Advertising and the present moment

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Purpose of this document

According to a recent survey, more than 60 percent of CEOs globally say that they expect a recession in their primary region of operations before the end of 2023 or earlier. As speculations about economic recession[1] continue to gain steam, marketers may once again be confronted with the classic dilemma of whether to cut marketing and advertising spend or not.

In this document, we summarize some of the industry's best thinking in terms of advertising in times of crisis, and we try to answer the key questions that block efficient marketing decision-making right now.

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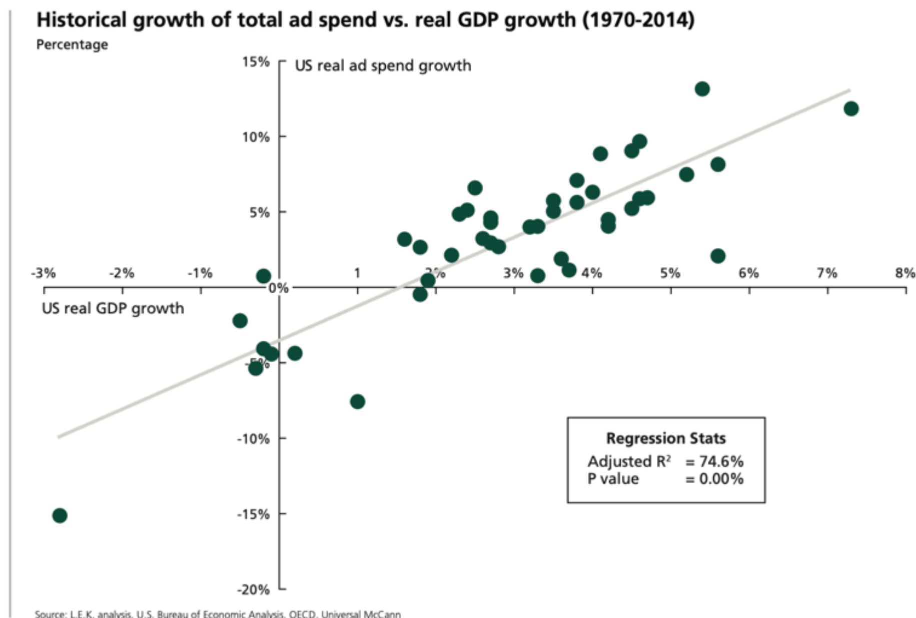
[1] A recession has been typically recognized as two consecutive quarters of economic decline, as reflected by GDP in conjunction with monthly indicators such as a rise in unemployment. However, the National Bureau of Economic Research (NBER), which officially declares recessions, says the two consecutive quarters of decline in real GDP are not how it is defined anymore. The NBER defines a recession as a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales.

1. Company expectations about GDP (gross domestic product) have a significant impact on advertising spend

Previous research[2] suggests a strong positive correlation between U.S. ad spend and real U.S. GDP growth. Specifically, research indicates that 75% of the change in ad spending is explained by differences in GDP, which suggests that advertisers adjust their spending levels based on their economic expectations more than anything else.

A regression analysis reveals a strong positive correlation between U.S. ad spend and real U.S. GDP growth, with ~75% of the change in U.S. ad spend explained by changes in real U.S. GDP.



