Impact of Advertising Expense on the Profitability of Banks: A Study on the Leading Banks of Pakistan

Ammad Arshad, Tahir Ali Karachi

University Business School, Pakistan

ammad7arshad@gmail.com

Abstract

Advertising has always been a crucial element in the uplifting of profitability in firms of every sector. The purpose of this paper is to investigate the impact of advertising expense on the profitability of banks in Pakistan. The research study utilized primary as well as secondary sources for data collection. This research focuses on five leading banks of Pakistan and data on their profitability and advertising expenditure from the year 2012 till 2021 was gathered from their financial reports for analysis. Two other instruments i.e., an online questionnaire and interview were also made use of in order to collect primary data. A total of 500 questionnaires filled by bank customers were included in the study to find out the impact of advertising on customers' purchase decisions and the Joint Director of the State Bank was also interviewed to develop a wholistic understanding of the variables and their impact on each other in the context of banking sector. The findings of this research indicated that advertising has a significant positive impact on the profitability of banks.

Keywords: Advertising, Profitability, Banking, Customers, State Bank of Pakistan

Introduction

Modern business tactics depend heavily on advertising, and the banking sector is no different. To reach new consumers, build brand awareness, and advertise their goods and services, banks spend a lot of money on advertising. The banking industry in Pakistan has grown significantly in recent years, and advertising has been essential to the profitability of banks. Previous studies have demonstrated the beneficial effect of advertising on banks' profitability. For instance, Chen et al. (2018) discovered that advertising is positively related to greater brand awareness and client acquisition, which improves banks' profitability. Another study by Kim and Lee (2015) discovered that banks with larger advertising expenditures are more likely to have higher revenue growth than banks with lower expenditures.

However, there is limited research examining the impact of advertising on the profitability of banks in Pakistan. The objective of this study is to fill this knowledge gap and investigate how advertising affects Pakistani banks' financial success. This article will review existing literature on the topic and present findings from the data collected to better understand the relationship between advertising and bank profitability in the Pakistani context. The article aims to provide insights for bank managers and marketers on how to effectively use advertising to enhance their profitability.

History of Banking

According to Richard Hildreth (2011), the first institution that can be considered a bank was the Chamber of Loans in Venice. This institution was formed during a time of war, when there was a shortage of funds and the government was looking for ways to make interest payments on forced loans. The Chamber of Loans started performing the functions of a bank, earning the label Bank of Venice. In the 15th century, Barcelona and Genoa established banks modeled after the Bank of Venice, and in the 17th century, the Bank of Amsterdam was established in the Netherlands to address the issue of currency depreciation. The Bank of Amsterdam later expanded to Hamburg and other free cities of Germany.

According to the book by Ranald Michie (2012), London became the hub of the banking industry and the center of payments for the global economy. In Asia, the banking industry was initially dominated by British banks, with the East India Company controlling international financial transactions before the arrival of British banks. However, after the first world war, banks from developing countries such as China also entered the international banking scene in Asia.

Pakistan also has a rich history when it comes to banking, with the establishment of the State Bank of Pakistan playing a crucial role in the country's financial system. The State Bank of Pakistan was established after independence in 1947 to address the country's weak financial system, and in the 1990s, the era of liberalization of banks in Pakistan began with favorable policies being implemented to promote the financial sector and strengthen the autonomy of the State Bank of Pakistan. In recent years, the number of commercial banks, microfinance banks, and Islamic banks has grown significantly in Pakistan. The SBP has also put in place a number of initiatives to support the banking industry, including tighter restrictions and the deployment of innovative technologies.

Research Methodology

This research aims to study the relationship of advertising expense with the profitability of banks in Pakistan.

Problem Statement

Advertisements if designed correctly can help show the value that a person expects from their bank like better interest rates, easy loans, and online banking which can result in the attainment of attention of the potential customer and also complete acquisition of the customer. Even people that already have accounts (with competitor’s bank) switch to the bank with the better services to offer. Advertisement is said to improve or establish the reputation and image of the banks which is why managers of banks similar to the managers of industrial firms see advertising as a tool that builds brand perception and shows the worth of the bank. For this very reason, effectiveness of advertisement is placed under the microscope to see what it actually does for the organization and in our case, for banks. This study aims to find out the relationship that advertisements have with the financial performance of the banks in Pakistan and also the total scope of this relationship if it actually exists.

