lambda^{MM})} & \text{if } MM = 1, \\[3mm] -\dfrac{\phi(z_i^{MM} \lambda^{MM})}{1 - \Phi(z_i^{MM} \lambda^{MM})} & \text{if } MM = 0, \end{cases} \tag{9}
$$

where ϕ and Φ are the probability density function and cumulative distribution function of the standard normal distribution, respectively.

We include the correction term (*IMR*) in Equation (7) to estimate the final model. To identify second-stage parameters, in line with the exclusion restrictions proposed by Maddala (1983) and Hausman (1978), we drop *ROA*, technological intensity, marketing intensity, number of employees, and board executives from our final model.[14] These variables satisfy the requirements of both relevance and exogeneity, supporting

---

[13] The *treatment effect model*, which includes the endogenous dummy variable as an independent regressor, is distinct from the *sample selection model*, which estimates the regression on a subsample of observations (for detailed discussions, see Guo and Fraser 2010, Lennox et al. 2011, Li and Prabhala 2007, Tucker 2010). The fundamental challenge of treatment effect models is that we cannot observe all of the information that managers use in their decision

making. For any given firm, we observe the outcome of a choice but not the outcomes of unmade choices. This missing information may result in a *selection bias due to observables*, such that we would fail to control for differences that can be observed (e.g., firm size, age), or it could prompt a *selection bias due to unobservables* due to the failure to account for differences that are unobserved. Heckman (1979) and Lee (1978) discuss *selection bias due to unobservables* and propose a two-step approach, in which the treatment choices are binary and the outcomes of the treatment depend on the combination of observable and unobservable factors. This approach requires estimating a choice model in the first stage and a bias correction term (i.e., *IMR*) in the second stage; it is a standard approach to correct for the endogeneity of binary variables due to unobservables (Vella and Verbeek 1999).

[14] Although the model can be identified by the nonlinearity of the correction term (*IMR*), using the exclusion restriction reduces our reliance on the functional form for identification (Greene 2003).

Table 3   Bivariate Correlations and Descriptive Statistics

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
(1) Myopic marketing	1						
(2) 1-year MPBHAR (%)	−0.16***	1					
(3) 2-year MPBHAR (%)	−0.17***	0.69***	1				
(4) 3-year MPBHAR (%)	−0.10***	0.58***	0.82***	1			
(5) Strategic emphasis	0.03	0.02	−0.06	−0.04	1		
(6) Strategic alliances	0.08	0.04	−0.00	0.03	−0.04	1	
(7) Key customer relationships	−0.05	0.04	−0.00	0.03	0.03	0.03	1
Mean	0.37	−0.12	−0.17	−0.12	0.18	1.13	0.45
SD	0.48	0.8	1.10	1.39	8.28	2.45	0.5

*** $p < 0.001$.

their exclusion (i.e., they do not have direct effects on our dependent variable, but have some power to explain myopic activities). Short-term measures, such as pre-IPO returns (ROA) or pre-IPO marketing and technological investments, should influence the decision to behave myopically (relevance), but are less likely to influence returns ($MPBHAR$) three years after the IPO, because they change over time (exogeneity). Similarly, the numbers of employees or board executives may constrain managers' ability to reduce investments in critical organizational activities arbitrarily, but they cannot explain post-IPO returns on their own. (We also include other size-related measures in the second stage.) In studies explicitly investigating this relationship, the number of employees had no relationship with long-term firm performance (Collins and Clark 2003, Ittner et al. 2003).

5.3. Model Estimation

To test H2, in line with Mizik and Jacobson (2007), we estimate Equation (6) using ordinary least squares. To test H3–H5, we use an endogenous dummy variable model to correct for the potential endogeneity of marketing myopia, and we estimate the probit model (Equation (8)) using maximum likelihood estimation and calculate the correction term (IMR). The dependent variable is an estimated quantity (estimated with the longer-term abnormal returns procedure outlined in Equation (5)), so we estimate the model parameters in Equation (7) (including the correction term) according to a weighted least squares regression, to account for the heteroskedasticity introduced by the estimated dependent variable (Hornstein and Greene 2012, King 1997).

6. Results

Table 3 contains the descriptive statistics and pairwise correlations of our focal variables. In Table 4, we report the estimates of Equations (3) and (4). The results fail to reject the null hypotheses in the Hansen test ($p > 0.15$ for ROA; $p > 0.09$ for marketing), so the model specification meets the moment condition, and the

Table 4   Fixed Effects Panel Data Forecast Models

	ROA equation (Equation (3))	Marketing equation (Equation (4))
ΔROA_{it-1}	0.28*** (8.58)	0.06 (1.90)
ΔMKT_{it-1}	0.04 (1.29)	0.33*** (9.36)
Hansen test	259.59 ($p = 0.15$)	266.97 ($p = 0.09$)

Notes. These results using Winsorized data suggest that both ROA and marketing series exhibit significant persistence, so the series decays over periods. The t-statistics are in parentheses. Time and year dummies have been suppressed for clarity.

