Illustration 3.3
Optimally Allocating Advertising Expenditures

The advertising decision is not as straightforward as it was not too long ago. As Joel Weiner, the executive vice president of marketing for Kraft, remembered, “In the olden days…you ran your commercials on the Big Three network stations and one or two locals [and] you basically reached everybody.” In the context of the discussion above, we could restate Mr. Weiner’s position as:

> In the past, the marginal benefit per dollar’s worth of expenditures in television advertising was so large that TV advertising was essentially the only game in town.

However, cable television, video recorders, and independent stations have reduced the power of network commercials. A.C. Nielsen Co. reports that the networks’ share of the TV viewing audience declined from 90 percent in 1979-80 to 76 percent in 1985-86. At the same time, factors like the increased number of working women has made it more difficult to reach that critical female audience responsible for so many consumption decisions.

The result has been that firms are using a much wider range of media to get their messages to consumers. Firms are using public relations (Cabbage Patch dolls were introduced with PR blitz) and event sponsorships (AT&T is sponsoring golf and tennis tournaments and Pepto-Bismol sponsors a chili cook-off). However, the primary alternative means of reaching consumers is through sales promotion: cents-off coupons, sweepstakes, and direct mail.

Why did the advertisers turn to these alternative methods? Why turn away from television advertising when the price of network TV ads is declining? The answer is that the marginal benefit—the increased sales—per dollar spent on TV advertising was decreasing. As the TV ad dollar brought in fewer additional sales, these other media became more attractive.

And, if a firm is going to spend money on all of these different kinds of promotions, how does it determine how to allocate its spending? The answer is simple. It will maximize the effectiveness of its promotion budget by allocating its spending so that the marginal benefits from the last dollar spent in each of the media are equal:

$$\frac{\text{MB Network TV}}{\text{P Network TV}} = \frac{\text{MB cents-off coupons}}{\text{P cents-off coupons}}$$

$$= \frac{\text{MB sweepstakes}}{\text{P sweepstakes}} = \ldots$$

Source: “As Network TV Fades, Many Advertisers Try Age-Old Promotions” by Joanne Lipman, The Wall Street Journal, August 26,1986.