Literature Review

Zhuravel (2018) conducted research on the marketing aspect of profitability management in the banking business. The aim was to identify areas in the banking industry that could be improved to increase efficiency and profits. The study included analyzing various financial, economic and psychological factors that could influence customers to use a specific type of financial services offered by a bank. The research found that the advertisement strategies used by banks play an important role in the management of profitability in the commercial banking sector. A well-designed marketing campaign is crucial for maintaining the financial stability of commercial banks. Another research by Wanninayake & Chovancová, 2019 studied the impact of advertising appeals on brand loyalty in the commercial banking industry in Sri Lanka. The study used a sample of 40 respondents selected through stratified sampling and collected data through self-administered questionnaires. The results showed that advertising had only a partial impact on consumer loyalty to commercial banks in Sri Lanka.

Moreover, Adrian Scutaru (2010) researched on the evaluating advertising effectiveness. The case study of the research was on the advertising campaign of Moldovan Bank. The data was collected through questionnaires from 500 people from different cities, and then another survey was filled out by 500 more people from different cities. The aim of the research was to determine which three media of advertising were the most effective, and the results showed that informational ads had a significant impact on consumers. Additionally, the research found that TV advertisements were effective in spreading awareness. Similarly, Mahamudul Hasan (2012) studied the marketing profitability metrics of first generation private commercial banks in Bangladesh. The study aimed to define marketing profitability parameters to assess the marketing efficiency of the banks. The research used data from the banks' annual reports and evaluated using SPSS software. The research found a positive relationship between marketing profitability and the banks' profitability. In light of the above discussion, we propose the following hypothesis for this study to investigate the impact of advertising.

H: High investment on advertising results in greater profitability of Banks in Pakistan.

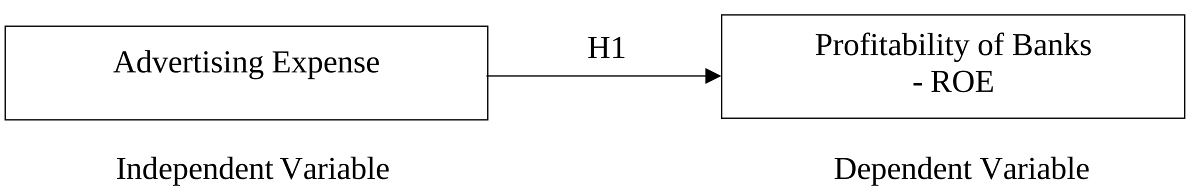

Figure 1: Research Model

Sampling and Research Instrument

For data collection, primary as well as secondary sources will be used. A close-ended questionnaire with a total of 12 items measuring the impact of bank advertisement on customers will be utilized and a total of 500 responses will be collected from bank customers with the help of convenience sampling. The collected data will be run through SPSS to calculate their mean scores and results will be analysed. In addition, a direct and unstructured interview of the Director of the State Bank of Pakistan will be conducted to get key insights on the topic. Finally, this research will also utilize secondary data for analysis. Advertising expenditure from the year 2011 till 2021 will be extracted from the financial reports of five banks namely, Habib Bank Limited, Meezan Bank, JS Bank, Alfalah Bank and MCB and analyzed for any indication of impact on the profitability of banks.

Advertising Expenditure and the Profitability of Banks

Advertising expense is the head that covers the expenses related to any kind of promotion of brand by a specific sponsor and through a media either social media, print media or digital media (Will Keaton, 2019). Some call advertisement an expense while today a large number of business analysts call it an investment. Advertisement has always been a major factor for influencing the growth and performance of any organization or institution. Studies have proven that advertisement is linked with variables representing profitability like brand awareness, customer perception, brand loyalty and all others (Doyle, 2000). In today's market it raises no eyebrows when we speak of advertisement as a necessity for an enterprise in order to evolve. The banking sector also like all other sectors is highly involved with advertising which goes to show the importance of advertisement not only in the fast-moving goods but also in the service industry like banking. Other industries have been put under the microscope and many researches have concluded how advertisement contributes to the profitability of that organization in terms of increase in sales, revenue and many other ratios that are accepted as determinants of profitability (Abdul Khalik, 1975).

Impact of the Profitability of Banks

In the context of previous authors' work, advertising is often considered as a key marketing tool for banks to increase brand awareness and attract new customers. The impact of advertising on bank profitability has been widely studied, with a focus on understanding the relationship between advertising expenditure and financial performance. A study by Adekanye and Adeyemi (2017) found a positive relationship between advertising expenditure and profitability of banks in Nigeria, suggesting that advertising can contribute to increased revenue. Another study by Shao et al. (2019) examined the impact of advertising on bank customer acquisition and found that advertising can significantly increase the number of new customers.

