Montreal Economic Institute
Ideas for a More Prosperous Nation

"Regulation" Series

ECONOMIC NOTE

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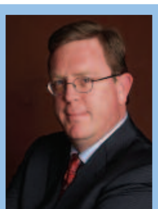
The Influence of Advertising on Consumption

In many countries around the world, governments are increasingly tempted to regulate the advertising industry. Whether in the name of consumer protection or health concerns, advertising for products that are perfectly legal must conform to ever stricter rules. Think of alcohol, tobacco or fast food, for example. This worldwide trend was recently highlighted by the head of planning for a well respected ad agency in the British newsweekly *The Observer*.[1] He predicted that governments, instead of banning the sale of certain products outright, would increasingly turn to prohibiting their advertisement.



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Along the same lines, a group of American health professionals has just called for the retirement of mascot Ronald McDonald because of his links to what they consider to be junk food. The same group campaigned against mascot Joe Camel in the 1990s.

This insistence on protecting consumers from themselves rests on the belief that advertising actually creates a demand for a product. Regulating or banning advertising is therefore thought of as an effective way to reduce the consumption of certain products. As we shall see, empirical research does not generally support this perception.

This *Economic Note* is the first in a series of two that will address the growing tendency to regulate the advertising industry. This first *Note* examines the general question of the influence of advertising on consumption.

The value of advertising to the consumer

Expenditures on advertising amount to about six billion dollars a year in Canada.[2] Advertising is a significant industry in its own right, representing around 0.5 percent of the country's gross domestic product. Advertising is useful to consumers because it supplies them with information that helps them make choices among various companies' products and services (automobiles, cell phone plans, etc.) based on their specific needs. Of course, advertising is not the only useful source of information to help consumers make choices: there are also magazines, the advice of friends, etc. Nonetheless, advertising has a value, for it exposes consumers to the options available.

If consumers paid no heed whatsoever to advertising, it would disappear thanks to competition, since businesses that spent no money on advertising could offer their goods and services at lower prices without hurting their sales. However, advertising is far from being a guarantee of popularity. Several cases have demonstrated that a large company with an astronomical advertising budget can fail to sell a product that has been rejected by consumers: we need only recall drinks like New Coke or Crystal Pepsi, automobiles like the Edsel or websites like Pets.com, for example.

The influence of advertising

Moreover, there are good reasons to doubt that advertising is required to create or sustain demand for a product. If this perception were true, the consumption of illegal drugs, for example, would not be so widespread.[3] Similarly, the consumption of

1. "20 predictions for the next 25 years," *The Observer*, January 2, 2011.
2. Statistics Canada, CANSIM Table 360-0003.

alcohol did not decrease substantially during American Prohibition (1920-1933).[4] Two categories of products have been specifically analyzed by researchers: alcohol and tobacco. These cases show that the impact of advertising on consumption is negligible, or at least very minor compared to other social and cultural factors. Studies have highlighted the importance of the opinions of one's family and peers in influencing one's consumption choices.[5]

Alcohol

Indeed, in the alcohol market for example, empirical studies[6] have concluded that advertising does not influence total consumption, by analyzing experiments undertaken in the United States, Canada, France, the United Kingdom, the Netherlands and Sweden. For instance, the legalization of alcohol-related advertising in the Canadian province of Saskatchewan in 1983 did not lead to increased consumption.

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In those cases in which consumption seems to increase in step with advertising, the true cause could in fact be the opposite of what it is thought to be. As highlighted in an article published by the World Health Organization,[7] when a market study shows a rising trend in the popularity of a product, many businesses try "to get in on the promising new bandwagon." They advertise more when they think that consumption of a product is growing in order to obtain the largest possible share of the growing market. In other words, the volume of advertising could very well grow in reaction to the increase in demand, and not the other way around.

