Potentials of Contra-Cyclical Advertising

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What is the effect when businessmen adopt a contra-cyclical policy with advertising expenditures? Can a firm improve its market position by such a policy? If a majority of America's businessmen increased advertising during a slump, would this policy help to mitigate business cycles? These and related issues are discussed here.

EFFECTS ON THE FIRM

There is evidence that firms which practice a contra-cyclical policy by increasing, or at least maintaining, advertising expenditures during recessions improve their relative sales and market position.

A compilation of empirical studies is presented to demonstrate that this has been true throughout recent representative periods.

The 1920's

Professor Roland Vaile made a study in 1927 in which he analyzed sales of over 200 companies which followed apparently different advertising practices. During the recession of 1920-1921, some of the observed firms decreased advertising expenditures and some increased expenditures. Those firms which decreased advertising had an average sales drop of 26 per cent while those which increased advertising had a sales reduction of only 12 per cent.[1]

Professor Vaile concluded that advertising mitigates the extent of declines in sales of those firms with the foresight to follow a contra-cyclical policy. His study included industry groups which he classified as follows:

Personal Items
Clothing
House Furnishings
Auto Equipment
Automobiles
Groceries
Building Materials

Without exception, Vaile found that firms which increased advertising during a recession suffered a much smaller reduction in sales and recovered more quickly. This evidence seems to indicate clearly that those firms following a policy of maintaining or increasing advertising during a slump emerged in a stronger relative position.

The late 1930's

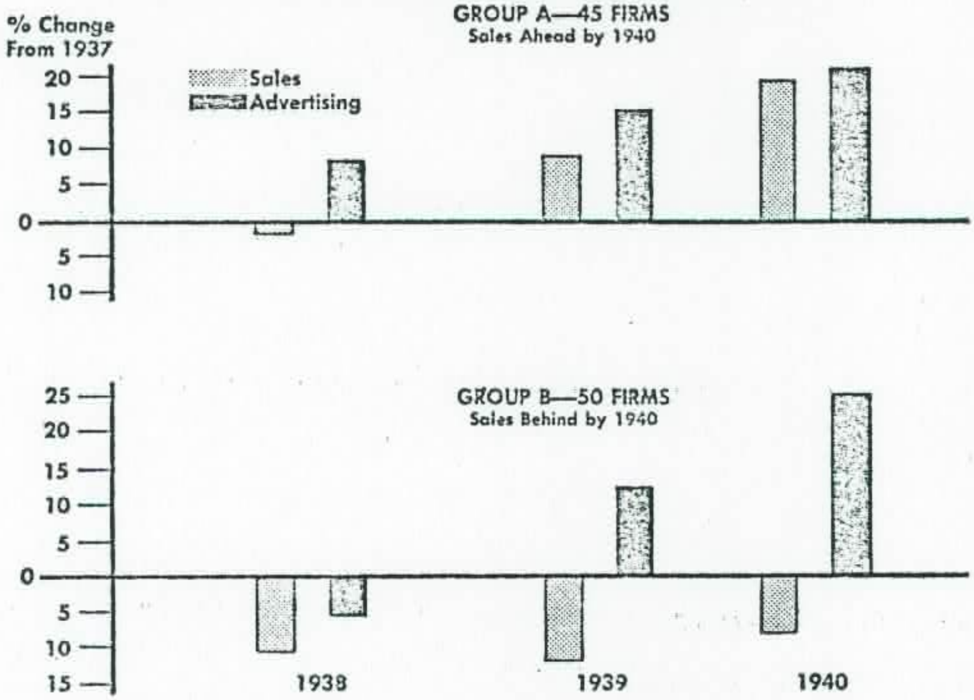
An exhaustive study of contra-cyclical advertising policies by George J. Keubler included 95 companies for the years 1937 to 1940, including the recession period in 1937-38.[2] The selection included very large,

[1] R. S. Vaile, Economics of Advertising (New York: The Ronald Press Company, 1927), p. 121.

[2] The statistical information and conclusions are summarized from "How Does Advertising Affect Sales and Company Growth in Recession and Boom? A Special Report," Printers' Ink CCLXIV (August 29, 1958), p. 25.

