Some firms benefit from increased spending despite recession

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During recessions, increased spending on research and development and on advertising can benefit certain types of firms and punish others, according to researchers, who identified the firm types that spend most effectively.

More than 10,000 firm-years of data from publicly listed U.S. firms from 1969 to 2008 -- a period that included seven recessions -- were examined by Gary L. Lilien, Distinguished Research Professor of Management Science, Penn State Smeal College of Business; Raji Srinivasan, University of Texas; and Shrihari Sridhar, Michigan State University.

The researchers found that during recessions, some firms overspend on R&D and advertising, some under-spend and others spend at the right level. To determine which types of firms are spending effectively, the researchers looked at how changes in R&D and advertising spending affect profits and stock returns for consumer services firms, consumer products firms, business-to-business products firms and business services firms.

They report in an upcoming *Journal of Marketing* that most business-to-business products firms have R&D and advertising spending levels during recessions that are at about the right level. Only 16 percent and 6 percent are over-spending on R&D and advertising, respectively, while 16 and 35 percent of them are under-spending on R&D and advertising. "However," the researchers noted, "many of these firms get positive stock returns to R&D spending (i.e., recessions are an opportunity for them) and negative stock returns to advertising."

About 96 percent of business services firms have about the right advertising levels in recessions.

The researchers found that the stock market rewards business-to-business products firms and consumer services firms for increases in R&D spending in recessions (29 and 42 percent, respectively) and for increases in consumer services firms' advertising spending in recessions (58 percent).

In some instances -- for example, R&D spending by consumer goods firms -- the stock market either does not reward or punishes virtually all firms for increases in R&D and advertising spending in recessions.

The researchers noted that in recessions, most consumer goods firms under-spend on R&D and are at about the right levels of advertising with respect to profits. Managers of these firms can consider increasing their R&D spending in recessions, which should increase their profits. However, consumer goods firms do not obtain positive stock returns from either R&D or advertising spending.

Most consumer services firms under-spend on R&D and over-spend on advertising with respect to profits during recessions. "Hence, these firms can consider increasing their R&D spending and decreasing their advertising spending in recessions to improve their profits," the researchers wrote.

More generally, the researchers found, with all else equal, in recessions the higher the firm's market share, the more an increase in R&D spending increases its profits while the more an increase in advertising spending decreases its profits. However, the higher the firm's financial leverage, the more an increase in advertising spending in recessions increases its profits. They found no comparable effect for R&D spending in recessions.

"Focusing on stock returns, the results are similar with respect to market share, i.e., the higher the firm's market share, the more an increase in R&D spending increases its stock returns while the more an increase in advertising spending decreases its stock returns," they wrote. "In addition, the effects of changes in R&D and advertising spending in recessions on firm performance vary across firms in different product-market profiles."

The researchers' results can be applied to firms outside the sample of those studied. Managers who wish to analyze their own R&D and advertising spending -- or that of their competitors -- can use the authors' models and approach to calculate the effects of their firm's expenditures both during recessions and in non-recessionary periods.

Provided by Pennsylvania State University

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