Graph 1: Correlation between GDP and US ad spend

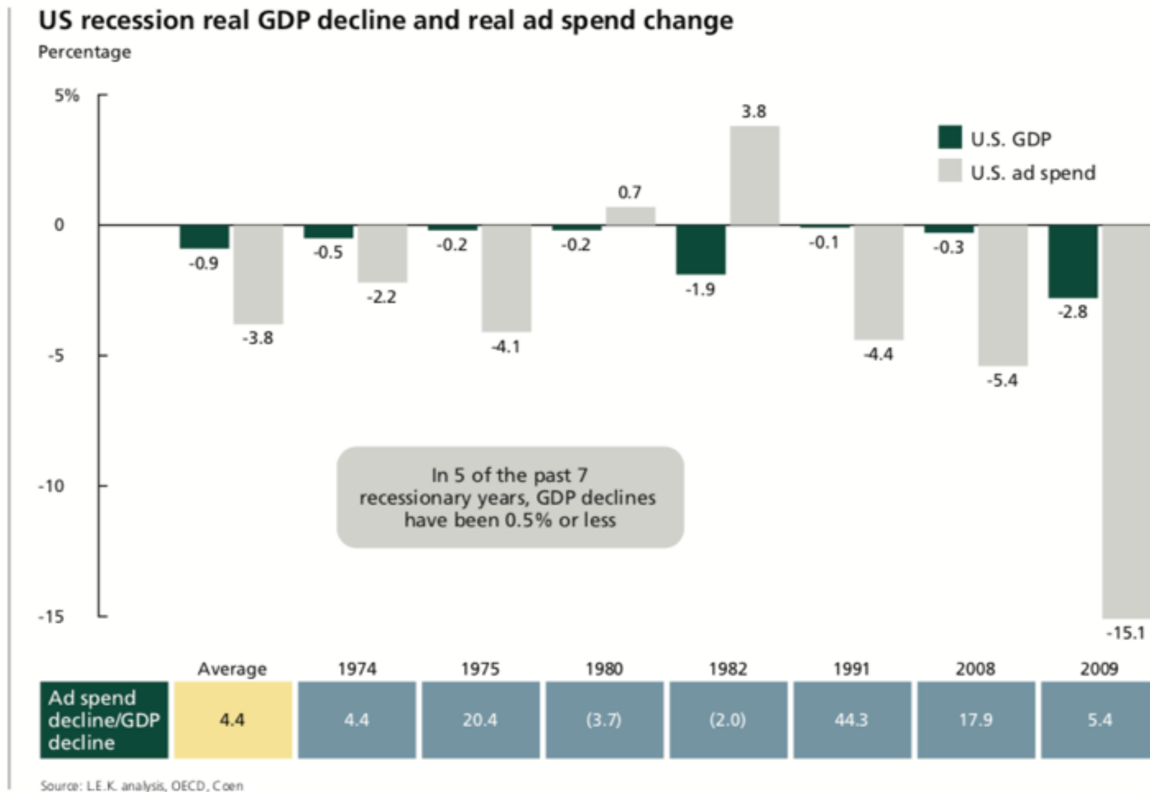
2. There is a negative multiplier effect for advertising spend

Because marketing communication costs can be trimmed down more quickly than other costs (e.g., production), advertising spend typically declines much stronger than GDP during recessions.

According to published research, a 1% change in U.S. GDP has resulted in an average swing of 4.4% of advertising spend over the past recession years. The average of the past

[2] Source: LEK consulting

three recession years is a significant (8.3%) decline in advertising spending. The magnitude of the decline varied significantly, from as small as ~(2.0x) to as large as ~20.4x.



Graph 2. Impact of recession on advertising spend

In line with these findings, MAGNA[3] also developed a statistical model (using data from the last 20 years) that shows a very similar relationship: a drop of real GDP by 2% caused a decline of 10% in ad spend. Other studies have validated this correlation, although the strength of the relationship may vary by country. According to one synthetic review of 40 studies of advertising in times of recession,[4] advertising's average co-movement elasticity with GDP across 37 countries of the world is 1.4. In other words, a 1 percent change in GDP results in a 1.4 percent change in advertising expenditures in the same direction.

