Coordination Economies, Advertising, and Search Behaviour in Retail Markets by Kyle Bagwell and Garey Ramey: A Comment

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Kyle Bagwell and *Garey Ramey* (1994)[1], hence (BR), address themselves to a challenging task. It is to make sense of the fact that advertising which is "ostensibly uninformative" (498) can nevertheless promote sales. Nor are they content with this effort, no matter how formidable in and of itself. In addition, they impose a side order constraint upon themselves that their explanation must be steeped in rationality. That is, not for them an elucidation based on consumer ignorance or superstition. On the contrary, there must be "method" in what would otherwise appear to be the madness of customers flocking to firms which fail to provide hard information on prices, qualities, guarantees, etc.

Nor is there a lack of anecdotal and other information which seemingly buttresses their point that a significant amount of advertising is of this "ostensibly uninformative" variety. In addition to the absurdity of the jingles cited by BR[2], other equally patronising ones come to mind: "We're number 2, we try harder," "Fly the Friendly Skies," "You're in good hands with...," "It's X time," "Get a piece of the Rock."[3] As well, there is the common advertising phenomenon of placing a beautiful blond (or either gender persuasion, but mostly female) adjacent to a tractor, or some such other implement, and implying that the purchase of the one will obtain for the buyer the services of the other.

I have no objection to their citation of this issue as an important one to be studied; nor with their view that it would be salutary to explain these modern petty series of annoyances on rational economic grounds. My complaint is that the BR explanation fails, and that these authors completely ignore an alternative hypothesis which renders a far superior account of this phenomenon.

What is the analysis of BR? It is that advertising, any advertising, as long as it is protracted, widespread and most important expensive, leads to increased sales;

the resulting economies of scale enable lower prices to be charged. This, in turn, rewards consumers of the finished products who offer their patronage from seemingly irrational motivations (they exhibit a sort of tropism toward advertised goods similar to that which attracts a moth to light). But this seemingly superficial, unreasonable sounding behaviour, according to BR, masks a more deep seated and fully rational motivation: by engaging in this behaviour, they can take advantage of the lower prices which emanate from this process.

On the face of it, this hypothesis sounds so counter intuitive and so unlikely that I am likely to be accused of making this all up. Lest such an accusation be allowed to stand, I refer to the words of BR themselves:

> "...greater investment in selling technology, an expansion in the product line, and lower prices are mutually reinforcing responses to an increase in expected market share" (498, 499).

> "Under the hypothesis that a firm's expected market share rises when it advertises more, the firm is led to offer better deals (i.e. lower prices and greater variety) when its level of advertising is increased. This in turn establishes a general sense in which consumers' responsiveness to retail advertising is consistent with rational consumer behaviour: if consumers respond positively to advertising, then a high advertising firm will justifiably expect greater market share and thus offer a better deal, confirming the consumers' original inclination to be responsive to advertising" (499).

> "Moreover, since firms with higher advertising anticipate greater expected market share, they also offer better deals. This means that the advertising search rule is optimal among all possible search rules for the informed consumers, as it directs them to the best deals in the market" (499).

This explanation appears to account for ostensibly uninformative advertising, but actually it does not. For one thing, it sounds as if BR have been taken in by the very "bigger is necessarily better" jingles they themselves see as ostensibly uninformative. Is there any real difference between the jingles they deride "the more we sell, the lower the price; the lower the price, the more we sell!" and "We're better because we're bigger, and we're bigger because we're better!" (498) on the one hand and on the other their own statement "...firms offer greater variety and lower prices when their expected sales volume expands?" (499) If so, it is difficult to discern it.

For another, BR's is *too good* of an explanation! Based on their account, *all firms*[4] should forthwith vastly increase[5] their advertising budgets in general, and in particular reallocate these funds toward the uninformative types, and away from informational ones. For in this way they would all prosper, given that this activity is akin to waving a magic wand. While this might be good news for such as a Young and Rubicon, despite BR there is an optimal amount of advertising that an economy can sustain at any one time, and there is no reason to suppose that there is any under allocation of resources in this direction at present.