Conversely, if advertising increased consumption, forbidding it should make the product less popular. This is not, however, what has been observed in practice in the case of alcohol. For example, the banning of beer ads in 1974 in Manitoba did not diminish consumption in that Canadian province as compared with consumption in the province of Alberta, where advertising remained legal.[8]

Tobacco

The case of tobacco has also been extensively studied. For the past 60 years, some 50 articles have been published on the subject of the impact of the total or partial ban of cigarette-related advertising in various countries. Researchers have published an unprecedented analysis integrating the results of 27 studies featuring data from some 40 countries.[9] Their results indicate that the banning of cigarette-related advertising, whether total or partial, has no significant impact on the consumption of this product.[10]

The proportion of smokers has been falling fairly steadily since the mid-1960s.[11] This trend is due to several factors, including health preoccupations and a host of public policies like tobacco taxes, the banning of smoking in various places, the "denormalization"[12] of smokers, etc. The limits imposed on advertizing played a negligible to nonexistent role. Although there are certain public health studies that make a link between tobacco advertizing and youth consumption, an article by a Nobel laureate in economics concluded that they do not respect the criteria required to establish a cause and effect relationship.[13]

The regulation of tobacco advertising has continued apace, with four countries banning the display of tobacco products: Canada, Iceland, Ireland and Thailand. Here again, the facts demonstrate that this display ban has not affected consumption habits and constitutes a "highly ineffective" policy.[14]

3. Filip Palda, "Publicité et commandites" in Pierre Lemieux and Jean-Luc Migué, *Évaluation économique de l'Étude d'impact sur le projet de loi proposé par le Ministre de la Santé et des Services sociaux du Québec*, May 1998, p. 78.
4. Angela K. Dills and Jeffrey A. Miron, "Alcohol Prohibition and Cirrhosis," *American Law and Economics Review*, Vol. 6 (2004), No. 2, p. 315.
5. See: Marc G. Weinberger, Harlan E. Spotts and Ereni Markos, "Joe Camel: Post-mortem of a Brand Spokesperson," *International Journal of Advertising*, Vol. 29 (2010), No. 3, p. 406.
6. Tim Ambler, "Can Alcohol Misuse Be Reduced by Banning Advertising?" *International Journal of Advertising*, Vol. 15 (1996), No. 2, pp. 167-174.
7. See: Juha Partanen and Marjatta Montonen, "Alcohol and the Mass Media," *EURO Reports and Studies*, Vol. 108 (1988), p. 7.
8. Tim Ambler, *op. cit.*, footnote 6, p. 170.
9. Michael L. Capella, Charles R. Taylor and Cynthia Webster, "The Effect of Cigarette Advertising Bans on Consumption," *Journal of Advertising*, Vol. 37 (2008), No. 2, pp. 7-18 (confidence interval: 95%).
10. *Id.*, p. 14.
11. Jessica L. Reid and David Hammond, *Tobacco Use in Canada: Patterns and Trends: 2009 Edition*, Propel Centre for Population Health Impact (University of Waterloo), p. 14.
12. The term "denormalization" is used to describe efforts aimed at making the consumption of tobacco less socially acceptable. See Health Canada, http://www.hc-sc.gc.ca/hc-ps/pubs/tobac-tabac/ns-sn/appendixc-annexec-eng.php.
13. James J. Heckman, Fredrick Flyer, and Colleen Loughlin, "An Assessment of Causal Inference in Smoking Initiation Research and a Framework for Future Research," *Economic Inquiry*, Vol. 46 (2008), No. 1, pp. 42 and 43.
14. Patrick Basham and John Luik, "Tobacco Display Bans: A Global Failure," *Economic Affairs*, Vol. 31 (2011), No. 1, p. 102.

Advertising and product life cycle

Why do businesses spend so much on advertising if it does not increase consumption? Quite simply to capture the largest possible market share as compared to their competitors.

This notion fits well with what marketing specialists call the "product life cycle theory." This theory stipulates that all products go through four stages: 1) introduction, 2) growth, 3) maturity, and 4) decline. During the first stage, advertising creates and develops a new market. Think, for example, of fax machines or more recently of tablet computers. However, during subsequent stages, advertising concentrates on brands, each company trying to secure the largest possible market share that is first growing, then stable and finally declining.

The impact of advertising on consumption is negligible, or at least very minor compared to other social and cultural factors.

A product like the cigarette, which has existed for centuries, has arrived at the stage of decline in which advertising only has an impact on the market shares of different brands.

Brands – well known and instantly recognizable names attached to certain products – are a fundamental component of advertising. They often borrow the name of the business itself, like "Ford" or "Dell." Sometimes, they come to represent the type of product to which they are attached in an almost generic manner, like "Tylenol" (from Johnson & Johnson) or "Kleenex" (from Kimberly-Clark). In a certain sense, these brands become an integral part of popular culture. From a commercial point of view, brands are also a way for businesses to publicize the quality of their product. A brand allows a company to distinguish its product from others[15] once it enters the second and subsequent stages of its life cycle, thus helping to establish consumer loyalty.