3. There is a strong case for maintaining or even increasing advertising during a recession.

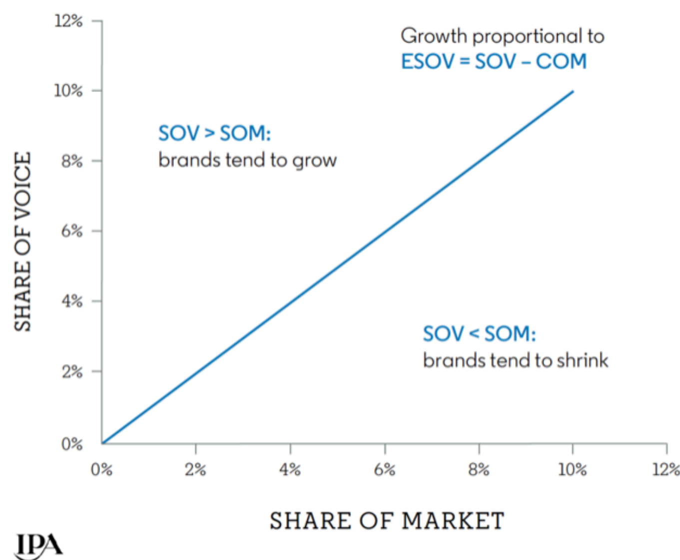
The argument for cutting advertising in times of recession is simple: If we assume that the effectiveness of advertising does not change during a recession, then advertising as a percentage of sales should not change, and given that sales are likely to decline during a

[3] Source: MAGNA

[4] Source: Journal of Advertising Research

recession, the new optimal advertising during a recession should be lower as a percentage of sales relative to a stable market.

Yet, research shows that advertising impact increases in such times, partly because the total level of "noise" from advertising in the media decreases (meaning that the probability of any single advertisement being noticed, observed, and persuading consumers increases) and partly because the cost of advertising decreases, which means that it's easier to maintain or build SOV. The argument of ESOV (excess Share of Voice) is well documented in research[5] and shows that the rate at which a brand grows or shrinks tends to be proportional to its Extra SOV (ESOV), defined as the difference between SOV and SOM.



Graph 3. SOV vs. SOM and impact on growth

That being the case, research supports the case for maintaining or even increasing spend in relation to cutting spend during a recession. Specifically:

1. Cutting ad spend: There is strong, consistent evidence[6] that cutting back on advertising during a recession can hurt sales during and after the recession without generating any substantial increase in profits. Four studies found that firms that cut back on advertising during a recession experienced lower sales during and after the recession.

[5] Source: IPA Research, ACA Research

[6] Source: Journal of advertising research

2. Maintaining spend: On the other hand, not cutting back on advertising during a recession could increase sales during and after the recession: Two studies found[7] that firms that maintained advertising during both years of a recession had higher sales in subsequent years than those firms that maintained advertising in only one year and cut back in the other year or those that cut back on advertising in both years of a recession.
3. Increasing spend: Evidence suggests that increasing advertising during a recession may boost sales, market share, or earnings during or after the recession because most firms tend to cut back on advertising during a recession.
    - Two studies[8] showed that firms that increased advertising during a recession experienced higher sales during and after the recession than those that maintained.
    - Moreover, increases in advertising from 20 to 100 percent led to a 0.9 percent increase in market share. The market share response to increases in advertising during a recession is much higher than the corresponding response during an expansion.
    - One of these studies found that this result held across categories but was stronger for those categories that relied more on advertising.

Advertising and the present moment: Key takeaways

1. As the world is coming out of two years of the pandemic, a combination of global and domestic challenges create new fears about the possibility of an upcoming recession.
2. Analysis of advertising expenditure during previous recessions shows a clear correlation with GDP expectations and a negative multiplier for advertising, suggesting that marketers usually overreact to prepare for a recession.
3. Instead, recession periods present an opportunity for marketers to gain ESOV (excess share of voice) and increase the productivity of their media investments.
4. Multiple research studies have shown that advertising impact increases during an economic slowdown because the total level of “noise” from advertising in the media decreases, meaning that the probability of any single advertisement being noticed, observed, and persuading consumers, increases at a lower cost.
5. We believe that marketers stand to gain from either maintaining their current spend or even increasing it if feasible.

[7] Source: Journal of advertising research

[8] Source: Journal of advertising research