*** $p < 0.001$.

instruments appear valid. Both ROA and marketing series exhibit significant persistence, with significant first-order lags (0.28 and 0.33, respectively), suggesting that the series decays over periods. Using the results from the forecast models, we compute the deviations in earnings ($ROA_{it} - \widehat{ROA}_{it}$) and marketing series ($MKT_{it} - \widehat{MKT}_{it}$), where $\widehat{ROA}_{it}$ and $\widehat{MKT}_{it}$ are forecast values for the respective series for each firm-year observation. We provide the descriptive statistics for the deviations in Table 5.

In Figure 1, we provide preliminary evidence of myopic marketing around IPOs. In aggregate, IPO firms exhibit significant positive deviations in earnings and negative deviations in marketing intensity during their IPO. To test the prevalence of marketing myopia formally, we examine the proportion of IPO firms in Group 2 ($MKT_{it} - \widehat{MKT}_{it} < 0$; $ROA_{it} - \widehat{ROA}_{it} > 0$), relative to the other groups. According to H1, we expect a greater proportion of firms to engage in myopic marketing (i.e., appear in Group 2) during their IPO. The results in Table 6 affirm H1, because in the year of their IPO, 37.22% of firms belong to Group 2, compared with only 28.47% in years when no IPO was offered, and this difference is statistically significant ($p < 0.01$).[15]

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[15] We find no statistical difference in the incidence of myopia before and after the enactment of the Sarbanes–Oxley Act. Going public

Table 5   Descriptive Statistics for Earnings and Marketing Surprises Around IPO

	Group 1		Group 2		Group 3		Group 4		Total	
	Earnings surprise	Marketing surprise	Earnings surprise	Marketing surprise	Earnings surprise	Marketing surprise	Earnings surprise	Marketing surprise	Earnings surprise	Marketing surprise
Mean	0.109	0.075	0.418	−0.350	−0.139	0.111	−0.083	−0.113	0.118	−0.106
SD	0.173	0.105	1.270	0.889	0.179	0.178	0.094	0.174	0.824	0.593
Min	0.000	0.000	0.000	−11.685	−1.286	0.001	−0.522	−1.859	−1.286	−11.685
Max	1.557	0.657	16.464	0.000	−0.001	1.514	0.000	0.000	16.464	1.514

Table 6   Prevalence of Myopic Marketing During IPO

	Number (percentage) of firms in year of IPO	Number (percentage) of firms in years IPO was not issued
Group 1 $(MKT_{it} - \widehat{MKT}_{it}) > 0$ $(ROA_{it} - \widehat{ROA}_{it}) > 0$	174 (16.11%)	1,873 (31.86%)
Group 2 $(MKT_{it} - \widehat{MKT}_{it}) < 0$ $(ROA_{it} - \widehat{ROA}_{it}) > 0$	**402 (37.22%)**	**1,671 (28.47%)**
Group 3 $(MKT_{it} - \widehat{MKT}_{it}) > 0$ $(ROA_{it} - \widehat{ROA}_{it}) < 0$	315 (29.17%)	1,627 (27.74%)
Group 4 $(MKT_{it} - \widehat{MKT}_{it}) < 0$ $(ROA_{it} - \widehat{ROA}_{it}) < 0$	189 (17.50%)	698 (11.93%)

Notes. Values in bold indicate the proportion of firms behaving myopically. Results indicate that more firms behave myopically in the year of the IPO than otherwise.

The first-stage probit model results in Table 7 suggest that total assets ($\beta = -0.279$, $p < 0.01$), age ($\beta = -0.144$, $p < 0.01$), marketing intensity ($\beta = -0.347$, $p < 0.05$), and going public during a bubble ($\beta = -0.529$, $p < 0.001$) reduce the likelihood, whereas funding by venture capitalists ($\beta = 0.505$, $p < 0.001$) increases the likelihood, of marketing myopia. These findings are reasonable. The amount of public information and post-IPO scrutiny increases with greater firm size and age, so larger, older firms become less likely to engage in myopic behaviors. Firms that value marketing investments also are less likely to reduce those investments. The irrational exuberance that marked the bubble period precluded the need to manage earnings to attract investors (Lowry et al. 2010, Ritter and Welch 2002). Finally, in line with venture capitalist moral hazard hypothesis, venture capitalists have both the incentives and the ability to encourage managers to engage in short-term earnings management (Darrough

and Rangan 2005), so their presence increases myopic marketing.