Chart 1

SALES AND ADVERTISING DURING RECESSION



Source: Charts 1 and 2. "How Does Advertising Affect Sales and Company Growth in Recession and Boom? A Special Report," Printers' Ink CCLXIV (August 29, 1958), p. 32.

medium, and small companies that were a cross section of all major industries.

The companies were initially divided into two groups. Group A consisted of 45 companies whose sales in 1939 had recovered from the slump and were equal to or above 1937. Despite poor general economic conditions, the 45 companies collectively continued an advertising policy of spending more each year.

The increase is shown in Chart 1. Sales in 1938 were down 2 per cent but by 1940 they had increased by 19.7 per cent. The 45 companies together spent about $9 million on advertising during 1938 and 1939 but realized a total gain of over $172 million in sales.

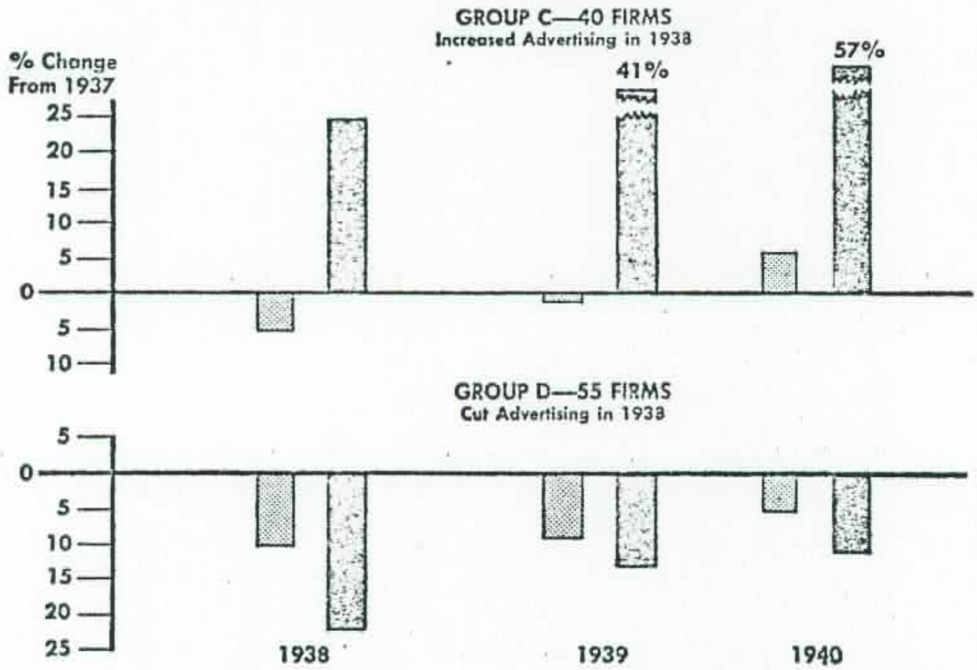
In contrast, Group B was comprised of 50 similar companies whose sales were still depressed in 1940. Chart 1 shows that these firms collectively cut back on advertising during the slump and experienced a 10.9 per cent decrease in 1938 sales. The sales of Group B were still down 8.2 per cent in 1940. This suggests that firms which cut advertising during the recession find it difficult to regain their relative market position during the upturn, even with the use of additional promotional effort at the latter time.

The 95 firms were then regrouped on the basis of those which deliberately *increased advertising* (Group C) and those which *cut advertising* budgets (Group D). Chart 2 shows that Group C firms lost sales in 1938, but regained in 1939. The 55 Group D firms reduced advertising in 1938 and experienced a sales drop nearly twice as severe as Group C.

By 1940 the Group D firms were still 5.8

Chart 2

SALES AND ADVERTISING DURING RECESSION



per cent behind 1937 and far below the firms which increased advertising during the recessionary period. Thus, firms which follow a contra-cyclical advertising program may experience some sales loss during the recession, but are able to recover more quickly.

