THE ECONOMICS
OF THE SERVICE SECTOR
IN CANADA

The Role of Advertising Agencies in Canada's Service Sector

Kristian S. Palda

THE FRASER INSTITUTE

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PREFACE AND SUMMARY

This study describes and analyses the services-to-business sector which, on behalf of the advertisers, prepares and places in media just under one-half of the advertising directed to Canadian buyers. The sector consists quite visibly of advertising agencies, and of a multitude of supporting businesses about which there is very little information. Total revenues of the sector are at the $1.5 billion mark; its share of the gross domestic product is in slight decline.

Despite its modest size, the sector's member firms play a crucial role in disseminating market information in Canada's economy. That role, its history and its organizational underpinning are described at length. The sector is intensive in human capital and readily adaptive to technological change. Yet its growth appears to depend on changes in the economy's output and is less dynamic than that of business services in general.

Of the several challenges the sector is facing, that of the alleged shift of advertisers' funds to sales promotion and that of global standardization of multinationals' advertising appear the most prominent. The first challenge presents an opportunity rather than a problem. The second may prove difficult for Canadian-owned agencies that service foreign multinationals.

The statistical information about the sector used to be (until 1977) much better but will improve again when the results of the yearly surveys started by Statistics Canada in 1985 become available. A co-operation between the trade associations of advertisers, media, and agencies with Statistics Canada would easily yield a valuable yearly compendium of information on this and allied sectors.

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The Fraser Institute, in the person of the director of these sectoral studies, Professor Herbert Grubel, and through the organization of three working conferences, was of great assistance. A Queen's undergraduate, Mr. Michael Detlefsen, an M.B.A. student, Brian Lewis, and a Ph.D. student, Eben Otuteye—all of the School of Business—were very capable research assistants. Mrs. Helen Chiasson managed the word processor admirably. To all of these, my thanks.

INTRODUCTION

The objective of this study is to contribute to the body of knowledge about the structure, evolution and dynamics of the service sector of the Canadian economy. This study is but one in a series commissioned by the Fraser Institute on behalf of the Department of Regional Industrial Expansion. It deals with a rather tiny slice of Canada's economic output, on the order of 0.15 percent of GDP in 1984. This output was embodied in the activities of advertising agencies and their subcontractors (sector SIC 774). It consisted of the creation and placement of about 45 percent of the nation's advertisements, worth about $2.75 billion of media space and time, or over 0.6 percent of GNP in that year. The social, cultural and economic impact of the sector's labour is of course out of proportion to its limited output significance.

Advertising is one of the chief means of information provision to buyers and so a precious lubricant of the wheels of the economy. Being highly visible and often loud, it accentuates many of our society's mass cultural traits and tends to impose them even upon the unwilling. Since it is the most perceptible of business activities, it frequently gives rise to controversy and anti-business clamour. Indeed, the small volume (in economic terms) of advertising preparatory activity and the disproportionate effects the results generate bring to mind another service activity with even greater consequences—the debating and passing of legislation.

This study, however, sticks strictly to the analytical description of the agency-plus-subcontractor sector. It shuns reflections of grander design, such as whether advertising is largely persuasive rather than informative, what its impact on competition may be, and so on. For this avoidance there is an excellent reason. In order to view advertising from the point of view of the "big think," one would have to acknowledge that its delivery before buyers is the joint responsibility of advertisers, agencies and media. But these three joint venturers constitute neither a homogeneous industrial sector nor are they all *service producing* enterprises. Together they therefore exceed the scope of the service sector inquiry mandate.

The major part of the monograph is given over to as thorough a description of the sector as possible. Not surprisingly, the chief obstacle to this endeavour was the absence of official statistics. It should, however, be pointed out that up to 1977 yearly surveys of advertising agencies by Statistics Canada yielded a reasonably rich source of data. (In 1965 the Dominion Bureau of Statistics published a rather magnificent compilation of advertising expenditures in Canada.) From 1985 on, too late for this

study, a fairly thorough yearly survey of the sector has been reinstituted. Where possible, therefore, official information was supplemented by recourse to trade association and private source information. However, there are neither government statistics nor trade associations—and so no trade information—dealing with the numerous small and medium-sized enterprises that supply the advertising agencies and that constitute the 774-*2-3-9* components of the sector.

The advertising services to business industry was found to be entrepreneurial, human capital intensive, open to technological development, and growing moderately in productivity. However, it did not grow in output nearly as fast as the total category it is embedded in, services to business or SIC 77. Indeed, its tiny share of total GDP shrank somewhat. The rosy official statistics on the profitability of the sector are in some contradiction to informed private and press opinion about the health of the larger advertising agencies. Since none of these has stock traded publicly, no verification of this issue is possible.

The challenges to the members of this industry are discussed in the last part of the paper. The two most obvious ones are the alleged shift of the advertisers' funds away from advertising to sales promotion and the so-called globalization of marketing and so of advertising. This may be responsible for the merger movement observed among the agencies. While there is consensus in trade circles on the shift to sales promotion, hard and reliable data come in small scraps only. There is no reason why this part of the communication dollar could not be handled by the agencies; most of it very likely is so handled already.

The challenge of globalization is a challenge originating with foreign multinationals which may prefer a standardized advertising campaign to be prepared in New York, London or Tokyo. In that sense, the problem of the Canadian-owned advertising (service) agency is not dissimilar to that of many other firms that service foreign multinationals in Canada. We need some solid data here which could be gathered by the industry itself. Such data could throw much needed light on a phenomenon that cannot be judged a priori as causing a welfare loss to the Canadian economy.

Perhaps of equal importance to the analytical description of the 774 sector is the recommendation for filling statistical information gaps. The understanding and acceptance of such a recommendation cannot be divorced from the study of the text which follows. Let it merely be mentioned here that Statistics Canada will now provide indispensable information that could be fruitfully merged with private trade association data. This would offer the business and academic students of the sector a single yearly and valuable compendium.

ABOUT THE AUTHOR

Kristian Palda is professor of business at Queen's University, Kingston, Ontario. Born in Prague, Czechoslovakia in 1928, he completed his undergraduate education at Queen's University in 1956 and obtained his M.B.A. and Ph.D. from the Graduate School of Business of the University of Chicago, where he was the recipient of the 1963 Ford Foundation doctoral dissertation prize.

Professor Palda taught business and economics at the Ecole des Hautes Etudes Commerciales in Montreal from 1958 to 1962, when he was appointed assistant and then associate professor at the State University of New York at Buffalo. In 1965 he went to Claremont Graduate School, Claremont, California where he was professor of business economics until 1970. He was appointed to his present position at Queen's University in 1970. He held visiting appointments and has lectured widely in North America and Europe, especially in French-language areas.

Professor Palda's research interests, always coloured by economic analysis, have been devoted to two fields: the examination of advertising effects in commercial and political markets, and issues in technological innovation. He has published six books touching on these areas, the latest two being *The Science Council's Weakest Link* and *Industrial Innovation* with the Fraser Institute. His most recent articles on campaign spending and technological innovation appeared in *Canadian Public Policy* and *Research Policy*, respectively. In 1987 Professor Palda won a Queen's University prize for excellence in research.

CHAPTER 1

A DESCRIPTION OF THE INDUSTRY

Definitions Used in This Study

Industry

In this study we examine the sector "Advertising Services," SIC 774 (before 1980: SIC 862). Recently completed surveys by Statistics Canada estimate the size of the sector at $1.56 billion in total revenue for 1984.[1] Another source indicates that the industry employed about 18,125 employees.[2] Private communication from Statistics Canada puts the share of this revenue accounted for by the four-digit component 7741, "advertising agencies," at approximately 70 percent.[3]

Agencies are defined as establishments primarily engaged in creating and/or placing advertising with publications, radio and television and other media such as outdoor. While agencies are the single largest component of the three-digit sector, little government information is available about them since annual surveys of their activities were stopped in 1977. No census was taken of the services industry in 1981.

The next four-digit constituent of this industry is "media representatives" (SIC 7742), establishments primarily engaged in selling time and space for various media. SIC 7743, "outdoor display and billboard advertising," represents establishments primarily engaged in the rental of space on signs, displays and billboards. Those primarily engaged in manufacturing neon signs, non-electric signs and other sign materials are classified and reasonably well documented under the manufacturing sector 3971, "sign and display industry" (StatsCan annual catalog 47-209; more about this in chapter 2.) Finally, "other advertising services" (SIC 7749) comprise establishments engaged in advertising services not elsewhere classified, such as

> commercial art services, copy writing services, direct mail advertising services, handbill advertising services, novelty promotion services, research services-advertising, sample distribution services, sign painting services.

Some of these may be a figment of the imagination of SIC classifiers in the sense that while such services are no doubt provided they are not "primarily" provided. For instance, public relations is not listed. It is a function more often than not supplied by advertising agencies. Its non-appearance under 774 may be due to the fact that it is not, typically, the agency's primary function.

It is worthwhile repeating that no separate report is available on the non-advertising agency parts of this service sector, that is on 7742, 7743 and 7749, and that the advertising agency series ends in 1977.

Services

Advertising services, SIC 774, are a part of the major group 77, business service industries, which comprise "establishments primarily engaged in providing services more to the business community than to the general public." We shall consider for the purposes at hand that the definition of business community includes the governmental as well as non-profit sectors such as charities. By definition, then, classified ads (an important proportion, up to one-quarter of newspaper advertising) do not benefit from the commercial advice of the 774 sector.

Characteristics of Services Provided

General Considerations

Advertising services, in the broadest terms, form an important constituent part of the marketing activities of the firms and institutions that advertise both to industrial and consumer markets. Here we have in mind services which are provided to the advertisers from the outside by advertising agencies and other supporting firms.

Advertisers do not wholly rely on agencies and other outside suppliers in preparing their final advertising "output." Their marketing function devotes some time to this task. We have interesting figures to document the costs incurred from a 1965 Dominion Bureau of Statistics survey of 10,000 advertisers. As table 1 indicates, in that year these advertisers spent $764 million, of which $83 million or about 12 percent was expended *in-house*.

It should also be pointed out that much of retail and small business advertising is prepared with the normally un-invoiced help of the media which, in such cases, plays the role of advertising counsel. A private communication from a major Canadian newspaper operation indicated that in 1985 the cost of selling advertising (which would in part cover the "free" advice to advertisers) as a percentage of total advertising revenue was 7.5

Table 1
Internal Costs of Advertising and External Expenditures on Advertising, 1965
(in thousands of dollars)

	Internal Advertising Costs (1)	External Advertising Expenditures (2)	(1) as percent of (2)
Manufacturing	42,242	403,510	10.5
Retail trade	20,289	151,254	13.4
Wholesale trade	7,228	41,103	17.6
Transportation and other public utilities	2,914	23,341	12.4
Telecommunications	3,388	8,227	41.5
Hotels and restaurants	2,713	12,744	21.3
Other services, including financial and government.4,392	40,786	10.8	
TOTALS	83,166	680,965	12.2

Source: *Advertising Expenditures in Canada, 1965*, Dominion Bureau of Statistics, 63-216 Annual, tables 8 and 9.
Note: Based on a survey of 10,000 advertisers.

percent. Production costs associated with the layout of the newspaper for the advertising portion were 4.8 percent of that advertising revenue in that year.

What are the characteristics of the services provided by this industry to its customers, the advertisers? Two perspectives can be taken in providing the necessary description.

The First Perspective

This section looks at the marketing activities of the advertiser and considers the advertising agency's assistance in supporting them. Most profit-oriented firms of a certain size and some non-profit organizations as well have customer publics which it would be uneconomical to reach by means of direct, employee-to-customer contact. Indeed, one of the determinants of advertising intensity (the ad/sales ratio) is the number of final users of the product

or service which the advertiser sells.[4] The information function, responsible for letting the ultimate[5] customer know about the existence and quality of the brand, plays a major role in expanding and sustaining the demand for the brand.

One can indeed represent demand for a firm's brand as:

$$q_i = f\,(p_i, x_i, s_i, d_i\,; \\ p_r, x_r, s_r, d_r\,; E_1,\ldots,E_n)$$

where

q_i = the quantity of brand i sold during a given period
p_i = i's unit price
x_i = i's index of quality
s_i = i's advertising expenditures
d_i = i's personal selling expenditures
r = a subscript standing for the activities of all rivals
E = environmental influences, such as income.

Over the last quarter-century this representation of demand for a product brand has become standard and serves as the basic departure point for its econometric estimation and for the profit-oriented optimization of the levels of the right-hand, i-indexed variables which are collectively known as the marketing mix.[6]

The advertiser's decision as to the optimal level of the advertising budget is necessarily conditioned by the market's response to advertising, given the levels of the other mix variables and those of its rivals, and by the skill or efficiency with which information about the brand is formulated and disseminated. The advertising agency is the specialist outside consultant on which the advertiser relies to create the copy (messages) and to place it into the mass media selected on its advice. The continuous interplay of past effectiveness, current advertising goals and the choice of copy and media to achieve them leads to the determination of the size of the advertising budget and so to the chosen level of the advertising ingredient in the total marketing mix.

The advertising agency, under best practice, participates in all the crucial steps of the brand's marketing planning. Its advice is determinant in the preparation of the brand's advertising strategy, typically translated into a formal advertising plan, an example of which is given in appendix figure A-1.

In the case of smaller and medium-sized advertisers, the agency often supplies general and specific marketing research expertise, usually at extra cost beyond the customary 15 percent fee on media billings. This may be

needed for efficient preparation of the marketing plan and its component, the advertising plan.

While the advertising agency's focus of attention is on the services it provides to the advertiser, it acts, of necessity, as a co-ordinator of media space and time offerings. It is also purchaser and production co-ordinator of a rich array of service and supply companies to itself. This second perspective on the activities of advertising agencies needs little elaboration; advertising revenues to print and broadcast media are currently at the $7 billion annual level. Yet the co-ordination of subcontractors such as commercial artists, photographers, and video and film production firms necessary for the preparation of the finished ad or commercial is also of significance. The production cost of a 30-second television commercial can easily reach $100,000 or more.

Officially, advertising has been defined by the Institute of Canadian Advertising (the national association of advertising agencies) as "the paid use of mass communications." The American Marketing Association's definition is wider, "any paid form of non-personal presentation and promotion of ideas, goods or services by an identified sponsor." Note the adjectives "paid" and "non-personal." The first excludes publicity, the output of the public relations function. The second goes beyond mass media to such vehicles as direct mail.

According to one of the business community's elder statesmen Robert Oliver, people in the business community regard advertising in several different ways: as a communications tool that helps open up new markets or expand existing ones; as a means of introducing or explaining new products or services; and finally, because of its very nature, as a catalyst in the economy.[7]

Do these various definitions and views of advertising help to provide us with a better insight into the fundamental nature of the services furnished by the principal "doers" and co-ordinators, the agencies? In my opinion they do so only indirectly, by insisting overwhelmingly on the communications aspect of advertising.

Yes, advertising does communicate or transmit messages from seller to potential buyer. Presumably, these messages contain useful information that may be relevant to the buyer's choice. And the agency, with its subcontractors, plays a central facilitating part in this process. But we should go further into the analysis of this facilitating process to understand the essential nature of the service provided by the agency. For this we shall employ the conceptual scheme recently proposed by Melvin.[8]

The Second Perspective

Melvin suggests that the typical production-consumption situation is one in which the two are separated by *distance* and *time*. The problem is then to convert or transform the output of the production process, defined as X_p, into a commodity that can provide utility for the consumer, defined as X_c.[9] A class of services, designated as *intermediation services*, arises naturally to overcome the distance and time constraints and provides the service transformation function, S:

$$X_c = S(X_p, K_g, L_g, M_g)$$

where the other inputs to this transformation process are various kinds of capital, labour and other intermediate inputs.

The most obvious kinds of intermediation services that come to mind are transportation and storage, the first overcoming the constraint of distance, the second the obstacle of time difference. They both rely on capital equipment, labour and other inputs to achieve their tasks.

One can well imagine that the provision of advertising-borne information is one of the components of the transformation which bridges the gap between the characteristics of the consumable commodity, X_c, and the "factory-door" commodity, X_p. This provision of information, be it merely the fact that the brand exists and is available, substitutes for the face-to-face communication in a contiguous location between individual seller and buyer. An advertisement is prepared with the help of highly human capital intensive labour, expensive printing or broadcasting equipment, and diffused over long distances at preselected times in an effort to reach a predisposed audience.

The seller will choose to have recourse to the advertising intermediation service whenever other forms of communication such as personal selling or public relations prove more costly in bringing together X_c and X_p or, to put it differently, more costly in lowering the price of X_c.[10] A reduction in the price of X_c can certainly be consistent with an increase in outlays for the "transformation process," S, provided one views that final price to the buyer as a real and not a nominal one. (By "real" is meant a price that includes search costs.) The practical meaning of this "academic" formulation is that costly advertising in capitalist economies may actually more than compensate for the private search costs of consumers.

On this view the principal economic function of the intermediation service furnished and co-ordinated by the advertising agencies is the lowering of buyers' search costs in the total acquisition cost of X_c. The true, and most likely elusive, measure of the productivity increase in the advertising services industry is to be found in the unit cost decrease between X_c and X_p

rather than in some within-the-agency productivity yardstick such as man-hours per 15-second commercial. As Melvin observes, trade is made possible by services that overcome the constraints of time and distance. If trade increases, there must be gains from trade to both parties. If trade is growing, economic benefits must be on the increase even if the total cost of the intermediation services rises.

A final reflection on the nature of the advertising service is in order. It is asserted frequently that one of the distinguishing characteristics of services is their evanescent, fleeting nature. Somehow, they are consumed rather than embodied in downstream products or in the capital equipment or capital assets of the enterprise. Accounting convention strengthens this tendency of viewing advertising as a rapidly value-losing activity. Advertising is deemed to be an expense rather than a capitalized investment.

The co-operation of the agency (and its subcontractors), the advertiser and the media results in the diffused advertisement which overcomes distance and time constraints and informs the prospective purchaser. In a number of instances, such as in the case of well-established national brands, the impact of advertising lingers and can be designated as goodwill. While accountants would be reluctant to value it at more than $1 on the balance sheet, econometricians have shown that the intangible capital investment in advertising goodwill (and in R&D-generated knowledge) is on occasion measurable and substantial.[11] It can therefore be stated without equivocation that the advertising services industry helps create economically useful knowledge that has the same aspect as knowledge created by other activities (e.g., research and on-the-job learning). Advertising is an intangible asset that is built up over time and dissipates (depreciates) over time and is often quantitatively measurable by its consequences.

Specific Descriptions

The specific, detailed functions carried out by the advertising agency for the account of the advertiser are described fully in most of the advertising management textbooks[12] as well as in the recent Canadian text *Advertising in Canada*.[13] They can be summarized, at the risk of over-simplification, in the following way.

Let us assume that a full-service agency, one that plans, prepares and places advertising, obtains an "account." This is an agreement to take care of the advertising needs of a brand, a line of products, or even a company. As a first step, the agency will appoint an account executive who will be the liaison person between the agency and the client. Agency personnel assigned to this account will start by becoming thoroughly familiar with the product and will request the advertiser to provide detailed market data

regarding the brand. The agency must understand the decision needs of the customers, their media usage and their buying habits, the activities of competition, the current distribution channels and so on. Frequently, a market study proves necessary to update this information. A full-service agency may carry out this study itself in co-operation with the advertiser. Often, an independent market research organization is called upon instead.

The agency will then be ready to co-operate with the advertiser in the elaboration of the marketing plan for the brand and then in preparation of the advertising plan which is subordinate to it. The specification of advertising goals is as important as the laying out of strategies to achieve them. The goals need not be sales-oriented. Frequently, communications objectives are set, such as increasing awareness of the brand's prime attribute by *x* percent among Canadian housewives age 18-49 over the next year.

This readies the ground for the traditional tasks of the agency, preparation of the message copy and selection of appropriate media to diffuse it. The success and reputation of the agency hinges perhaps most critically upon its creative strength, but a full-service agency is deemed to be an expert on media choices as well. Subcontracting or hiving-off these functions is, in principle, possible. There are some "creative" boutiques and media buying firms in the market which are specialist suppliers.

The preparation of copy often implies preliminary testing of alternative appeals. This again calls for the skills of marketing researchers which may be available in-house or are bought from outside research suppliers. Copy execution definitely requires a host of specialized skills that may be co-ordinated by the agency's print and broadcast specialists—the services of photographers, photo-engravers, commercial production studios and others. Many of these services will be bought from outside, that is, from the other members of SIC 774; some of them will be available in-house. One of the principal reasons for the successful long-run existence of the advertising agency is its skill as a master co-ordinator of the variety of assembly inputs that go into the finished advertisement. This is a skill that few advertisers are willing to invest in for themselves. The challenges this co-ordination presents to the advertising agencies and a general overview of the production input suppliers are outlined in Zarry and Wilson (op.cit., ch. 6) and Wright et al. (op.cit., 162-3). The elaboration of a media schedule or plan is followed by the placement of ads or commercials and by the continuing and costly monitoring of the accuracy of such placements in the media.

Often the effects of an advertising campaign are measured and evaluated, both in their communications form (recall, awareness, knowledge, attitude) and in their behavioural form (coupons sent in, store traffic increase, sales or market share change). Again, the agency may take the

lead in organizing this effectiveness appraisal. It would draw on the services of media, consumer and retail panel data providers, that is, on inputs from outside the 774 sector. Agency remuneration may vary with the services provided.

With the possible exception of accounting auditors, the advertising agency is the outside service organization which lives in the closest continuous symbiosis with its commercial client. With some hyperbole but also with a large grain of truth it has been said that there is no other industry where the prosperity of a service company and its future growth are so closely linked with the success of its clients as in advertising.[14]

Evolution of Advertising Service Characteristics

Volumes have been written on the history of advertising.[15] Here we attempt to present only such aspects of its evolution as may be relevant to understanding the current services supplied by the sector to advertisers and possibly to the discernment of future trends.

Evidence of advertising has been found on Babylonian clay tablets and Egyptian papyrus, and this means of commercial communication has been in continuous existence ever since. Nevertheless, its blossoming was closely bound up with the rise of the first mass medium, print. Newspapers and, later, magazines increasingly relied on advertising as a source of income. However, the main impetus to advertising growth came with the progressive specialization of production, of its mass manufacturing forms, and of its removal from local neighbourhoods to a few centralized locations. The lessening of the contact between buyer and seller and the diminishing possibility of verifying quality reputation locally led to the development of branding as a means of quality guarantee and feedback and this led to national advertising by the manufacturer.

The consumer was then to rely increasingly on the uniform quality of a brand, about which he learned and was being reminded by advertising. To the manufacturer, branding and consumer advertising provided the opportunity to be reasonably independent of downstream distribution and sometimes even to dominate it. As Weilbacher puts it, the development of advertising depended on the growing complexity and diversity of the distribution system and on the growing sophistication of increasingly affluent consumers who found an important source of knowledge about products in advertising.[16]

For our purposes it is more important to trace the development of the advertising agency and its supporting suppliers. English language historical accounts are silent about events on the Continent, where such notable

marketing innovations as the department store arose.[17] They situate the rise of the agency in the United States, even though its precursors, "space brokers," were also operating in the U.K.

As regional and national manufacturers grew in the United States and found advertising in newspapers and magazines of value, a contact function between the advertiser and the innumerable local publishers had to be developed. The legendary Volney Palmer of Philadelphia became the first sales agent of advertising, selling space to advertisers in the 1,400 or so newspapers in existence at that time. For his efforts he was rewarded by a commission which varied by his principal's eagerness to accept advertising. Some of his imitators then developed into wholesalers of advertising space; they bought space in big blocks from publishers at a low price for cash and retailed it to advertisers. This led to a uniformization and standardization of rates which, in turn, depended on the newspaper's circulation and ultimately on readership.

The advertising sales agents, whose most precious asset was the knowledge of (print) media opportunities, soon realized that advertisers were eager to receive advice on how to put together effective advertisements and, indeed, on how better to understand their markets. As usual, Philadelphia was in the lead with the first advertising agency that became an agency of the advertiser rather than of the medium, offering not only media selection assistance but also copywriting skills and marketing advice.

Nevertheless, the commission-type of remuneration remained and was skillfully transformed by publishers into a trade-restrictive device. First magazines and then newspapers set the agency commission, which they would rebate from the full price charged to advertisers at 15 percent. However, only recognized or accredited agencies qualified to place advertisements. To be recognized by publishers (and later on by broadcasters) an agency had to act as the bill collector for the media and thus had to first prove its financial solvency. It also had to agree to charge the client the full media rate with no discounting. The 15 percent commission across all media and the accreditation process was also adopted in Canada. The no-rebate rule ultimately withered under U.S. antitrust attacks in the '50s.