6.1. Myopic Marketing and Short-Term IPO Outcomes

In line with extant research, we look at IPO outcomes at the end of the first trading day to evaluate the short-term implications of myopic marketing (Ritter and Welch 2002). We use initial returns, the most widely adopted measure to evaluate short-term IPO outcomes.[16] Initial returns also are referred to as underpricing; they reflect the percentage difference between the offer price at which the stock was offered to investors and the first-day closing price (Daily et al. 2003). They also are associated with pre-IPO excitement (Staikouras and Tsatsanis 2004). An enthusiastic response, in the form of a high first-day bump in the stock price, tends to yield other benefits, such as media attention, interest among potential customers, and analyst coverage (Demers and Lewellen 2003). To calculate initial returns, we used the first-day closing price obtained from the CRSP and the offer price obtained from SDC. In line

---

has significantly higher stakes than reporting annual or quarterly results, so IPO firms that seek to engage in short-term earnings manipulations typically should use all available methods. Although reliance on accounting manipulations to attain short-term objectives may have diminished since the passage of the act (e.g., Cohen et al. 2008), our results do not allow us to comment directly on this possibility.

[16] We obtain qualitatively identical results using the market-to-book ratio, another popular short-term IPO performance measure of the ratio of the price at the end of the first day relative to the book value.

Table 7   Parameter Estimates for the First-Stage Probit Model

Independent variables	Parameter estimates	Standard errors
Total assets	−0.279**	0.095
Number of board executives	−0.019	0.011
Return on assets	−0.148	0.165
Marketing intensity	−0.347*	0.165
Technological intensity	0.141	0.344
Strategic alliances	0.012	0.017
Patents	0.000	0.000
Age	−0.144**	0.054
Bubble	−0.529***	0.117
Run-up	1.289	1.259
Technological turbulence	0.035	0.077
Market turbulence	0.004	0.024
Competitive intensity	1.075	1.450
Underwriter reputation	−0.054	0.035
Total employees	0.166	0.108
Venture funding	0.505***	0.105

Note. The first-stage probit model seeks to correct for the endogeneity of marketing myopia (Equation (8)).

*$p < 0.05$; **$p < 0.01$; ***$p < 0.001$.

with a meta-analysis by Daily et al. (2003) and reviews by Kennedy et al. (2006), Ritter (2003, 2011), Ritter and Welch (2002), Ljungqvist (2007), and Yong (2007), we include factors related to the firm, market conditions, and IPO, as discussed previously. The results (see Table 8) suggest that myopic marketing has a significant positive effect on the outcome variables ($\beta = 0.05$, $p < 0.05$); myopic IPO firms obtain higher valuations when they start trading. The coefficients of the control variables are in the expected directions. Upward revisions of the offer price (partial adjustment) and good market conditions (bubble) positively influence initial returns. By contrast, a competitive environment (competitive intensity) hurt initial returns. Although investors should be able to discern myopic behavior from the financial statements, because IPO firms are required to report their past earnings, they

Figure 1   (Color online) Abnormal Earnings and Marketing Surprises around IPO

Table 8   Myopic Marketing and Short-Term IPO Outcomes (Initial Returns)

|	Coefficient	SE
Myopic marketing	0.050*	0.023
Strategic alliances	−0.003	0.003
Key customer relationships	0.027	0.022
Strategic emphasis	0.000	0.002
Age	0.021	0.011
Net income	0.009	0.011
Sales	−0.087	0.105
Patents	0.281	1.458
Total buzz	0.007	0.006
Bubble	0.276***	0.033
Underwriter reputation	0.006	0.009
Venture capital funding	0.062*	0.028
Price adjustment	1.257***	0.106
Offer range	−0.068	0.241
Ownership dilution	0.000	0.000
Technological turbulence	0.000	0.007
Market turbulence	−0.001	0.003
Competitive intensity	−0.434*	0.185
Correction term (IMR)	−0.017	0.037

*$p < 0.05$; ***$p < 0.001$.

appear to overweight recent financial performance and reward myopic managers at the time of their IPO listing.

6.2. Myopic Marketing and Longer-Term IPO Outcomes
To test for the longer-term implications of myopic behavior (H2), we report estimates for Equation (6) in Table 9. These estimates provide support for H2; firms engaging in myopic marketing management (Group 2) have significantly lower returns after their IPO. No such negative stock returns are observed for groups that do not engage in myopic marketing. One year after the IPO, myopic firms (Group 2) underperform their matched counterparts by −28%. Two years later, they underperform by −41%, and the three-year cumulative return shows a difference of −30%.[17] All of the differences are statistically significant and confirm our hypothesis that IPO firms pay penalties for their myopic behavior in the longer term.[18]

