



Should Advertisement Expenditure be minimized During Recession?

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Abstract: The financial turmoil is the most interesting and an alarming issue of the keen global economist. Throughout this crisis that has so consumed the attention of the world in recent months, we have watched with grave concern as it cascaded outwards from the sectors originally affected. Alan Greenspan recently called it a “once-in-a-century credit tsunami”, born of a collapse deep inside the US housing sector. Instability has surged from sector to sector, first from housing into banking and other financial markets, and then on into all parts of the real economy. The crisis has surged across the public-private boundary, as the hit to private firms’ balance sheets has now imposed heavy new demands on the public sector’s finances. . And now there are reasons to fear that the crisis will swamp emerging markets and other developing countries, cutting into the considerable economic progress of recent years. The paper of our tries to understand the marketing strategies under the recession period based on the research of the past marketing and advertising strategies during the recession period. Thus our paper is a short audit of existing thinking on the topic of marketing during a recession — is a synthesis of historical and current material published by advertisement agencies and organizations, marketers, journalists and research and consulting companies based on findings from past recessions. It highlights key recurring ideas about why marketers should continue to spend during down times and strategies for how best to go about it. And should the advertisement expenditure be curtailed during recession?

Keywords: Greenspan, banking, housing, once-in-a-century credit tsunami.

I. INTRODUCTION

For years, conventional wisdom in the advertising industry has suggested that it is better to increase rather than decrease advertising expenditures during economic recessions. The assumption is that firms can take advantage of a soft advertising market to increase their advertising relative to the competition. The increased share of industry ad spending and resulting gains in media impact are expected to reduce a recession’s effect on the firm’s current and future financial performance (American Business Press [ABP], 1993; Biel, 1998; Dhalla, 1980; O’Toole, 1991). Despite the importance of its strategic implications, the argument for advertising in recession remains largely untested outside the realm of business-to-business advertising. Additionally, its focus has been on indirect measures of success, such as share of market or level of sales, rather than on profitability and return on investment. Although share of market and sales level can reflect a firm’s relative competitive position, they may not always be an appropriate indicator of financial “**In a recession, the most productive route for most companies is to increase rather than decrease advertising spending.**”—John O’Toole, President of the American Association of Advertising Agencies, 1991 success (Day and Fahey, 1988). For example, market share does not explicitly consider future cash flows, adjustments for risk, or irregularities due to current U.S. accounting rules and practices (Srivastava, Shervani, and Fahey, 1998). Granted that advertising makes a financial contribution to the firm, it must still be shown that investors regard present-day advertising as a firm resource that enhances the firm’s value. This study rethinks the question of advertising during recessions and investigates what financial earnings outcomes are likely to occur when firms increase or decrease advertising spending during recessions. It draws three main conclusions,

1. On average, increases in advertising spending increase a firm’s long-term financial performance.
2. Increases in advertising provide a bigger boost to performance than increases in non-recessionary periods, while decreases in advertising during recessions have little effect on performance beyond the year of the decrease.
3. Industry type plays a role, with advertising spending having a bigger effect in the consumer and industrial products industries than in the services industry.

The argument for increased advertising during recessions is grounded in a series of studies summarized in the report making a Recession Work for You (ABP, 1993). Cumulatively, the studies indicate that firms that do not cut advertising during a recession report higher sales and earnings relative to competitors after a recession. (See Table 1, page 15.) The studies are frequently used by others (e.g., Biel, 1998; Dhalla, 1980; O’Toole, 1991) to support arguments to increase advertising spending during recessions, but additional research examining advertising expenditures during recessions is surprisingly absent. Overall, the study excludes comparisons that would address the more pertinent question of whether the effects of increases or decreases in advertising investments during recessions are any different than the effects of increases or decreases during non-recessionary periods. In addition, none of the studies explores the effects of advertising changes on financial performance. Because there is increasing



recognition that marketing decisions can augment future cash flows and enhance the value of the firm to shareholders (Day and Fahey, 1988; Srivastava, Shervani, and Fahey, 1999), research needs to investigate the financial repercussions of any given marketing decision. Let us see the role of advertisement.