Post-World War II

Further indication of the effects of contra-cyclical advertising upon business firms is provided in a survey prepared by McCann-Erickson covering the years 1948-1957.[3] Firms surveyed were selected from the 100 leading advertisers in the nation. The results are plotted in Chart 3 and show that the companies which increased advertising an average of 197 per cent experienced a 113 per cent rise in sales. In contrast, the companies which increased advertising at a slower rate, and decreased it during the 1953-54 recession (gray band), had substantially slower sales recovery.

During the postwar period it was also found that the fastest growing firms increased advertising expenditures over the previous year by an average of 13 per cent more than the medium growth firms, and the medium growth companies 14 per cent more than the slower growing. Although this was a period of rapid expansion, the inference seems clear that those firms which maintained a consistent advertising pattern throughout grew more rapidly than those which held back on advertising, particularly during the 1953-54 recession.

Explanation of increased sales

The evidence indicates that firms which increased advertising during a recession maintained better sales performance than those which decreased advertising. Some

[3] Ibid.

explanations of this phenomenon are outlined below.

Consumers react in different ways to environmental influences and it is difficult to make generalizations about advertising appeals which are true for all market segments. Many consumers have incomes which are stable during a recession. They may view a period of soft prices and excess supply as the best time to make additional purchases. It would appear that an informational, persuasive type of advertising campaign (often called a Gestalt approach), is most effective in reaching this market segment.

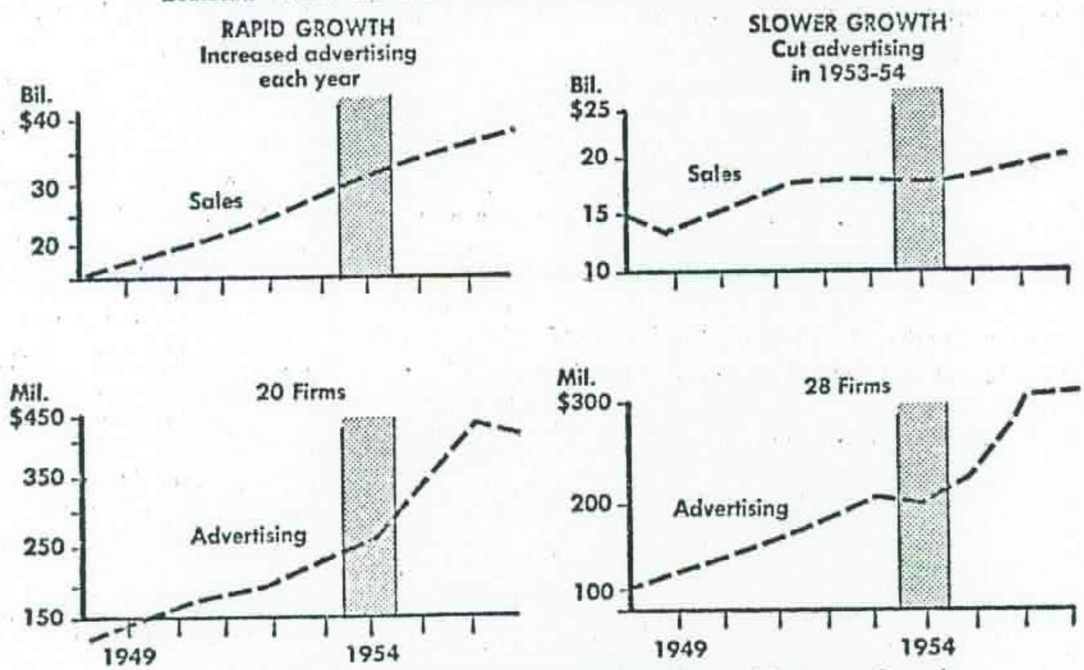
Other consumers who have a loss of income or job may feel depressed and seek a stimulant in the form of a purchase of new articles. For this market, a campaign which presents the advertised product as a means of cheering themselves up may be most successful. For example, a woman who buys a new dress may make the purchase at that time primarily to counter her depressed feelings.

For many products, there may be no need to change a successful campaign, but only to maintain or increase it. The tendency of many consumers to exhibit more shopping type of behavior (increased emphasis on price and quality) during a recession may be an explanation for greater receptiveness of the advertising message.