6.3. Moderating Effects
The results from the estimation of Equation (7) provide further support for our theory (Table 10). The coefficient of the correction term (IMR) is significant,
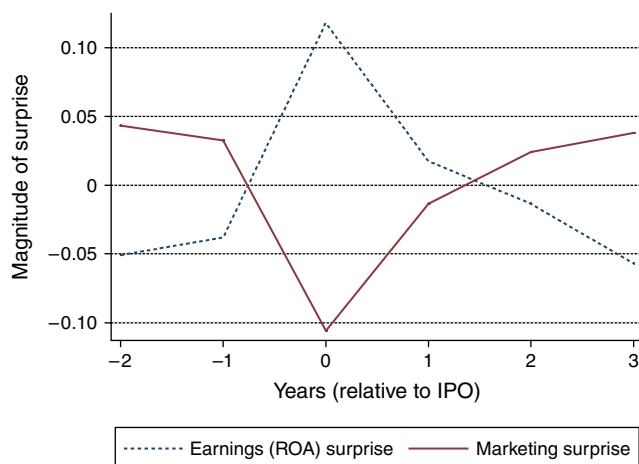
[17] Abnormal returns are higher than in studies that investigate myopic marketing in a seasoned equity offering context (Mizik and Jacobson 2007, Roychowdhury 2006), because post-IPO abnormal returns for myopic firms include long-run IPO underperformance (Ritter 2011).

[18] Although the MPBHARs provide reliable test statistics (Barber and Lyon 1997, Kothari and Warner 2008), we also tested H2 using nonparametric tests that did not rely on the normality assumption. The results matched those in Table 10.

Table 9   Myopic Marketing and Long-Term IPO Outcomes

	Group 1 λ_1	Group 2 λ_2	Group 3 λ_3	Group 4 λ_4
One-year abnormal stock return post-IPO, $k = 1$	−0.056 (−1.01)	−0.280*** (−6.91)	0.008 (0.19)	−0.049 (−0.88)
Cumulative two-year post-IPO abnormal stock return, $k = 2$	−0.077 (−1.09)	−0.410*** (−6.85)	0.019 (0.33)	−0.096 (−1.24)
Cumulative three-year post-IPO abnormal stock return, $k = 3$	−0.103 (−1.30)	−0.302*** (−3.67)	0.044 (0.65)	−0.068 (−0.73)

Notes. We used a dummy variable regression to estimate the impact of group membership on k-year post-IPO cumulative abnormal returns, $MPBHAR_{ik} = \lambda_k^1 I(Group\ 1) + \lambda_k^2 I(Group\ 2) + \lambda_k^3 I(Group\ 3) + \lambda_k^4 I(Group\ 4) + \varepsilon_{ik}^{MPBHAR}$ (Group 2 is the group of firms that engaged in myopic marketing). The t-statistics are in parentheses. Results using nonparametric tests that do not rely on the normality assumption are qualitatively identical to those reported here.
***$p < 0.001$.

highlighting the need to correct for the endogeneity of myopic marketing actions.[19] Consistent with H2 and our previous results, myopic marketing harms IPO firms in the years subsequent to their IPO, even after controlling for various factors that also influence post-IPO performance ($\beta = -0.367$, $p < 0.01$).[20] Strategic alliances (SA) have a positive effect ($\beta = 0.099$, $p < 0.01$) on the cumulative three-year post-IPO buy-and-hold abnormal returns, which confirms the benefits of resources accrued through such alliances and their long-term value (e.g., Kale et al. 2002). The significant negative coefficient for the interaction between myopic marketing and strategic alliance ($\beta = -0.132$, $p < 0.001$) also affirms H3: Strategic alliances enhance the negative effects of myopic marketing (Figure 2).

The significant positive coefficient for the interaction of myopic marketing and key customer relationships ($\beta = 0.571$, $p < 0.01$) also supports H4. Key customers buffer firms from the negative consequences of myopic marketing (Figure 2).

Strategic emphasis (SE) on value creation relative to value appropriation has a significant positive effect ($\beta = 0.039$, $p < 0.01$) on cumulative three year post-IPO buy-and-hold abnormal returns. However, our results for strategic emphasis indicate a significant negative interaction ($\beta = -0.052$, $p < 0.01$), such that an emphasis on value creation, relative to value appropriation, intensifies the deleterious effects of myopic marketing. Value creation activities have a longer-term payoff and typically rely on sustained investments. The speed of execution is a primary mechanism for small IPO firms (Chen and Hambrick 1995), so underinvestment in value creation activities and resulting delays in product development may render existing investments less useful; that is, such strategies provide competitors time to catch up and develop their own products, making it difficult for young IPO firms to attract customers.