Previous Literature has shown that advertising can have a significant impact on the profitability of banks, but the extent of this impact depends on various factors such as targeting, medium, and execution.

Findings and Analysis

This study looks at the records and reports of five selected banks and examines the relationship between advertising expenses and return on equity. The data from ten years of annual reports is analyzed to understand the influence of advertising expenses on profitability. The research aims to determine if there is a positive, negative, or neutral relationship between advertising and profitability. The study will also focus on each bank individually to see the impact of their advertising expenses.

Habib Bank Limited

Figure 2 shows the relationship between advertisement expenses and return on equity (ROE) of Habib Bank Limited from 2012 to 2021 has been irregular, with

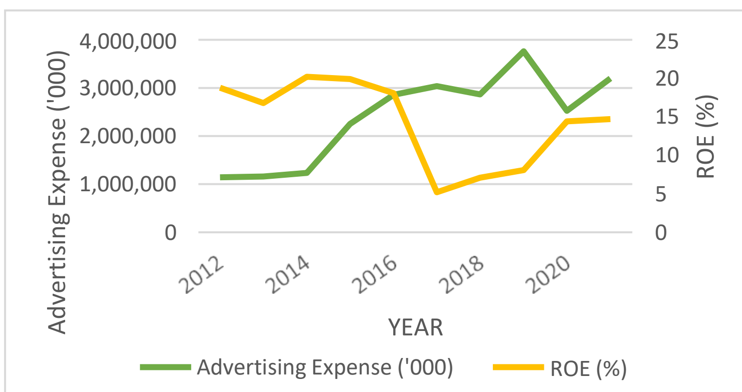

Figure 2: Advertising Expense by HBL

increases and decreases in both variables. Despite the increase in advertisement expenses each year, ROE was not consistently increasing and reached its lowest point in 2017. However, Habib

Bank Limited was able to recover and showed an increase in ROE in subsequent years, with a double increase in 2020 despite a decrease in advertisement expenses due to the COVID-19 pandemic. Despite reaching almost the same level of advertisement expenses as the all-time high in 2019, the ROE is still not at the highest level observed in 2014.

MCB

Figure 3 shows that MCB experienced a fluctuating trend in return on equity from 2012 to 2021, with a constant trend for three years before switching to a new trend. The data also shows that the advertising expense of MCB Bank Limited increased from 2013 to 2021. When comparing the impact of advertising expense on return on equity, the data shows a positive relationship between the two variables, but with a difference in the degree of change. The data shows that a decline in advertising expense in 2013 resulted in a slight decline in return on equity. In 2014, an increase in advertising expense led to an increase in return on equity. However, from 2015 to 2018, an increase in advertising expense had a negative impact onreturn on equity. From 2018 to 2021, although MCB Bank Limited continued to increase its advertising expense, the return on equity started to increase, resulting in a positive relationship.

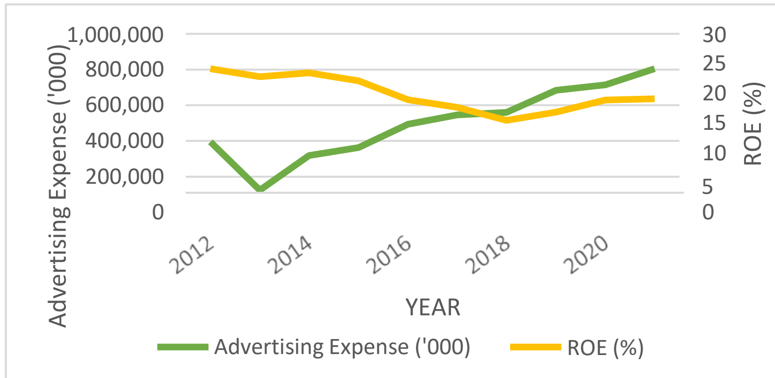

Figure 3: Advertising Expense by MCB

JS Bank

JS Bank started operations as a commercial bank in 2012 with a relatively small market share of 8.7% compared to other established