Although these are but a few of the possibilities, it can readily be seen that the form and effectiveness of a contra-cyclical advertising policy is influenced by the market target and the characteristics of the product. Construction of a contra-cyclical policy must take into account these variables if it is to provide the optimal marketing strategy for the firm.

Chart 3

SALES AND ADVERTISING IN POST-WAR PERIOD



Source: "How Does Advertising Affect Sales and Company Growth in Recession and Boom? A Special Report," Printers' Ink CCLXIV (August 29, 1958), p. 32.

Limitations of the policy

There are limitations to the practice of contra-cyclical advertising expenditures. The most obvious one is the financial structure of the firm. Not every commercial enterprise has sufficient resources to maintain or increase advertising during a recession and that is why some firms may not do so. Even if funds are available, top management is usually quite dollar conscious and sometimes looks for the easiest way to restrict expenses. Some firms, with the resources and the desire to increase advertising, may have difficulty persuading stockholders to forego some dividends in order to emerge from the recession in a stronger market position.

It appears that the practice of maintaining or increasing advertising during a slump is confined primarily to large firms. But there are indications that this practice of large firms is becoming more widespread. For smaller firms which maintain sound financial structure, the problem of setting advertising budgets does not seem to be lack of resources but rather the human relations involved in the allocation of resources. Most companies, however, obtain necessary Board of Directors' action for advertising budgets when officials present valid arguments that they will produce increased profits.

Another limitation is that the practice seems applicable to recessions and not to a prolonged severe depression. Studies by Borden indicate that it was not included in the range of business experiences during the continued depression of the early thirties.[4] But postwar recessions have generally been short and are susceptible to the use of contra-cyclical advertising.

[4] Neil Borden, The Economic Effects of Advertising (Homewood: Richard D. Irwin, Inc., 1940), pp. 726-736.

Marketing mix needed

Clearly, advertising is only part of the answer to the maintenance of a firm's sales during a recession. What is needed during an economic downturn is a dynamic marketing mix, in which advertising is one of the most potent variables. In addition it may be unwise to curtail personal sales effort or other areas of promotion. And most businessmen are very much aware of the importance of pricing policy during a recession.

Most certainly, continued research and development is necessary—to make the most satisfactory product—if advertising is to be effective. The relationship of each of these and other variables differs among firms and products; hence, the development of the best marketing mix is a process which must be individualized.

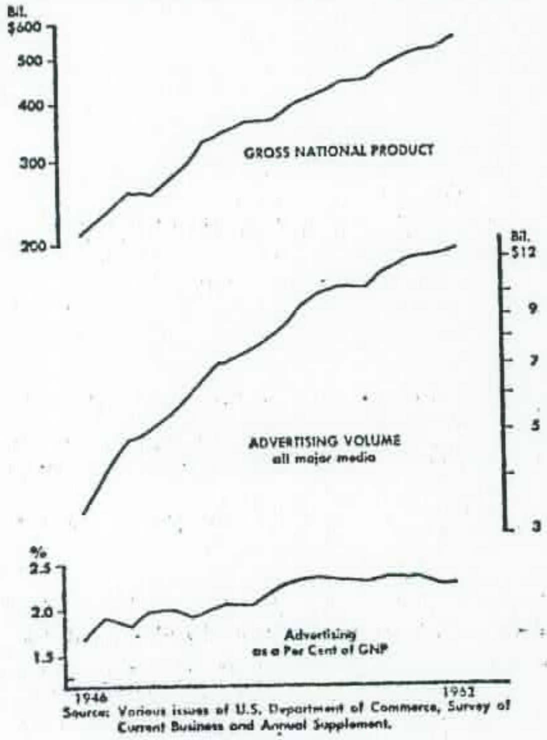
Attention has been focused upon advertising because it is most susceptible to rapid changes as a variable in the total mix. Because it is so easy to decrease advertising when a slump is observed, it may often have been unwisely curtailed. But firms which increased advertising volume, coupled with an effective marketing mix, have been affected less by a recession than firms which curtailed advertising. Furthermore, a recession can offer an opportunity to the firm, which follows an aggresive promotion policy, to emerge from the recession with a larger share of the market.