The coefficients for the control variables are also in the expected directions. Short-term IPO outcomes (i.e., initial returns) have significant positive effects on longer-term returns, in line with the attention benefits of enthusiastic responses (Demers and Lewellen 2003). Longer-term abnormal returns decrease with firm size (TA) and firm age, but increase with net income during the IPO. Larger size and greater age often lead to structural inertia, making it difficult for the firm to compete with rivals (Audia and Greve 2006). Profitability (net income) instead indicates the presence of resources that foster the firm's abilities to defend against competitive moves and environmental turbulence (Cestone and Fumagalli 2005) and thus protect investor wealth in the long run. The IPO firms that benefited from irrational exuberance during the bubble period or hot markets report inferior post-IPO performance, in the form of poor longer-term abnormal returns (Coakley et al. 2007). Underwriter reputation relates positively to long-term abnormal returns. Underwriters have their reputations to protect, and those with strong reputations likely are more informed about the quality of an IPO. These reputed underwriters may actively discourage manipulative behavior that conflicts with shareholders' interest, to avoid the threat of future litigation (Lee and Masulis

[19] Results from an estimation without the endogeneity correction procedure provided qualitatively identical insights, offering confidence in our results. We also explored other variables that may be endogenous, with the objective of finding variables that exhibit "first order endogeneity" (Rossi 2014, p. 655) and correct for them. For example, because firms choose their strategic emphasis in an attempt to increase their performance, we estimated a model in which we corrected for the potential endogeneity of our strategic emphasis variable using the control function approach (Luan and Sudhir 2010). The results remained similar. The other moderators (key customer relationships and strategic alliances) cannot be chosen by the focal firm, because they require commitments from other entities that may have different utility functions.

[20] In an unreported analysis, we compared the long-term performance of firms that overinvest in marketing activities at the expense of current earnings (Group 3) with others. Results suggest that Group 3 firms that invest in marketing activities (presumably to boost future performance) perform significantly better than both myopic firms (Group 2) and firms in Groups 1 and 4 in the long run (three years). We thank the associate editor for suggesting this analysis.

Table 10 **Parameter Estimates for the Full Model**

|	Cumulative MPBHAR one year post-IPO	Cumulative MPBHAR two years post-IPO	Cumulative MPBHAR three years post-IPO
Myopic marketing (MM)	−0.0490 (−1.51)	−0.087* (−2.33)	−0.367** (−2.87)
Strategic alliances (SA)	−0.018* (−2.29)	−0.014 (−1.92)	0.099** (3.21)
Key customer relationship (KCR)	0.061 (1.89)	0.004 (0.15)	−0.099 (−0.86)
Strategic emphasis (SE)	−0.007 (−0.59)	−0.003 (−1.33)	0.039** (2.81)
MM × KCR	−0.0377 (−0.80)	0.107* (2.29)	0.571** (3.18)
MM × SA	−0.009 (−0.85)	0.011 (1.08)	−0.132*** (−3.40)
MM × SE	0.006 (0.47)	0.001 (0.11)	−0.052** (−2.85)
Age	0.065*** (3.93)	0.025 (1.61)	−0.329*** (−5.25)
Net income	−0.004 (−0.48)	0.021** (2.88)	0.120* (2.28)
Total assets	0.032 (1.71)	−0.032* (−2.51)	−0.314*** (−5.65)
Patents	0.275 (0.39)	−1.416 (−0.91)	10.23 (1.73)
CEO with marketing background	−0.101*** (−3.39)	0.029 (1.46)	−0.142 (−1.34)
Market-to-book ratio	0.001 (0.95)	−0.0002 (−0.33)	−0.003 (−1.04)
Underwriter reputation	−0.036** (−3.10)	0.031** (2.61)	0.139*** (3.52)
Bubble	−0.302* (−2.16)	−0.129 (−1.88)	−1.129*** (−4.36)
Venture funding	0.097* (2.14)	−0.042 (−1.79)	−0.013 (−0.09)
Initial returns	0.007 (0.37)	−0.155*** (−3.60)	0.457*** (4.20)
Total buzz	0.131*** (3.43)	0.047** (3.08)	0.023 (0.30)
Technological turbulence	−0.062 (−0.50)	−0.194* (−2.13)	−0.205 (−0.54)
Market turbulence	0.001 (0.10)	0.007 (0.82)	0.058* (2.27)
Competitive intensity	−0.142 (−0.33)	−1.595* (−2.37)	−1.714 (−1.02)
Correction term (IMR)	0.019 (0.21)	−0.019 (−0.50)	0.782** (2.85)

Notes. The *t*-statistics are in parentheses. Industry quarter and year dummies have been suppressed for brevity. Some variables are scaled to avoid zeros.
 *$p < 0.05$; **$p < 0.01$; ***$p < 0.001$.

2011). Finally, IPO firms benefit from market turbulence, which is in line with prior studies that highlight that changes in consumer preferences offer an opportunity for IPO firms to gain influence (e.g., Srinivasan et al. 2002).