The first Canadian advertising agency—still on the scene today—was founded in Montreal in 1889 by Anson McKim, who was a space-brokering agent for a Toronto establishment and who soon recognized the opportunities for a full-fledged advertising service. Canadian agency services closely followed the evolution of their American cousins. The next stage in their growth and in the demand for their services came with the new technologies of radio and, especially, television broadcasting.

The one striking aspect of agency history is the constancy of its organizational form. Since at least the first World War, full-service agencies offer essentially the same services backed up by an institutional arrangement that has changed but little. Full-service agencies appear to have withstood competition from more specialized shops and have experienced a shift only in the slide from commission to fee-for-service payment arrangements or combinations thereof.

Main Consumers of SIC 774 Services

As was stated previously, this services to business industry has two hierarchical components: suppliers to the advertising agencies and the agencies themselves. The predominant category of customers are advertisers, at least as far as the agencies are concerned. (While one could argue that the agencies' intermediation is crucial to the well-being of media, this type of assistance is but a fallout consequence of the services supplied by the agencies to advertisers.) Most of the revenues of the 7742, 7743, and 7749 categories are derived from sales to advertising agencies. These, presumably, in turn incorporate the cost of such supplies in both the commissions and fees that they receive from advertisers. Therefore, while the vast majority of the 774 sector's income was derived from purchases by advertisers, a reasonable guess would be that the $1.56 billion total revenue figure for 1984 for this industry should be reduced by about a quarter to arrive at the value of the final services provided to advertisers.[18]

We do not have any current information on the sectoral (industry-by-industry) structure of advertiser spending. It is, nevertheless, of some interest to examine the statistics assembled by the Dominion Bureau of Statistics more than 20 years ago and displayed in table 2. Manufacturing (59 percent of all media expenditures recorded in the survey) and the retail trade (22 percent) are clearly the most important advertising categories. The DBS data also give tables, much too detailed for the present purpose, of advertising-to-sales ratios by three-digit categories. As can be expected, the chemicals sector (pharmaceuticals, soaps, toilet preparations, et cetera), with ratios as high as 15 percent, leads all others, such as foods and beverages, where breakfast cereals spent 12 percent of sales revenue on advertising. It is probable that a similar distribution of industrial use of advertising still prevails, yet with a certain shift away from manufacturing to retail and financial services.

Current information is obtainable on the distribution of clients to advertising agencies only in restricted and incomplete ways. For a substantial fee, Media Measurement Services offers data on national advertising in media financed by certain consumer product or consumer service in-

Table 2
Media Advertising Expenditures in Selected Industries

Industry	Amount $ Millions	Percentage of Total
Manufacturing	404	59%
Retail trade	151	22
Wholesale trade	41	6
Transportation, Telecommunication	32	5
All other surveyed services (including banks, insurance)	53	8
TOTAL	681	100

Source: Same as table 1.

dustries. The definition of these industries is difficult, if not impossible, to reconcile with SIC classifications. More interestingly, the same firm makes its figures on the top 100 advertisers in Canada available to the weekly *Marketing* which publishes them every year. Table 3 lists the top 35 advertisers according to their national advertising outlays in print, radio and TV during 1985.[19]

The prominent place occupied by the governments of Canada, Ontario, Quebec and Alberta is to be noted, though the Ontario and Quebec (as well as Alberta?) figures include lottery advertising. The federal figure includes all Crown corporation advertising; separate listings for these are not available from *Marketing*. Table 4 lists some figures, mainly gleaned from the annual *How Ottawa Spends* publication, which pertain to federal government advertising.[20]

Taking strictly the national advertising media expenditures of the federal government departments, we see that they grew from $12.8 million in 1976 (index = 100) to $24.1 in 1982 (index = 188). Procter and Gamble, the perennial runner-up to or leader of the feds in this field, spent $16 million (100) in 1976 and $46.2 million in 1985 (288). Parliamentary questions revealed that the total advertising budget of the federal departments, which includes in-house advertising preparatory costs, separate production billing from agencies, et cetera, was more than double the corresponding national media figures for 1976 and 1979. Comparisons of the U.S. federal govern-

Table 3
The Top 35 Advertisers in 1985
(in thousands of dollars)

	Company	National Measured Media Expenditures
1.	Government of Canada*	71,349
2.	Procter and Gamble	46,246
3.	Government of Ontario	34,836
4.	John Labatt	34,249
5.	Rothmans	33,210
6.	General Motors of Canada	31,073
7.	The Molson Companies	29,607
8.	Unilever	26,637
9.	Dart and Kraft	26,109
10.	RJR	25,541
11.	Canadian Pacific	25,522
12.	Ford Motor Co. of Canada	23,943
13.	Chrysler Canada	21,096
14.	Government of Quebec	20,496
15.	General Foods	18,602
16.	Bell Enterprises Canada	18,476
17.	American Home Products	17,768
18.	The Thomson Group	17,538
19.	McDonald's Restaurants Canada	17,488
20.	Imperial Oil	17,272
21.	Coca-Cola	17,263
22.	Kellogg Salada Canada	17,162
23.	Warner Lambert Canada	17,051
24.	Imasco Holdings Canada	16,171
25.	Pepsico	13,861
26.	Ralston Purina Canada	12,921
27.	Effem Foods	11,558
28.	Kimberly-Clark of Canada	11,124
29.	Dairy Bureau of Canada	10,975
30.	Quaker Oats of Canada	10,797
31.	CKR	10,788
32.	Shell Canada	10,416
33.	Government of Alberta	10,266
34.	Royal Trustco	10,219
35.	Gillette Canada	10,175

Source: *Marketing*, June 16, 1986.
Note: *Includes all Crown corporations.

Table 4
Selected Statistics Regarding Canadian
Federal Government National Advertising Expenditures
(in millions of dollars)

	1976	1979	1982
National advertising expenditures of all federal government departments	12.8	17.1	24.1
	1976/77	1979/80	
Federal advertising* expenditures by departments or agency	29.9	53.2	
	1976	1979	1981
Ratio of Canadian federal civilian departments' ad expenditures, per capita, to U.S. federal civilian, excluding Amtrak	13.1	17.1	21.3

Source: Tables 6.3, 6.5 and 6.7 in Stanbury et al., "Federal Advertising Expenditures," in G. Bruce Doern, ed., *How Ottawa Spends, 1983*, Toronto: Lorimer, 1983; and *Marketing*, June 16, 1985 and June..., 1987.
Note: *Includes intradepartmental and extra-agency production costs.

ment non-defence and Canada's federal government non-defence spending show Americans spending 20 times less per capita than Canadians. But the amounts are small; Canadian per capita outlay is $2.34. The conclusion is that there are no significant trends in federal advertising spending and that it is of comparatively modest size, perhaps one-half of one percent of national media advertising. This obviously does not imply anything about the welfare consequences of such advertising. Expenditures to maintain the Parliament of Canada are equally modest, yet the effects of its activities are omnipresent.

The influence of the dominant advertisers is felt throughout the advertising agency and other advertising services world. These advertisers come from the low-unit-cost, mass-merchandised products and services sectors (Procter, Rothmans, McDonalds, et cetera) and have succeeded in imposing their cultural imprint on their suppliers. That influence is felt even in non-related sectors, such as in industrial products and government advertising. As a consequence, advertising agencies tend toward slickness in their copy but tend also to spread the newest marketing technologies among their less customer-oriented clients.

Finally, more information on advertisers is provided further on, under the heading "Industrial Associations."

Characteristics of Employees

A statistical profile of the personnel employed in advertising agencies and their suppliers is presented in a later chapter. Here, a few general observations are offered.

The advertising agency and supporting services are not basically different from other private business. The two most pronounced of its distinguishing traits are the smallness of the typical firm and the variety of skills required (at least in the agency sector). According to estimates based on 1982 taxation returns, there were only 24 firms employing more than 100 but less than 500 persons; 2,200 firms employed four or less.[21] The largest employer among the agencies in 1986 was Foster Advertising with 492 employees.[22] This smallness makes for a relatively higher turnover of employees (no data available here), a competitive spirit and a taste for risk. Generalizing, one could say that personnel employed in this sector consists, on the whole, of dynamic, risk-taking, entrepreneurial individuals.

Among the supporting services, such as engravers, video-production specialists and photographers, there is clearly a need for specialized skills. The same applies to the agencies, but the mix of skills is much more varied and calls for educational backgrounds that stretch from formal training in arts and graphics to university education in classics, business and chartered accounting. The internal organization chart of the agency (figure 6) hints at some of the background and on-the-job training requirements. One advertising text cites a 1982 American Association of Advertising Agencies (AAAA) study which estimated that 85,000 persons were employed by agencies in 1982.[23] The breakdown into functional groupings was as follows:

Creative	24%
Secretarial	20
Account management	15
Media	10
Financial (including data processing)	10
Unclassified	10
Specialist (including research, marketing, public relations)	7
Agency management	4
Total	100%

Importance of Research and Technology

The innovative stance of this industry, particularly of its agency sector, cannot be divorced from that of the media and advertisers with whom such a close symbiosis exists. In this client-oriented activity it is moot to insist on provenance or pedigree of innovation. In general the following can be affirmed. Computer and electronic technology gets married with social science, marketing-oriented university research to improve efficiency in two areas in particular: the monitoring of advertising effectiveness and the selection of media.

The two areas are not independent; a good illustration is the latest technique devised to gather market feedback, single source data collection. Improved microprocessors allow the installation of a monitoring device in the TV set of a co-operating sample household, one that records and transmits second-by-second reading of channels switched on. One version of this device also allows the watcher to identify himself. Household members are equipped with electronic identification cards which they present at the supermarket check-outs; their purchases are thus identified. Another version has the shopper return home and have an in-home scanner read (and transmit) the universal purchase code (UPC) identification on package goods that need not have been bought in a scanner-equipped store.

This technological advance, now spreading rapidly in various forms, identifies TV target audiences with much greater precision than heretofore, by time-of-day and by programme. This helps in media selection. At the same time, overt (not survey-solicited) shopping behaviour is now more easily measured. It confirms or disconfirms both media choice and copy selection (different test commercials can be shown in test cities). In tandem with marketing interpretation, this rather direct ad-sales measurement and media measurement technique makes advertising agencies more accountable to their clients and so probably more efficient in lowering the cost of providing consumer information.

Other developments, such as advances in copy pre-testing via physiological reactions or in focus group interviewing to generate consumer appeals, keep the advertising scene in turmoil. They are perhaps less dependent on technological improvement than on university research in psychology, sociology, social anthropology and marketing. The profession is an eager receptor and trier-out of new ideas.

Movement between academic and agencies is considered normal. Practitioners assume university teaching positions and academics frequently accept positions in agencies, if not on a full-time career basis then on sabbaticals or shorter consulting assignments. This cross-current of ideas has been in effect for several decades. While one cannot designate this service industry as "high technology" in the sense of carrying out such research on its own behalf, it is certainly "technology intensive" with respect to its output. And this technological intensity is, perhaps, akin to the management consulting service sector, as much social science based as natural science derived.

Regulation

Perceived Need for Regulation of Advertising

In Canada, regulation of advertising is achieved through a series of checks and balances that includes both government and industry self-regulation. In many countries, such an approach produces conflict and is not as effective as it might be in preventing advertising from carrying messages which are factually incorrect, misleading or deceptive. However, in Canada, government regulation and industry self-regulation tend to overlap and are viewed as complementary processes.[24] The trend recently has been toward less federal involvement and greater reliance on the provinces and industry.[25] This section looks at regulation of advertising from the viewpoint of the advertising community. The goal is to provide insight into the impact of regulation on operating behaviour rather than to examine the development of the consumer rights movement *per se* in Canada.

It was not until the widespread use of the brand name in the latter part of the 19th century that modern advertising as we know it began. Up to that time the typical merchant sold unbranded bulk goods that were indistinguishable from one manufacturer to another.[26] The brand name was a way for the producer to tap the demand of the consumer directly by creating product identification and product differentiation. These lessened the need to rely on the whims of the seller to inform the customer about product characteristics and allowed the producer to address the consumer directly. Benefits included the encouragement of repeat buying, the development of

loyal customers, and the establishment of a company image. Controversy, however, developed over the proper function of advertising. Critics argued that the informative function of advertising was only part of the picture. Advertising, they pointed out, also has the power to persuade people to purchase things they do not normally buy or do not need. This assumption regarding the power to manipulate and alter the preferences of the consumer provided the basis for much of the early criticism of advertising and the foundation for the development of a regulatory process to check advertising claims.

Market failure is given as the chief justification for the regulation of advertising. In Canada, the establishment of a regulatory system reflected the growing asymmetry of information flow favouring the seller and the belief that market forces were unable to promote generally acceptable objectives of fairness and equity in commercial interactions. Markets serve to co-ordinate the activities of producers and consumers. The economic rationale for a free market is based on the resulting efficient allocation of resources. Such an economy functions by responding to signals provided by prices, costs and profits. These signals channel resources into the more productive uses and pull them away from those that are less productive. A purely competitive economy with no barriers to entry and perfect information with respect to the quality and nature of products and their prices achieves a welfare optimum and is efficient. However, there are instances where the free market may not result in an efficient outcome. In order to correct such shortcomings, the government may intervene, not necessarily with the desired results. Government regulation of the market is intended to correct perceived market inefficiencies; it may create others.[27]

The problem of less than perfect information flows is such an example of a market failure. Resources are allocated in the most efficient way when decisions are made with full information. Inefficiency occurs when either the buyer or the seller has insufficient information about the consequences of a transaction paying due regard to the costs of information provision.[28] Buyers desire information in order to improve the level and likelihood of satisfaction derived from commodities purchased in the marketplace. Sellers, on the other hand, supply information to inform the consumer of a product's advantages and to persuade him to make a purchase. It is argued that sellers have an unequal advantage in the transaction process because they can control the flow of information to the buyer through advertising.[29] Inefficiency occurs when an advertiser discloses less than full information about a product's relevant properties and leads a buyer to make a different buying decision than would otherwise have been made. The power of advertisers to advance selected product information or to withhold relevant information may lead to government intervention, regulation, or both. The

argument is that if sellers cannot be relied upon to provide accurate and relevant product information, the inadequacies of the information flow circumvent the normal efficient operation of the market and necessitate intervention to safeguard the welfare of both consumers and producers.

Government intervention is not confined just to information remedies. Information problems may also lead to product market imperfections that can confer monopoly power on those who can control the flow of information. In many instances, government responds by trying to correct the failure in the product market through the setting of product standards or regulating production rather than focusing attention on the underlying informational deficiencies. It has been pointed out that informational remedies are usually the preferable solution as they allow consumers to retain their freedom of choice while at the same time eliminating much of the rigidity that goes with product market regulation.[30]

Chief among such remedies is the removal of private or governmental restraints on the free flow of information that inhibit competition and promote market inefficiency. Regulation in many instances can be redundant, infeasible or inefficient. Often the costs of regulation far outweigh the benefits.[31] In other cases, government overspecification of disclosure is counterproductive and only clouds the advertising message received by the consumer.[32] This points up the benefits of greater advertiser control in the disclosure of information. A remedy along this line can make better use of private market incentives and minimize the possibility of introducing unwanted inefficiencies in the market. Left to itself, the private market is then often better able to achieve the appropriate behaviour, in this case, the development of advertising messages that are not factually incorrect, misleading or deceptive.

Canada's Regulatory Set-Up

Canadian control of advertising relies on both direct government regulation and industry self-regulation. It is in the advertiser's interest to engage in self-regulation. For the truthful advertiser, the fraudulent claims of the less honourable seller serve only to discredit advertising and cause consumers to distrust all commercial messages. Sellers thus have a strong incentive to maintain industry integrity and control. Debate in the literature centres on the advantages of self-regulation vis-à-vis government regulation.[33] Those in favour of self-regulation claim that a self-regulatory body knows its industry best and for some types of complaints it achieves faster solutions, is less expensive, and is more flexible than government intervention.[34] Critics of voluntary guidelines for industry conduct have likened self-regulation to

the fox guarding the hen house and caution giving industry too great a control over its operating environment.[35]

The presence of both industry codes and legislation suggest a desire on the part of advertisers and government to recognize the potentiality for abuse of the market unless all bases are covered by a system of checks and balances. A question that arises is that of the appropriate mix between government control through regulation and law and self-regulation by the business community.[36] Data from countries around the world indicate that there is no one right mix that can be established. The extent of regulation is a function of the social and economic characteristics particular to each country. Canada's advertising industry, for example, operates in a highly regulated environment compared to that of the United States. The process of deregulation of industry in general has proceeded at a faster rate there than in Canada. Canadian advertisers have responded by protecting themselves against the heavy hand of government through greater self-regulation and the development of an improved dialogue with the government.[37]

There appears to be a lessening of the regulatory mood by the federal government and greater support for the self-regulatory process in cases where industry can police itself at a lower cost or where the provinces are better able to administer regulation or law. This development has eliminated much of the overlap between federal and provincial policy. Federal law for the most part governs national advertising, while the provinces police local and provincial advertising. Problems, however, persist with interprovincial regulatory diversity or overlap. Such overlap can make it impossible for a national advertiser to use a single advertising theme or the same campaign across the country. An extreme case is the advertising of beer, wine or liquor. Some provinces, such as Prince Edward Island, ban it outright, while others limit content or the media used.[38]

Federal regulation is administered by the Department of Consumer and Corporate Affairs through enforcement of the Competition Act (previously known as the Combines Investigation Act). (Table 5 gives a glimpse of the various jurisdictional competencies.) The act deals not only with misleading advertising but also with anti-competitive behaviour. Violations are met in most cases by fines and imprisonment under criminal law. Several provinces have imposed their own laws in the area of consumer protection and unacceptable trade practices. The Ontario Business Practices Act says that any false, misleading or deceptive misrepresentation is an unfair practice. Similar legislation exists in Alberta and British Columbia and is proposed for other provinces. Unlike federal enforcement, provincial regulations fall under civil jurisdiction. In addition to these regulations, the advertisers and media are subject to regulation in broadcasting by the

Table 5

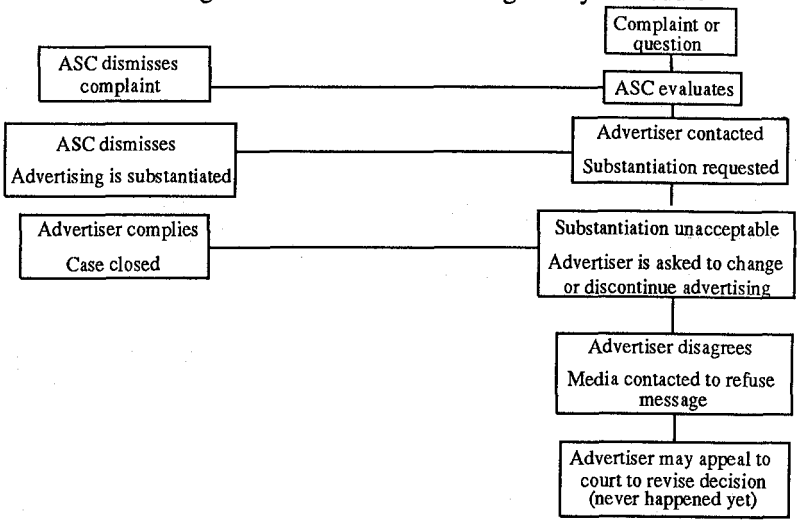
Advertising Self-Regulation and Government Regulation

	Self-Regulation	Federal Regulation	Provincial Regulation (example)
Organizations	Advertising Standards Council - National (English) - CNP (French) - Regional (6 Committees)	Consumer and Corporate Affairs, Canada Marketing Practices Branch - National - Regional (12 Offices)	Ministry of Consumer and Corporate Affairs British Columbia Trade Liaison Branch
Code/ Legislation	Canadian Code of Advertising Standards 1. Accuracy, clarity 2. Disguised advertising techniques 3. Price claims 4. Testimonials 5. Bait and switch 6. Comparative advertising 7. Professional and scientific claims 8. Slimming, weight loss 9. Guarantees 10. Imitation 11. Safety 12. Exploitation of human misery 13. Superstition and fears 14. Advertising to children 15. Taste, opinion, public decency	Combines Investigation Act 1. False and misleading advertising representations 2. Deceptive price promotion 3. Bait and switch 4. Performance claims 5. Warranties 6. Testimonials 7. Testing 8. Pyramid and referral selling	Trade Practices Act Deceptive Practices 1. Untrue product claims 2. Exaggerated price reductions 3. Sales solicitation misrepresentation 4. Bait and switch Unconscionable acts: 1. Taking advantage of mental and physical infirmity 2. Misleading a consumer as to the value of a product or service 3. Use of excessive pressure
Other Codes/ Legislation	Non-Prescription Medicines Horticultural Products Cosmetics, Toiletries, Fragrances Broadcast Code for Children Comparative Advertising for Food Products Feminine Sanitary Products	The Broadcast Act, Health and Welfare Department Act, Patent Medicine Act, Food and Drug Act, Hazardous Products Act, True Labelling Act, and others	Consumer Protection Act, Closing-Out Sales Act, Trading Stamp Act, Liquor Distribution Act, and others.

Source: Robert G. Wyckham, "Industry and Government Regulation," *Canadian Journal of Administrative Sciences*, March 1987, table 1.

Figure 1

Advertising Standards Council Self-Regulatory Procedure



Source: Figure 28.4, p. 612, Otto Kleppner, Thomas Russell, Glenn Verrill, Byron Collins, *Advertising Procedure*, Canadian Eighth edition, Toronto: Prentice-Hall Canada, 1984. By permission of the publishers.

Canadian Radio and Television Communications Commission (CRTC), the Canadian Broadcasting Company (CBC), and private networks.

The Canadian Advertising Foundation is the self-regulatory body of the three components that constitute the advertising industry as a whole: the advertisers, the media and the agencies (see figure 2). It represents the interests of advertisers, advertising agencies and media. Through its Advertising Standards Council, it administers the Canadian Code of Advertising Standards and several industry-specific codes. The self-regulatory procedure is outlined in figure 1. As a guideline for ethical business conduct, the Code (see appendix A) is designed to improve the quality of advertising and to ensure the integrity of advertising content. The Code is considered to be a supplement to government regulation, complementing rather than conflicting with it.

In addition to misleading advertising, various regulations and codes deal with related consumer issues such as advertising to children, sex stereotyping, and the advertising of "obnoxious" products. For example, Quebec's Consumer Protection Act prohibits all advertising directed at children under the age of thirteen. Also, advertisers are prevented from urging children to buy or ask others to buy for them the advertised product. Clear-

ly, however, American television stations that can be viewed in Quebec are not touched by this regulation. As well as provincial regulation, both the CBC and the Canadian Advertising Foundation limit the scope of children's advertising by mandatory pre-clearance.

In a case in the mid-1970s, Kellogg's Company of Canada was found in violation of the Quebec Consumer Protection Act when it used cartoon characters to promote its line of breakfast cereals. Kellogg's defended its action by arguing that the provincial legislation encroached on federal jurisdiction in interprovincial trade and because advertising on television falls under federal control. The Supreme Court of Canada upheld the Quebec law, stating that the purpose of the law was to protect consumers and not to infringe on the broadcast operations of Kellogg's Company.

Another area, sex stereotyping, deals with matters of taste and opinion. The Advertising Advisory Board, the advocacy arm of the Canadian Advertising Foundation, developed the Sex-Role Stereotyping Guidelines as an educational tool to aid advertisers in developing contemporary images in their commercials. Advertisers are urged to ask themselves whether, if the roles were reversed, the ad would still work. If it does not, there may be unconscious sexism in the ad. Such guidelines, the CAF says, are evidence of the progressive stand that self-regulation can take.

Thirdly, through a clause on taste, opinion, and public decency, the Canadian Code of Advertising Standards limits the content of ads for products that some people may for one reason or another find offensive. Commercials for obnoxious products such as feminine sanitary protection products must be pre-cleared in final form by the Advertising Standards Council. The purpose of such a clause in the Code is to deal with how products or services may be advertised, not with what may be advertised.

Along with commercials directed at children and those for feminine products, advertisements for several other products require pre-approval. The CRTC does not have authority to regulate directly the activities or advertisements produced by advertisers or their agencies. However, under the broadcasting regulations of the Broadcast Act, all radio and television commercials for foods, drugs, alcohol, cosmetics, medicines, and therapeutic devices must receive prior approval by the CRTC.[39] Print advertisements in most instances do not have to be pre-cleared. This supports the notion of the immediacy effect of electronic media and its great power to persuade.