EFFECT UPON THE ECONOMY

The preceding evidence demonstrates the effect of contra-cyclical advertising upon the individual firm. But if large numbers of firms maintained and increased advertising during a slump, what would be the effect upon the economy?

The *direct effect* of advertising expenditures upon the economy is substantial.

Chart 4
ADVERTISING IN THE ECONOMY



Source: Various issues of U.S. Department of Commerce, Survey of Current Business and Annual Supplement.

Chart 4 shows that total annual advertising expenditures exceed $12-billion and account for over 2 per cent of Gross National Product. Since most advertising money goes into services, additional expenditures for advertising produce an immediate effect upon employment.

The economic impact upon the various media and allied industries should be considered. Employment in such diverse industries as newsprint, electronics, printing equipment, photographic supplies and many others is related to advertising.

A more important consideration is advertising's role in stimulating consumption. In past analyses of business cycles, primary attention has been given to investment. It is now recognized that attention should be focused upon other reasons for fluctuations in consumption. One reason for studying consumer expenditures is given by Theobald:

> . . . if we compare expenditures by consumers with the amount of investment at the present time,. changes in consumers' attitudes can have more serious repercussions than a major change in business attitudes towards investment. . . . Thus a 3-per cent alteration in consumers' expenditure would have much the same effect on the operation of the economy as a 10-per cent variation in investment.[5]

Consumer demand important

Each postwar recession has been characterized by inventory adjustments, primarily in consumer durable goods. The 1948-49 recession was a readjustment from the pent-up demand of war years to a time when consumer demand could be satisfied in most industries.

In the 1953-54 recession, inventory adjustments were concentrated in durable goods, especially in the sales of automobiles. With the tight money policy of the Federal Reserve during early 1953, many firms were prompted to reduce production as consumer demand fell off.

In the severe but short recession of 1957-58, constriction of consumer demand for durable goods was evident. Consumer demand for appliances and other durables declined in the second quarter of 1957, and was severely restricted by the latter part of 1957. With spring 1958 came a renewal of buying action which was to lead the economy to recovery.

It is significant to note that through each postwar recession, Personal Income was remarkably stable. Chart 5 shows increases each year except 1949. The gray bands mark National Bureau of Economic Research cyclical recession periods. Because of unemployment compensation, long-term union contracts, the tax structure, social security and other measures, income does not fluctuate greatly. If income did de-

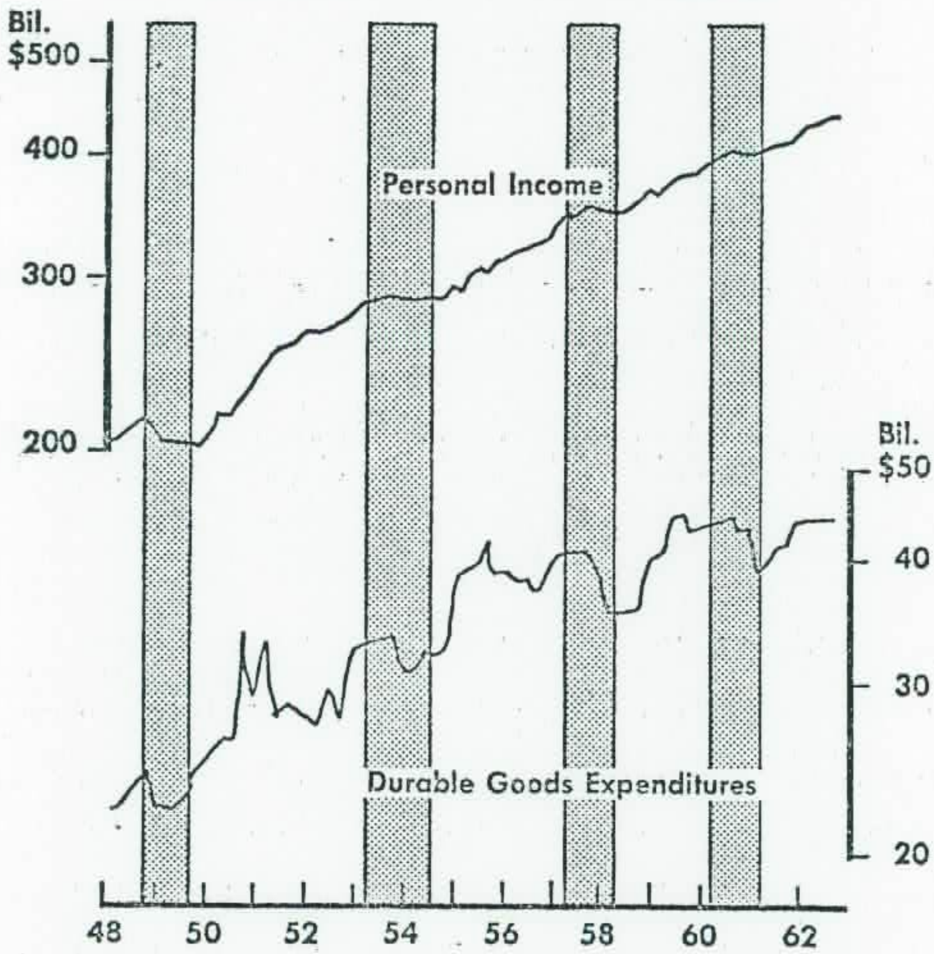
[5] Robert Theobald, The Challenge of Abundance (New York: Clarkson N. Potter, Inc., 1961), p. 33.