6.4. Alternative Explanation: Are Myopic Firms Low on Cash?

Underinvestment in marketing might not be deliberate; that is, firms exhibiting myopic behavior might be low

Figure 2 **(Color online) Interactions of Myopic Marketing**
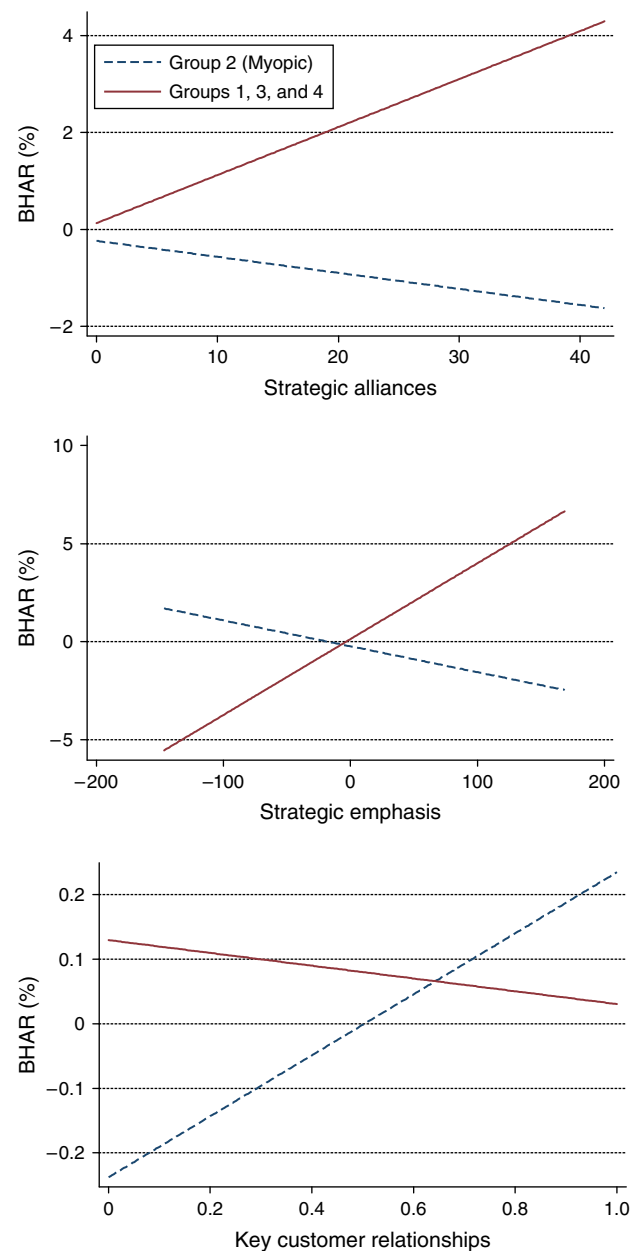
on cash, such that they simply *cannot* invest in marketing activities. To rule out this alternate explanation, we compare the cash flow (using Compustat measures of cash and short-term investments, CHE) against the positions of myopic firms (Group 2) and others (Groups 1, 3, and 4) but find no significant difference. On average, firms engaging in myopic marketing exhibit cash flows similar to those that do not engage. We also computed the proportion of firms with positive versus negative size-adjusted cash flow surprises during their IPOs; that is, we estimated the difference between observed size-adjusted cash flows and those predicted from a time-series model, analogous to the one in

Table 11   Return on Assets Comparison

Years	Group 2	Groups 1, 3, and 4	Difference
One year post-IPO, $k = 1$	−0.422	−0.088	$p < 0.001$
Two years post-IPO, $k = 2$	−0.531	−0.111	$p < 0.001$
Three years post-IPO, $k = 3$	−0.703	−0.108	$p < 0.001$

Equations (3) and (4). Again, we found no support for the alternate explanation that myopic firms are cash constrained. Rather, underinvestment in marketing appears deliberate, in line with our theorization.