It seems that advertisements for goods or services requiring prior approval through industry codes or government regulation are those that can directly affect the health of the individual, arouse public sensitivities, or border on bad taste. Many of these products have hard-to-substantiate qualities (Brand X is twice as effective as Brand Y), and it is the aim of

these pre-approval procedures to eliminate false, misleading or deceptive ads that are likely to create a false impression about the merits of the product, especially where the health of the consumer is concerned.

At a 1986 conference on advertising self-regulation in Chicago, the moderator claimed that without self-regulation there are two possibilities: no regulation resulting in increased unfair and deceptive trade practices, or greater intrusion by the government into business practices. Proponents of self-regulation feel that industry codes are more able to adapt to the changing business environment and can respond more quickly than legislation.

Rather than wait for the government to become involved, industry often initiates proposals in order to maintain its good name. While self-regulatory codes are guidelines lacking legal enforcement power, the Advertising Standards Council can invoke media sanctions that urge the media to refuse offending ads. Serious complaints involving the health and safety of the public, large sums of money, and repeat offenders are subject to the legal enforcement of government regulation. Budget constraints limit government investigations to major violations. The Advertising Standards Council investigates all complaints received and determines whether the Code has been violated. Depending on the viewpoint taken, each form of regulation backs up its counterpart, be it self-regulation backing up government regulation or government regulation backing up industrial codes. This serves to check unwanted behaviour and balance the policing activities between internal and external control.

The constraints imposed by regulation on the advertiser serve as a check on unethical business conduct. While the advertiser is not denied access to the media to advertise legal products for sale, he is often prevented from using factually incorrect, misleading or deceptive advertising. Industry self-regulation is a response to unwanted outside intervention. The feeling is that a less costly alternative such as this is just as effective as government regulation, is more flexible, and lets advertisers retain a degree of autonomy in their operations. External control is seen as a hindrance that interferes with the market in many instances and is less effective in protecting the consumer and the producer from misleading advertising and unethical business practices.

On the whole, it would appear that advertising agencies are not hampered excessively in their operations by the regulatory and self-regulatory processes. Compared to the medical and legal professions, whose doctors and lawyers are severely restricted from engaging in self-promotion, or to the pharmaceutical industry for that matter, advertising agencies and advertisers are allowed a reasonable degree of freedom in their operations. But "reasonable" is a matter of judgement. We have no re-

search estimates on the costs of regulation imposed on the members of the advertising agency sector.

Industrial Associations

Vigorous and intertwining are perhaps the most apposite adjectives to give the several associations preoccupied with the welfare of this sector. Before describing their organization and activities, we remind the reader again of the close symbiosis of advertisers, media and agencies in the creation and diffusion of advertising. At the outset it should also be said that the non-agency sector of SIC 774, fragmented into many specialized activities, does not appear to have any important associations.

The largest association which most closely represents agency concerns is the Institute of Canadian Advertising (ICA). The 1985 membership is given in table 6. The information booklet from which the data are gleaned states that:

- membership is open to full-service agencies[40] having "financial competence."[41]
- in 1985 its 65 members, representing probably less than 15 percent of all the agencies in the country, had combined billings[42] representing at least 75 percent of all agency billings in Canada.
- these 65 members had aggregate revenues of almost $300 million.[43]

ICA sees itself as serving four publics:

> *owners and managers of agencies*—with confidential operating statistics and surveys.
>
> *staff of member agencies*—with educational courses, advisory services et cetera available to agency employees.
>
> *advertising agency industry*—with "external missions" such as spokesperson, negotiator, defender; with "internal missions" such as steering business to members.
>
> *advertising industry*—supporting self-regulation, et cetera.

Due to the service to business nature of agency activities, co-operation with media associations and the advertiser organization is very important. This co-operation, considered to fall under the heading of "external missions," is accomplished within the advertising industry umbrella association called the Canadian Advertising Foundation (CAF). Figure 2 gives the organization chart of the foundation and indicates the two principal roles the foundation's subsidiaries carry out. Two of the most active member or-

Table 6

Membership in the Institute of Canadian Advertising, 1985

Annual Billings* (Millions of $)	Number of Agencies	Percentage of Membership
Over $75	10	15.4%
40-75	6	9.2
20-39	11	10.9
10-19	15	23.1
5-9	8	12.3
3-4.9	7	10.8
Under $3	8	12.3
TOTALS	65	100.0

Source: ICA Booklet.

Note: *Billings = total amount charged to client, including media bills, production costs, service charges.

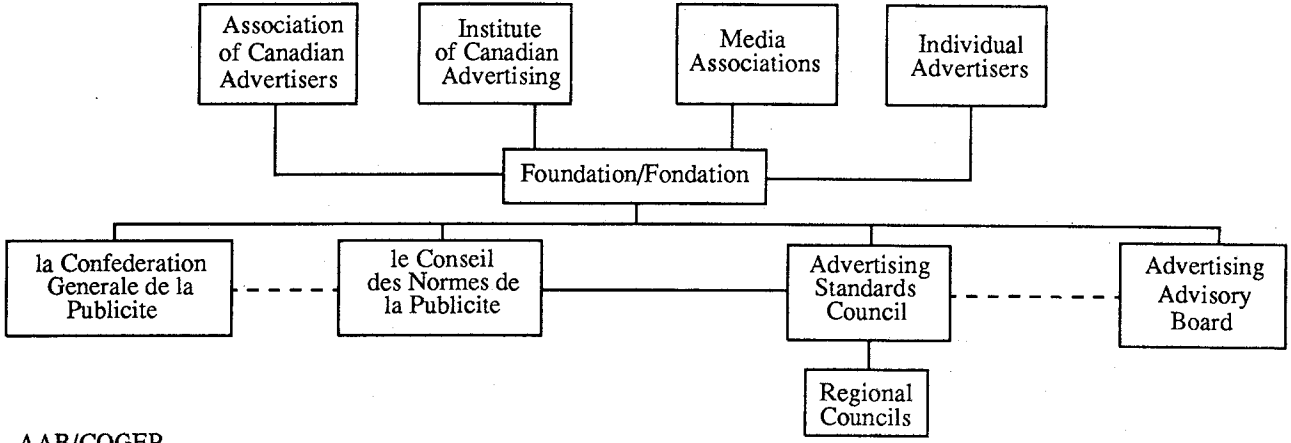
ganizations are the ICA and the ACA, the Association of Canadian Advertisers, to which we shall come presently.

Apart from the ICA there is also *Le conseil des agences de publicité du Québec* (Advertising Agency Council of Quebec) which, according to a private communication, had 28 members in 1986, of which 24 were branch agencies of out of province establishments. It is not clear how active this association is; the admirable study of advertising in Quebec undertaken by the consulting firm CEGIR does not even mention it in its chapter on agencies.[44]

The Transcanada Advertising Agency Network groups about 21 agencies in a loose, informal and friendly association whose main purpose is to exchange valuable information. It consists chiefly of smaller regional agencies who meet every year for an information session lasting several days.

The Association of Canadian Advertisers, founded in 1914, had a little over 200 corporate members in 1986.[45] According to a private communication from the association, the membership accounted "for an estimated $1 billion in advertising which is 82-85 percent of total national advertising." This organization appears as vigorous in the promotion of its members' welfare as the ICA. Among the seven key areas for its actions are government relations (to work toward a regulatory environment in which adver-

Figure 2
Canadian Advertising Foundation/ Fondation Canadienne de la Publicite



AAB/COGEP
What It Does

- Fights to protect the freedom of advertising.
- Lobbies with government, educators and public interest groups.
- Promotes advertising in speeches, publicity and ad campaigns.
- Unites the ad industry in support of action-oriented programmes, such as sex-role stereotyping and multiculturalism.
- Sponsors industry research.

ASC/CNP
What It Does

- Works with governments on self-regulation and deregulation.
- Develops codes of practice.
- Promotes codes and handles complaints from consumers, competitiors and government.
- Enforcement through media.

Source : Margaret Summers Booth, "The Advertising Industry and the Government," MBA course paper, University of Toronto, April 1986.

tisers can operate with minimum interference) and issue management (to anticipate and identify public issues likely to influence advertising), as well as inter-association relations with ICA and media organizations.[46]

Possibly the strongest achievement of the two trade associations (ICA and ACA) is the successful self-regulatory mechanism which they evolved and maintain under the umbrella of the Canadian Advertising Foundation. Partly due to their efforts—in co-operation with the media associations—no powerful and independent regulatory agency along the lines of the notorious, Congress-sponsored Federal Trade Commission has emerged on the Canadian scene.

It is therefore possible to conclude that the outside-directed activities of the agencies' and advertisers' associations contributed as much to the cost efficiency of the industry by making regulation reasonable as the inner-directed educational efforts that one finds in most trade associations.

Treatment in Government Statistics

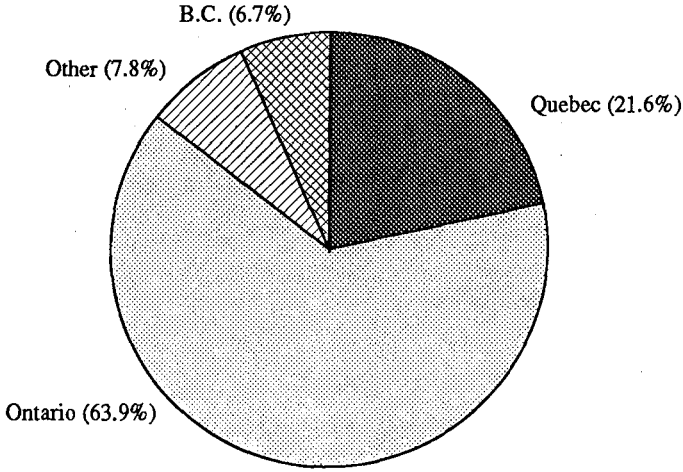
As with most other services, the statistical treatment of this sector is susceptible to considerable improvement. We shall leave the technical discussion to later chapters and to the concluding section with recommendations. Here we shall give an outline of the current situation of data availability.

As stated before, the SIC 774 sector really comes in two sections: the advertising agencies, which may account for 70 percent of total sales, and the rest, the overwhelming part of which are really suppliers to the advertising agencies. Statistical information regarding advertising agencies stops with the last annual survey (Statistics Canada annual 63-201) conducted in 1977. No service census has been conducted since 1971. Finally, the gross domestic product by industry series was stopped for this sector in 1983 and has not re-emerged in the revamped series. Statistics Canada launched a new annual survey of the whole 774 sector in 1985 which will give details on all of the sector's components, but the results of this survey will not be available before the appearance of this report.

There are two kinds of information on the entire sector, agencies as well as others. Annual corporation financial statistics (61-207) carry income and balance sheet statistics, of which the last available record is for 1984. Matching this continuing series with the 1977 defunct annual surveys of agencies leaves one with doubt: commissions for (presumably) the whole sector given in the financial statistics series are up to a half lower than those reported for the agencies. In 1982, '83 and '84, direct surveys of the whole sector (but with no detail on agencies) were taken by Statistics

Figure 3

Total Revenue—Regional Distribution
Advertising Services 1984



Source: Statistics Canada, Cat. 63-231.

Canada (63-231) that give useful, but very limited information. (The 1985 survey is an enriched continuation of the 1983, '84 and '85 pilots.)

To sum up, since the abandonment of the annual agency surveys in 1977 and given the absence of the decennial census of services in 1981, critical pieces of information about the sector are missing and will not be reinstated until the 1985 whole-sector and sector-components results from Statistics Canada surveys become available. There are very few non-governmental statistics to fall back on, mostly on the top 100 advertisers' expenditures and the top 100 agencies' billings. Adequate government statistics are available regarding advertising expenditures in media, but these are only tangentially useful in the analysis of this industry. Finally, some data on employment characteristics trickle through decennial censuses and specialized labour surveys.

Regional Differences in Production and Sales in Canada

The 1982, '83 and '84 surveys (Statistics Canada, catalogue 63-231) of the whole advertising services industry indicate a high concentration of total revenue in Ontario (about 65 percent) and Quebec (about 22 percent). This is shown graphically for the year 1984 in figure 3. There are some statistics

for a small part of the non-agency services: in 1981 Quebec accounted for 32 percent or $16.3 million of the commercial audiovisual production in Canada.[47]

It is very likely that the revenues of advertising agencies, the 70-odd percent component of SIC 774, are even more highly concentrated in Ontario or rather in Toronto. There are simply no data; not even the thorough CEGIR study of Quebec provides information on this point. All we know is that the advertising revenues of the six largest media categories in Quebec constituted about 20 percent of the Canadian total. Finally, in his study of regional concentration of service activities that the Institute for Research on Public Policy runs concurrently with this Fraser Institute-DRIE series, W. Coffey finds that in regions of more than 300,000 inhabitants the concentration of advertising service employees is, in 1981, 55 percent higher than the all-Canada average.

Importance of Imports and Exports

Detailed figures will be provided in chapter 3. Suffice it to say here that international trade in advertising and promotional services is rather limited. In 1984 Canadians exported $46 million worth of such services and imported $64 million worth of them, of which $23 million represented imports by U.S.-owned subsidiaries in Canada. Compare this to the estimated $1.56 billion of revenue in 1984 generated in this sector.

NOTES

1. Statistics Canada, *Selected Service Industries in Canada,* Ottawa, 1987, catalogue 63-231 annual. But see the qualifying remarks in the section headed "Main Consumers of SIC 774 Services."
2. Calculated in table 18.
3. Based on the previously mentioned survey.
4. P.W. Farris and R.D. Buzzell, "Why Advertising Costs Vary," *Journal of Marketing,* Fall 1979, pp. 112-122.
5. This insistence on "ultimate" wishes to convey that the larger firm often must have its output distributed by intermediaries.
6. Palda, *Economic Analysis for Marketing Decisions,* Prentice-Hall, 1965. The derivation of the optimal advertising outlays is based upon standard profit-maximization economic principles from which emerges the so-called Dorfman-Steiner allocation rule.
7. Robert E. Oliver, "Advertising and Society," in P.T. Zarry and R.D. Wilson, eds., *Advertising in Canada,* Toronto, McGraw-Hill Ryerson, 1981, p.7.
8. James R. Melvin, "Services: Dimensionality and Intermediation in Economic Analysis," January 1987, Discussion Paper, Institute for Research on Public Policy.
9. Beginning in the 1920s, marketing texts oriented toward the distribution services discuss utilities of form (X_p) and of time and place (Xc).
10. Melvin, op. cit., p. 19.
11. Among the earliest studies is Palda, *The Measurement of Cumulative Advertising Effects,* New York, Prentice-Hall, 1964. Among the most recent, Mark Hirshey, "Intangible Capital Aspects of Advertising and R&D," *Journal of Industrial Economics,* June 1982, pp. 375-90.
12. See, for instance, John S. Wright et al., *Advertising, First Canadian Edition,* Toronto, McGraw-Hill Ryerson, 1984, ch. 5, and Otto Kleppner et al., *Advertising Procedures-Eighth Canadian Edition,* Toronto, Prentice-Hall, 1984, ch. 21, as well as William W. Weilbacher, *Advertising,* 2nd ed., New York, Macmillan Publishing, 1984, ch. 4, and David A. Aaker and John G. Myers, *Advertising Management,* 2nd ed., New York, Prentice-Hall, 1982, ch. 1.
13. P.T. Zarry and R.D. Wilson, eds., sponsored by the Association of Canadian Advertisers and published in 1981 by McGraw-Hill Ryerson in Toronto.

14. Wright, op. cit., p. 155.
15. H.E. Stevenson, *The Story of Advertising in Canada*, Toronto: Ryerson Press, 1940. W. Fletcher, *The Ad Makers*, London: Michael Joyce 1973. David Pope, *The Making of Modern Advertising*, New York: Basic Books, 1983, et cetera.
16. Weilbacher, op. cit., p. 10.
17. Emile Zola, *Au bonheur des dames*, circa 1885.
18. See also the opening paragraphs of chapter 1.
19. The distinction between national and local media rates is important; local advertisers, such as automobile dealers and other retailers, benefit from substantially lower space and time rates. Some of the national advertisers' outlays pay for co-operative advertising with local distributors and are excluded from such statistics.
20. W.T. Stanbury et al., "Federal Advertising Expenditures," in G. Bruce Doern, ed., *How Ottawa Spends*, 1983, Toronto: Lorimer, 1983.
21. Statistics Canada Business Microdata (A064A-20-07-86).
22. Globe and Mail, *Report on Business Magazine*, Toronto, July 1987, p. 146.
23. Weilbacher, op. cit., p. 69.
24. Robert G. Wyckham, "Industry and Government Advertising Regulation: An Analysis of Relative Efficiency and Effectiveness," *Canadian Journal of Administrative Sciences*, March 1987, p. 49.
25. Margaret Summers Booth, "The Advertising Industry and the Government: Self Regulation and Dialogue," Faculty of Management Studies MBA course paper, University of Toronto, April 1986, p. 8.
26. Benjamin Singer, *Advertising and Society*, Don Mills: Addison Wesley Publishers, 1986, p. 26.
27. Charles Wolf, Jr., "A Theory of Non-market Failure," *Journal of Law and Economics*, April 1979, pp. 107-139.
28. Economic Council of Canada, *Reforming Regulation*, 1981, p. 9.
29. Robert Pitofsky, "Advertising Regulation and the Consumer Movement," in Tuerck, (ed.), *Issues in Advertising*, Washington, DC: American Enterprise Institute for Public Policy Research, 1978, p. 28.
30. Howard Beales et al., "The Efficient Regulation of Consumer Information," *Journal of Law and Economics*, December 1981, p. 513.

31. K. Filip Palda and Kristian S. Palda, "Ceilings on Campaign Spending," *Public Choice*, V.45 (Summer), pp. 313-331.
32. William L. Wilkie et al., "Marketing's Scarlet Letter: The Theory and Practice of Corrective Advertising," *Journal of Marketing*, Spring 1984, pp. 11-31.
33. Booth, op. cit., p. 26.
34. Wyckham, op. cit., p. 31.
35. Booth, op. cit., p. 12.
36. Robert E. Oliver, "Ethics in Advertising—A Shared Responsibility," in *Advertising Self-Regulation, Who Benefits Most, The Advertiser or the Consumer*, New York: International Advertising Association, May 29, 1986, p. 1.
37. Ibid., Introduction.
38. Booth, op. cit., p. 18.
39. P.T. Zarry and R.D. Wilson (eds.), op. cit., p. 380.
40. Full service agency: must create, produce advertising and be responsible for the media purchases for at least two clients (not an in-house agency).
41. Financial competence is defined by financial ratios. Presumably this is to guarantee payments to media, first collected from advertisers. There is no hint here of an entry barrier erected by a trade association.
42. Billings: total amount of money charged to client by advertising agency, including media bills, production costs, and service charges.
43. Note that "revenues" are "sales revenues," a sum much smaller than billings, since agencies typically receive only 15 percent of media bills as commission.
44. CEGIR, *Le positionnement de la publicité au Québec*, Gouvernement du Québec, 1984.
45. ACA, *Agency Compensation Survey*, Toronto, February 1986.
46. ACA, *Why Advertisers Need ACA and Vice Versa*, Toronto, 1985.
47. CEGIR, op. cit., p. 114.

CHAPTER 2

INDUSTRIAL ORGANIZATION AND INTERNATIONAL POSITION

Industrial Organization Characteristics

Legal Forms of Ownership

There is no way to ascertain the current proportions of output accounted for by unincorporated businesses, and there is probably little economic interest in doing so. The latest (1982, '83, and '84) surveys of SIC 774 confined themselves to incorporated businesses only.

A more interesting question pertains to the public tradeability of shares of the larger businesses in this industry, namely, advertising agencies. Many of the larger New York agencies trade on the U.S. stock markets, and it is therefore possible to assess their profitability or performance. None of the Canadian-owned agency stock or foreign-owned affiliates is listed on Canadian exchanges as far as can be checked out; certainly not (according to a private communication) any of the stock of the members of the Institute of Canadian Advertising.

Size Distribution of Firms

There is one basic issue that is interesting from the viewpoint of economic analysis under this heading: is the structure of this industry conducive to market power by sellers or buyers? The clear answer is no. To justify this answer we look at some (less than perfect) indications of firm size in the sector as a whole and among the agencies. Then we consider economies of scale among agencies, and finally, we take a look at the size of the advertisers' outlays for a possible detection of monopolistic buying power (monopsony).

The Whole of SIC 774

As we noted before, the last census of services took place in 1971, much too far back to be of current relevance. All we have are the already men-

tioned service surveys of 1982, '83 and '84 that give but scant information. Figure 4 shows two classes of firms, those with less than and more than $250,000 worth of revenues. The larger ones numbered 712 in 1982 and 726 in 1984. The small ones grew over this period by 24 percent to about 3,600. Figure 5 shows that the average size of the firm, as measured by revenues, changed hardly at all at about $360,000 per annum. This does not tell us anything about the concentration of the sector but leaves what we believe is a correct impression of a service industry peopled by small enterprise.

Advertising Agencies

The last government statistic we have indicates that 300 agencies responded to a Statistics Canada survey in 1977 (catalogue 63-201 annual). At that time 23 agencies had gross billings[1] of $10 million or more, making up exactly two-thirds of the total billings of those surveyed.

This "concentration" figure should be compared to the previously mentioned membership information from the Institute of Canadian Advertising, pertinent to 1985 and summarized in table 6. If we assume that inflation doubled the figures between 1977 and 1985, we note that 27 ICA member agencies billed $20 million or more. This is hardly indicative of a concentrated industry. The impression is strengthened by examining table 7 which lists the top 12 agencies about which *Advertising Age* could obtain information. The smallest firm, as measured by billings in 1986, was Ted Baker with $82 million, the largest Foster with $180 million.

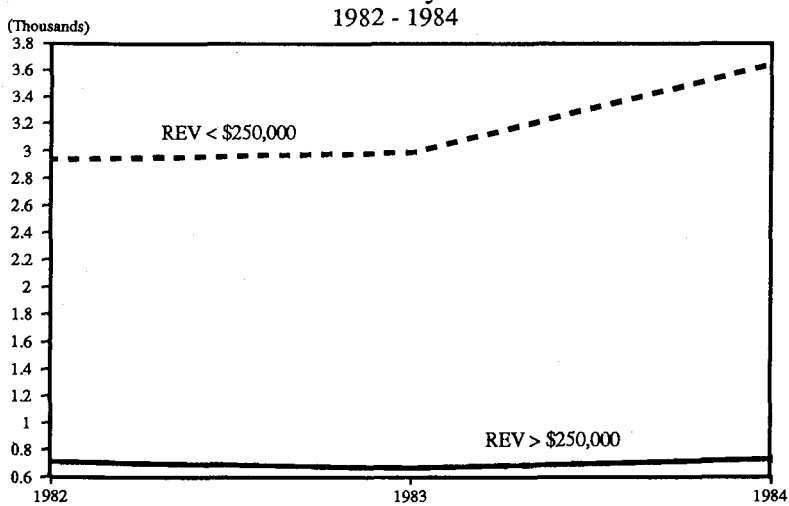
Concentration, in any case, is a static figure. What matters are the changes in market share or clients held by the agencies. There is no global statistical information here, but even a casual reader of the trade press such as *Marketing* (Canada) and *Advertising Age* (United States) knows about the continuous and significant game of musical chairs that shuffles advertisers' accounts among agencies. A more formal glimpse is caught when observing the annual rankings of the agencies on billings or income—there is a continuous re-ordering of positions.

The recent merger move, occurring on the New York (and so global) scene may reduce somewhat the number of foreign-owned larger agencies in Canada.[2] But as movement toward the mega-agency started, so did the resistance of client advertisers develop. They are afraid that very large scale agencies will not be as creative and as attentive to client needs as their previous constituent parts.[3] What is more, there is a natural limit to an agency's size or, for that matter, specialization. That limit is imposed by the principle of non-competing accounts: an agency, by long custom, cannot create advertising for rival brands.

Figure 4

Number of Firms by Revenue Size

1982 - 1984

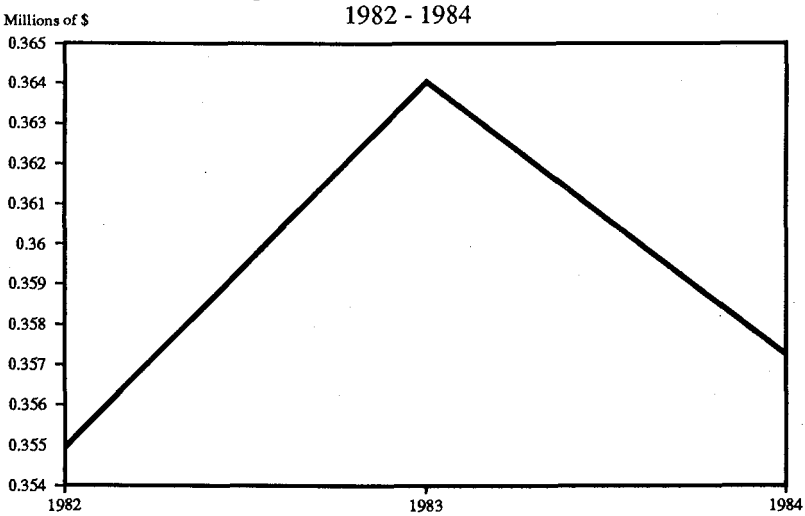


Source: Statistics Canada, Cat. 63-231.

