An assessment of the role of advertising in the economic system offers the following benefits:

1. Advertising is a guide to prospective buyers — Information utility
2. Advertising influences primary and secondary demand for a product.
3. Advertising Stimulates product differentiation — Product utility
4. Advertising Stimulates introduction of new products — Encouraging innovation
5. Propensity to consume; and
6. Advertising Provides financial support to media

### Advertising Acts as Guide to Prospective Buyers

Information utility Advertising provides information. It provides information about products, their specifications, features, functions and prices to prospective buyers.

The consumer becomes knowledgeable of the various attributes of a product or service due to advertisements. Further, he is assumed to be aware of the product — price alternatives available to him and has well defined tastes and preferences and can determine his marginal rate of substitution for each product from among the possible alternative products involved in a particular [purchase decision](https://accountlearning.com/consumer-buying-behavior-types-of-consumer-involvement-in-purchasing/).

In real life, however, consumers are not so well informed. They have to rely on whatever information they can gather from various sources including advertisements. There can be little doubt about the genuine need for certain amount of information for making decisions about the purchase of products and exercise of choice between products and their substitutes among several brands.

### 2. Advertising creates Demand for a Product

The demand for a class of product as a whole may be termed primary demand and the demand for a particular company’s products as the selective demand.

Advertising may shift the demand for a class of products when the demand for that product is expansible, i.e., subject to increase through appeals to [consumers’ buying motives](https://accountlearning.com/characteristics-consumer-buying-motives/). In influencing the shape of the demand curve for any type or class of products, advertising may make the demand either more or less elastic.

If a company is able to shift its demand curve with the help of advertising, it will attain a larger share of the industry’s total sales unless the primary demand expands in equal ratio. If the product does not present a good advertising opportunity, it does not bring a change in a company’s demand schedule

Advertising has not only increases the [demand for some products](https://accountlearning.com/forecast-demand-new-products/) but has also changed the shape of the demand curve by the introduction of new products. In the early stages, there may be a relatively small and inelastic demand. Later, with aggressive advertising, public acceptance is built and other firms start imitating the product. Then the shape of the demand curve is altered.

Advertising tends, in some instances, to make the demand for specific brands of some products relatively price inelastic for varying lengths of time. If the brands have won the loyalty of consumers, they (consumers) may be expected to regularly use them, even when their price relationship with existing brands is disturbed.

### 3. Product Differentiation

Another factor affecting the firm’s capacity to influence demand is product differentiation. In product differentiation rests the opportunity to influence consumers to develop brand preferences. Products in which differentiation is not possible will not be affected by advertising.

Advertising playing a role in expanding the range of merchandise through the stimulation of product differentiation among brands has been much more direct than their influence in widening the range through new inventions of major nature. The desire on the part of producers to offer a variety of products under their [brand names](https://accountlearning.com/selection-of-trademark-or-brand-name-things-to-avoid/) has led them to continue experimenting with different combinations of desirable product qualities.

Technology has contributed towards developing new products which might gain consumer acceptance. It must be noted that artificial product differentiation based solely on advertising is fruitless. Rational economic considerations are probably more important elements of buying decisions than widely assumed.

### 4. Encouraging Innovation

Advertising encourages [product development](https://accountlearning.com/product-development-meaning-methods-categories-stages/) by informing potential buyers about the launch of new products or of improvements made in some products. In many situations, new product introductions require extensive research, development expenditure and substantial investment in production facilities. Advertising can help in recovering such expenses.

### 5. Propensity to Consume

Advertising affects the long-run propensity to consume by influencing tests, though it is doubtful that the effect could occur so rapidly as to affect spending over a [business cycle](https://accountlearning.com/business-cycle-meaning-features-characteristics/)

On the other hand, advertising might affect the short-run propensity to consume by informing consumers of bargains. A study shows that a 1% increase in [advertising expenditure](https://accountlearning.com/total-promotion-budget-methods-of-determining-budget-for-promotional-expenditure/) results in an average short term increase of 0.1% either in sales or market share.

In the long term, it was observed that a 1% increase in advertising was correlated with an average of 0.25% increase in the sales or market share. While advertising apparently created a preference for the advertised goods, the sales response to advertising did not rise in proportion to the increase in advertising expenditure.

### 6. Financial Support to Media

The major functions of the mass media are to provide education, entertainment and information to the audience. For example, the revenue from subscriptions of readers alone is quite inadequate to support the publication of newspapers and magazines. It is the advertisements that they carry bring them more revenue which enable newspapers and magazines to reduce their cover price

Selling of space or time by the media to advertisers is essential for the financial viability of the media. Availability of advertising revenue is a per-requisite for the growth of media through introduction of new media vehicles and for continuation of existing ones.

## ECONOMIC EFFECTS OF ADVERTISING

Advertising performs an economic function for an advertiser, and is an integral part of the whole economic system.

Questions have often been raised about the effects of advertising on consumer welfare and on the economy. Of late, this subject has assumed great importance due to a [growing consumer movement](https://accountlearning.com/reasons-for-slow-growth-of-consumer-movement-in-india/). A lobby of public opinion considers expenditure on advertising, wasteful, and an increase in advertising expenditure undesirable.

Advertising is closely linked with economic development of a country in the long term, considering that it can be a vital marketing input for any new product introduction. It can thus be a valuable aid in the process of market development. Economic growth is the outcome of expansion in demand on the one hand and augmenting of resources on the other

Advertising is also helpful in dissemination of technology. Economic systems are basically constituted over a series of transactions between individuals and organizations. The relevance of advertising may be seen at all stages of interface between a supplier and a buyer at a micro level and also in the macro-economic context.

### Advertisement a useful tool during recession

A study conducted reveals the utility of advertising in periods of economic recession. Recession, refers to periods of sluggish economic and industrial activity when the rate of growth of the market served is substantially lower than the long-term market trend.

An analysis showed that during recessionary period, average business houses recorded gains in their market shares, apparently at the expense of smaller competitors and those who were less willing to defend themselves.

However, during expansion period, however, some business houses had difficulty in meeting growing demand, thus allowing competitors an easier entry into the market.

### Advertising is regarded as a market power

Advertising is regarded as market power due to the following reasons.

1. Advertising affects consumer preferences and tastes, changes product attributes,  and differentiates the product from competitive offers.

2. Consumers become brand loyal and less price sensitive and perceive fewer substitutes for advertised brands.

3. Potential entrants must overcome established [brand loyalty](https://accountlearning.com/brand-loyalty-meaning-levels-of-brand-loyalty/) and spend relatively more on advertising.

4. Firms are insulated from market competition and potential rivals; concentration increases, leaving firms with more discretionary power.

5. Firms can charge higher prices and are not as likely to compete on quality or price dimensions. Innovation may be reduced.

6. High prices and excessive profits accrue to advertisers and give them even more incentive to advertise their products. Output is restricted compared with conditions of perfect competition.

### Advertising is viewed as an information guide

1. Advertising inform consumers about product attributes but does not change the way they value those attributes.

2. Consumers become more price sensitive and buy best “value.” Only the relationship between price and quality affects elasticity for a given product

3. Advertising makes entry possible for new brands because it can communicate product attributes to consumers.

4. Consumers can compare competitive offers easily and competitive rivalry increases. Efficient firms remain, and as the inefficient leave, new entrants appear, the effect on concentration is ambiguous.

5. More informed consumers pressure firms to lower prices and improve quality; new entrants facilitate innovation.

6. Industry prices decrease. The effect on profit’s due to competition and increased efficiency is ambiguous