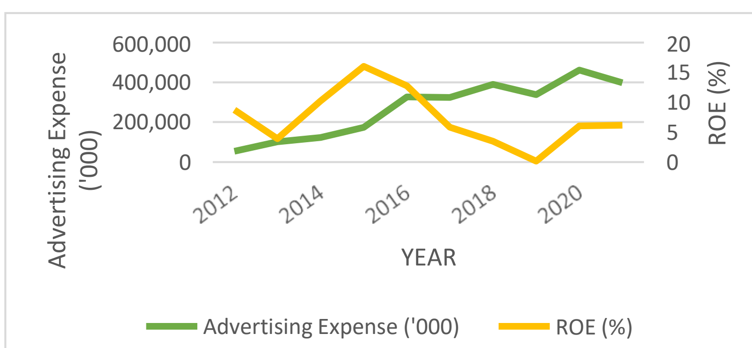

Figure 4: Advertising Expense by JS Bank

banks in Pakistan In order to increase market share, JS Bank increased its advertising expenditure in 2013 (as shown in Figure 4) to more than double the previous year. Despite the increase in expenditure, the bank saw a drop in its return on equity in that year. In 2014, JS Bank continued to increase its advertising expenditure and finally saw an improvement in its return on equity, which reached a record high of 16%. However, the bank's return on equity started to decline in the following years, reaching a low of 5.84% in 2017, despite maintaining similar advertising expenditure levels.

Bank Al Falah

As shown in Figure 5, Bank Al-Falah had a 19.46% return on equity in 2021, ranking second among the three banks discussed. In 2014, the bank reduced its advertisement expenditure, resulting in a decline in return on equity. However, in 2015, the bank increased its advertisement spending, resulting in a 19.46% return on equity, close to its all-time high. Despite increasing its advertisement spending in 2016, the bank saw a decline in return on equity. In the following years, the bank reduced its advertising expenditure, but saw a decline in return on equity. The bank experienced its lowest return on equity in a decade in 2020 due to the COVID-19 pandemic. In 2021, the bank's return on equity bounced back to the consistent percentage seen before the pandemic.

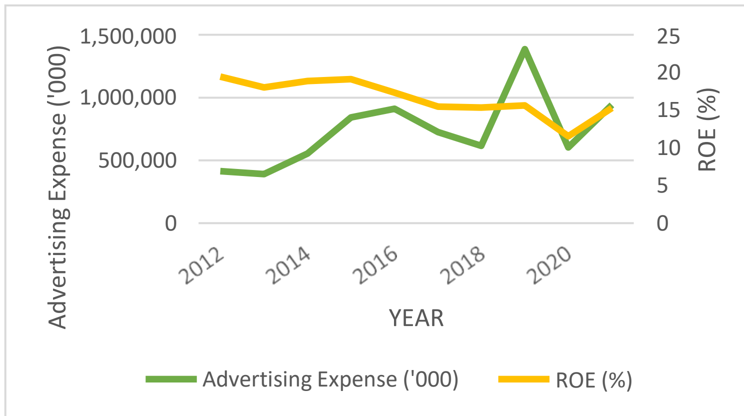

Figure 5: Advertising Expense by Bank Al Falah

Meezan Bank

Meezan Bank is the first Islamic Bank In Pakistan and has a strong brand recall and recognition. It started operations in 2002 and has a high return on equity compared to other top five banks in the country. In 2012, it had a return on equity of 24.34% (as shown in Figure 6) and a low advertising expense of 77,845,000 rupees. From 2013 to 2017, the return on equity declined while advertising expense increased. However, in the past four years, Meezan Bank's return on equity has been higher than other top five banks including HBL, Bank Al-Falah, MCB and JS Bank

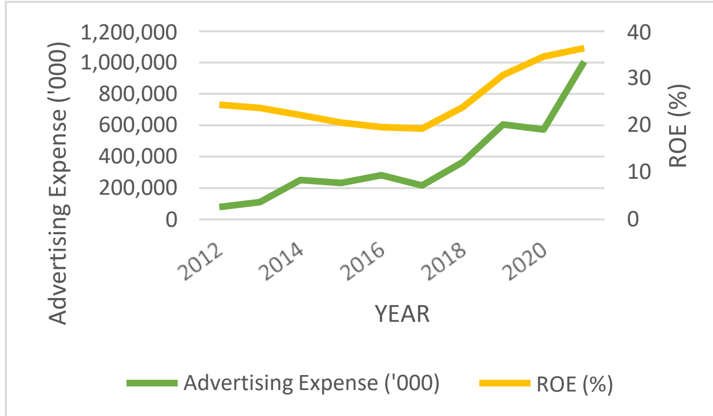

Figure 6: Advertising Expense by Meezan Bank

To conclude, the relationship between advertising expenses and return on equity of five banks in Pakistan over a period of ten years is irregular. The COVID-19 period in 2019 to 2020 showed a pattern where HBL & Meezan Bank dropped their advertising expenses and saw an increase in return on equity while MCB Bank Limited and JS Banks increased their advertising expenses and also recorded an increase in return on equity. Bank Al-Falah faced a dip in the return on equity after decreasing their advertising expense. The relationship between the two variables is not clear and primary data is needed for a better analysis. The banks that increased their advertising expenses over a period of two to four years saw an increase in return on equity, but the impact is delayed and irregular.

