

The Economic Impact Analysis of Advertising in the Republic of Kosovo

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Abstract

The study aims to analyze the economic impact of advertising in the Republic of Kosovo. This aim is achieved through (1) an analysis of the direct effects of advertising on the economy (the impact of advertising on company sales and the impact of advertising on customer brand loyalty); and (2) an analysis of the indirect effects of advertising on the economy that includes an analysis of the impact of advertising spending on the profitability of banks in Kosovo. This section includes an analysis of the eight largest banks in the country and the data used cover the period 2011-2018. The study findings speak of a significant positive impact of advertising on the economy of Kosovo, both directly as well as indirectly. In general, companies spending more on advertising, achieve better financial performance, such as higher sales and higher profitability and thus they have a positive impact on the relevant industry and the economy in general.

Keywords: Advertising, Advertising Spending, Economic Effects, Sales, Profitability.

Introduction

In terms of advertising, it can be claimed that it is a prominent feature in economic life. Advertising reaches consumers through television, radio, newspapers, magazines, mailboxes, emails, etc. It is not surprising that spending in advertising continues to be enormous from year to year.

Since it has existed, advertising has had a great role and impact on the economy of a country, thus affecting many of the most important macroeconomic components. However, it is surprising how economists of the 19th century, and even earlier, have paid so little attention and importance to the study of this field. The study of advertising from an economic point of view is entirely a step taken in the 20th century. The reason why advertising was not analyzed from an economical perspective before the 20th century may be because 19th century economic research was primarily focused on developing a theory of perfect competition, and at that time such a theory did not envision a role for advertising. Specifically, the analysis of advertising from an economic perspective began with Marshall (1890, 1919) and then continued with Chamberlin (1933), thus making the second half of the 20th century show a rapid advancement in economic analysis of advertising.

Perhaps the main role of advertising in the economy is related to the advertising spending, or in other words to the expenditure incurred by companies to advertise the products/services they offer. It is quite simple to argue that this part of organizational investment would not exist if the advertising industry through which products and services are promoted did not initially exist. In many aspects it can be stated that the advertising industry is the backbone of a large part of the economy, influenced by

spending in advertising.

Therefore, it all starts with the advertising spending and its role within the company. Practice and theory have proven the positive impact of advertising spending on the financial performance of companies. Advertising spending is positively correlated to financial performance, specifically to sales and profitability of companies that spend on advertising.

In a capitalist economy, the profitability of companies plays an important role in creating incentives for businesses and entrepreneurs. For an existing company, profitability means encouraging and urging the company to develop new products, thus positively affecting the overall profitability of the respective industry. A profitable industry means an industry that encourages the introduction of new ventures into it. In other words, the profit made by companies is the blood a country's economy lives on. By achieving profitability, a company ensures its survival and continuous growth in the market, thus affecting the country's economy as well. Therefore, an analysis of advertising in relation to sales and profitability of companies implies an analysis of the role and impact of advertising on the economy in general.

1. Literature Review

The analysis of advertising from an economic perspective began with Marshall (1890, 1919) and then continued with Chamberlin (1933), thus making the second half of the 20th century show a rapid advancement in economic analysis of advertising. The end of the 20th century brought a rich and essential body of literature on the analysis of advertising in economic terms. According to Marshall (1890, 1919), advertising can play a constructive role by conveying information to consumers about the location of products, and can also convey pre-purchase information about the functions and qualities of products. He also stressed that advertising can play a combative role, which means that advertising aims to transfer consumers from rival firms to the advertising firm. Despite his excellent work, Marshall failed to formally integrate advertising into economic theory. This was done by Chamberlin (1933) with his theory of monopolistic competition (Bagwell, 2005). According to Chamberlin, companies within a certain industry sell differentiated products which means that each company faces a downward-sloping demand curve, and thus possesses monopoly power. Chamberlin points out that the use of advertising by companies helps them further differentiate their products which will serve them to expand the market. So, when a company invests in advertising, it means that it expects growth in demand, market expansion and consumption growth, and when all this is achieved, then it is impossible not to talk about the impact on the economy as a whole.

2. The Direct Economic Effects of Advertising in Kosovo

In terms of the advertising industry, Kosovo is characterized by a complex media environment, with a plethora of media channels, which have limited sources of funding, and thus advertising plays a very important role in the survival and successful operation of such media. Although advertising is becoming increasingly

important in the Western Balkans, in Kosovo, private media in particular suffer low revenues from advertising. In terms of the public media advertising revenue is not too important due to the fact that they receive large amounts of revenue from the state budget. Thus, although the advertising market in Kosovo is limited, the number of advertising companies is increasing and the quality of advertising depends on the client. International companies operating in Kosovo, such as banks and insurance companies, produce better and more advertisements than local companies. However, any advertisement that is broadcast in any of the media must comply with the rules set by the IMC (Independent Media Commission).