6.5.   Post-IPO Operating Performance
The values of the MPBHAR provide strong support for our theory that underinvestment in marketing expenses hurts post-IPO performance, assessed using stock market–based measures. To understand the drivers of post-IPO stock market underperformance, we also assessed the consequences of myopic marketing on an operating performance measure. Specifically, we compared the post-IPO ROA of myopic firms with the ROA of other groups. The results in Table 11 suggest that myopic firms realized a significantly lower ROA than other firms, starting in the first year after their IPO (Figure 3).[21] Thus, myopic marketing significantly lowers firm profitability and results in serious underperformance in future periods.
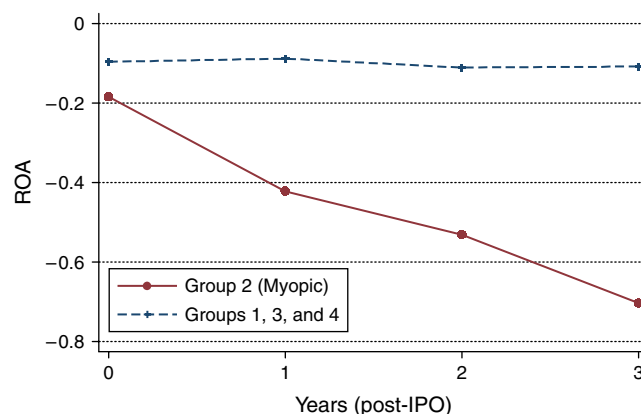
7.   Discussion
Consistent with our theorizing, the IPO setting seems to encourage firms to engage in myopic marketing practices and rewards them for this myopic behavior during the IPO. However, firms are penalized in the longer term for their myopic marketing. The presence (versus absence) of key customers can compensate for myopic practices, but the deleterious effects of myopic marketing worsen with the number of strategic alliances the IPO firm has. A strategic emphasis on value creation, relative to value appropriation, also enhances the negative longer-term effects of myopic marketing. These theoretically grounded findings have implications for both theory and practice.

7.1.   Implications for Theory
In prior resource allocation literature, the adverse performance consequences of myopic marketing have been established in several contexts (Chapman and Steenburgh 2011, Mizik and Jacobson 2007). However, in none of these contexts have researchers established the possibility that the consequences of myopic marketing could vary due to firm heterogeneity (i.e., in their external resources and internal strategy). We contribute to this theory by investigating the boundary conditions

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[21] We obtain identical results when we use operating income before depreciation, interest, and taxes (OIBDP).

Figure 3   (Color online) Post-IPO Return on Assets of Myopic vs. Other Firms

of the impact of marketing myopia. These consequences clearly could be masked or aggravated, depending on how well firms can deploy their resources and strategies when they manage fundamental activities such as advertising and R&D myopically.

Specifically, we find that key customer relationships can strengthen organizational defenses against temporary variations in marketing expenses (which otherwise might disrupt product development or weaken customer equity). This result also highlights the importance of customer-relevant constructs, such as customer satisfaction and loyalty, for IPO firms. By contrast, firms with many strategic alliances are bound by resource sharing contracts, so shortages lead to disruptions. In particular, myopic marketing weakens the firm's defensive capabilities, because of its disruption of the constructive output coming from strategic alliances. Thus, we highlight a contrast between two sources of external resources—strategic alliances and key customer relationships—and accordingly caution against research that combines these sources. Key customer relationships, unlike strategic alliances, fortify organizational defenses against variations in marketing spending. We also note the differential effects of an emphasis on value creation or value appropriation on performance outcomes. Extant literature recognizes the importance of both strategies (Mizik and Jacobson 2003, Swaminathan et al. 2008) but does not offer clear guidelines to help firms strategically increase resource allocations to one process or the other. We take a step toward creating such guidelines by highlighting the relative superiority of downstream value-appropriating activities in fortifying organizational defenses, especially in an IPO setting. If IPO firms have limited slack, they may be better off emphasizing value-appropriating processes, such as investing in customer relationships with shorter payback periods, and diminishing their focus on value-creating processes, such as building new knowledge that requires a longer payback period.

Figure 4   (Color online) Performance of IPO Firm Portfolios: Group 2 (Myopic) vs. Groups 1, 3, and 4
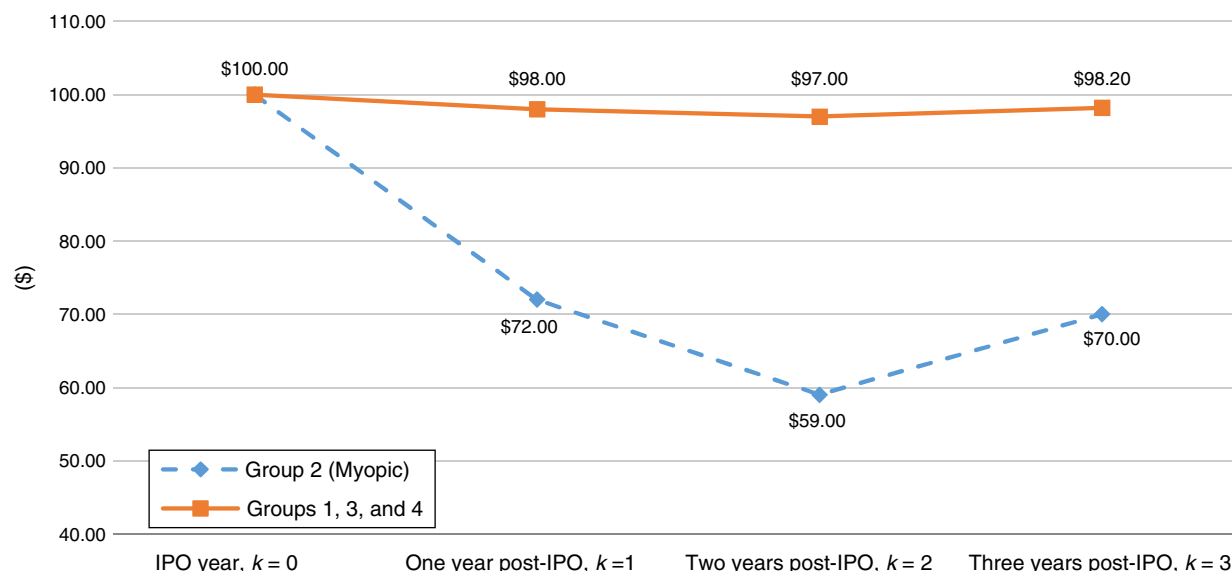
Notes. The figure compares the performance (market value) of one portfolio comprising myopic firms with one that does not include myopic firms. Results indicate that $100 invested in myopic firms is worth only $70 after three years, compared with $98.20 for firms that do not engage in myopic activities.