Opinion of Bank Customers

An online questionnaire was shared with the customer of the five selected banks. 59.2% of the respondents were women and the remaining were men whereas majority of the respondents belonged from the age group of 26-30 with a percentage of 39.4% In order to avoid biasness or unequal representation in the data collected, 100 customers from each of the selected bank were made part of the study and a total 500 responses were obtained. The questionnaire consists of a total of twelve items that the respondents had to mark on a Likert scale ((i.e., -2= Strongly Disagree, -1 = Disagree, 0=Neutral, 1=Agree, 2=Strongly Agree.) which helped us to individually look into each question by calculating their means.

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
The advertisements of banks give me proper product knowledge.	500	-2.00	2.00	.5220	.66211
Banks ads convince me of the benefits of their products.	500	-2.00	2.00	.6560	.74214
Advertisements of banks are enough to make me understand about their product.	500	-2.00	2.00	.4380	.74785
I remember the last bank advertisement I saw.	500	-2.00	2.00	.6320	.91117
When I see a bank's ad, I recommend that bank to others.	500	-2.00	2.00	-.1600	.86943
I have a positive image of the banks that are advertised more.	500	-2.00	2.00	.8780	.62602
The advertisements of banks help me in choosing my brand of preference.	500	-2.00	2.00	.8260	.68459
Bank ads are interconnected and follow a theme that helps me build a brand image.	500	-2.00	2.00	-.1000	.85291
I trust the banks that are advertised.	500	-2.00	2.00	.8960	.61477
I have considered switching to other banks after watching the services shown in their ads.	500	-2.00	2.00	.6520	.81745
I prefer banks that are advertised.	500	-2.00	2.00	.9020	.62704
My willingness to become a bank's customer gets high after watching its advertisement.	500	-2.00	2.00	.7440	.75605
Valid N (listwise)	500				

Figure 7: Descriptive Statistics

Figure 7 shows that mean score of the sixth and seventh items are 0.8780 and 0.8260 respectively hence customers strongly believe that they have a positive image of a bank as a corporate entity if that bank is advertising more to connect with the target audience and trial generation is also linked to advertisements as they would prefer a bank that advertises more frequently. Similarly, the mean of score of the ninth and eleventh items are 0.8960 and 0.9020 which means majority of the customers trust the brands that are advertised more and advertisements also increased their preference towards the advertised bank. On the contrary, the fifth and eighth items of the questionnaire achieved the lowest mean scores of -1.6 and -1.0 respectively which shows that advertisements alone are not enough for customersto make them refer the brand to others and the respondents also feel that advertisements of banks do not usually follow the same theme which results in a confused image of the advertised brand inthe mind of the customers. The combined mean as shown in Figure 8 is 0.5525 which shows that advertising have a moderate to strong impact on profitability of banks. This means that that most of the customers agree that bank advertisements have a positive impact of their purchase decision which eventually can result in increased profitability of banks. In light of the results of this data, we accept our hypothesis which states that high investment of advertisements can result in greater profitability of banks in Pakistan.

Descriptive Statistics

	N	Mean
Average Mean	12	.5525
Valid N (listwise)	12	

Figure 8: Combined Descriptive Statistics

Opinion of Joint Director of SBP

An online interview was conducted of Mr. Naveed Ahmed who is the Joint Director of The State Bank of Pakistan to help understand our variables and their impact in a more prolific and wholistic way. A total of five questions were asked regarding the topic. Being the Joint Director of a regulatory body that is the State Bank of Pakistan, Mr. Naveed Ahmed clearly understands the operations of banks as well as the factors that the consumers find most relevant and attractive when it comes to the deposit of their most valued asset that is money.

The thought behind the structuring of the questions was to get a particular view on the variables we have chosen as well as a wholistic view to identify the limitations and the prospects that future researches can pull out from the interviewee's opinion. First, we got to know very clearly that advertisements do have an impact and are beneficial for the banks of Pakistan but the means or the mediums used can vary from bank to bank and model to model. It was also found out that the way advertising expense reflects on the selected variable of profitability varies and some profitability measures might have an early response to this expense and some might see a response even later than ROE which is the one that our study focuses on. But the main element that is to be extracted here is that investment on advertisements does reflect on all variables of profitability no matter the time it takes.