II. ROLE OF ADVERTISEMENTS

Advertising is used to gain market share by influencing awareness of a firm and its products. Because advertising increases are expected to boost the number of potential customers that know about a product, such increases are expected to create additional sales. It is difficult, in fact, to argue against the expectation that advertising leads to sales. In a competitive market, non-value-added expenditures are uncompetitive; if there were no value-added benefit to advertising, the practice would have ended long ago, as firms that did not advertise would have outperformed the firms that did. In fact, empirical research does document positive relations between advertising increases and current and future sales (Abraham and Lodish, 1990; Assmus, Farley, and Lehmann, 1984; Clarke, 1976; Erickson, 1995; Graham and Frankenberger, 2000; Vakratsas and Ambler, 1999). Intuition suggests that increased advertising produces positive results for firm performance, while decreased advertising produces negative effects, but these expectations apply only if advertising strategies are effectively implemented. Holding other factors constant, poor executional elements such as unproductive messages, faulty media choices, or poor message timing may work against the value-adding potential of increases in advertising expenditures. On the other hand, advertising expenditures may already be at optimal levels, such that sales or profits (or both) have already peaked. If so, additional spending will be unlikely to produce incremental gains (Aaker and Carman, 1982). Research indicates that managers can be motivated to over-advertise under certain agency and free cash flow conditions (Joseph and Richardson, 2002; Aaker and Carman, 1982). Overspending on advertising is unlikely to have a positive effect on financial performance. Alternatively, because primary demand for goods and services is in part a function of general product category awareness, any advertising effort that results in increased category awareness can benefit other firms in the category. Hence, particularly effective media weights and message executions by one or several firms may create advertising spillover that benefits firms that maintain or reduce their budgets. Conceivably, overspending would create a similar effect. Advertising expenditures that are unsuccessful in producing selective (brand or firm) demand may still stimulate primary demand. Thus, when category-level advertising spillover or overspending is in place, one or several firms' short run reductions in advertising may have little long-term effect on their future performance. There can be advertisement expenditure increase or decrease and has the consequences as.

III. CONSEQUENCES FOR INCREASE AND DECREASE IN ADVERTISEMENT DURING RECESSION

Firms face quite different decision environments during recessionary periods, depending on their relative financial positions before the recession. Firms in weaker pre-recession positions may be forced to cut advertising during the recession. For these firms, advertising is one of several investment opportunities constrained by scarce resources. Advising cash-poor firms to increase recessionary advertising budgets may be unrealistic, especially when a cut to advertising could save jobs or preserve other assets. But what is the cost? If future benefits are a function of current-year expenditures, as research has shown, it is logical to expect that firms that reduce advertising during a recession adversely affect their future earnings. However, because **the recession eventually ends with an expanding economy, sales may grow regardless of advertising policy during the recession**. It is therefore possible for a decrease in ad spending to be followed by an increase in sales and earnings after the recession. The practical implication of economic recovery is that reduced advertising may bear firms that survive little opportunity cost. Firms in stronger pre-recession financial positions seemingly have a unique opportunity to increase their future benefits. As other firms succumb to recessionary pressure by reducing promotional spending, stronger firms that can maintain advertising levels could effectively increase the company's share of voice (SOV), the ratio of the company's ad spending relative to total industry spending. This is the foundation upon which the argument for increasing advertising during recession is based. If budget maintenance during a recession leads to a virtual gain in advertising through increased SOV, it seems logical to expect additional benefits to the firm if advertising spending is increased. This expected result, however, depends not just on the initial position of the firm, but on the nature of the industry as well. Balasubramanian and Kumar (1990), Farris and Buzzell (1979), and Zinkhan and Cheng (1992) show that advertising levels vary by industry. Also, Graham and Frankenberger (2000) find that the size and duration of advertising assets are a function of industry type. It is therefore prudent to examine industry effects in addition to economy-wide effects when assessing the average contribution of advertising to earnings and market value. It has implications for the manager and the firms to overcome this financial tsunami.