Advertising and market size

As we have just seen, the purpose of advertising is generally to increase a brand's market share rather than to develop the market for all brands. This intent is easily observed when we see the quantity of advertising that aims to attack (more or less directly) rival brands. There are rare exceptions to this principle: first, for products that are in the first stage of their life cycles, as we saw above, and second, for generic advertising sometimes carried out by producers' associations (for example, for dairy products).

However, it is helpful to specify what exactly is meant by a "market." Indeed, researchers[16] have enumerated the following "levels" in a market:

- the **brand** (for example Philadelphia cream cheese), which applies to a particular company's product;
- the **sub-sector** (cream cheese), which includes several brands in direct competition;
- the **sector** (cheese), which includes several sub-sectors whose products are close enough substitutes for one another;
- the **category** (dairy products), which includes sectors close enough to one another that consumers would be prepared to make substitutions, but not as easily as in the case of sectors; and
- the **super-category** (food), made up of linked categories, which has little risk of being substituted for another super-category of products.

Advertising is not concerned with transportation (a super-category), with road vehicles (a category) with automobiles (a sector) or even with four-wheel-drive automobiles (a sub-sector) in general. Automakers and dealers advertise their particular brands. This advertising can have the effect of growing the size of the sub-sector, but it is rare for the effect to be felt up to the sector or category levels.[17] This hierarchy is not uniform from one study to another, but the important thing to understand is that advertising almost always concerns brands, and that as soon as we examine a higher "level" in the market, it very rapidly loses its impact on consumption.

According to a study that examined 156 cases of advertising campaigns that had achieved a high level of success in the United Kingdom,[18] this conclusion applies to most products.

15. See: Richard Posner, "Advertising and Product Differentiation" in John S. Wright and John E. Mertes (dir.), *Advertising's Role in Society*, West Publishing Co., 1974, pp. 44-46.
16. Tim Ambler, Simon Broadbent and Paul Feldwick, "Does Advertising Affect Market Size?" *International Journal of Advertising*, Vol. 17 (1998), No. 3, p. 271.
17. Michael L. Capella, Charles R. Taylor and Cynthia Webster, *op. cit.*, footnote 9, p. 8.
18. Tim Ambler, Simon Broadbent and Paul Feldwick, *op. cit.*, footnote 16, pp. 284-293.

For example, an advertising campaign for a chewy bar (*Quaker Harvest Chewy Bar*) led to an increase in the consumption of chewy bars, but did not increase consumption in the chocolate sector. Similarly, a campaign for canned meatballs (*Campbell's*) increased the size of the market for canned meatballs, but not for canned food or processed meat in general.

An extensive review of the relevant scientific literature shows that the total consumption of "undesirable" products cannot be reduced by limiting or banning their advertisement since consumers do not simply allow their choices to be dictated by ads.

Alcohol and tobacco being categories of products (a higher level in the market "hierarchy"), it is normal to find, as we have, that the advertising of brands does not increase the size of the market. One brand's advertising in a certain sense cancels out another brand's advertising.[19] At the end of the day, an extensive review of the relevant scientific literature shows that the total consumption of such "undesirable" products cannot be reduced by limiting or banning their advertisement since consumers do not simply allow their choices to be dictated by ads.

Conclusion

Advertising informs people about the choices available to them, or about the characteristics of certain products. But when all is said and done, the choice remains the consumer's. What a company hopes to do when it advertises a product is promote what it can do better than its competitors and establish the best possible brand image. In this game, what one gains, another loses, and total consumption is not affected in the vast majority of cases.

Advertising is also a service industry that relies on creative professionals and adds value to economic activity. Public policies aiming to limit or ban the advertisement of certain products harm this industry, and do so in vain. Indeed, empirical research shows that regulating it in the hope of discouraging certain consumption habits is ineffective. As is very often the case, between the intentions of these public policies and their actual results, there is an enormous gulf into which are dumped the concepts of freedom of choice and individual responsibility, never to be heard from again over the course of the debate.

19. *Id.*, pp. 284 and 290.

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