Abstract

Tests of the investor recognition hypothesis posed by Merton (1987) have been featured in recent literature that links brand perception to stock market holdings and performance. We shed further light on the relationship between the consumption and investment decision, but in this paper, rather than explore the idea that awareness spills over to financial markets, we test if changes in shareholder base influence product consumption, and document their effect on asset prices. In particular, we use an instrumental variables approach to test whether a change in investor base (measured by shareholder growth) is associated with an increase in sales (profitability). We find that a 10 percent increase in shareholder growth leads to statistically significant 1.65 percent increase in sales and a 40 basis point increase in profitability. We also find that shareholder growth is associated with lower future returns. Our results are robust to focusing only on firms that split their stock and to controlling for changes in advertising. While our results are consistent with the Merton (1987) model, our paper documents a distinct, but not mutually exclusive, chanel through which value changes occur: a firm's fundamentals.