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Marketing spending strategy in recessions

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A B S T R A C T

Recessions provide challenges to managers seeking to develop and justify an appropriate level of market-facing activity. The literature on the topic offers limited guidance on what strategy is most appropriate. We briefly review the literature on the topic and report on recent results that show (a) that R&D spending by B2BGoods firms and B2BServices firms in recessions increases both profits and stock returns, while advertising spending decreases both profits and stock returns; (b) for B2CServices firms, both R&D and advertising spending in recessions increases profits and stock returns and (c) for B2CGoods firms, R&D spending in recessions increases profits and stock returns, while advertising spending increases profits but decreases stock returns. Further, these effects are either strengthened or weakened depending on the firm's market share and financial leverage.

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Recessions happen repeatedly, even if the time of their occurrence cannot be easily predicted. And while a recession may be triggered by events in a single sector its effects are usually widespread. Hence, recessions entail a significant contraction in market demand for goods and services, lowering sales, cash flows and profits (Kijewski, 1982). And most firms cut franchise building investments in innovation and marketing to conserve resources, e.g., (Barwise, 1999). In this article, we focus on what the marketing literature has to say about firms' marketing spending decisions in recessions.

Marketing is concerned with the creation of value for firms and their customers through effective differentiation of goods and services. Two key marketing activities, R&D and advertising, are central for that differentiation. The outputs of R&D programs are new technologies, products, and processes that can create value for the firm through rent appropriation. Advertising leverages the output of R&D programs, creating awareness of products, increasing sales, building brand equity and inducing customer loyalty.

During recessions, firms are pressed to control costs to maintain liquidity; hence R&D programs, which have limited ability to increase short term cash flow, see close scrutiny. However, if a firm cuts its R&D spending, it risks losing its long term technological advantage. In spite of that risk, a report from the Federal Reserve notes, "R&D, one important source of economic growth, falls rather than rises during recessions, even for firms that do not appear to be credit constrained." (Barlevy, 2005, p. 1).

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A similar situation occurs for advertising programs. While some observers (e.g., Welch, 2009) suggest an aggressive approach to spending in recessions, most firms appear to view advertising as a dispensable luxury in recessions (Biel and King, 1985). Scholars and practitioners have studied the effects of advertising in recessions on firm performance and the evidence from these studies is mixed. For example, some studies (Frankenberger and Graham, 2003; Graham and Frankenberger, 2009) report that increases in R&D and advertising spending (see Kamber (2002) for advertising only) in recessions increases firms' earnings; others report that cutting advertising in recessions does not affect firms' profits (Kijewski, 1982). The mixed evidence for the rewards to R&D and advertising spending in recessions may arise because of firm- and market-level contingencies in the rewards to firms' marketing spending in recessions, which we examine here.

For example, focusing on the 2001 recession in the United States, Srinivasan et al. (2005) find that a firm's trait that they term *marketing proactivity*—the interpretation of the recession as an opportunity and the execution of a marketing response to capitalize on that opportunity—improves firm performance. A way to think about their findings is as follows: firms with the *will* (the nerve or culture), the *skill* (marketing and customer knowledge and the ability to turn that knowledge into strategy) and the *till* (resources to fund investments in a downturn) are amply rewarded both during and after the recession. Think about cyclists in the Tour de France–the fittest and strongest don't attack on the flat or early in the race but attack on the roughest, steepest, most gruelling sections. Attacking when times are tough allows them to separate themselves from the weaker cyclists and provides them a return later on. And what about the weak cyclists? Our research says that they can try to keep up with the strongest (trying to chase

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the strongest cyclists in tough conditions) and risk out-and-out-failure or they can conserve their energy for a reasonable finish. Returning to implications for firms, the strong (those with the skill, the will and the till) should invest in franchise building activities, such as new product development and brand enhancement, during the recession, while the less strong should focus on securing core customers and markets for the longer haul.

In more recent research, we develop a contingent model of the effects of R&D and advertising spending in recessions on firm performance (Srinivasan and Lilien, 2009). We propose that the central process by which a recession affects firm performance is through its impact on consumer behaviour, which we call the "consumer-centric" effect of a recession. During recessions, not only does consumers' purchasing power decline, but consumers' uncertainty about the potential recovery makes them thrifty, leading them to delay purchasing goods and services or to avoid purchases altogether.

Changes in consumer behaviour in recessions create a direct demand contraction for firms in industries serving consumers and an indirect demand contraction for firms in upstream industries serving other firms. The distinctive characteristics of services relative to goods, i.e. their intangibility, inseparability, variability, and perishability may compound the demand contraction effect for service firms, relative to goods firms (Parasuraman et al., 1985). For example, Rampell (2009) reports that, in recessions, consumers often insource previously outsourced services such as haircuts, spa treatments and home maintenance.

Hence, we hypothesize that a firm's market share (Buzzell and Gale, 1987) and financial leverage (Jensen and Meckling, 1976), as well as its product-market profile (whether it is in the B2B or B2C marketplace and whether it offers services or goods) will moderate the rewards to R&D and advertising spending in recessions. We examine the rewards to R&D and advertising spending in recessions using one short-term metric—accounting profit, and one long-term metric—stock return.

We use a panel of publicly listed US firms from Standard and Poor's COMPUSTAT database that includes 10,580 firm-years, covering the period between 1969 and 2008; a period covering seven recessions. We find that R&D spending by B2BGoods firms and B2BServices firms in recessions increases both profits and stock returns, while advertising spending decreases both profits and stock returns. In contrast, we find that for B2CServices firms, both R&D and advertising spending in recessions increase profits and stock returns. For B2CGoods firms, we find that R&D spending in recessions increases profits and stock returns, while advertising spending increases profits but decreases stock returns. Our findings suggest that, in general, B2B firms should consider focusing on R&D programs relative to advertising programs during recessions while B2C firms should consider the reverse. Other findings in our work show how these effects are strengthened or weakened depending on the firm's market share and financial leverage.

The paper's findings demonstrate a key role for firm- and market-level contingencies on the rewards to firms' marketing spending in recessions. Our findings suggest that the rewards to firms' R&D and advertising programs differ depending on such firm characteristics as market share, financial leverage, product-market profile, and likely by other variables that our data set did not permit us to measure.

The results extend Srinivasan et al.'s finding that proactive marketing activities in recessions do not improve profits for all firms (Kamber, 2002). On the one hand, the positive effects of advertising spending (profits for B2CGoods firms and B2CServices firms) are consistent with the idea that proactive marketing, i.e. counter-cyclical marketing initiatives in recessions, improves profits. On the other hand, the negative effects of advertising spending (profits for B2BGoods firms and B2BServices firms) suggest that proactivity in advertising in recessions is not always rewarded.

The research we have cited here (our work and that of others) implies two things: (1) there is no single best marketing spending strategy in a recession—the answer is.... "it depends" and (2) more research is needed to really understand exactly what those dependencies are. We view marketing spending strategy in turbulent times as a domain where academics and practitioners should collaborate to find improved answers to a question that will become even more salient the next time a recession comes along. And there will be a next time.

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