For IPO literature, we provide some resolution to the long-run underperformance puzzle, in which firms do well during their IPO but underperform relative to benchmarks thereafter (Ritter 1991). Firm actions during the IPO, such as myopic marketing, have significant effects on their post-IPO performance and should be explicitly accounted for in any examination of long-run IPO outcomes. In particular, investors adjust their expectations and penalize stocks once the consequences of myopic management are realized.

7.2.   Implications for Practice

With their short-term desires to enhance their IPO outcomes, IPO firms may be tempted to report high earnings by lowering their marketing investments, because such reductions are legal and seem harmless. Our study provides compelling evidence that this approach is highly counterproductive. Myopic IPO firms miss out on the longer-term value produced by marketing investments and fail to realize the true potential of other, complementary investments (e.g., strategic alliances). Firms that engage in myopic marketing perform significantly worse than others, including those that honestly report poor earnings during their IPO. By empirically showing the negative effects of myopic marketing, we hope to sensitize IPO firms to the consequences of their actions.

This study also provides guidance to investors, who appear to overweight recent financial performance when valuing IPO firms. These overweighting effects are economically significant: Valuations of myopic firms are 30% less than valuations of firms that did not engage in myopic marketing. Consider two investors

that invest $100 in IPOs. Investor A invests in myopic stocks (Group 2), but Investor B invests in stocks belonging to Groups 1, 3, and 4. Three years after the IPOs, Investor A's portfolio is worth $70, whereas Investor B's is worth $98.20 (Figure 4). These effects also vary with the moderators we have addressed, as the statistical significance of our interaction results reveals.

Consider some real-world examples: Achillion Pharmaceuticals, Inc., engaged in myopic marketing and had key customer relationships; it experienced a negative three-year MPBHAR of −5%. Targacept, Inc., also engaged in myopic marketing and was similar to Achillion, but it did not have any major customers, and its three-year MPBHAR was −13%. Two other firms also both engaged in myopic activities and were similar, but Jive Software, Inc., which had no strategic alliances, experienced a negative three-year MPBHAR of −84%, whereas Solazyme, Inc., with its seven strategic alliances, suffered a value of −151%. These examples are just anecdotal, but they align with our rigorous approach and vividly reveal the need for investors to recognize that myopic marketing can destroy firm value, so they should try to identify such practices during the IPO process.

7.3.   Limitations and Avenues for Research

Our study provides interesting results about the phenomenon of myopic marketing and should caution managers against engaging in such activities. The robust analyses of a large sample of IPO firms from multiple industries provide strong confidence in our results. Yet our research is not without its limitations.

First, combining secondary data with primary data from executives might provide a richer understanding of drivers of myopic management, such as by distinguishing firms that engaged in myopic behavior (*actions*) from those that contemplate such behavior (*intent*).[22] Second, we explore myopic marketing around the IPO event, but further research might investigate other situations in which short-term pressures force managers to behave myopically, such as retirements, quarterly or fiscal year ends, and acquisitions. Third, we examine a subset of factors that influence myopic activities. Other boundary conditions may influence the consequences of myopic actions too. Structural models might specify the investments required at a later stage to compensate for previous myopic cuts.

Another research avenue could investigate the drivers of myopic activities and then identify governance structures to mitigate them. Scholars might consider the roles of different factors, such as top management team composition, compensation structures, other institutions (e.g., venture capitalists), or key customer constructs (e.g., customer satisfaction, brand equity, customer focus), in driving myopic behavior. Considering the negative consequences of myopic activities, such research would help public policy experts, regulators, and shareholders design valuable and appropriate controls to minimize the managerial incentives to engage in such activities.

Supplemental Material

Acknowledgments

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