IV. IMPLICATIONS OF THE STUDY

This study indicates that advertising has long-term benefits that exceed its cost. Advertising contributes most to earnings in the year of the expenditure, but the same expenditure continues to contribute to firm performance for up to three years. Advertising is also shown to have an asset value that is considered by investors when evaluating the market value of a firm. Managers who invest in advertising not only create future earnings for the firm, but in doing so send a positive signal about future performance to investors. Decision makers can therefore defend advertising increases by pointing to the resulting enhanced value creation. Trade reports argue that recessions are particularly opportune times to increase advertising, and this appears to be true for companies



selling consumer and industrial products. The two-year benefit of recessionary advertising increases may represent an added-confidence signal to these firms' customers during a period of economic uncertainty, a clue that is acted upon by investors. The effect disappears by year three, but by this time the economy likely has begun to recover. At the same time, budget administrators can console themselves that when forced to temporarily draw out advertising, the effect on future earnings may not be overly consequential. Firms reducing advertising during a recession appear to maintain the status quo; they may lose momentum, but as long as they survive, past advertising efforts appear to carry them through. Although companies in the services industry showed no benefit from increased recessionary advertising spending, they were not harmed by reduced recessionary spending. This result should not imply that advertising spending has no effect either way for services companies. Recall that, on average, advertising makes a long-term contribution to earnings for all firms, even if the services firms show a statistically significant effect only during the second year. Our speculation is that the analysis used in this study may not adequately capture the effect of advertising in the services industry, which may fluctuate quarterly rather than yearly. This interesting question alludes to the aggregation issues mentioned previously, but remains to be addressed by future research, as does a series of other questions. For example, this study demonstrates that decreased recessionary advertising spending does not hobble most firms' financial performance, but the analysis does not tease out why this is so. Is it due to advertising spillover, individual firm overspending, or some other factor that we have yet to consider? The analysis presented describes only what results occur (for example, that recessionary advertising decreases show little financial consequence), but not why they occur. Our results capture only average, economy-wide results, but we are similarly interested in what happens to firms on the margin. For example, it may be that for some firms, increases in average industry advertising could increase earnings of other firms in the industry at the expense of their own earnings. The influence of more narrowly defined industries is also of interest. The analysis reported herein is limited to three broad industry categories (i.e., consumer, industrial, and service) to maintain statistical parsimony, but results are likely to vary the further these industries are parsed into narrower categories. A related question is what financial performance effects are shown at shorter time durations (for example, quarterly) and if they differ from the longer-term effects shown here. In summary, overall and for consumer and industrial products firms, current-year recessionary increases in advertising create added value that extends through the year following a recession. Conversely, we find little evidence, outside of a current-year effect for industrial products firms, that recessionary decreases have incremental effects for current or future earnings. Similarly, on average, neither increases nor decreases in advertising during recessions have effects beyond two years following a recession. Thus we can conclude the study

V. CONCLUSION

In conclusion, overall and for consumer and industrial products firms, current-year recessionary increases in advertising create added value that extends through the year following a recession. Conversely, we find little evidence, outside of a current-year effect for industrial products firms, that recessionary decreases have incremental effects for current or future earnings. Similarly, on average, neither increases nor decreases in advertising during recessions have effects beyond two years following a recession. From the preceding discussion we formulate the following expectations:

1. As past research suggests, advertising should provide a benefit beyond current sales and share; that is, advertising should contribute to firm earnings and market value.
2. Contrary to the advertising-in-recession argument, firm performance does not necessarily increase and may actually decrease if firms increase advertising during a recession. Similarly, recessionary advertising decreases may not adversely influence firm performance.
3. Because past research verifies an industry effect on financial performance measures, an industry effect should be observable for increases and decreases in advertising for both the base case of firms not in a recession and in the test case of firms in a recession.

In conclusion, as is often true of research, this study raises more questions than it can adequately answer. It does, however, generally confirm the long held notion illustrated in John O'Toole's quote at the beginning of the paper: For most companies, the most productive decision is to increase rather than decrease advertising spending during a recession.

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