Figure 5

Average Revenue— Advertising Services

1982 - 1984



Source: Statistics Canada, Cat. 63-231.

Table 7
Income, Billings, Employees and Offices of 12 Canadian Advertising Agencies

Company and Year End	Gross Income ($000)	Gross Billings ($000)	Employees	Offices
Baker Lovick (De86)	17,140	114,265	241	6
Cossette Comm.-Marketing (De86)	15,685	104,567	252	4
Foster Advertising (De86)	26,980	179,954	492	9
Grey Advertising (De86)	13,833	92,269	179	2
J. Walter Thompson (De86)	23,072	153,810	385	4
McCann-Erickson (De86)	13,408	89,431	184	na
Ogilvy & Mather (De86)	25,488	169,920	319	12
Ronalds-Reynolds & Co. (De86)	12,268	95,415	193	3
Saatchi & Saatchi-Compton-Hayhurst (De86)	12,150	103,469	135	1
Ted Bates Advertising (De86)	12,047	82,170	158	2
Vickers & Benson (De86)	18,200	118,000	320	3
Young & Rubicam (De86)	20,569	137,008	260	na

Source: *Globe and Mail*, Financial Report, July 1987, from *Advertising Age*.

Finally, the question may nevertheless arise whether the minimum efficient size (MES) in the agency sector is not large enough to leave but a few firms supplying a market as small as Canada's. The most obvious retort is to note the large number of agencies "surviving" in this country. Yet the question of MES, and so of the existence of possible economies of scale, merits some attention.

We simply have no Canadian evidence on this issue, but there is some from the U.S. scene. A careful article analysing 1977 agency data came to the conclusion that about 240 of the largest American agencies exceeded minimum efficient scale as measured by billings.[4] In 1986 the 240th U.S. agency had billings of U.S. $21.8 million or approximately $ 29.4 million Canadian. This figure was comfortably exceeded by all the 12 top Canadian-based agencies listed in table 7 and by 16 to 20 agencies listed on the ICA membership list, table 6.

Advertisers

Table 3 shows the top 35 advertisers in 1985 as measured by expenditure in national media. (This is probably an under-estimate of their total ad expenditures, since the figures do not show production costs or any retail ad spending.) Take, for instance, the 17th largest advertiser, American Home Products. This company markets a wide range of home, over-the-counter and prescription remedies and is not likely to have but one "agency of record" but rather several different ones for its various product groups. If it were to concentrate all of its business in one agency, a 15 percent commission would be worth $2.63 million to the agency. We are not talking big figures here, and we are hardly talking monopsony.

Perhaps the only purchasing influence in the market is exercised by the federal and some provincial governments in the sense that their accounts are typically reserved to wholly owned Canadian agencies.

Internal Advertising Agency Organization

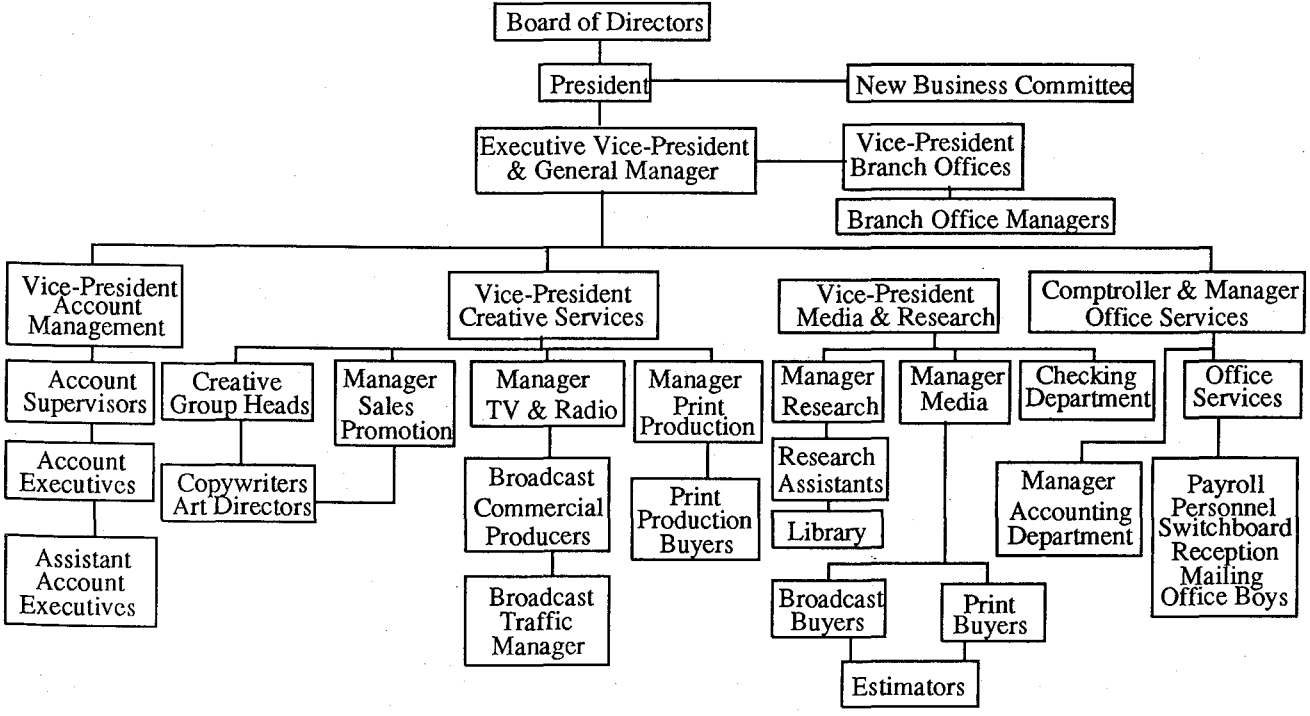
Within SIC 774 only the agencies have an internal organization form that lends itself to generalized, schematic representation. Almost all advertising management textbooks carry descriptions and discussions of this subject. Suffice it here to make a reference to figure 6 which shows the organization chart of a (sizeable) full-service agency and to mention briefly the most important functional groups.

The account management group is responsible for getting new accounts, for interpreting the client's needs to the research, creative and media functions, and for co-ordinating the agency's specialists' efforts in developing a campaign for the client. Creative services "house" copywriters who conceptualize the creative solution and write the words in co-operation with art directors and television directors who put the advertising message into effective visual form.

Media services, always in close co-operation with all the other departments, develop media strategies, place ads, and monitor their appearance. Research helps in providing background data to client advertising plans, co-ordinates pre- and post-testing of ads and helps in media decisions. Finally, there are other supporting staff functions concerned with finance, accounting and office management. Nowadays, provision is often made, as well, for the legal and new business development function.

It should also be noted here that most of the agency personnel get exposed to a variety of client marketing situations since they work simultaneously as well as successively on different advertising accounts. This prevents the development of rigid guidelines or controls, discourages or-

Figure 6
Organizational Chart of a Typical Advertising Agency



Source: Exhibit 3-1 in P.T. Zarry and R.D. Wilson, eds., *Advertising in Canada*, Toronto: McGraw-Hill Ryerson, 1981, p. 79. Reprinted by permission of McGraw-Hill Ryerson Limited.

ganizational slack and keeps the business in perpetual turmoil, also fed by frequent account turnover. The agency provides thus a highly competitive breeding ground of entrepreneurially inclined persons who often go on to top corporate marketing positions among the advertisers.

Degree of Foreign Ownership and Influence

Officially, there are no statistics available on this sector as a whole. CALURA, the Corporate and Labour Union Registration Act which gives its name to the annual publication regarding assets, sales, et cetera of foreign-owned corporations, lumps all services together. There is little, as well, that can be said in this respect, about the non-agency part of this sector.

J. Bruce Varcoe[5] reports that a select committee of the Ontario government determined that in 1971 foreign-controlled agencies placed 31.4 percent of total advertising billings in Canada. The Institute of Canadian Advertising had, in that year (it was disclosed), 13 members which were foreign-controlled, or 24 percent of its then 53-strong membership.

Currently, it is likely that the proportion of billings going to foreign-controlled agencies is at least as high as in 1971, and probably higher. The *Financial Post 500* summer 1986 supplement reported that eight of the top 15 agencies on its list were foreign controlled. At least seven of the 12 agencies listed in table 7 were foreign controlled in 1986. Why should this matter? It matters because of the phenomenon of the so-called account realignment which stems from a global marketing attitude. Global marketing, or using the same advertising in several countries, is sometimes viewed as resulting in lower costs. Canadian agency affiliates of New York or London-based multinational agencies may thus have a built-in advantage over locally owned domestic-only firms. This topic will be further discussed in chapter 7, which is devoted to the major issues facing the industry.

The Industry in the World Economy

Current Aspects

"Overseas income surges 19.2%" states a headline in the special issue of the authoritative New York publication *Advertising Age*, devoted to reports on 1986 U.S.-based agency incomes and dated March 26, 1987. Since this exhaustive report is dealing with the top 500 agencies based in the United States, the headline attests to the importance of their multinational commitment. As table 8 shows, the proportion of both billings and gross income generated by non-U.S. operations of the top five agencies is nearly one-half of the total. These five agencies are probably representative of the top 25

Table 8
1986 U.S. and Non-U.S. Billings and Gross Income of Top 5 U.S.-based Agencies (in U.S. $ millions)

Agency	Billings		Gross Income*	
	U.S.	Non-U.S.	U.S.	Non-U.S.
Young & Rubicam	$2,389	$1,802	$ 358	$ 270
Saatchi & Saatchi Compton Worldwide	1,377	1,943	195	296
Ted Bates Worldwide	1,897	1,365	283	203
J. Walter Thompson	1,732	1,410	260	211
Ogilvy & Mather Worldwide	1,665	1,490	250	210
TOTAL	9,060	8,010	1,346	1,190
Non-U.S. as percentage of total	47%		47%	

Source: *Advertising Age*, March 26, 1987; calculated from table on p.8.
Note: *Gross income: commissions and fees for services.

listed which, among them, accounted for 66 percent of the worldwide gross income of the 500 agencies reported on.

The proportion of business generated by U.S. multinational agencies abroad can be interpreted as having several origins.[6] As with the classical non-natural-resource multinationals, the technological skills fostered by large mass market developments were developed in the United States and exploited by branch operation abroad. This gave the U.S. agencies an early start. It was assisted by the frequent insistence of U.S. manufacturing branch plant operations abroad upon receiving advertising service to which the parent was accustomed in the home market. While a cultural anti-American wave weakened these ties in the '60s and '70s and favoured development of home-grown agencies,[7] this tendency seems now lessened by the trend toward globalization.

The weakening American dollar has probably contributed to the shifting of the proportion of income originating from abroad in the most recent period. The rapid growth of Pacific markets and economic development in Latin America may give a boost to U.S. multinational agencies, but we do not possess figures for the Japanese competition or for the geographical dis-

tribution of income sources.[8] Suffice it to say that the more rapid economic growth outside OECD countries should make foreign, particularly NIC, markets the growth areas of advertising.

As usual, there are no statistics whatever that would throw light on the prospects of Canadian-based agencies in non-Canadian markets. The puny export and import figures available are practically meaningless given the service-determined bodily presence of agency personnel near the advertiser's corporate location. In particular, we do not know what, if any, income is generated abroad by Canadian-owned agencies.

In principle, the most obvious avenue of multinational expansion for Canadian agencies is servicing Canadian-based multinational marketing operations abroad. It would thus be of great interest to learn whether the Seagrams, Alcans, Moores, Olympia Yorks and the chartered banks have an inclination to "go global" in their marketing operations with the help of Canadian agencies.

Another possible way into markets abroad is by means of specialization. There is one Canadian-owned agency that apparently has a prosperous branch in the American market, specializing in retail advertising.

Future Prospects

Will the need for suppliers of advertising services on the global scene increase faster than in other service and goods sectors? Should Canadian agencies look to that scene? Only the sketchiest attempts at answering these questions can be made.

The analytical way to the prediction of worldwide advertising growth is to isolate determinants of advertising, forecast their growth and predict numerically their impact on some measure of advertising outlay. This is clearly a daunting task. One not only needs a reasonable theory of advertising determination to pick out the predictor variables, but also a consistent set of data on such variables in many countries.

Daunting or not, two attempts have been made in the last decade. Leff and Farley computed an advertising-to-domestic consumption of manufactures ratio for 44 countries in 1969 and 33 countries in 1976 and regressed it on per capita income.[9] They found the estimated advertising/income elasticities to be in the 0.3 range, well below unity. The sample included developed as well as less-developed countries. The finding that advertising-sales ratios do not rise sharply with higher income levels in this cross-section, the authors state, may appear surprising. It is consistent, however, with the pattern observed in time series data for the United States and, let us add, broadly speaking for Canada as well. In the United States, advertis-

ing expenditure as a percentage of GNP reached a peak in the first decade of this century and has been on a plateau ever since.

More recently, Seymour Banks used data from 43 countries covering the years 1968, 1970, 1974 and 1979 to throw light on the determinants of growth of advertising expenditures in a many nation context.[10] He first factor-analysed some 28 variables, grouping them into six factors. These factor scores were then used as regressors against the advertising/GNP ratio, the advertising/manufactures ratio and other indices of advertising spending. In almost all of these regressions, factor 1 proved the most important, statistically significant determinant. Banks calls it an index of economic development. It contains variables such as the number of TV receivers, energy consumption, GNP, proportion of labour force in the commercial sector, population in urban areas, et cetera. Banks does not, however, present elasticities among his results, so we cannot gain an insight into what might be called the growth magnitudes.

Overall we are left with the impression that economic growth stimulates the use of advertising and, by implication, that areas exhibiting fast growth have the best market potential for advertising services. It seems also that the growth of advertising and the necessary services to provide it is not any faster—and possibly slower—than the growth of other service sectors on the world market. These are not very profound findings. Furthermore, in the above cited research two-way causation between advertising and economic aggregates has not been considered to be a possibility. (This aspect is given further consideration in chapter 5.) The omission is curious, since there is something of a tradition of research in the United States trying to estimate advertising's influence on total consumption.

The part Canadian agencies may play in the world's growing areas, apart from the previously mentioned link to Canadian multinationals, could depend on much the same scenario as the one played out in the engineering consulting sector. Wherever the Canadian International Development Agency (CIDA) spreads its beneficence, and in particular in ex-colonial francophone and anglophone Africa, Canadian agencies could find contracts for provision of advertising advice to local firms. From this beachhead they could then expand without the further assistance of the Canadian taxpayer.

NOTES

1. Gross billings are not agency revenues. They are charges invoiced to client advertisers by agencies and include the media outlays of the advertiser and production of advertisements charges incurred outside the agency. Traditionally, however, they are considered to be one of the indicators of an agency's size. (See box insert page 52.)
2. See, for instance, the merger of BBDO International, Doyle Dale Bernbach and Needham Harper Worldwide with implications for Canadian-based affiliates Grant Tandy and Baker Lovick (*Financial Post*, May 10, 1986). Or the acquisition of Ted Bates by Saatchi and Saatchi with implications for Ted Baker Canada and Saatchi Compton Hayhurst (*Financial Post*, November 3, 1986). The box insert on page 88 taken from the *Globe and Mail* gives a good general impression of the acquisition and merger tendencies.
3. *Time*, November 17, 1986.
4. Richard Schmalensee, A.J. Silk and R. Bojanek, "The Impact of Scale and Media Mix on Advertising Agency Costs," *Journal of Business*, 1983, No. 4, pp. 453-475.
5. In Zarry and Wilson, *Advertising in Canada*, Toronto: McGraw-Hill Ryerson, 1981, p. 67.
6. Perhaps only the largest among them, Saatchi and Saatchi—which also now includes Ted Bates Worldwide—could be called, tenuously, non-American.
7. The best example of all being, undoubtedly, Quebec.
8. Dentsu, the Japanese agency, is rumoured to be the world's largest.
9. N.H. Leff and J.W. Farley, "Advertising Expenditures in the Developing World," *Journal of International Business Studies*, Fall 1980, 64-79.
10. Seymour Banks, "Cross-National Analysis of Advertising Expenditures: 1968-1979," *Journal of Advertising Research*, April/May 1986, 11-24. The advertising series was obtained from the International Advertising Association's *World Advertising Expenditures*, New York, various dates.

CHAPTER 3

INDUSTRY OUTPUT

Advertising Expenditures in Canada

The output of the 774 sector, measured in sales revenue, co-varies very closely with the advertising revenues of the media. Since these are reported regularly and fairly exhaustively in government publications—and then re-assembled handily in the Maclean-Hunter research bureau annual reports—they are sometimes used as surrogates for the missing statistics of the whole sector and of its component, the agencies.[1]

Gross advertising revenues of Canadian media, that is those including the as yet unrebated agency commission, are listed in table 9 and plotted in figure 7 over the last 15 years. The next figure (8) shows the comparative stability of media advertising expenditures as a proportion of GNP over the last 15 years. (The stability of the U.S. ratio, at around 2.1 percent has already been commented upon.) More will be said on this subject in chapter 5.

There is an important classificatory division between national and local advertising, as well as classified advertising which is mostly carried by daily newspapers and sometimes by radio. The national advertiser as a rule sells his wares indirectly through stores or sales agents. He directs advertising campaigns to stimulate sales at these outlets; usually he promotes his brand and its attributes. The advertising is normally produced by an agency on a fee or commission basis.[2]

Local or retail advertising may be undertaken by nationwide businesses such as the department stores and supermarket chains, local stores and service establishments, or by the co-operative venture of national brands with local distributors or franchisees. Often, local advertisers do not think to turn to advertising agency services. The media, mostly newspapers, provide "free" advice[3] on copy preparation or bill for production costs. However, advertising supply companies, the non-agency part of SIC 774, frequently do furnish photographic, engraving and other assistance.

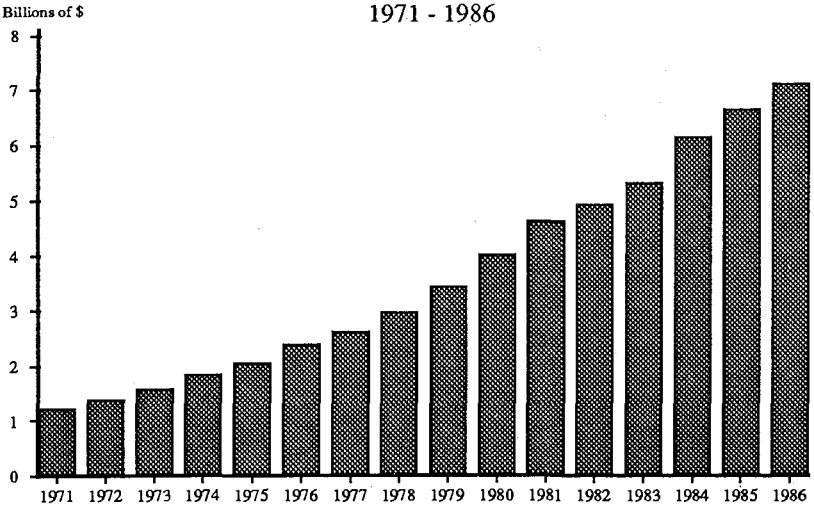
Table 9
Advertising and GNP,
1971-1986

	Gross Advertising Revenues of Media (000's)	GNP (000,000)	A/GNP %
1971	1,227,727	94,450	1.300
1972	1,390,617	105,234	1.321
1973	1,578,447	123,560	1.277
1974	1,829,728	147,528	1.240
1975	2,054,696	165,343	1.243
1976	2,387,228	191,857	1.244
1977	2,615,994	210,189	1.245
1978	2,972,815	232,211	1.280
1979	3,432,166	264,279	1.299
1980	4,011,436	297,556	1.348
1981	4,618,853	339,797	1.359
1982	4,932,442	358,302	1.377
1983	5,311,066	389,844	1.362
1984	6,141,000	443,327	1.385
1985	6,644,000	476,361	1.395
1986	7,108,000	508,700	1.397

Source: Maclean Hunter Research Bureau, *Advertising Revenues,* Toronto: Annual.
Note: The 1984 to 1986 figures were communicated by telephone; 1985 figures are "preliminary," 1986 are "estimated." The last three GNP figures differ from those listed in the January 1987 Bank of Canada monthly *Review.*

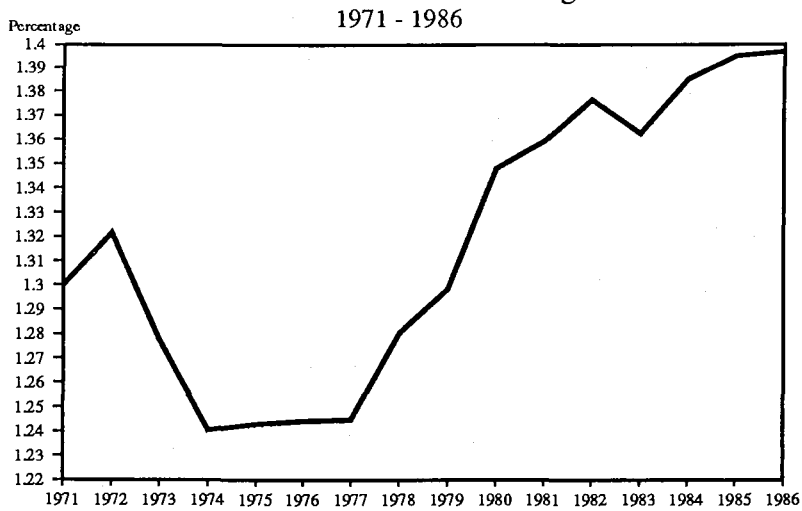
Table 10 lists estimates of the three-way division of advertising revenues (net of commissions and other rebates) accruing to the three major media classes for 1984. These figures are basically estimates, not hard and fast statistics. Their true value for our analysis is that they indicate that no more than one-half of media advertising expenditures in Canada, and probably less, is channelled through advertising agencies. To check this statement we go back to the last year during which we have statistical information on agency revenues derived from placing advertisements from so-called ad billings. Media gross advertising revenues in 1977 amounted to $2.616 billion, 45 percent of this gives $1.177 billion. An average agency commission on media expenditures of 15 percent yields $177 million. This is to be

Figure 7
Gross Advertising Revenues of Media
1971 - 1986



Source: Maclean-Hunter, Advertising Revenues in Canada, Annual.
Last three figures communicated by telephone: 1985 is preliminary, 1986 is a Maclean-Hunter estimate.

Figure 8
Gross Ad Revenue as Percentage of GNP
1971 - 1986



Source: Maclean-Hunter, Advertising Revenues in Canada, Annual
(GNP figures are not necessarily those published in the Bank of Canada Review)

Table 10
National and Local Components of
Media Net Advertising Revenues, 1984
(millions of dollars)

	Radio	TV	Daily Newspapers	Total Across
Total	$545	$970	$1,387	$2,902
National	26.7%	78.6	19.7	40.7%
Local	73.3%	21.4	57.9*	48.6%

Source: Maclean Hunter Research Bureau, *Advertising Revenues in Canada*, Jan. 1986 edition. Only selected figures were taken from the table on p.9, and they were re-calculated into percentages. Note that the figures are estimates.

Note: *It is estimated that $311 million, or 22.4 percent, was accounted for by classified advertising.

compared to survey reported agency revenues of $156 million reported by the Statistics Canada survey in 1977, a reasonably close match.

This leads us directly to the revenues of the SIC 774 sector itself. We should note, however, that the important topic of *forecasting* advertising revenues to media and to SIC 774 is left to chapter 5.

Revenues of SIC 774 Enterprises

Table 11 and figure 9 give revenue estimates for the whole sector from 1965 to 1984 based on two sources. The first source, Statistics Canada's *Corporation Financial Statistics* (catalogue 61-207), covers all income and balance sheet data of the sector except those derived from personal income tax returns. Our confidence in its accuracy is somewhat enhanced by comparing this series' revenues with the 1982, '83, and '84 survey results of StatsCan's catalogue 63-231. We also note that during the 15-year period 1970-84, these revenues increased from $230 million (=100) to $1,498 million (=651), at an annually compounded growth rate of an astonishing 13.3 percent.