As per the interviewee, no one size fits all organizations and for advertisement to be successful, a careful study on the banking institute is of paramount importance. Advisement will impact none the less but whether this impact will be a positive, negative or neutral may dependon the advertising mediums, frequency, target audience and many more other factors of the market.

Conclusion

The research aimed to investigate the relationship between advertising expenses and the profitability of banks in Pakistan. To gather data, both primary and secondary sources were utilized. The analysis of secondary data indicated a correlation between advertising expenses and profitability, but the pattern was found to be random. On the other hand, the primary data collected through questionnaire and interviews showed that advertising expenses had a positive impact on the profitability of banks. Moreover, the Joint Director of SBP also suggested during the interview that variables such as Net Income Margin and Total Deposits will be more suitable variables of bank performance and profitability if advertising impact is to be studied.

Limitations and Recommendations

In light of the results of our study, banks are advised to spend on advertising as it has a positive impact on profitability. However, selection of the right channel and medium for advertising is important to effectively reach the target audience and support the overall business goals. Secondly, banks should also explore digital channels, as these are increasingly becoming a preferred means of communication for consumers.

Despite positive results, this research was subjected to a number of barriers which must have impacted the findings and results of this study. Time was one of the main constraints as data of only five banks could be extracted in the given time. Similarly, only 500 responses from bank customers were received and involved in the study. If data was collected from more banks or respondents, the number of observations would have increased which might have improved the accuracy of the results. The research also lacks diversity in terms of banks as Islamic banks and other micro finance banks were not included which future researchers can explore to further expand the scope of the study.

References

Adekanye, O., & Adeyemi, O. (2017). Advertising and bank profitability: evidence from the Nigerian banking industry. *Journal of Economics and International Finance,* 9(6), 141-148.

Chen, Y. S., Chen, M. S., Lee, C. C., & Fang, W. T. (2018). The impact of advertising on financial performance of banks: Evidence from Taiwan. *International Journal of Bank Marketing*, 36(4), 365-376.

Doyle, P. (2000). Value-based marketing: Marketing strategies for corporate growth and shareholder value. John Wiley & Sons.

Hasan, M. (2012). Measuring marketing profitability metrics of first generation private commercial banks in Bangladesh. *Journal of Marketing, 15*, 267-286

Hildreth, R. (2011). The history of banking. Journal of Banking and Finance, 35(8), 2074-2082.

Keaton, W. (2019). The role of advertising in modern business. Marketing Review, 19(2), 123- 129.

Kim, J. B., & Lee, J. (2015). The effect of advertising on the profitability of banks: Evidence from Korea. *Asia Pacific Journal of Marketing and Logistics*, 27(1), 21-40.

Michie, R. (2012). The London Market for Money and Finance in the Twentieth Century. Cambridge University Press.

Scutaru, A. (2010). *Evaluating advertising effectiveness: the case study of moldovan bank advertising campaign* (Doctoral dissertation, MA Thesis, Central European University, Department of Economics)

Shao, J., Chen, J., & Li, X. (2019). The impact of advertising on bank customer acquisition: Evidence from China. *International Journal of Bank Marketing*, 37(4), 561-576.

Wanninayake, W. M. C. B., & Chovancová, M. (2019). Impact of advertising appeals on brand loyalty: special reference to the commercial banking industry in Sri Lanka. *Innovation and Knowledge Management Journals*, *4*(5), 1222-1239

Zhuravel, V. (2018). Marketing aspects of profitability management of the banking business. *Іншомовна компетентність–платформа професійного розвитку в XXI столітті: збірник матеріалів IV Міжнародної науково-практичної студентської конференції для студентів немовних спеціальностей: Житомир, 18 квітня 2018 р./за заг. ред. НМ Андрійчук*

Appendix: Interview Questions

Q1. How do you think advertisement has impacted the banking industry of Pakistan in the past decade?

Q2. Do you think that banking being a serious industry should be using humor in their ads or will it backfire?

Q3. Which variable do you think other than advertisement expense impacts a bank’s profitability and why?

Q4. We have taken ROA as the representative of profitability for this study do you think that it is the best variable to be the representative of profitability? If not which according to you is the best representative of profitability?

Q5. If we ask you the list such factors that might have been more crucial and we missed so that we can identify the limitation that comes from our choice of the variables and a future study might benefit from keeping those aspects in to account. What would those factors be?