Third, it is simply not true that "a high advertising firm will justifiably expect greater market share" (499). Perhaps there is a positive relationship between advertising and profit, even a statistically significant one. But the correlation is by no means 1.0, as implied by BR. The Edsel, for example, was a highly touted product; the campaign was conducted in the usual manner, for automobiles: heavy emphasis on the "ostensibly uninformative" variety, very little presence, at least in the major media outlets, or knowledge that might be of interest to an engineer or scientist. Yet the Edsel went down to ignominious commercial defeat. So much so that the term "Edsel" now functions in the English language as a shorthand for business failure, on a gigantic scale. If merely by engaging in big budget "ostensibly uninformative" advertising a firm could render an otherwise unacceptable offering profitable, there would literally be no end to this industry.

BR claim that the consumer will exhibit what in effect seems like a tropism toward highly advertised products. He will do this because he knows he can obtain bargains thereby, since everyone else will join in this (otherwise) lemming like behaviour, and economies of scale can be counted upon to lower prices.

A minor problem with this is that not all cost curves are downward sloping in the relevant sections. By the law of averages, at least some will be in the bottom part of the traditionally shaped "U" cost curve. If so, and to that extent, then economies of scale will not be operational: even if advertising of the BR variety succeeds in promoting a land office business in terms of volume, costs will rise, not fall, as the BR thesis requires.

A major problem, in contrast, is that the rational customer will not patronise *every* BR type offering. Budget limitations alone would preclude any such conduct. Rather, he will wait and see which ones really eventuate in bargains. "Ostensibly uninformative" advertising will work only if all or most potential customers act as BR posit them to do. No one consumer, however, has any assurance, let alone guarantee, that others will act as he is intending to do. So even granting them their own unlikely premises, the BR thesis fails: it is defeated by the phenomenon of spill overs, or positive externalities. Let us give BR the most generous interpretation possible: on the macro level, the phenomenon they point to will work. That is, *if* all or most people direct their purchases to the "ostensibly uninformative" advertisers, everything these authors say will then follow. However, on the micro level, which necessarily underlies the macro (Barro; Mises, 1957; Hayek, 1931) their argument fails. Each rational individual will *not* rush pell mell to embrace these products. Rather, he will wait to see what others do, and others will wait for him. Everyone will wait for someone else to free ride upon, and no one will want to be the first to start, for advantage will then be taken of him. This is the death knell of the BR effect.

In the view of these authors, consumers will flock to those firms which support the heaviest advertising budgets, used for the purpose of promoting "ostensibly uninformative" information. Such business enterprises will "expect" or "anticipate" that if they but invest in this sort of advertising, they will prosper. There is a name for business concerns which act in this way; it is not "profitable," as BR would have it, but rather "bankrupt." There is no evidence for the claim that those who follow such simplistic advice as "Advertise more, but do it in an 'ostensibly uninformative' manner" will enhance their chances for success. For the rational consumer does not play dog to the Pavlovian bell. Instead, he waits and sees, bides his time, considers all the alternatives known to him.

Another difficulty with this analysis is that BR have not even claimed, let alone proven, that there is something unique about advertising that it should have the properties they ascribe to it. Their inquiry is completely general and non specific. To wit, I could substitute for the linchpin of their case "ostensibly uninformative advertising," any number of other variables, without changing their insight in the least. For example, "painting the product red," or blue, or any other colour; "packing it in an environmentally correct package;" making it bigger or smaller. Any of these characteristics have (sometimes) led to marketing success. If so, then the same snowball effect can be generated from them as BR do for advertising. But they do not always succeed, as it implicitly claimed for advertising by BR. It is not too much of an exaggeration, in fact, to interpret the relationship between these authors, and advertising, on lines similar to those which obtain between the cargo cultists and their paper mache airplanes and fake runways, built to entice the gods to land flying cornucopias in their territory.

All this would not be so unsatisfactory if BR had at least mentioned an alternative explanation for "ostensibly uninformative" advertising, even if they then went on to criticise it from their own perspective. But not to even take it into account casts serious aspersions on the whig notion of the development of economic theory: that our profession is on a continual upward course. In this case at least, the passage of time has meant a memory loss, not a building up onto the shoulders of those who have preceded us.