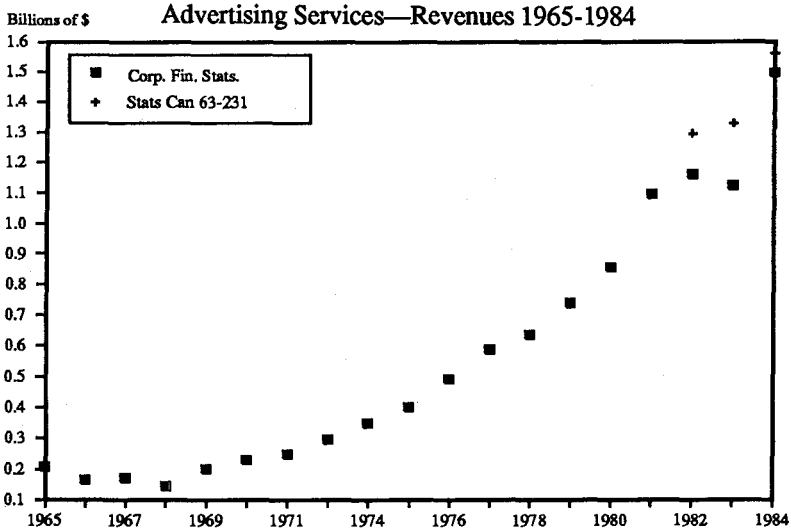
The profitability indices are equally admirable. Table 12 and figure 10 allow us to consider profit as a percentage of total income and, more importantly, return on equity. Between 1970 and 1984, the first index moved in a range of 4 to about 8 percent. For better comparability to other sectors, however, we should look to the return on equity, defined as income before

Table 11
Advertising Services—Revenues
(millions of dollars)

	Total Income[a]	Revenue[b]
1965	209.0	
1966	166.8	
1967	172.4	
1968	145.0	
1969	203.1	
1970	230.2	
1971	249.2	
1972		
1973	297.5	
1974	349.5	
1975	401.8	
1976	492.3	
1977	589.4	
1978	638.6	
1979	740.0	
1980	857.1	
1981	1096.3	
1982	1162.3	1294
1983	1124.9	1329
1984	1497.6	1561

Sources: [a] Statistics Canada, Catalogue 61-207;
[b] Statistics Canada, Catalogue 63-231.
Note: As far as can be ascertained total income and revenue are equivalent concepts.

Figure 9
Advertising Services—Revenues 1965-1984



Source: Statistics Canada, Cat. 61-207 and 63-231.

Approximate Explanations of Revenue Concepts Used in the Advertising Trade

Gross or advertising or simply BILLINGS of advertising agencies:

Comprise:

a) charges that advertisers incur in placing advertisements in media through an advertising agency; the agency is billed by the media and, in turn, bills the advertiser

b) charges for production work done in the preparation of advertisements, typically by agency subcontractors

Gross or before-tax REVENUES or INCOME of advertising agencies:

Comprise:

a) from advertising billings a *commission*, typically 15 percent, is deducted by the agency

b) *fees* for special services, such as market surveys

c) other revenues, such as from public relations affiliates

(a) and (b) would be referred to as "advertising-based" income

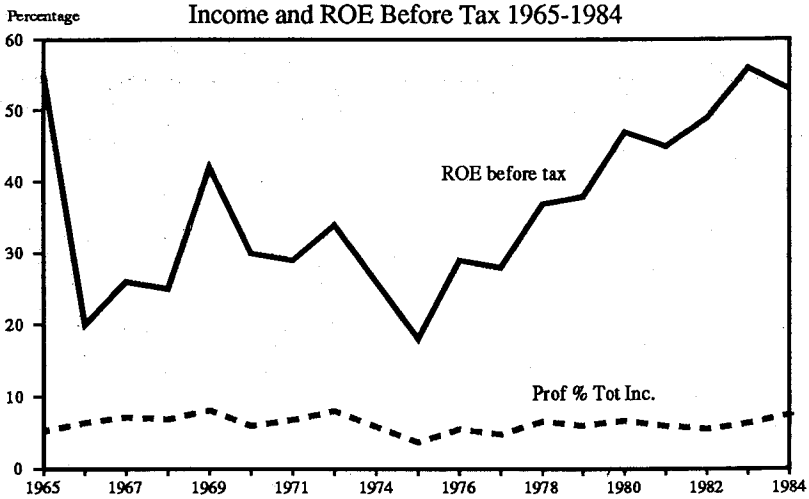
Note: Table 21 gives details on the commission-fee remuneration mix.

Table 12
Net Profit Before Tax and Return on Equity of Incorporated Advertising Service Businesses (1965-1984)
(millions of dollars)

Year	Net Profit Before Tax	Total Income	Total Equity	ROE Before Taxes
1965	10.9	209.0	19.8	0.55
1966	10.7	166.8	53.4	0.20
1967	12.2	172.4	47.6	0.26
1968	9.9	145.0	39.3	0.25
1969	16.5	203.1	39.4	0.42
1970	13.6	230.2	45.5	0.30
1971	16.6	249.2	57.6	0.29
1973	23.7	297.5	68.7	0.34
1974	20.1	349.5	78.1	0.26
1975	14.8	401.8	81.9	0.18
1976	26.7	492.3	91.5	0.29
1977	27.8	589.4	99.8	0.28
1978	41.6	638.6	111.9	0.37
1979	43.6	740.0	114.9	0.38
1980	57.0	857.1	122.3	0.47
1981	64.0	1096.3	141.5	0.45
1982	63.7	1162.6	130.1	0.49
1983	70.1	1124.9	124.4	0.56
1984	83.7	1497.6	159.2	0.53

Source: Statistics Canada, *Corporation Financial Statistics*, 61-207.

Figure 10
Net Profit Before Tax as a Percentage of Total Income and ROE Before Tax 1965-1984



Source: Statistics Canada, Cat. 61-207.

tax divided by share capital plus retained earnings. Between 1970 and 1984 it fluctuated between 18 and 56 percent, with a median value of 34 percent (20 percent after tax). Could it be that this excellent profit achievement is partly an accounting mirage? The most valuable asset of the firms in this sector is human capital, unrecorded on the balance sheet and so missing from the denominator of the rate of return ratio.

Revenues of Advertising Agencies[4]

The most recent scraps of non-governmental source information on the billings and income of advertising agencies are contained in the already mentioned table 7 which lists 12 of the largest agencies operating in Canada. Every year in December the trade publication *Marketing* lists the top 100 agencies according to "capitalized" billings, which are computed by multiplying advertising-based income by 6.67, a factor reflecting the 15 percent commission system. The top 12 agencies "billed" about $1,431 million in 1986, that is, they placed approximately this amount for time and space among the media on behalf of the advertisers.[5] Taking an estimate of $7 billion of all media advertising expenditures in 1986, we may guess that 45 percent or $3.15 billion of this amount represents national advertising, that is, advertising placed by agencies. Thus the top 12 agencies, whether of the *Marketing* or the *Advertising Age* count, placed about 46 percent of this total. This estimate is in line with the figures given in chapter 2, which dealt with the size distribution of firms.

More detailed breakdowns are only available from the Statistics Canada annual surveys (catalogue 63-201) which were stopped in 1977 and restarted in 1985, with probable publication in 1988. Despite their antiquity, these figures merit a glance. Table 13 and figure 11 plot the agencies' total billings. Revenues derived from these run at around 16.5 percent (15 percent on media outlays plus all those production charges), revenues from mostly market research work are at about 5 to 6 percent of total gross income—all of this for the years 1972 to 1977. No profit indices are available.

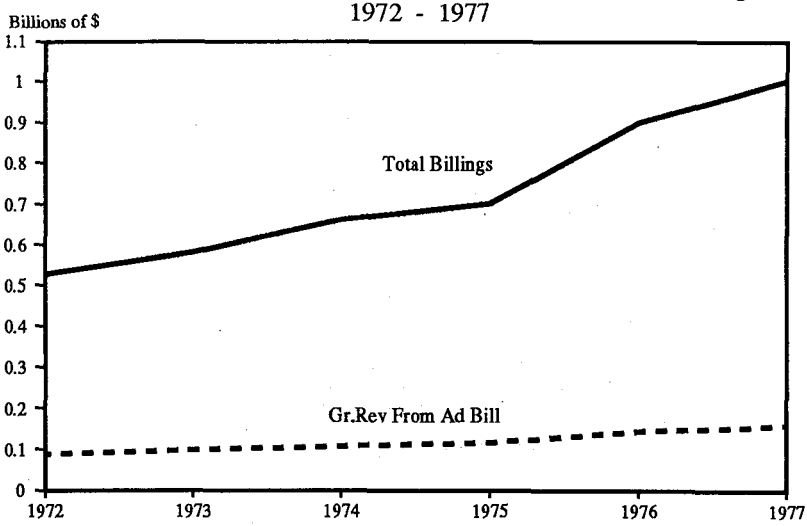
Billings by media for the years 1972 and 1977 are shown in figures 12 and 13. Matching these with individual agency's internal costs, if such were available, could throw light on whether TV commercial conception and preparation is more or less costly than similar work for other media, and whether agencies doing work for this medium are at an advantage or not.

Table 13
Advertising Agencies--Revenue Statistics
(in thousands of dollars)

	1972	1973	1974	1975	1976	1977
Total billings (includes production work)	523,204	577,117	657,209	697,041	890,974	994,958
Gross revenue from ad billings (includes production)	87,712	99,026	109,063	116,213	143,472	157,988
--as percent of billing	.168	.172	.166	.167	.161	.159
Market surveys, other revenue	4,351	4,641	6,358	6,666	10,541	9,782
Total gross income	92,064	103,667	115,421	122,880	154,013	167,770

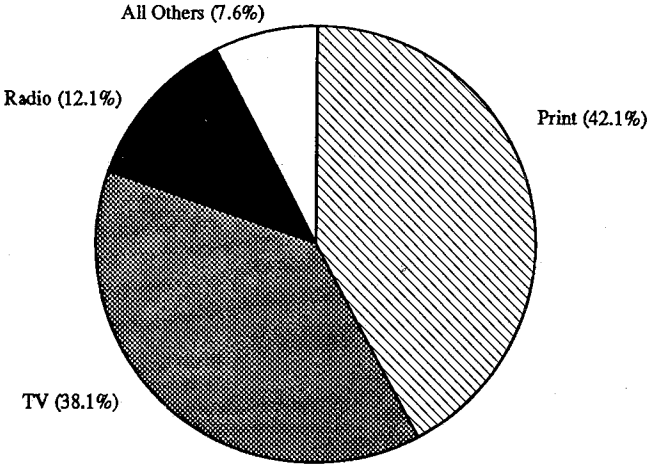
Source: Statistics Canada, *Advertising Agencies*, Catalogue 63-201.

Figure 11
Total Billings & Gross Revenue from Ad Billings
1972 - 1977



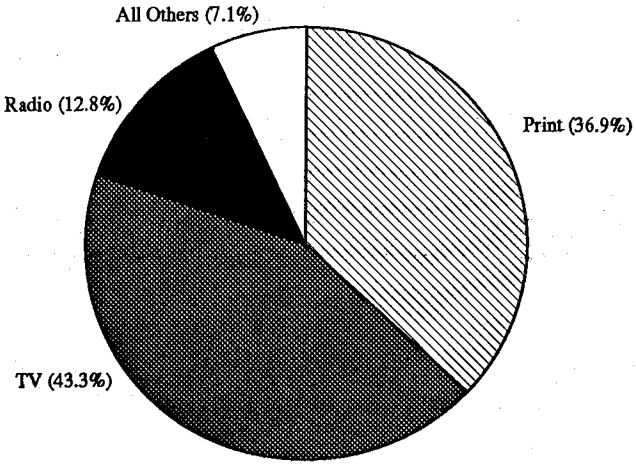
Source: Statistics Canada 63-201

Figure 12
Media Billings to Clients
1972



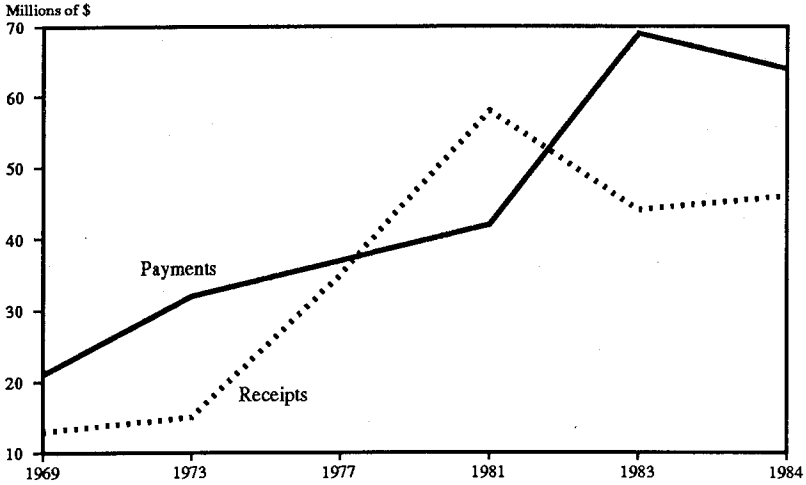
Source: Statistics Canada 63-201

Figure 13
Media Billings to Clients
1977



Source: Statistics Canada 63-201

Figure 14
International Receipts & Payments
Advertising & Promotional Services



Source: Statistics Canada, Cat. 67-510.

Exports and Imports

As already mentioned, the export and import values of the SIC 774 industry are tiny. Receipts reached $46 million or about 2.9 percent of the $1.56 billion gross income; payments amounted to $64 million or about 4.1 percent of income.[6] Figure 14 shows the trends between 1969 and 1984. In real terms, the slopes of the connecting lines would have been much flatter. One may only speculate that these figures represent, on the import side, the consulting fees of U.S.-based agency personnel billed to Canadian affiliates.[7] What the traffic in the other direction represents is hard to say.

NOTES

1. Maclean-Hunter's (Toronto) annual *Advertising Revenues in Canada* gives, for instance, estimates of advertising agency revenues from advertising billings which are, as far as can be ascertained, projections of pre-1978 commission percentages of the national component of advertising.
2. P.T. Zarry and R.D. Wilson, eds., *Advertising in Canada*, Toronto: McGraw-Hill Ryerson, 1981, p. 5.
3. See, on this point, chapter 1, "Characteristics of Services Provided."
4. The concepts of "billings" and "revenues" are explained in the box insert on page 52.
5. Compare this to the total billing of $1,439 million of the 12 agencies in table 7, three of which are different from those listed by *Marketing*. That table was based on a survey by *Advertising Age*. The most striking observations are that (a) the results are insensitive to inclusion, and (b) that the top biller in table 7, Foster Advertising with $189 million, came in only in eighth place in the *Marketing* list with $104 million of billings. Industry sources opine that these results are due to differences in survey questions; the reader may have a different interpretation.
6. Compare this to the trade in related commodities. In 1986 "Advertising matter, printed n.e.s.," code 895-59, was exported to the tune of $26 million and imported to the extent of $68 million. See Statistics Canada, *Exports (Imports) by Commodity*, catalogue 65-004, December 1986.
7. It is much easier, with respect to immigration procedures, to bring in a permanent employee of an international company on a consulting stint to the affiliate than to bring a consultant into a Canadian-owned agency.

CHAPTER 4

INDUSTRY EMPLOYMENT AND PRODUCTIVITY

Expenditures on Inputs Into the Industry's Output

Capital Inputs

This is a human capital not a physical capital intensive industry. Fixed assets in the industry run at around 15 percent or less of total assets.[1] In 1980 depreciation represented 1.2 percent of total income.[2]

Labour Expenses

Figure 15 shows a time series of wages and salaries as a proportion of total income in the whole sector for the years 1973 to 1985. (This proportion runs significantly higher than in the recent 1982, '83, '84 Statistics Canada surveys series 63-231, already mentioned several times.)

According to a private communication, the proportion devoted to compensation, including benefits, is higher yet among Canada's advertising agencies. Based on a small but reasonably representative sample of larger full-service agencies, payroll costs were 60 percent of agency gross revenues in 1985. Another private communication indicates that among U.S. agencies of comparable size, employee compensation takes about 56 percent of total income.

Input/Output

Table 14 shows the input/output statistics for 1981, especially tabulated for this study by Statistics Canada (1981 is the last available year for this industry). There seem to be no remarkable items on the input side, except perhaps for "spare parts" worth $58 million.

The output figure of $792 million is to be compared to the $819 million listed in Statistics Canada's gross domestic product series for that year (catalogue 61-213).

Table 14

Input/Output Table for the Advertising Services Industry

(1981 current dollars in millions)

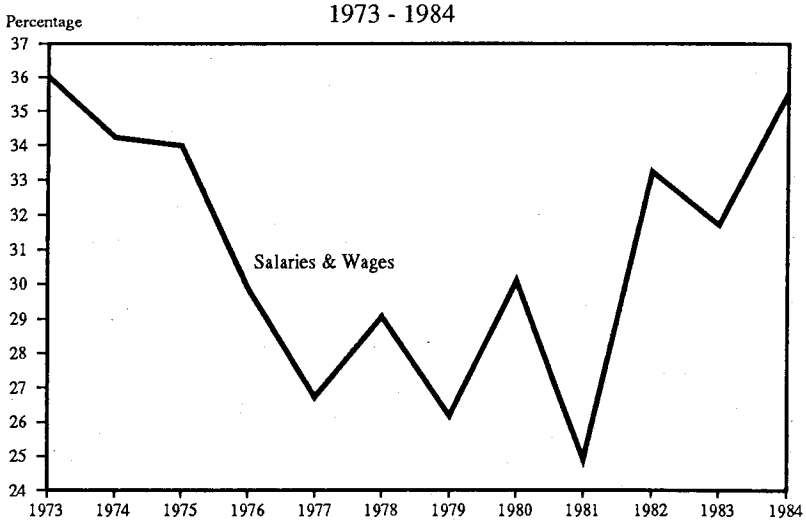
Code	Commodity	Inputs	Outputs
03900	Natural gas	2	
16600	Other cordage, twine & rope	1	
23100	Other printed matter	2	
39500	Motor gasoline	12	
39600	Fuel oil	1	
39700	Lubricating oils and greases	1	
48700	Adhesives	1	
52000	Phono records and artist material	2	
53600	Truck transportation	5	
54000	Pipeline transportation	1	
54400	Telephone & telegraph	18	
54500	Postal services	4	
54600	Electric power	3	
54700	Gas distribution	1	
54900	Water and other utilities	3	
55000	Wholesaling margins	2	
55100	Repair service	5	
55300	Retailing margins	1	1
55400	Imputed service, banks	4	
55500	Oth Real Est (non-rent) & Fin.Se	4	
55600	Insurance & W.C.B.	1	
55900	Other rent	24	
56600	Services to business management	11	
56700	Advertising services		792
57300	Photographic services	14	
57500	Rental data processing equipment	2	
57600	Other serv. to businesses & perso.	28	
57700	Rental of automobiles & trucks	7	
57800	Trade association dues	4	
57900	Rental AO mach & Eq. Incl. Const. M.	4	
58000	Spare parts & maint. suppl. mach & E	58	
58100	Office supplies	14	
58300	Transportation margins	1	
58500	Travelling and entertainment	36	
58600	Advertising & promotion	9	
59600	Commodity indirect taxes	16	
59800	Other indirect taxes	7	
59900	Wages and salaries	343	
60000	Supplementary labour income	19	
60100	Net income unincorp business	37	
60200	Other operating surplus	86	
60300	All other		1
TOTAL		794	794

Table 15
Various Employment Statistics

Employment	1961	1971	1977	1981	1986
a Total labour force	6,471,850	8,626,925		12,054,155	
b Total service employees	308,465	545,734			
b Total services to bus mgt.	31,124	129,666			
a Advertising services	8,657	14,350		25,665	22,790[d]
c Ad agency employees	4,280	4,735	5,480		

Sources: (a) General Census, 1961, Vol. 3 Pt. 2; 1971, Vol 3 Pt. 4; 1981 V.1 Nat Series B.
(b) Services Census, 1961, Vol. 6 Part 2; 1971 Vol. 9.
(c) 1961-1971, same as b; 1977 *Advertising Agency*, Annual Statistics Canada Catalogue 63-201.
(d) Statistics Canada, *Employment, Earnings, Hours*, Cat. 72-002 monthly.

Figure 15
Remuneration as Percentage of Total Income
1973 - 1984



Source: Statistics Canada, Corporation Financial Statistics, 61-207.

Size and Characteristics of the Labour Force Employed

This ground was already covered in part in chapter 1. Here we focus on statistical descriptions and the detection of trends. We should first point out that more reliance had to be placed on the 20 percent sample results of the 1961, '71 and '81 general censuses rather than on the idiosyncratic service censuses of 1961 and 1971. The census information was supplemented, wherever possible, by other data not always consistent with it.

Table 15 shows that while total labour force in the economy just about doubled between the general censuses of 1961 and 1981, employment in the advertising services sector just about tripled. Taking, however, the probably more reliable employment survey figures, we note that in 1986 (the 12 months' average) employment stood at 22,790—3,000 less than the 1981 census figure. The rest of the table shows figures too old to be commented upon; the slow growth of advertising agency employment cannot be extrapolated with any confidence whatever to the present.

Table 16 and figure 16 show that the female share of labour force is higher in the advertising services sector than in the general labour force and that it is growing. By 1981 women reach 48.3 percent of employees in advertising; in the general labour force they attain 40.6 percent.

Table 17 and figure 17 indicate that, compared to all industries, advertising services have employees with more formal education—more college graduates (14.3 percent versus 10.7 percent in the total labour force in 1981) and fewer employees with less than high school. The trend for all industries is toward a more educated work-force.

While men tend to dominate at the low and high end of education (categories 1 and 4), there is a higher percentage of women in advertising services with university education than in the general labour force. As figure 18 shows, in 1981 this proportion reached 12.7 percent against 9.3 percent in general employment.

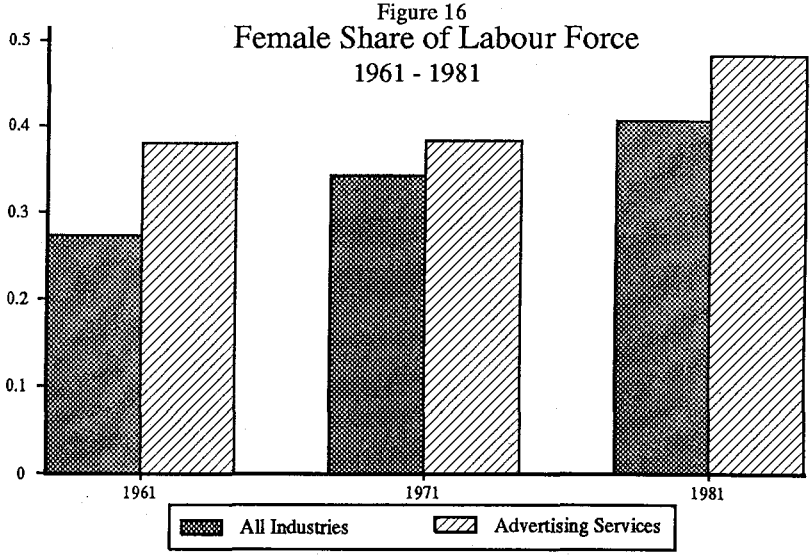
We now ask the reader to check back to chapter 1, and particularly the last paragraph under the heading "Characteristics of Employees," showing a table of functional groupings in an advertising agency. A communication from Dr. Barrie A. Wilson, former vice-president and education director of ICA (Institute of Canadian Advertising) is reproduced, in part, below. It gives an expert's opinion on the current educational background of advertising agency employees, grouped somewhat as in the above-mentioned table, and his judgement on future skills required.

Table 16
Employment and Male/Female Proportions

All Industries	1961	1971	1981
Total Labour Force	6,471,850	8,626,925	12,054,155
Males	4,705,518	5,665,715	7,155,265
% of Total Labour Force	(.727)	(.657)	(.594)
Females	1,766,332	2,961,210	4,898,890
% of Total Labour Force	(.273)	(.343)	(.406)
Advertising Services (862)	**1961**	**1971**	**1981**
Total Employment	8,657	14,350	25,665
Males	5,368	8,850	13,290
% of Total (862)	(.62)	(.617)	(.518)
Females	3,289	5,500	12,375
% of Total (862)	(.38)	(.383)	(.482)

Source: General Census; 1961- Vol 3 pt.2; 1971, Vol. 3 pt. 4; 1981, v.1 National Series B.

Figure 16
Female Share of Labour Force
1961 - 1981



Source: Statistics Canada, General Census.