In fact, every advertisement has a certain effect, which may be positive or negative. And when talking about the effects of advertising, we are dealing with different categories, where the effects on the economy of a country are the most disputable and mostly of interest to be reviewed currently. The effects of advertising on the economy consist of direct and indirect effects. Among the direct effects the most important and worth mentioning are the impact of advertising on company sales and the impact of advertising on brand loyalty. In the following paragraphs, we will discuss these two points separately with a special focus on Kosovo.

1.1. Advertising spending and companies' sales

It was the beginning of the 70-s that brought a considerable number of statistical studies which explained the sales and market share of companies through advertising, but also through some other variables (Bagwell, 2005). Although such studies were characterized by various limitations, in a way they marked the beginning of the analysis of relationships between advertising and sales in a company. In continuation of the advertising-sales analysis, we cannot help but mention Lambin (1976) who used data on sales, quality, price and advertising for 107 brands of 16 different categories in 8 different Western European countries. Through this study he concluded that changes in advertising spending of a brand, affect the actual sales of such brand but also of rival brands. In addition, whenever we talk about advertising and its direct effects, we should mention the early opinion of Braithwaite (1928), who claimed that advertising can have lasting and long-term effects even on a company's reputation.

In our specific case, in order to analyze the relationship between advertising and companies' sales in Kosovo, we analyzed a total of 5 categories of brands (banks, micro-financial institutions, insurance companies, furniture stores and super-markets), resulting in 24 brands in total. All selected brands within each category have different market positions, and they also have different marketing features which add value to these findings.

By using brand websites and other online resources, general information was obtained such as: number of employees, year of establishment, type of founding capital and local presence at the city level. On the other hand, we made use of certain financial reporting rules from the "Financial Reporting Council" in Kosovo that require all financial institutions and limited liability companies to publish financial statements every year. Such financial statements were used to extract information related to advertising expenditure in the last three years, brand value, sales and net profit of each of the brands included in the study.

Further, information was collected on each brand regarding the number of followers

on social networks, the number of posts on each of such networks and also the Google search trend through "Google Trends". In addition, information on TV campaigns was collected by counting advertisements prepared to appear on TV in the last month before the survey. Finally, information on the intensity of presence in the six main portals (Gazeta Express, Telegrafi, IndexOnline, Blic, Insajderi and Koha Net) was collected, by counting the number of articles sponsored in the last month before the study.

In terms of advertising expenditure, as expected, the biggest brands with the highest level of sales are those that spend the most on advertising whether in relative or absolute terms. Our sample of brands is dominated by supermarkets in terms of the amount of money spent on advertising, this category spends on average more than 1 million Euros on advertising, specifically Viva-Fresh and ETC are the largest spenders in this regard with about 1.7 million and 1.4 million respectively. The second category by level of advertising spending are banks with average spending of about 500 thousand Euros in 2019, the largest spender within the category is Raiffeisen Bank with about 1.2 million followed by ProCredit bank with 595 thousand and so on. Advertising spending in other brands are heterogeneous and there is no clear trend within the category, therefore advertising spending appear to be motivated by internal company characteristics (such as managers' attitudes towards advertising) which we have no information on (Table 1).

Table 1. Advertising Spending and Companies' Sales in Kosovo

Brand	Advertising	Company's sales
	Spending	
	t-1 (000)	(000)
Banks		
BpB	225	14.821
Banka Ekonomike	220	16.020
Raiffeisen bank	1242	44.677
Pro-Credit	695	29.512
TEB	551	30.650
NLB	254	36.788
BKT	272	21.300
MFI (micro-financial institutions)		
KEP	126	9.403
AFK	.	.
Finca	237	10.712
KRK	82	7.016
Insurance Companies		
Scardian	65	10.071
Sigal	423	10.509
Illyria	50	10.320

Furniture Stores

Binni	51	8.394
Berto	47	3.254
Palma	132	4.966
Walker	.	.
Mobin	.	.