crease, consumers would still be reluctant to reduce their standard of living (explained by the Duesenberry analysis) and an individual firm would need to continue aggressive advertising to maintain its market. But when the decline in National Income is primarily in the corporate and governmental sectors—and Personal Income remains quite stable (as it has in postwar years)—then the potential exists for preventing declines in consumption by use of demand stimulants such as advertising.

Psychology of business cycles

The increased discretionary spending power of today's consumer has given him the power to spend and the power to withhold—he has exercised this latter power on several occasions since World War II.

Chart 5
INCOME AND DURABLE GOODS SALES



Source: Business Statistics, and Survey of Current Business, various issues from 1949 through January 1963. Recession referents from Business Cycle Developments.

Increased attention upon the psychological influences on business cycles has given some insight into aggregate business decisions. But additional research is needed to determine relationships between factors responsible for aggregate consumer buying action.

The evidence indicates that one factor responsible for mass consumption decisions is advertising. It is difficult to separate the direct effect of stimulating purchases, and the indirect effect of creating a favorable attitude, that give consumers confidence to maintain or expand consumption.

The effectiveness of advertising in stimulating purchase should not be questioned. Case histories of many firms provide ample evidence and Charts 1 and 2 also show the stimulatory effect upon consumption, even during a recession.

Some observers have commented that advertising serves only to switch existing demand among competing brands. But this has been shown to be a false assumption for most products. Chamberlin demonstrates that advertising stimulates primary demand, as well as the demand for a particular product brand, and states, "It is even a familiar result that sellers are *benefited* by the advertising of their closest rivals."[6] He points out that advertising (and other forms of promotion) can shift the demand curve for a firm or an industry upwards and to the right, as well as alter the shape of the curve.

Advertising which is designed to promote only one brand often increases consumption of all brands. An example is the recent aggressive promotion campaigns of two of the dried-soup companies which appears to have increased demand for soups generally.

[6] Edward Hastings Chamberlin, The Theory of Monopolistic Competition (Cambridge: Harvard University Press, 1958), p. 129.

Newspaper strikes

An analogy of advertising's effect on the economy can be made by looking at regional department store sales during a newspaper strike. Since department stores depend primarily upon newspaper advertising, their sales results are relevant. It should be noted, however, that the full impact is not reflected because stores are able to divert some advertising to other media and to surburban newspapers.