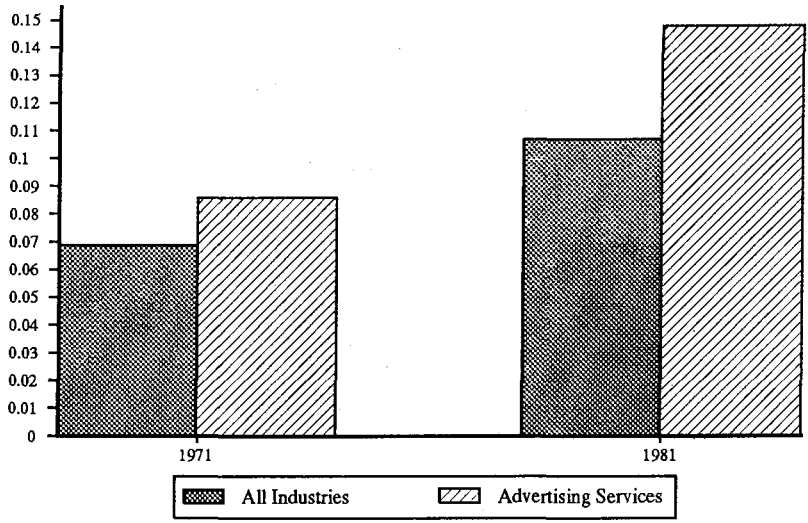
Table 17

Employment and Education, by Sex (1971 and 1981)

1971	Total	Less Than High School	High School/ Trade Cert.	Some University	University Degree
All Industries	8,626,925	5,385,485	1,964,475	684,815	592,155
(% of Total)	1	.624	228	.079	.069
Male	5,665,715	3,681,590	1,103,450	434,570	446,110
(% of Male)	1	.65	.20	.077	.079
Female	2,961,210	1,703,895	861,025	250,245	146,045
(% of Female)	1	.575	.291	.085	.049
Advertising Services	14,350	6,010	5,030	2,070	1,235
(% of Total)	1	.419	.351	.144	.086
Male	8,850	3,615	2,810	1,490	935
(% of Male)	1	.408	.318	.168	.106
Female	5,500	2,395	2,220	580	305
(% of Female)	1	.435	.404	.105	.055
1981					
All Industries	12,054,155	4,946,245	4,234,575	1,582,120	1,291,210
(% of Total)	1	.41	.351	.131	.107
Male	7,155,265	2,821,845	1,914,775	1,581,670	836,980
(% of Male)	1	.394	.268	.221	.117
Female	4,898,890	1,716,305	1,269,585	1,458,770	454,235
(% of Female)	1	.35	.259	.298	.093
Advertising Services	25,665	6,695	9,715	5,580	3,680
(% of Total)	1	.261	.379	.217	.143
Male	13,290	3,030	2,735	5,410	2,110
(% of Male)	1	.228	.206	.407	.159
Female	12,375	2,345	3,290	5,175	1,570
(% of Female)	1	.187	.266	.418	.127

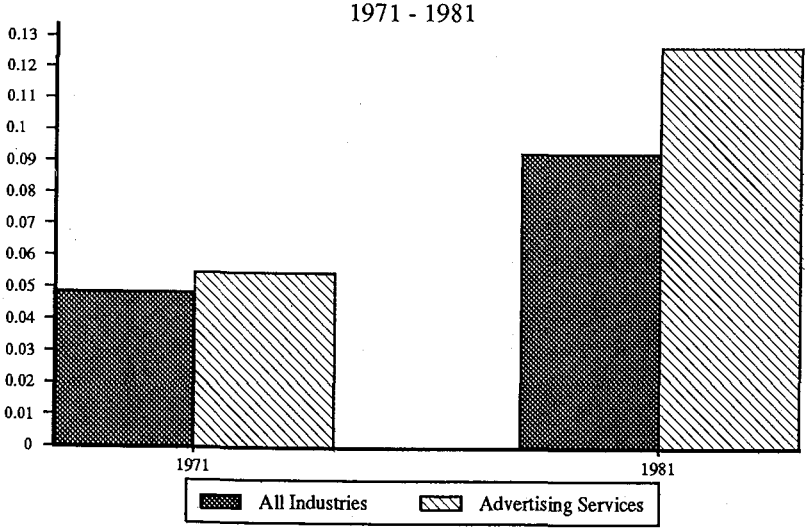
Source: General Census; 1971, Vol. 3 pt. 4; 1981, v.1, National Series B.

Figure 17
Share of Labour — University Degree
1971 - 1981



Source: Statistics Canada, General Census.

Figure 18
Percentage of Females — University Degree
1971 - 1981



Source: Statistics Canada, General Census.

... Since no formal education survey has been conducted in our industry (to my knowledge), the following is highly impressionistic.

Research

current: MA + in Marketing Research, Statistics.
future: same, plus computer facility.

Account Management

current: varies from BA in Liberal Arts to B. Comm, BBAs, HBAs, MBAs.
future: same.

note: most agencies look for a cluster of skills—business, communication, interpersonal—however acquired.

Creative

current: highly divergent, from no university education to graduates of Ontario College of Art to Creative Writing/Fine Arts graduates.

future: same, plus computer facility.

Media

current: community college/university graduation.
future: same, plus computer facility.

Traffic, Secretarial, Miscellaneous Support

current: mostly community college.
future: same.

Top Management

current: tends to come mostly out of Account Management, with some from Creative or Media.
future: likely to continue.

Once in advertising, agencies train their personnel partly (a) through small in-house programmes designed to reinforce corporate culture, and (b) through co-operative educational programmes run by ICA, specifically:

- CAAP—3-year programme in advertising management.
- CPPP—2-year programme in print production.
- TV—1-year programme in TV commercial production.
- Presenters Club—10-week course in presentation skills.
- Introduction to Advertising—11-week course on advertising basics.
- Introduction to Print—8-week course on print production basics.
- 1-day seminars on Media Planning, Media Buying, et cetera.

Labour Productivity

As was stressed in the first chapter, the true measure of productivity increase in advertising is the unit cost decrease between X_c and X_p, the ready-to-consume commodity and the just-produced commodity, which is due to the lowering of buyer search costs. Since advertising activity is the outcome of co-operation between advertising suppliers, advertising agencies, advertisers and media, it is not practicable to estimate the input part of the productivity ratio. At this stage of data availability, it is equally impracticable, on the output side, to measure the search costs of buyers. Consequently, we can only consider the output of SIC 774 or of advertising agencies as measured by their revenues for the numerator of the productivity ratio.

The denominator could, in principle, be measured as an index of both labour and capital inputs. Given that capital depreciation runs at only 1 or 2 percent of total income in this sector whereas labour costs are at least 20 times and as much as 30 times higher, we are justified in calculating labour productivity as a proxy for total productivity. But it must be remembered that we are not satisfied with the output measurement and that we have no means of measuring the accumulation of human capital as a determinant of our flawed measure of labour productivity beyond reference to table 17 on educational attainments. Table 18 shows the measures of labour productivity calculated here. Figures 19 and 20 show the time series of real value added between 1971 and 1984 and the per employee real value added in 1971 and in 1984, calculated from the corporation financial statistics reports of Statistics Canada.[3]

A first look at the table shows the 1981 productivity measures to be out of line, due to the less than believable, excessive numbers of people in the sector's labour force, as captured by the 20 percent sample 1981 general census figures. Between 1971 and 1984 labour productivity, as measured by constant-dollar value added per employee grew by 29 percent (1.9 percent average rate of growth), as measured by constant-dollar revenue per employee by 35 percent (2.3 percent average rate of growth). As measured by the proportion of total labour force in the advertising sector accountable for the percentage of GNP spent on advertising, it grew by 25 percent. Employees per million of revenue, a trade measure of productivity used by advertising agencies, declined by (necessarily) 35 percent. We come to the reasonable minimalist conclusion that labour productivity in the overall sector has not declined and has probably grown somewhat.

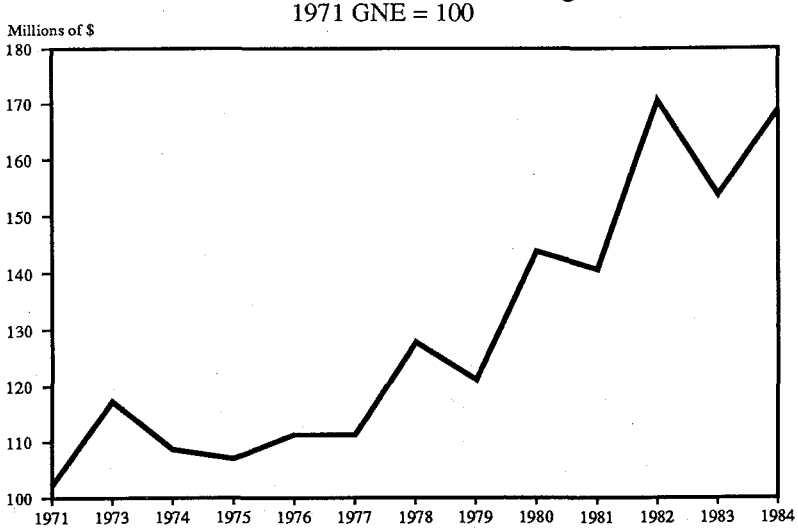
For advertising agencies (see table 19) we use survey figures gathered in 1972 and 1977 (the last available) and 1986 figures for the largest 12 agencies (the only ones available) listed in the *Globe and Mail* special issue.

Table 18
Labour Productivity Indices in SIC 774
(based on 1971 GNE--deflated dollars)

	1971	1981	1984
SIC 774			
Value added (millions)[a]	$102	141	166
Revenues (millions)[b]	294	441	500
Labour force	14,350[c]	25,505[c]	18,125[d]
Value added per employee	$7,108	5,515	9,158
Revenue per employee	20,487	17,250	27,586
Employees per million of revenue	48.8	58.0	36.3
Percentages of GNP spent on advertising divided by percentage of labour force in advertising--index	100	83	125

Sources: a Computed from Cat. 61-207;
b Taken from Cat. 61-207;
c General census;
d 12 months average from Cat. 72-002.

Figure 19
Real Value Added— Advertising Services
1971 GNE = 100



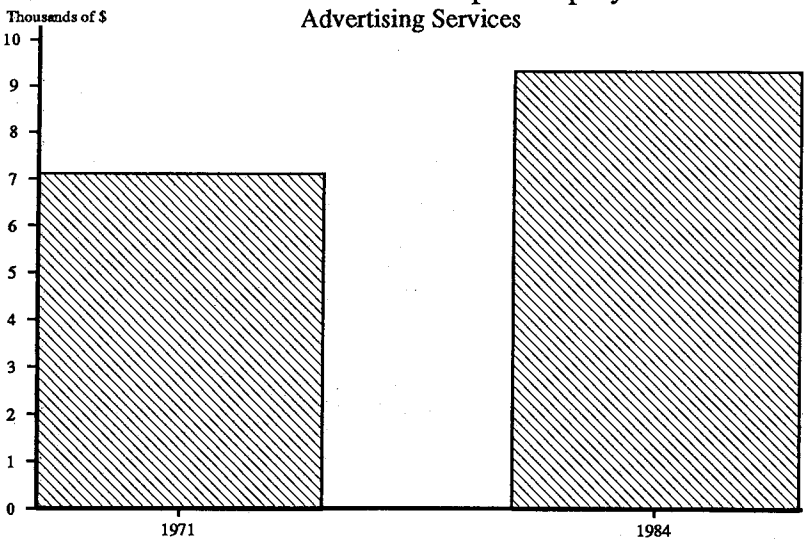
Source: Cat. 61-207.

Table 19
Labour Productivity Indices in the Agency Sector
(based on 1971 GNE–deflated dollars)

	1972[a]	1977[a]	1986[b]	
Billings (millions of dollars)	$497	586	464	1,440*
Gross income (millions of dollars)	87	99	68	
Employees	4,474	5,480	3,118	
Billings per employee	111,086	106,934	148,813	
Income per employee	19,446	18,066	21,809	
Employees per millions of				
--billings	9.0	9.3	6.7	2.16
--income	51.4	55.3	45.8	

Sources: a Cat. 63-201;
b table 7.
Note: *1986 dollars

Figure 20
Real Value Added per Employee
Advertising Services



Source: Cat. 61-207, Services Census 1971, Cat. 72-002.

Between 1972 and 1977 we discern small decreases in labour productivity.[4] We realize, of course, that the 1986 figures are gathered from a sample of possibly more efficiently run large agencies, exploiting the modest scale economies indicated in this industry. We find about a third less employees per million of constant 1971 dollar billings (6.7 employees versus 9.3). Expressed in 1986 Canadian currency, these top 12 agencies employ 2.16 employees per million of billings. This can be compared to the average EPM, or ratio of employees per U.S. $1 million in billings, for the 100 top U.S. agencies of 1.56.[5] If the Canadian dollar is really worth less than the U.S. currency on the Canadian market, then the Canadian EPM of 2.16 looks much better than were we to use the 1986 conversion rate of U.S. $1 = CDN $1.40 which would lead to an EPM of 3.0.

We conclude that (a) we cannot pronounce on any trends in agency productivity, and (b) the large Canadian agencies are almost as labour efficient as their U.S. counterparts given the dispersed and small-scale nature of the Canadian advertising market.

NOTES

1. Of course, accounting convention does not permit the presence of human capital on the balance sheet.
2. Both figures from catalogue 61-207.
3. Value added is calculated by adding salaries and wages, depreciation and net profits before direct taxes.
4. Here as before the use of the GNE deflator is not necessarily very efficient.
5. *Advertising Age*, March 26, 1987.

CHAPTER 5

SOURCES OF CHANGING DEMAND IN THE INDUSTRY

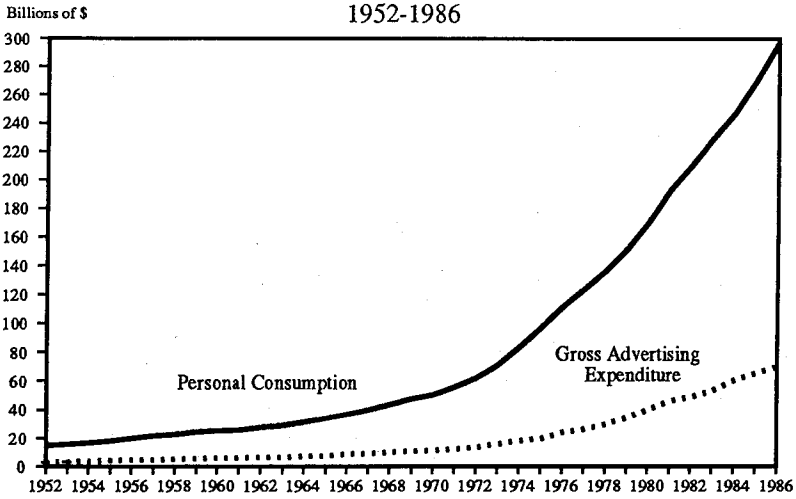
General Considerations and Formal Models

The "commodity" that the two-thirds of the sector sell, we remind ourselves, is a service that is created in co-operation with the customer, the advertiser, and another service sector, the media. (One-third of the industry supplies the inputs necessary for the agencies to create the final commodity.) In chapter 1 we described how the advertiser's decisions regarding his brand's marketing mix will determine his outlays on advertising. Basically, it is the value of the advertising's marginal revenue product in relation to the MRPs of the other mix elements which will play a key role in this.

We have a reasonably good theory of the determinants of this value and so of the advertising intensity (the ad/sales or A/S ratio) of a brand. This theory, used in conjunction with the proprietary PIMS data, makes it possible to forecast how the A/S ratio and so, *mutatis mutandis*, advertising outlays will move.[1] To move from there to the forecast of advertising agency individual brand-specific revenue is difficult but probably feasible. Among the crucial determinants of advertising intensity on the brand level are the number of potential customers, the number of product changes introduced (that have to be announced), the size of the brand's market share (an element in marketing economies of scale) and others.

It is clear that at the more aggregate level of firm or industry the theory weakens and data become less available. The data we dispose of come only at the economy-wide level. Nevertheless, can total advertising expenditures be predicted and can a forecast for the SIC 774 sector, or at least for the agency part of it, be formulated on this basis? Since the prediction of nation-wide advertising expenditures cannot be built up from sectoral data, some macroeconomic variable must be postulated as its determinant. Personal consumption expenditure seems a reasonable candidate. We can assume that advertising, as any other tangible or intangible investment, is undertaken in order to take advantage of an expanding economy and

Figure 21
Gross Advertising Expenditure and
Personal Consumption Expenditure
1952-1986



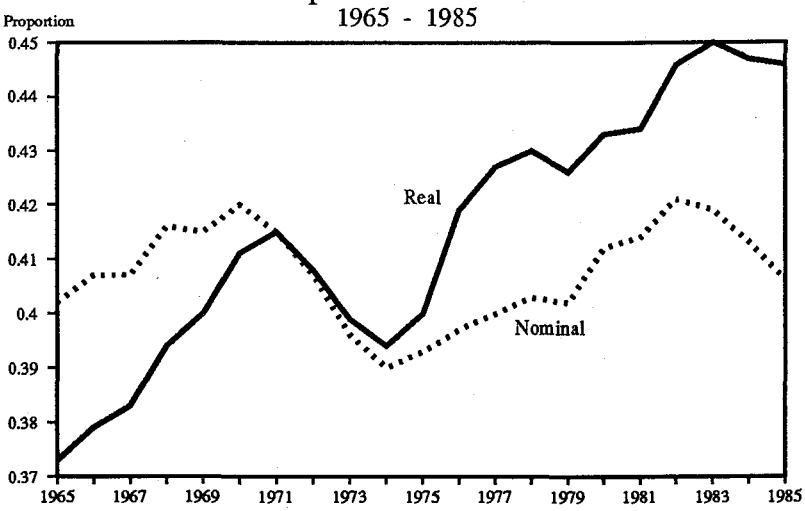
Source: Bank of Canada Review; Maclean-Hunter, Advertising Revenues in Canada.

markets. Since GNP growth is usually accompanied by the growth of personal consumption, this in turn would stimulate advertising outlays.

In a paper written as background research for this study, we examined first in some detail whether a causal relationship could be inferred between annual personal consumption expenditures and annual aggregate advertising outlays in Canada (graphed in figure 21) between 1952 and 1985.[2] (The paper is included as appendix B.) The hypothesis received only slight support. In a further attempt, the Canadian Leading Indicator, postulated to be a proxy for next year's personal consumption expenditures, was used as a regressor for total advertising outlays: $A_t = f(I_t)$. A naive alternative for this model, the autoregressive ARIMA model, forecast better over the 33-year period.

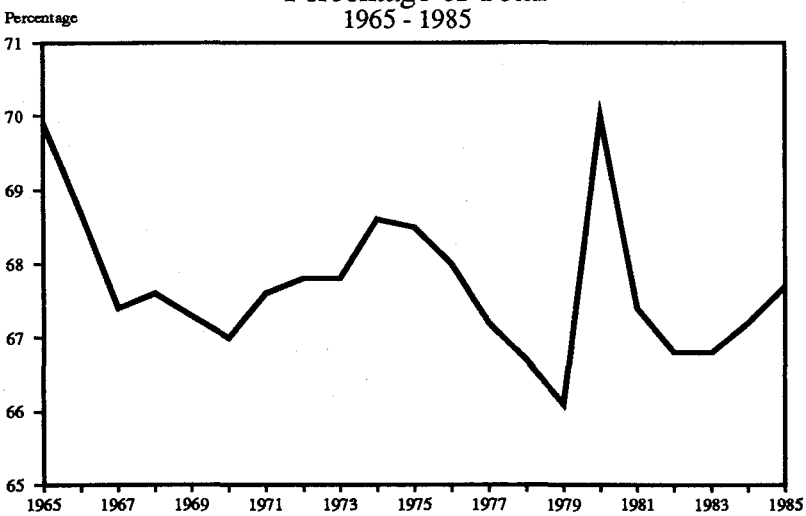
There has been a suggestion in the literature which comes close to the preoccupation of the whole Fraser Institute study of the service sector. It is that the shift away from goods to services has an impact on advertising-to-sales ratios.[3] One observation is that "the ad/sales ratio for service businesses has always been considerably less (2.7% among the 100 leading advertisers in 1984) than for manufacturing businesses. The implication would seem to be that advertising will get a decreasing percentage of a growing gross national product."[4] Another thought is that consumer ser-

Figure 22
Personal Expenditures on Services
Proportion of Total
1965 - 1985



Source: Statistics Canada, Cat. 13-001.

Figure 23
Expenditures in Print Media
Percentage of Total
1965 - 1985



Source: Maclean-Hunter, Advertising Revenues in Canada.

vices furnish benefits which require detailed explanation and cannot be handily summarized by a phrase or visual symbol. This would imply that consumer services would turn more heavily to the use of print than broadcast for their advertisements. This particular hypothesis can be tested with the Canadian data at hand.

Figure 22 shows the shares of personal consumption expenditures in total consumption expenditures, based on current dollars and on 1971 dollars from 1969 to 1985. The latter share, as other Fraser Institute studies have shown, has hardly moved. Figure 23 shows that in the total media expenditure share of print media there was not much systematic movement either. A simple regression of the print media share on current dollar-based services share yields a significantly negative coefficient; on constant dollar-based services share the significance of the coefficient goes down to 10 percent. If anything then, the share of service expenditures and the print media share move in opposite directions during that period. It must be remembered, however, that we have no information regarding print media expenditures geared directly to either total or consumer-oriented services.

We conclude that the attempt to model formally a demand forecast for the services of the advertising industry has not succeeded. We turn to less satisfactory, non-quantifiable types of analysis.

Informal Analysis of Potential Changes in Demand

The A/GNP Ratio

Our cautious subjective analysis of table 9 and figure 8 was to affirm a relative stability in the A/GNP ratio from 1971 to 1986. A check run on this affirmation was to regress the ratio on time, counting years from 1 to 16. With 14 degrees of freedom, the positive coefficient proved to be statistically significant (t=4.8), giving a value of 0.00962. On average then, between 1971 and 1986, each year added this amount to the ratio. For instance, using this perspective, the ratio in 1979 of 1.299 could be expected to increase to 1.308 in 1980. Perhaps the right way to look at the situation is to state that no *downward* tendency in the proportion of GNP devoted to advertising is discernible, and that the constancy—and even some slight increase in this ratio—would spell good news for the industry as long as GNP continues its growth. We stress, however, that we talk association, not causation, here.

The Advertising-Promotion Mix

From time to time, and perhaps more frequently of late, a threat to the advertising industry's continued prosperity is perceived—an alleged shift in

advertisers' *marketing funds* toward promotion.[5] What is sales promotion? The definition is not hard and fast, but the article in *Marketing* opines that sales promotion offers a direct incentive or inducement with the primary object of creating an immediate sale. Such promotion can come in the form of sales personnel incentives, in-store demonstrations, point-of-purchase displays, trade shows, but above all in the form of coupons. It is believed that in the United States 62 percent of marketing budgets went to promotion, with the rest going to advertising. In Canada, also in 1983, the proportion was apparently 70 percent.

These proportions are mere estimates.[6] Are they shifting in favour of promotion? The trade press takes it for granted, adducing some evidence.[7] Does this spell trouble for advertising agencies? "Clients have always had requirements for such non-media things as sales promotion, and we've had a sales promotion division here for years and years."[8] "And all of the agencies—regardless of whether they're merging, Canadian or Canadian internationals—are going where the money is going."[9]

We conclude that no matter what form the information that lowers buyers' costs takes, the advertising industry stands ready to supply it. It is flexible, innovative and geared to survival.

Other Developments

Technological changes in media, such as split runs, cable and pay television, allow a greater focusing on market segments, ever better detectable by electronically aided measurement devices. This would seem to portend shifts of preference by advertisers between media, but not necessarily away from them and so away from the suppliers of advertisements.

Television advertising itself is affected by two technical improvements. The use of remote-control devices encourages "zapping" which in turn enables viewers to eliminate commercial sequences.[10] VCRs affect viewing directly by displacing television programmes with rented film cassette use. It is not at all clear, however, that these two developments are having an effect on the total volume of advertising.

Conclusions

We are left with the impression that dynamic changes are indeed occurring among market and supply factors affecting the composition of the output of the 774 sector. Such dynamic developments have been part and parcel of this sector's lifestyle at least since the beginning of this century. They do

not seem to have influenced to any considerable extent the share of advertising in the GNP over the last two decades.