The alternative theory may be found in Kirzner (1973) published by a press that is hardly obscure. This author adumbrates his analysis in part as a reaction to Stigler (1961),[6] so we might begin describing the Kirznerian system by first mentioning the latter's information search model. According to Stigler, then, there are marginal but declining gains to be made from search, and marginal and increasing costs to be suffered, the longer the search continues. Optimal search time is reached at the point of intersection between the two. To stop beforehand would leave expected benefits greater than expected costs; to stop after this equilibrium has been reached would have the opposite, but also inefficient, effect. One criticism that can be launched at Stigler is that his model leaves no room for real error. Even in the face of an egregious case of failing to search one more day for a magnificent bargain, the Stiglerian can always reply that the *expected* gains and losses were such that it was optimal to stop at the chosen point.[7]

Kirzner's main criticism was that the Stigler model could only account for the advertising of an explicitly informational sort, particularly *not* the BR type that is "ostensibly uninformative." Why? Because before one can rationally search for something, one must first be aware of it. He must know that he wants it, that he lacks it, and possible places where it may be found. Stigler's was a reasonable explanation, from the Kirznerian perspective, for goods and services such as houses and apples about which people full well knew the existence and beneficial attributes.

But what of new products such as - before or during their first introductions - hula hoops, frisbees, computers, air conditioning, the music of Mozart, the pet rock, etc? They were completely unknown at the time, so by definition people *could not* have been searching for them.

Here is where Kirzner's insight comes in. The function of motivational (BR's "ostensibly uninformative"), as opposed to informational advertising, is to attract the consumers' attention to a completely new product. Its purpose is to grab the potential customer by the lapels, shake him back and forth, slap him in the face with this new opportunity, in effect, so as to practically *compel* him (in a non violent, non fraudulent manner, of course) to be cognizant of the new offer, and to take advantage of it. The reason for the typically attractive human (typically female)[8] specimen perched on the tractor or automobile was *not* to commit fraud, or, as BR would have it, to set in motion their economies of scale scenario. It was to attract the otherwise roving eye of the potential buyer; the one who was marching around blissfully unaware of this magnificent opportunity.

If the Kirzner and BR analysis were both focused on the phenomenon of "ostensibly uninformative" advertising, they approached this topic in sharply contrasting manners. For BR, as we have seen, the implication is that advertising will always be successful; for Kirzner, no such assumption pertains. For BR the function of this trade is to attract the masses to make purchases, and this, through economies of scale, will lower the price sufficiently to attract them there in the first place. For Kirzner, the function is a very different one: it is to capture the consumers' attention to an offer for which he was *not* searching, indeed, for which he *could not have been* searching, since he was totally unaware of it in the first place. Thus, for BR there is a circularity in the argument which does not appear in Kirzner. For BR, implicit externalities abound: each consumer depends upon all the others, and all the others on him, in order to purchase the highly advertised good. Unless all cooperate in such a manner, and none exhibit opportunistic behaviour, the price cannot fall due to the economies of scale created by "ostensibly uninformative" advertising. There is no such requirement for Kirzner.

Endnotes

1. All otherwise unidentified page citations refer to this one article.

2. "The more we sell, the lower the price; the lower the price, the more we sell," "We're better because we're bigger, and we're bigger because we're better!" (498).

3. BR's jingles in addition to being absurd are also variations of the economies of scale argument; mine share only in the former characteristic.

4. Am I not exaggerating here? Should I not confine myself to the claim that this only applies to an overwhelming majority of firms? After all, BR's thesis only encompasses ostensibly uninformative advertising, and not all goods and services would appear compatible with this sort of promotion. Many products, after all, are advertised in a straightforward informational manner, where objective characteristics (height, weight, speed, durability, price, delivery time, warranties, etc.) are typically given. This practice might apply more to commercial and industrial (e.g. promotions for computers and engineering products are typically long on information and short on uninformative bally hoo).

All this is undeniable. But the point is that if BR were correct, none of this would take place. Rather, informational advertising would give way to the purposefully uninformative variety, for the reasons given by them in the text.

5. No limit to this emerges from the BR model. Are we to conclude that it would be optimal for the entire GDP to be devoted to advertising? If not, where are the forces that preclude such a conclusion?

6. This, in turn, was a critique of the full information models of perfect competition, which were in vogue at that time, and still, unfortunately, continue to haunt us.

7. This is yet another example of a theory being too good for its own good.

8. The Marlboro man is an exception.

References

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