Reports of weekly department store sales by the Federal Reserve Bank of New York show a consistent pattern of poor sales in New York stores during the strike of late 1962 and early 1963. New York department store sales were substantially below other areas in the New York Federal Reserve District which had similar weather and market conditions but had newspaper advertising. A typical comment of the effect of advertising on sales was made during the strike by the Federal Reserve Bank:

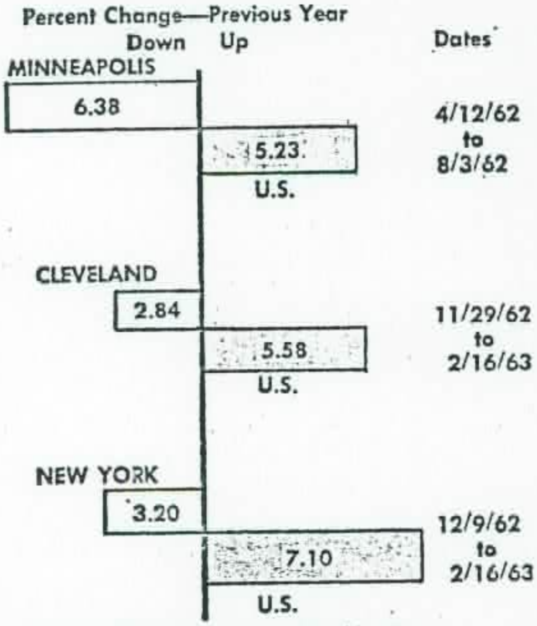
> The New York-Northeastern New Jersey area had weekly sales equal to a year-ago, but in New York City they decreased by 10 per cent. Absence of newspaper advertising because of the prolonged newspaper strike has apparently hurt sales.[7]

Similar results from absence of newspaper advertising, were felt in Minneapolis and Cleveland during strikes in those cities. Chart 6 shows their decreased department store sales against increases in the United States. The conclusion from this analysis is that advertising has the capacity to *stimulate demand for a geographic area*, as well as the individual firm. Therefore, if advertising in all media is cut back, as in a recession, it is to be expected that demand will also decrease, contributing to the slump. The conclusion is that adver-

[7] "Weekly Department Store Sales" H.8 (mimeographed letter of the Federal Reserve Bank of New York, dated February 14, 1963).

Chart 6

DEPARTMENT STORE SALES DURING NEWSPAPER STRIKES



Source: Federal Reserve Weekly Reports. Statistics compiled by Daniel Starch & Staff in Printers' Ink CCLXXXIII (April 19, 1963), p. 43.

tising should not be curtailed during a slump, if a high rate of consumption is to be encouraged.

Consumer psychology

The impact upon consumer psychology during a recession may be equally important with the direct persuasion of advertising. An extensive examination of the impact of the consumer in the economy was undertaken by Professor George Katona. He identified cumulative, self-reinforcing expectations as a source of contraction in economic activity.

> As a result of slight misgivings, consumer purchases of durable goods may slacken, or capital expenditure plans of business may be slightly reduced; when the news about such decisions reaches the consumers or businessmen, it is seen as justifying the misgivings and results in additional and more widespread curtailment of expenditures.[8]

This was verified by a Survey Research Center study which found that when the news of declining automobile sales reached people in late 1957, their Intentions to Buy and actual sales dropped significantly.[9] During this period consumers' automobiles grew older and their debts smaller with a corresponding increase in ability to buy but a decrease in willingness to do so.

A function of contra-cyclical advertising can, therefore, be to inform the public of favorable prices and buying conditions and to instill buying confidence. If consumers see less advertising and promotion, their opinion that it is a bad time to buy may be reinforced. But if the majority of advertisers increase the volume of effective advertising, they may help to prevent and reverse the cumulative, self-reinforcing expectations and thereby reduce severity of the downturn.

Good economic news

The importance of consumer psychology cannot be minimized and is not limited to advertising. During the downturn of 1960, one group undertook to find new methods of creating consumer confidence.

They search for good economic news and used public relations and mass media to inform consumers of the bright spots in the economy to bolster buying confidence. Their executive officer commented:

> There is money in the consumer's pockets. What is needed is to create the proper psychology to get them spending normally again.[10]

[8] George Katona, The Powerful Consumer, Psychological Studies of the American Economy (New York: McGraw-Hill Book Company, Inc., 1960), p. 212.