NOTES

1. Farris and Buzzell, "Why Advertising Costs Vary," *Journal of Marketing*, Fall 1979, pp. 112-122.
2. Eben Otuteye and Kristian S. Palda, "Testing for Causality Between Aggregate Advertising and Consumption in Canada," *Proceedings* of the 1987 Administrative Sciences Association of Canada Conference, pp. 226-235; Toronto, 1987.
3. Leo Bogart, "What Forces Shape the Future of Advertising Research?," *Journal of Advertising Research*, February/March 1986, pp. 94-104.
4. Ibid., 101.
5. Jo Marny, "Sales Promotion: A $7 Billion Enigma," *Marketing*, June 8, 1987, p. 14.
6. Don Schultz, "Growth of Sales Promotion in the United States," *International Journal of Advertising*, 1987, pp. 17-27.
7. *Marketing News*, American Marketing Association, Chicago, May 22, 1987, p.8.
8. Tony Miller, President of MacLaren Advertising, quoted in *Marketing*, December 15, 1986, p.12.
9. David Rutherford, President of Ogilvy and Mather, ibid.
10. *Marketing News*, American Marketing Association, Chicago, May 22, 1987, p.8. *Marketing Communications*, August 1987, gives the figure for the United States as 55 percent.

CHAPTER 6

WELFARE AND INCOME DISTRIBUTION EFFECTS

Employment Growth and Share in Total

All of the available statistics have been presented and analysed in chapter 4. Table 20 takes the figures from table 15 and presents them in a different fashion to cast specific light on share and growth. As before, we stress the doubtful results of the 1981 general census. Omitting these, we see that the employment index in the SIC 774 sector between 1961 and 1984 grew a bit faster than general employment (210 versus 192) and that its share of that employment increased fractionally (0.134 to 0.145 percent).

The Bimodality Hypothesis

It is often asserted that a characteristic of the service industries is a bimodal distribution of skills and remuneration among employees: the bulk of the labour force is unskilled, there is little of a "middle class" among employees, and there is a highly skilled and highly paid managerial hump on the right-hand side of the skills/remuneration distribution. If McDonald's hamburger franchise is the model of our ever more service-oriented economy, then there will be a handful of franchise holders-managers and an army of short-order cooks and cashiers. (Curiously, all those people at headquarters, at the advertising agencies, media and market research firms and auditors which sustain the hamburger chain are not counted.)

We have already seen in table 17 and the corresponding figures the only data we possess which are relevant to the hypothesis. In 1981 in the advertising services industry 26 percent of employees had less than high school education and 14 percent had completed university. In contrast, 41 percent of the total labour force did not complete high school and only 11 percent finished university. There are less pronounced humps in this service industry's educational skills distribution than in the general economy.

Table 20
Growth and Share of Labour Force in Advertising Services and in the Economy, 1961-1984

	1961	1971	1981	1984
Total labour force index	100	133	186	192
Advertising services index	100	166	296	210
Share of advertising employees in total labour force	0.134%	0.166%	0.213%	0.146%

Sources: Table 15. For 1984 advertising services labour force, a 12-months' average was calculated from figures in Cat. 72-002 (18,125 employees). Total labour force figures for 1984 from *Canada Handbook, 1986* (12,4000,000 people).

Value Added to the Economy

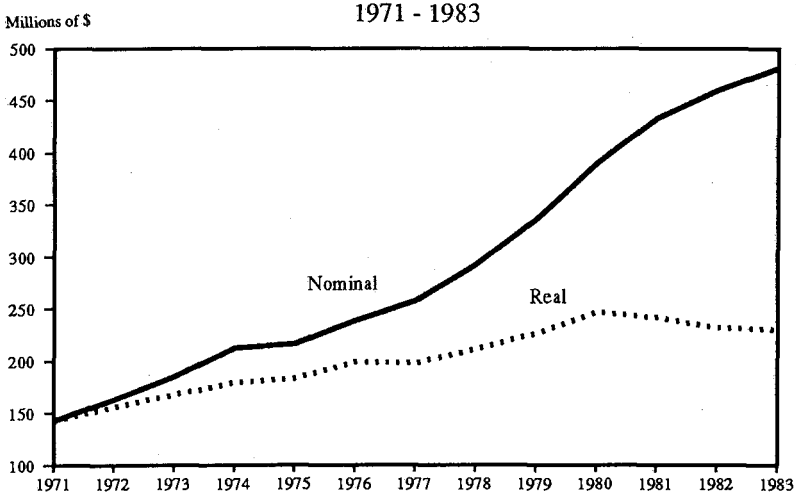
In table 18 and figures 19 and 20 we had recourse to value added figures calculated from corporate income tax returns. Here we show (figure 24) the gross domestic product generated by the industry over the years 1971 to 1983 (the last year of available statistics) in current and 1971 prices. We see that it has increased by about 60 percent in real terms, as compared to the 145 percent increase in the GDP generated by all the services to business sector (figure 26). Figure 25 shows the share in total GDP generated in the advertising sector over these years. It has declined from about 0.172 percent to about 0.137 percent from 1971 to 1983, while the share of all business services—which of course contain advertising as well—has risen from 2.39 to 3.37 percent of GDP.

Our interpretation of these statistics is that the advertising services sector is a mature, slowly growing industry. It does not appear to receive impetus from a hiving-off process of services internal to larger enterprises. As has been proposed in the historical section, advertising is perhaps one of the oldest independent, *outside* services to business.

Riskiness of the Business

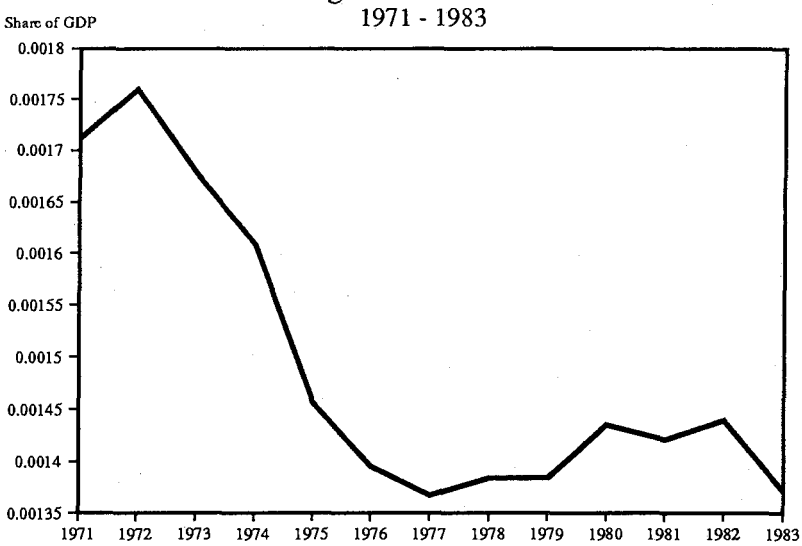
The rate of return on equity before tax figures for the years 1965 to 1984 average 36.1 percent.[1] Their standard deviation is 11.6 percent. Over the five years between 1978 and 1982 there were 734 deaths and 1,568 births of firms in this industry, starting at a base of 1,863 firms.[2]

Figure 24
GDP of Advertising Services in Current and Constant (1971) Prices
1971 - 1983



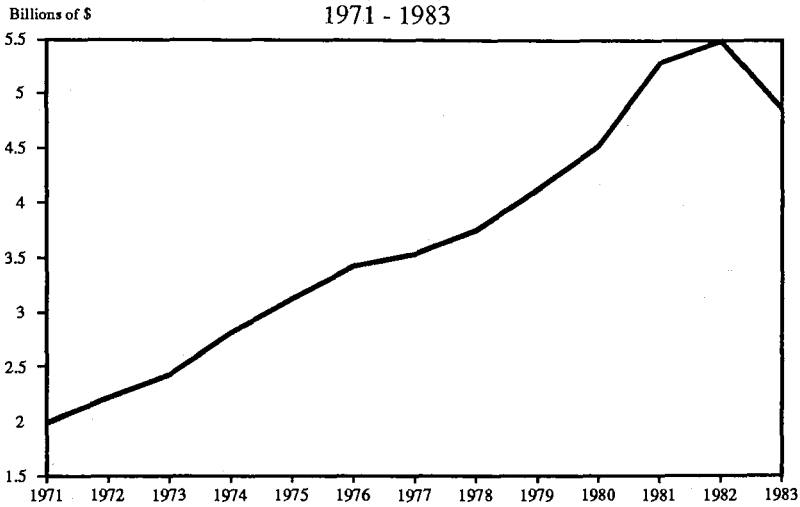
Source: Statistics Canada, GDP by Industry, Cat. 61-213.

Figure 25
Advertising Services' Share of GDP
1971 - 1983



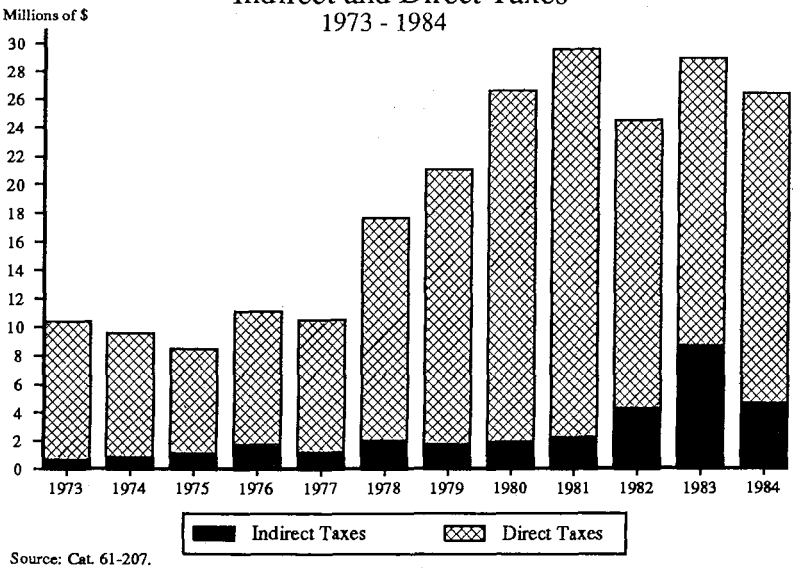
Source: Statistics Canada, Cat. 61-213.

Figure 26
GDP of Services to Business in Constant (1971) Prices
1971 - 1983



Source: Cat. 61-213.

Figure 27
Indirect and Direct Taxes
1973 - 1984



Source: Cat. 61-207.

Using the results of the monthly labour survey,[3] a yearly average of persons employed was calculated, as well as the within-year range:[4]

	1984	1985	1986
mean	18,125	24,680	22,790
range	(16.0-21,200)	(18.0-30,300)	(16.3-29,400)

It is not possible to judge whether the within-year fluctuations are due to the seasonality of employment or to sampling error.

It would be a bold person who would, on the basis of this evidence, assert that this business is risky or not. The impression does linger, however, that it is.

Taxes Paid by the Industry

Figure 27 shows a time series of direct (income) and indirect income taxes paid by the industry, according to *Corporation Financial Statistics* (catalogue 61-207), between 1973 and 1984.

An unknown amount of taxes is being paid *by advertisers* who are dunned 2 percent on broadcast advertising by Quebec and 4 percent on all advertising by Newfoundland. Agencies consider this tax—perhaps an example to be followed by other provinces—as threatening their continued prosperity.

NOTES

1. The before-tax figure was selected given the non-uniform outcome of corporate taxation rates in an industry of small businesses.
2. Statistics Canada, *Employment Creation by Industry Classification, Firm Size and Life Status for Selected Service Industries, 1978-1982*, 1985.
3. Knowledgeable sources in the 774 sector consider these monthly labour survey figures to be over-estimated.
4. Catalogue 72-002; 1983 and earlier figures are not comparable.

CHAPTER 7

MAJOR ISSUES FACING THE INDUSTRY

Most of these issues, with one or two exceptions, have already been discussed in the preceding text. Here we take another, concentrated look at them.

Shift Away from Media Advertising[1]

In the trade literature one perceives a fundamental inquietude that the marketing communication imperatives will shift the seller's dollars away from mass media to sales promotion, event sponsorship and other as yet only dimly noticeable vehicles. While this may harm traditional media, it is difficult to see why advertising agencies and their suppliers would suffer, given their willingness and aptitude to manage communications carried outside mass media. We see not only sales promotion and public relations departments within agencies but also launchings of new and acquisition of existing establishments specializing in these functions by agencies.

From a statistical point of view it can be said that the SIC 774 sector does not now include certain specialized functions such as public relations, but this is merely an artifact. Where will the statistical office place the newly emerging so-called marketing organizations which put together promotions, counsel in telemarketing, and have packaging design and photography studios?[2] We arrive at the limit of a three- or four-digit industry definition here and conclude that while business may indeed transfer slightly toward another statistical niche, the human and institutional actors will remain essentially the same.

Mergers and Globalization[3]

The *Globe and Mail* article was included here because it highlights some of the main issues under discussion in this area. The key issue in the acquisition of Ronalds-Reynolds appears to be "the inability to establish an international presence for prospective clients." Does this mean that Canadian

Ronalds-Reynolds Bought By Giant U.S. Ad Agency

Ronalds-Reynolds & Co. Ltd. of Toronto, a major Canadian advertising agency with annual billings of about $100-million, has been bought by Foote Cone & Belding Communications Inc. of Chicago, says Foote Cone chairman Norman Brown.

The 10th-largest agency in the country, Ronalds-Reynolds will be folded into Foote Cone's Canadian operations this year to create FCB/Ronalds-Reynolds, a new company with 375 employees and combined billings of $177 million.

Hank Karpus, chairman and chief executive of Ronalds-Reynolds, will head the new operation.

Ronalds-Reynolds will stop doing work for Toyota Canada Inc. of Scarborough, an account that creates a conflict of interest with Foote Cone client Mazda Canada Inc. of Pickering, Ont. It also will give up Canada Trust Co. of London, Ont., an account that creates a conflict of interest with the Royal Bank of Canada, another Foote Cone client.

With other acquisitions made by U.S. agencies in recent years, the Ronalds-Reynolds buyout reduces the number of senior Canadian advertising agencies to a handful.

Ronalds-Reynolds, whose clients include Hiram Walker-Gooderham & Worts Ltd., Nestle Enterprises Ltd. and the Canadian Egg Marketing Agency, was established in 1960 with the merger of E.W. Reynolds Ltd. and Ronalds Advertising Agency, two companies with their roots in the 1920s.

Foote Cone, ranked as the world's seventh-largest advertising agency with estimated billings of more than $2-billion (U.S.), launched its Canadian operation in the early 1950s.

By Ben Fiber, *The Globe and Mail*, Toronto, July 14, 1987, p. B6.

Last year, it acquired a Montreal-based advertising agency, Publicité Michel Provost & Associés Inc.

This year, Foote Cone also acquired two senior Toronto-based public relations firms, Continental Public Relations Ltd. and Public Relations Services Ltd., which it merged with its own public relations arm to create Continental Golin Harris Communications Inc.

The Ronalds-Reynolds purchase is the latest in a four-year shopping spree that has doubled the multinational agency's presence to 68 wholly and partly owned offices and 29 affiliate offices in 40 countries.

Foote Cone is one of the few U.S.-based multinational agencies that have not been touched by the intense mega-merger activity within the industry recently.

Over the past 25 years, the combined revenue of U.S. advertising agencies from operations outside of the continental United States has grown to 35 per cent from 10 per cent. Foreign operations provide Foote Cone with 25 to 30 per cent of its revenue.

Inability to establish an international presence for prospective clients was a major contributing factor to the disposition of Ronalds-Reynolds, Mr. Karpus said. An earlier attempted affiliation with a large, U.S.-based agency did not work out.

Unlike their U.S. or British counterparts, Canadian agencies are handicapped by their inability to raise capital for expansion or for acquisitions that could enlarge their operations base, he said.

In the early 1970s, Mr. Karpus was one of the spokesmen for the "Rosedale group," an ad hoc collection of senior Canadian advertising agency executives who lobbied heavily for the protection of the Canadian advertising industry.

advertisers with operations abroad would prefer that the same local Canadian agency, now merged with a U.S. multinational agency, handle their accounts in other countries? This could be read between the lines but is a dubious assumption.

The other major issue is stated in the penultimate paragraph. Canadian agencies, unlike their U.S. or British counterparts, are unable to raise capital for expansion or for acquisitions that could enlarge their operations base. This assertion clearly implies two things. One, these agencies have not sufficiently profitable prospects. Two, expansion leads to greater profitability via economies of scale or, possibly, of scope. Informed sources in the industry opine that medium to large Canadian-owned agencies do indeed find themselves in a profit squeeze. However, these same sources, and the article by Schmalensee et al. (1983), cast doubt on the premise that scale economies are important profit determinants in this industry.

We thus fall back on the account alignment or globalization hypothesis as the explanation of acquisitions of Canadian-owned agencies by agency multinationals.[4] The London and New York agency merger or acquisition movement may, however, also have as explanation the general takeover rationale, that is, the achievement of stockholder wealth maximization.[5]

The article also mentions a natural limit to agency merger, the conflict of interest created by having two clients with competing product lines.[6] (Incidentally, the Foote Cone acquisition of two public relations firms is also reported.) This is perhaps the place to refer again to knowledgeable industry sources who believe that the precarious situation of the larger agencies is not mirrored in the economic state of medium to small, chiefly regional agencies. These appear to service smaller advertisers whom they provide—at lucrative extra charge—with advanced marketing know-how that may be lacking and gain, in the course of their activity, solid client loyalty. On reflection, such a state of affairs is merely an earlier stage in the economic development of large-scale advertisers.

Technological Change[7]

Here the two major issues facing the agencies, the true standard bearers of the 774 sector, are in our opinion single source data gathering and market fractioning. Supermarket scanners, part of the system of single source reporting, enable retailers to know on the morrow the effectiveness of their advertising or of their promotions. Microprocessor television monitors, another component of the system, similarly begin to inform advertisers very rapidly of audience exposure to their ads. The whole system then, both in test and actual market phases, yields unprecedented amounts of informa-

tion, extremely rapidly. This puts much greater pressure on the agency to show results, even though the longer term effects of its efforts may be under-estimated.

Market or audience fractioning merely means that there are now, in many markets, more specialized segments which can be reached by specialized media. This requires better data, but these are forthcoming from media associations, private research firms and governments and are chomped up by faster computers. What it all comes down to is increased complexity evoking greater sophistication among agencies.[8]

The Remuneration System

The slow erosion of the 15 percent commission system on media billings has been under discussion for decades.[9] Objections against a straight commission mode include, among other things, the observation that under the system the agency is motivated to recommend maximum spending on mass media. Objections against a fee-for-service mechanism include the assertion that accounting records, upon which such fees may be based, do not accurately reflect the true cost of the service.

The Association of Canadian Advertisers carried out a compensation survey among its members which was published in February 1986.[10] Of the 207 members, 136 responded (a 65 percent rate of response). Table 21 shows the most important results. Only 37 percent of the surveyed advertisers relied on a pure commission system, as opposed to 76 percent of those responding to a 1970 survey; 30 percent as opposed to 10 percent in 1970 used a pure fee system. The rest relied on a combination of fees and commissions.

The most often cited fee services under a commission system related to promotion, research and new product development. The most frequent method of fee calculation (59 percent) was based primarily on agency time and staff. And 62 percent of ACA respondents indicated that their agencies customarily reviewed financial information with them regarding the profitability of their accounts. The fee-based relationship apparently requires regular discussion of stewardship issues.

We conclude that the move toward fee-based compensation is slow but relentless and brings the agencies close to the general remuneration system common among consulting businesses.

Table 21

How 136 Canadian Advertisers Compensated Their Agencies in 1985 (compared to 3 previous surveys)

	Number of Advertisers	1985 %	1977 %	1970 %
Traditional 15% Commission System	50	37	57	76
Variation of Commission System (more or less than 15%)	12	9	N.A.	N.A.
Fee	41	30	28	10
Combination of Fee and Commission	33	24	12	12
Total	146	100%	97%*	98%*

Source: Association of Canadian Advertisers, *Agency Compensation*, Toronto, February 1986, table 4.

Note: *Balance not indicated.

Regulation and Taxation

The regulatory system has already been exhaustively described (see chapter 1). From that description it is evident that the industry relies heavily on a rather unique self-regulatory system that co-operates closely with the government regulatory set up. But the situation cannot be considered static as long as electoral changes are likely to reflect public attitudes inimical to the free enterprise system. Heavier regulation as well as heavier taxation, on a federal or provincial level, cannot be excluded in the future.

Freer Trade with the United States

There are probably, as in other industries, no collective views on how freer trade may affect enterprises in this sector. The two major trade associations, the Association of Canadian Advertisers and the Institute of Canadian Advertising (for agencies), represent both U.S. (and other foreign-owned) and Canadian members.

Canadian-owned agencies may be uneasy on several accounts. If an eventual treaty outlaws "buy local" laws, such agencies would no longer be the sole potential suppliers of federal and provincial government advertising. A freer trade may speed the process of account realignment, as foreign-controlled advertisers no longer feel a commitment to Canadian-owned sources of supply. Perhaps it is basically a question of what would happen to the autonomy of subsidiaries-advertisers in Canada under a free trade initiative. And, of course, one should not under-estimate the growth potential of Canadian advertisers with access to the U.S. market.

We conclude with the general impression that a freer flow of goods and services across the Canadian-U.S. border presents equal challenge and opportunity to the members of this industry as to most of the other service sectors. It would not, however, affect the advertising scene drastically of itself.

Concluding Remarks

The business service sector described in this study represents a rather tiny slice of Canada's economic activity, less than 0.15 percent of the nation's gross domestic product. But its dominant component, the advertising agencies, co-ordinate and indeed mastermind national, regional and some local advertising worth about $3.5 billion in media revenues. More importantly, the advertising they create is a crucial component in the communication of information from sellers to buyers in our economy and lowers considerably, though as yet unmeasurably, the costs of the search process. Because it is the most visible and audible of all business activities, advertising also awakens passions well beyond its intrinsic merit.

We have found that the industry seems to have attained a mature, slowly growing stage influenced perhaps more by the increasing volume of goods and services whose existence and qualities must be announced than by some inner dynamics. Putting together advertisements and placing them in media has largely been the independent agency's prerogative since the beginning of this century. No hiving-off process of this activity from advertiser to outside consultant can really be observed unless one takes into account a "pre-agency" stage in which the small advertiser relies directly on advice from his local media.

Several other aspects of the industry merit mentioning again. It will have been noticed that most of our descriptions, organization charts and analytical efforts pertain to the originators of roughly 70 percent of the industry's output, the advertising agencies. We picture the rest as mostly suppliers of specialized services. Beyond some one-paragraph textbook descriptions of

what they do, we only have a rather uninformative input/output table (14). It is to be hoped that this veil of mystery will be partially lifted when the results of the 1985 survey by Statistics Canada is published in 1988.

As we would expect in this sector dominated by agencies, the workforce has higher educational attainments than the labour force at large. It has a higher proportion of women. It is probably more mobile and more entrepreneurially oriented, given the small size of the representative firm. These appear to be the characteristics of a consulting industry or profession with a high investment in human capital. But this consulting sector is not growing as fast as some others, just slightly exceeding the increase in the general labour force.

Nevertheless, it seems reasonably prosperous. Return on equity rates have lately attained 50 percent before tax. This impression is contradicted by the industry's informed sources, at least as regards the larger advertising agencies. The on-going takeover trend of Canadian by American (and British) agencies does not cast any particular light on this issue since we cannot tell, in the absence of stock market listings, whether the purchase prices are generous or not.

What can be asserted with some confidence is that the industry is adapting itself well to the on-going technological change. Most of that change is based on electronic developments which give audiences greater autonomy in choosing their sources of information and entertainment and which offer sellers an astonishingly detailed and rapid means of checking on advertising effectiveness. We are less assertive in opining that labour productivity in the sector, as measured by various inadequate indices, has risen. We are, however, confident in our opinion that the industry, in collaboration with advertisers, media and governments, has fashioned a regulatory framework which minimizes obstacles to productivity growth.

We close with a plea for better information about the industry which, be it remembered, owes its existence to the information provision skills it dispenses. Given the forthcoming publication by Statistics Canada of a rather detailed annual survey of the industry divided into its individual four-digit components, we suggest to that organization the assembly and publication of a more complete yearly report. Such a report would not only comprise the revenue, employment, number and size distribution of enterprises to be yielded by the survey but also, from other existing federal sources, the industry's contribution to the gross domestic product, a digest of the pertinent corporation financial statistics and foreign trade and foreign ownership figures. There is no reason why such an annual report could not be supplemented, either by the sole efforts of the industry trade umbrella association, the Canadian Advertising Foundation, or in direct co-operation

with Statistics Canada, by private industry surveys and/or by expert reports on current developments in the industry. Statistics Canada's recent commercial success with small business statistics could conceivably be repeated here.