[9] Ibid., p. 215.

[10] Phillip N. Schuyler, "Marshalling Facts to Fight Recession," Editor and Publisher (April 18, 1961), p. 17.

Advertising during boom

A contra-cyclical policy implies lower advertising expenditures in boom, thus reducing the amplitude of the business cycle. But this is less true in a growing economy where the size of the pie is increasing and everyone gets a larger bite despite the fact that some inflation may exist.

The effects of advertising on inflation may not be significant because of market conditions. In most industries in the United States, there is sufficient production capacity (in many an abundance) to meet current sales targets. Most firms can, therefore, sustain a substantial increase in sales without serious production bottlenecks.

Therefore, increasing demand is considered a worthy goal and a stimulant to the nation's economic health. During the early postwar years, advertising and marketing effort may have had an inflationary effect because consumer demand was heightened for products already in short supply. However, this does not seem to be the problem now.

Some writers have suggested that the Federal Income Tax laws should be changed to make reserves for recession advertising *deductible* in a boom year.[11] Although such a law could encourage use of a contra-cyclical advertising policy, it has not received much attention or support. If the law were enacted it would be necessary to deal with the escalator effect created, so advertising would be *reduced to normal* in the years after a recession.

Adoption of policy

What are the possibilities that a policy of maintaining or increasing advertising during a slump will be adopted by a majority of business firms? Some firms already follow such a policy[12] They are generally the larger and more astute advertisers, but not always. The transition from percentage of sales, or similar methods of allocating advertising budgets to the task method should contribute to economic stability. The task method is the practice of defining the specific task for advertising to accomplish—such as acquainting 25 per cent of the potential market with a new product—and allocating sufficient funds to accomplish that task in a given time.

An expression of the realistic attitude that modern firms have toward the task method, and its effect upon the economy, is found in the comment of one industrial leader.

> We're shifting more and more to the task system of advertising rather than one based on percentage of sales. Particularly with new products, we consider the money an investment rather than an expenditure. . . . It (advertising) has always been a strong anti-recession and pro-growth device. Our top management is well aware of advertising's vital role in the growth pattern of our company.[13]

I am not suggesting that increasing advertising expenditures, at the first appearance of an economic downturn, is the panacea for all recession ailments. To do so would over-simplify economic relationships and ignore many pertinent factors. Rather, it appears that—when coupled with facilitating credit policies, and sound merchandising, product, and pricing policies—maintenance or increase of advertising expenditures by a wide sector of the business community can significantly limit the severity of modern recessions.

[11] See Albert Wesley Frey, **Advertising** (New York: The Ronald Press Company, 1961), p. 469.

[12] Specific examples include Proctor & Gamble, General Mills, Kellogg, Miles Laboratories, Coca-Cola, National Biscuit, Pepsi-Cola, U.S. Steel, Dow Chemical, Kaiser Industries, American Cynamid, Prudential Insurance, Eastman Kodak, Bell & Howell.

[13] "How Does Advertising Affect Sales and Company Growth in Recession and Boom? A Special Report," **Printer's Ink** CCLXIV (August 29, 1958), pp. 25-34.

SUMMARY

The evidence points to the conclusion that firms, which maintain advertising during economic downturns, increase sales and improve their market position. This seems to hold true during postwar recessions although not during a major depression such as the early 1930's.

Although the majority of advertisers have not yet followed this policy, there is a growing tendency to maintain advertising expenditures during those recessions which appear to be mild. Since consumers' *ability to buy* has become relatively stable, increased attention is being devoted to maintaining their *willingness to buy*.

If a contra-cyclical policy of promotional effort were adopted by a majority of firms, one may speculate on the economic effects. In *recession*, increased promotional expenditures would tend to maintain willingness to buy and thus consumption, which in turn would maintain income.

In *boom periods*, with some goods scarce, a reduction of promotional expenditures tends to reduce demand and thus lessens the excessive consumption which leads eventually to another downturn. Contra-cyclical advertising, therefore, has the potential of helping decrease the *amplitude* of the business cycle.