Finally, it seems about time that the industry's research arm, the Canadian Advertising Research Foundation, awake to the necessity of laying a systematic foundation to the creation of a comprehensive periodic report on advertisers, agencies and their suppliers, and media which would present a much needed unified view of the state of advertising in Canada.

NOTES

1. See also chapter 5, "The Advertising-Promotion Mix."
2. *Globe and Mail*, "British Companies Arrive in Takeover Heaven," June 8, 1987, p. B5.
3. See also chapter 2, "Degree of Foreign Ownership and Influence."
4. For a heated debate on this issue see "Marketing Can Be Global But Ads Must Remain Cultural," *Marketing News*, July 31, 1987, p. 26.
5. M. Jensen, "How to Detect a Prime Takeover Target," *New York Times*, March 9, 1986.
6. Which, incidentally, is also a limit to the growth of specialization of industry-specific agencies.
7. See also chapter 1, "Importance of Research and Technology."
8. See, for instance, the organizational change in the media departments of agencies, as described in Zarry and Wilson, *Advertising in Canada*, op. cit., pp. 199 ff.
9. Association of National Advertisers, *Evaluating Agency Performance*, New York, 1979.
10. Association of Canadian Advertisers, *Agency Compensation*, Toronto, February 1986.

Appendix A

Canadian Code of Advertising Standards (May 1986)*

Authority and Scope of the Code

The Code deals with how products or services may be advertised, not with what may be advertised. Thus, the authority of the Code and the jurisdiction of the Council are over the content of advertisements and do not include, in any way, the right to prohibit the promotion of legal products or services or their portrayal in circumstances of normal use.

Definition of Advertising

For the purpose of this Code, advertising is defined as any paid communication, addressed to the public or a portion thereof, for the purpose of influencing the opinion or behaviour of those addressed.

The various clauses in the code apply to all such messages (with the exception noted below) in all media, and to all components thereof.

Exception:

The ASC does not rule on election campaign advertising, partly because of the constraints of time and partly because such messages are usually highly subjective, reflecting a candidate's or party's point of view. This exclusion does not extend to advertising by government departments or by crown corporations.

The Code

Public confidence exerts an important influence upon the effectiveness of advertising, just as it affects any other communication process in a democratic environment. So directing advertising practices toward meriting and enhancing such confidence is both socially responsible and an act of practical self-interest.

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*Issued by the Advertising Standards Council of the Canadian Advertising Foundation.

This Code of Standards, which has been approved by all participating organizations, is designed to help set and maintain standards of honesty, truth, accuracy, and fairness in the marketplace.

Since products and values in the marketplace are constantly changing, the Advertising Standards Council will periodically review the Code and where it seems appropriate will recommend proposed revisions to the Copy Standards Committee. The principles underlying the Code and more detailed descriptions of its application are presented in the Manual of General Guidelines for Advertising.

No advertisement shall be prepared or knowingly accepted which contravenes this Code of Standards.

The clauses should be adhered to in letter and in spirit.

1. Accuracy, Clarity

(a) Advertisements may not contain inaccurate or deceptive claims or statements, either direct or implied with regard to price, availability or performance of a product or service. Advertisers and advertising agencies must be prepared to substantiate their claims promptly to the Council. Note that, in assessing the truthfulness of a message, the Council's concern is not with the intent of the sender or the precise legality of the phrasing. Rather *the focus is on the message as received or perceived,* that is, the general impression conveyed by the advertisement.

(b) Advertisements may be deceptive by omission of relevant information.

(c) All pertinent details of advertised offers should be clearly stated.

(d) Disclaimers or asterisked information should be so located and large enough as to be clearly visible.

2. Disguised Advertising Techniques

No advertisement shall be presented in a format which conceals its commercial intent. Advertising content, for example, should be clearly distinguished from editorial or programme content. Similarly, advertisements are not acceptable if they attempt to use images or sounds of brief duration or physically weak visual or oral techniques to convey messages below the threshold of normal human awareness (such messages are sometimes referred to as subliminal).

3. Price Claims

(a) No advertisement shall include deceptive price claims or discounts, unrealistic price comparisons or exaggerated claims as to worth or value. "Regular price," "Suggested retail price," "Manufacturer's list price," and "Fair market value" are misleading terms when used by an individual advertiser to indicate a savings—unless they represent prices at which a reasonable number of the item was actually sold within the preceding six months in the market where the advertisement appears.

(b) Where price discounts are offered, qualifying statements such as "up to," "XX off," etc., should be in easily readable type, in close proximity to the prices quoted, and, where practical, regular prices should be included.

(c) Prices quoted in Canadian media in other than Canadian funds should also be identified.

4. Testimonials

Testimonials must reflect the genuine, reasonably current opinion of the endorser and should be based upon adequate information about or experience with the product or service advertised. This is not meant to preclude, however, an actor or actress presenting the true experience of an actual number of users or presenting technical information about the manufacture or testing of the product.

5. Bait and Switch

The consumer must be given a fair opportunity to purchase the goods or services offered at the terms presented. If supply of the sale item is limited, this should be mentioned in the advertisement. Refusal to show or demonstrate the product, disparagement of the advertised product by sales personnel, or demonstration of a product of superior quality are all illustrations of the "bait and switch" technique which is a contravention of the Code.

6. Comparative Advertising

Advertisements must not discredit or attack unfairly other products, services, or advertisements, or exaggerate the nature or importance of competitive differences. When comparisons are made with competing products or services, the advertiser must make substantiation available promptly upon the request from the Council.

7. Professional or Scientific Claims

Advertisements must not distort the true meaning of statements made by professionals or scientific authorities. Advertising claims must not imply that they have a scientific basis they do not truly possess. Scientific terms, technical terms, etc., should be used in general advertising only with a full sense of responsibility to the lay public.

8. Slimming, Weight Loss

Advertisements shall not state or imply that foods, food substitutes, meal replacements, appetite suppressants, creams, lotions or special devices will enable a person to lose weight or girth except in conjunction with a balanced, calorie-controlled diet; and reference to the part played by such a diet shall be so located and large enough to be clearly visible.

9. Guarantees

No advertisement shall offer a guarantee or warranty, unless the guarantee or warranty is fully explained as to conditions and limits and the name of the guarantor or warrantor, or it is indicated where such information may be obtained.

10. Imitation

No advertiser shall deliberately imitate the copy, slogans, or illustrations of another advertiser in such a manner as to mislead the consumer. The accidental or unintentional use of similar or like general slogans or themes shall not be considered a contravention of this Code, but advertisers, media, and advertising agencies should be alert to the confusion that can result from such coincidences and should seek to eliminate them when discovered.

11. Safety

Advertisements shall not display a disregard for public safety or depict situations which might encourage unsafe or dangerous practices, particularly when portraying products in normal use.

12. Exploitation of Human Misery

Advertisements may not hold out false hope in the form of a cure or relief for the mental or physically handicapped, either on a temporary or permanent basis.

13. Superstition and Fears

Advertisements must not exploit the superstitious, or play upon fears to mislead the consumer into purchasing the advertised product or service.

14. Advertising to Children

Advertisements to children impose a special responsibility upon the advertiser and the media. Such advertisements should not exploit their credulity, lack of experience, or their sense of loyalty, and should not present information or illustrations which might result in their physical, mental or moral harm. (See also Broadcast Code for Advertising to Children and the Quebec Consumer Protection Act, Bill 72).

15. Advertising to Minors

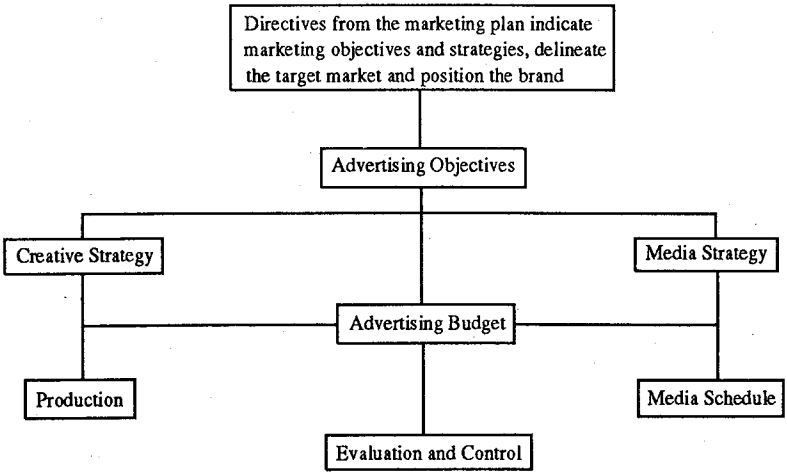
Products prohibited from sale to minors must not be advertised in such a way as to appeal particularly to persons under legal age and people featured in advertisements for such products must be, and clearly seen to be, adults under the law.

16. Taste, Opinion, Public Decency

As a public communication process, advertising should not present demeaning or derogatory portrayals of individuals or groups and should not contain anything likely, in the light of generally prevailing standards, to cause deep or widespread offence. It is recognized, of course, that standards of taste are subjective and vary widely from person to person and community to community, and are, indeed, subject to constant change.

Figure A-1

The Plan for an Advertising Campaign



Source: Adapted from figure 15.11 on p. 529 of John S. Wright, Willis L. Winter, Sherilyn K. Zeigler, D. Noel O'Dea, *Advertising—First Canadian Edition,* Toronto: McGraw-Hill Ryerson, 1984. Reprinted by permission of the publishers.

Appendix B

Testing for Causality Between Aggregate Advertising and Consumption in Canada*

The causal relationship between aggregate advertising expenditures and personal consumption expenditures in Canada is examined and compared to U.S. investigations.

Introduction

Member firms of any industry have a strong interest in the prediction of total market sales. Here we take the first necessary steps in establishing the feasibility of forecasting total advertising expenditures in Canada. Such forecasts would be useful to media and advertising agencies; none is in the public domain in this country as yet. We speculate briefly about the possibility of building an econometric forecasting model of aggregate advertising. Concluding it is not on the foreseeable horizon, we turn to the strongest suspected determinant of advertising outlays, namely, personal consumption expenditures, and test the most fundamental proposition: does consumption causally influence advertising? The rather inconclusive results parallel those of American investigations. Finding, nevertheless, some indication of causality, we try a next step. We replace consumption by the leading indicator and forecast advertising expenditures. This forecast turns out to be less successful than one based on a naive ARIMA model prediction. We are momentarily frustrated.

Determinants of Advertising Expenditure

The logical and simple way of preparing any economic forecast is to erect a model of the dependent variable's determinants, to estimate it, adjust it and then use it. We have a reasonably strong theory of the determinants of the advertising intensity of individual brands that can be extended, at least par-

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*Prepared for the Administrative Services Association of Canada 1987 Conference, University of Toronto, Eben Otuteye (doctoral student) and Kristian S. Palda, School of Business, Queen's University. The motivation for this exploration came from a study of the advertising industry undertaken on behalf of the Fraser Institute which commissioned large-scale research into Canada's service industries.

tially, to firms and perhaps even to individual industries. The effective guidance of this theory showed up in Farris and Buzzell's (1979) econometric estimates of the A/S ratio based on PIMS data. Data scarcity prevents us, at least in Canada, from extending this approach to individual industries. (As a matter of fact, the last Dominion Bureau of Statistics survey of ad/sales ratios dates back to 1965.) For our money, for instance, the number of new products introduced by the industry would be the leading candidate determinant of the ad outlays in an industrial sector; clearly, there is little hope of obtaining information on it.

Since the prediction of nationwide advertising expenditures cannot be built up, following sound theory, from sectoral data, some macroeconomic variable must be postulated as its determinant. Three American author teams (Taylor and Weiserbs 1972, Ashley et al. 1980, and Jacobson and Nicosia 1981) chose as the most plausible determinant at this aggregate level personal consumption expenditure. Or, more accurately, they tested for the influence of advertising on consumption and had, naturally, to test for the opposite influence as well.

The theory that aggregate advertising expands aggregate consumption is one of the weakest. The opposite theory has not been stated much more strongly. One could appeal to the hoary opinion about the prevalence of constant ad/sales ratios, where the sales denominator has a (t+1) attached to it. More plausibly, perhaps, one could stipulate that advertising, as any other tangible or intangible investment, is undertaken in order to take advantage of an expanding economy and markets. Since GNP growth is usually accompanied by the growth of personal consumption, this in turn would stimulate advertising outlays.

But to talk of a model usable for forecasting aggregate advertising when we have only one candidate predictor seems too grandiloquent. And even so, we are not sure that consumption expenditures are a causal predictor. What we do here, then, is focus our attention simply on the causality flow between economy-wide advertising and consumption outlays.

Testing for Causality

The study was carried out with annual data on gross advertising expenditure and personal consumption expenditure from 1952 to 1985 and with the StatsCan Leading Indicator series. Data on gross advertising expenditure was obtained from the Maclean-Hunter annual reports and from Firestone (1966) and the personal consumption expenditure series from the CANSIM tape.

In a study of this nature, more frequent data (e.g., monthly or quarterly) would have been more appropriate. The problem with annual data is that it fails to capture the within-year sales response to advertising which is estimated to range between 75 to 100 percent (see Schmalensee 1972, and Clarke 1976). Unfortunately, there is neither a monthly nor a quarterly series for advertising expenditure in Canada officially available.

The most obvious drawback of relying on total media expenditures is that they include classified advertising in newspapers. Such advertising is of no interest to agencies and may not be greatly influenced by macroeconomic forces. We believe that anywhere between one-third and one-half of newspaper advertising revenue is generated by classified ads, but this is too unreliable an estimate to incorporate in our data preparation.

Another tricky issue is price indexation. We examined the relationship between consumption expenditures and advertising outlays and queried whether inflation affected the two series differently. We believe not, after a preliminary investigation of the consumer price index and the media cost indices published by the Media Directors' Council. Nevertheless, a more formal inquiry here is necessary.

The methodology employed to test causality is that introduced by Sims (1972). The Sims proposition is that

> if and only if causality runs from current and past values of some list of exogenous variables to a given endogenous variable, then in a regression of the endogenous variable on past, current, and future values of the exogenous variables, the future values of the exogenous variables should have zero coefficients (Sims 1972:541).

Applying this test in the present context means that in a regression of gross advertising expenditures on past, current and future values of personal consumption expenditures, zero coefficients on future personal consumption will imply that causality runs from consumption to advertising. Similarly, if the coefficients on future advertising are zero in the reversed regression, it will be concluded that there is causality from advertising to consumption.

An important feature of this test is that the residuals of the regression must approximate white noise. But since the prewhitening transformation has to be chosen a priori, the residuals cannot be guaranteed to be white noise. We followed the method adopted by Aaker, Carman and Jacobson (1982:122) to deal with the problem, namely, to include lagged dependent variables on the right-hand side of the regression to "soak up" any serial correlation.

The transformation applied to the variables was the first differences of their logs, i.e., each variable was replaced by the first difference of its log:

$$C_t = \log PCE_t - \log PCE_{t-1} \quad (1)$$

$$A_t = \log GA_t - \log GA_{t-1} \quad (2)$$

where

PCE = personal consumption expenditure, and
GA = gross advertising expenditure.

The parameters of the regression were estimated by OLS and the results are reported in tables B-1 to B-4. Table B-1 contains the results of Model 1:

$$\text{(Model 1): } A_t = b_o + b_1A_{t-1} + b_2C_{t-2} + b_3C_{t-1} + b_4C_t + b_5C_{t+1} + b_6C_{t+2} + U_t \quad (3)$$

The results in table B-2 are for Model 2, the restricted form of Model 1; the restriction being that the coefficients on the future values of C are constrained to be zero:

$$\text{(Model 2): } A_t = b_o + b_1A_{t-1} + b_2C_{t-2} + b_3C_{t-1} + b_4C_t + U_t \quad (4)$$

Testing for causality then is essentially testing the null hypothesis $H_o : b_5 = b_6 = 0$ against the alternative that the b's are non-zero. An identical test was carried out on Models 3 and 4 in which consumption was regressed on advertising. The results are reported in tables B-3 and B-4.

In previous tests of this type (eg., Aaker et al. 1982, Jacobson and Nicosia 1981) with monthly and quarterly data, lags of up to 12 were specified. It makes sense to specify as many as four lags when using quarterly data since one would still be measuring within-year effects of one variable on the other. When it comes to annual data, as is the case in this study, it is difficult to justify that many lags. Advertising or consumption four quarters ago can conceivably affect one another during the current time, but it is not as plausible to posit that advertising four years ago could cause today's consumption. It is for this reason that we specified only two lags. In similar regressions, one with four lags and the other with only one lag, the sense of the results turned out the same.

In the test of Model 1 against Model 2, the fact that the null hypothesis (consumption causes advertising) could not be rejected means, by the Sims proposition, that causality may run one way from consumption to advertising. On the other hand, in the test of Model 3 versus Model 4, H_o (advertising causes consumption) is rejected at the 5 percent level but not at the 1 percent level. If we stick strictly to the 5 percent significance level as our a priori decision-making criterion, then we will conclude that causality does not run from past and current advertising to consumption. However, in

view of the limited degrees of freedom (29 observations and 7 parameters) within which we are operating, the fact that H_o is not rejected at the 1 percent level is not trivial. With this caution we may only conclude that the evidence of one-way causality from advertising to consumption expenditures is not clear.

There is another interesting point to note here. By accepting the first H_o, we are implying that Model 2,

$$A_t = b_o + b_1A_{t-1} + b_2C_{t-2} + b_3C_{t-1} + b_4C_t \qquad (5)$$

holds. However, a look at the p-values of the coefficients shows that only the coefficient of current consumption, C_t, is significant. It seems, therefore, that the causality from consumption to advertising is mainly contemporaneous. In the regression of consumption on advertising, we observe also that current advertising has a significant coefficient, even though the null hypothesis is rejected. If causality is one-way from advertising to consumption, the coefficients of future advertising should not be significant. But we observe that in Model 3, the coefficient of A_{t+1} is significant. We conjecture that there might be two offsetting effects: the significance of A_{t+1} that will tend to cause the null hypothesis to be rejected versus the significance of At that will tend to cause the hypothesis to be accepted. And that is probably responsible for the inconclusive result.

In order to gather more evidence on the direction of causality, we also did a Pierce-Haugh test (Pierce and Haugh 1977) by cross-correlating one variable with the lags of the other. The results are reported in table B-5. The correlations with lags represent causal flows from consumption to advertising and the correlations with leads represent causal flows from advertising to consumption. If there is no relation between the variables, then the correlations are asymptotically normally distributed with mean zero and variance of 1/N, where N is the number of observations.

The correlations were calculated between the residuals of twice differenced logs of personal consumption expenditure and an MA(1) (a first order moving average) model of advertising expenditure. The difference in the prewhitening transformation procedure between the Sims test and the Pierce-Haugh test is that, in the latter, the two series need not be transformed by the same function. The results show that with a standard error of 0.1768, only the lag zero correlation is significant. This evidence points again to the possibility of a contemporaneous two-way causality.

On the basis of the foregoing, one cannot make very definitive statements about the direction of causality between advertising and personal consumption. A prudent tentative conclusion at this stage will be that there is causality from consumption to advertising over this period. There is also

some indication of the possibility of feedback from advertising to consumption, but the evidence on that is not very clear. In comparison with the U.S. studies, these findings lie somewhere between those of Ashley, Granger and Schmalensee (1977) that causality is only from consumption to advertising and those of Jacobson and Nicosia (1981) that causality between these variables runs both ways.

A Forecast of Advertising Expenditures

Given that consumption is not a truly exogenous variable, the question arises as to whether we can forecast advertising by means of a variable that can be a proxy for, or an indicator of, consumption expenditures. One candidate variable for this role is the Canadian Leading Indicator. A drawback encountered is that advertising expenditures are available only annually, whereas the Leading Index series is monthly, with no easy nor theoretically plausible means of aggregation into an annual index.

A generalized least squares regression of advertising on the Leading Index for January was run. The result was

$$A_t = .09 + .17\, I_t \qquad R^2 = .15 \tag{6}$$
$$(.0114)\ (.0769)$$

(standard errors in parentheses)

where

$I_t = \log(L_t) - \log(L_{t-1})$
L_t = Canadian Leading Indicator for January of year t.

The question we are asking, essentially, is whether the leading index for January of a given year can be useful in predicting advertising expenditure for that year. The last three observations were excluded from the estimation and the estimated model was used to forecast those out-of-sample advertising expenditures (see table B-6). The root mean square error and the percentage root mean square error of the forecast are 0.041 and 1.355 respectively. A plot of all the actual and predicted (both within and out of sample) values is shown in figure 1.

In the absence of any structural forecasting model, the naive alternative will be an ARIMA model. We therefore estimated an ARIMA model for advertising as a benchmark for comparison with the leading indicator model. The root mean square error for this model is 0.042 and the percentage rms is 0.006. We believe that before proceeding any further in attempting to forecast aggregate advertising expenditure in Canada more attention will have to be devoted to data assembly. In particular, it is not impossible

that quarterly data could be obtained. Also, proper price indexing would have to be undertaken. We are currently investigating these possibilities.

Table B-1
Results for Model 1

Model 1: $A_t = b_0 + b_1A_{t-1} + b_2C_{t-2} + b_3C_{t-1} + b_4C_t + b_5C_{t+1} + b_6C_{t+2} + U_t$

Dependent Variable	Independent Variable	Coefficients (Std. Error)	P-value	R^2
	Intercept	.0108 (.0226)	.6378	
	A_{t-1}	-.1772 (.2124)	.4132	
	C_{t-2}	-.1346 (.3155)	.6739	
	C_{t-1}	.1979 (.4712)	.6786	
A_t	C_t	1.1849 (.4452)	.0143*	.5595
	C_{t+1}	-.2534 (.4602)	.5874	
	C_{t+2}	.0976 (.3495)	.7827	

** significant at 1% or less
* significant at 5% at least

H_0: $b_5 = b_6 = 0$
H_1: $b_5, b_6 = 0$
$N = 29$ $K = 7$ $q = 2$

$F = .374$ $F_{2,22} =$ 3.44 at 5%, 5.72 at 1%

$\therefore H_o$ accepted.

Table B-2
Results for Model 2

Model 2: $A_t = b_0 + b_1A_{t-1} + b_2C_{t-2} + b_3C_{t-1} + b_4C_t + U_t$

Dependent Variable	Independent Variable	Coefficients (Std. Error)	P-value	R^2
	Intercept	.0055 (.0193)	.7764	
	A_{t-1}	-.2922 (.1856)	.1284	
A_t	C_{t-2}	.0053 (.3122)	.9865	.5445
	C_{t-1}	.3588 (.4554)	.4385	
	C_t	.8951 (.3104)	.0082**	

Table B-3
Results for Model 3

Model 3: $C_t = b_0 + b_1C_{t-1} + b_2C_{t-2} + b_3A_{t-1} + b_4A_t + b_5A_{t+1} + b_6A_{t+2} + U_t$

Dependent Variable	Independent Variable	Coefficients (Std. Error)	P-value	R^2
	Intercept	.0015 (.0100)	.8847	
	C_{t-1}	.4015 (.1620)	.0214*	
	A_{t-2}	.0151 (.0781)	.8487	
	A_{t-1}	.0167 (.0943)	.8613	
C_t				.8198
	A_t	.2777 (.0803)	.0023**	
	A_{t+1}	.2003 (.0719)	.0108**	
	A_{t+2}	.0605 (.0766)	.4383	

H^2_0: $b_5 = b_6 = 0$
H^2_1: $b_5, b_6 = 0$
$N = 29$ $K = 7$ $q = 2$

$F = 4.87$ $F_{2,22} =$ 3.44 at 5%; 5.72 at 1%

Table B-4
Results for Model 4

Model 4: $C_t = b_0 + b_1C_{t-1} + b_2A_{t-2} + b_3A_{t-1} + b_4A_t + U_t$

Dependent Variable	Independent Variable	Coefficients (Std. Error)	P-value	R^2
	Intercept	.0106 (.0105)	.3216	
	C_{t-1}	.4894 (.2067)	.0263*	
A_t	A_{t-2}	.0381 (.0908)	.6787	.7400
	A_{t-1}	.0553 (.4554)	.6277	
	A_t	.2907 (.0996)	.0075**	

Table B-5
Cross-Correlation of Advertising with Personal Consumption

Lag	-2	-1	0	1	2
Correlation	-.0755	.3201	.4063*	-.1298	.0963

Table B-6
Actual and Predicted Gross Advertising Expenditure
from Leading Indicator Model, Eq. 6
(in millions of dollars)

Year	Actual	Predicted	Residual	Residual/Actual (%)
1983	5311	5311.34	.34	.00644
1984	6000	6043.48	-43.48	-.0725
1985	6520	6599.27	79.27	1.2

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