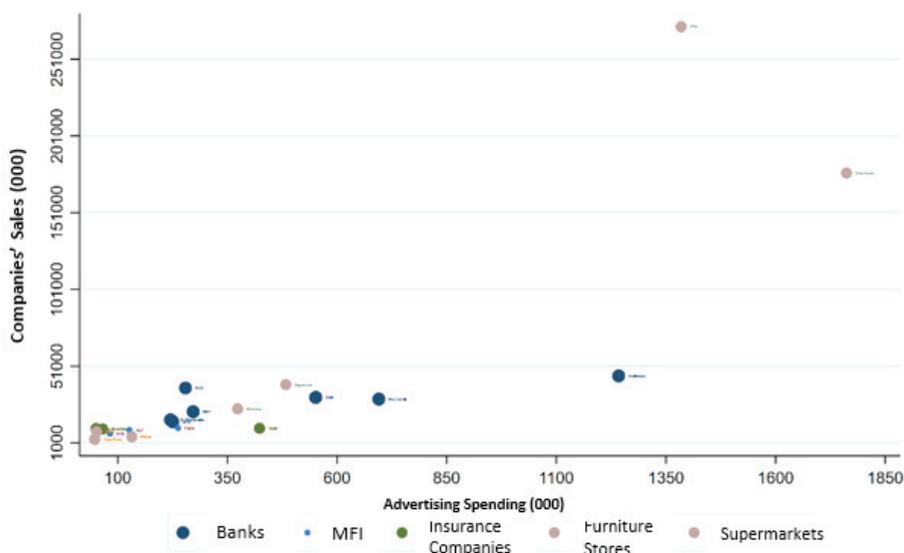
Supermarkets

Interex	483	38.987
Superviva	483	38.987
Viva Fresh	1762	176.842
ETC	1385	272.156
Meridian	373	23.191

Total	434	38979
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On basis on this finding, it can be said that advertising has a direct impact on the economy of Kosovo, through the impact it has on company sales (also illustrated through Chart 1).

Chart 1. Advertising Spending- Companies' Sales relationship



1.2. Advertising Spending and Brand Loyalty

According to the persuasive view, one of the direct effects of advertising is to build brand loyalty (Bagwell, 2005). The relationship between advertising and brand loyalty

was also analyzed by Lambin (1976) who captures brand loyalty with a measure of consumer inertia. However, despite all his efforts, Lambin fails to find a significant positive relationship between advertising and brand loyalty or, as he describes it, between levels of brand inertia and brand advertising intensity. Apparently brand loyalty is more related to the brand price and quality than brand advertising. This was also supported by Landes and Rosenfield (1994) and Thomas (1989), according to whom, brand loyalty is more related to brand-specific factors such as product quality, rather than advertising in particular.

In the case of Kosovo in terms of the impact of advertising on brand loyalty, a study was conducted where advertising was analyzed in the context of perceived advertising spending and on the other hand brand loyalty was analyzed as the tendency of consumers to continue buying and using the advertised brand in the future (Zejnnullahu Pllana, 2021). The results concluded that advertising spending has an indirect effect on brand loyalty, with customer orientation and perceived quality as variables with a mediating role in such impact. This study has included only the banking sector in Kosovo and in summary it can be said that advertising spending affects brand loyalty by improving the perceived service quality of the customer, as well as through influencing the orientation of the customer who is interested and accepts banking services (Zejnnullahu Pllana, 2021).

3. The Indirect Economic Effects of Advertising in Kosovo

The following paragraphs will provide a discussion of the indirect effects of advertising on the economy of Kosovo. Specifically, the relationship between advertising spending and company profitability will be analyzed and discussed.

When talking about the economic aspect of advertising in Kosovo, we should mention the fact that the advertising industry in Kosovo is one of the industries with the least data available. In particular, there is lack of data on advertising spending iv the national level, and this is one of the biggest handicaps of the economic analysis of advertising in Kosovo. However, seeing the importance of company profitability in the economy of a country, the analysis of the indirect effects of advertising on the economy of Kosovo will be performed through an analysis of the advertising spending -profit relationship.

The main finding of a study conducted by Comanor and Wilson (1967, 1974) is that there is a strong and positive relationship between advertising intensity and company profitability in the consumer goods manufacturing industry in the USA. Unlike Comanor and Wilson, the study on the relationship between advertising and company profitability in Kosovo was conducted in the services sector, specifically in the banking sector. Although we often see in literature that the advertising-profit relationship is a weak or often even negative one for the services sector and the retail sector (Bagwell, 2005), in the case of Kosovo we focused the study on the banking services sector and we have very interesting findings discussed as below.

3.1. Advertising spending, bank profitability and the country's economy

Researchers support two schools of thought regarding the effects of advertising

on company profitability. In the first school of thought (industrial economics), advertising is regarded as a factor of product differentiation. It has been argued that advertising affects company profitability through product differentiation (Caves and Williamson, 1985), and through the creation of entry barriers for new companies in the respective industry. The other school of thought is focused on the informative character of advertising, claiming that advertising makes markets more competitive, and reduces company profitability by providing consumers with useful information on price and quality (Greuner, Kamerschen and Klein, 2000).

Researchers have highlighted two main channels in particular through which banking profitability can affect economic growth: (a) financial stability and (b) competition between banks.

Financial stability can affect economic growth through high profitability of banks, because profitable banks mean that they continuously increase revenue, increase their core capital and provide higher returns to shareholders (Flannery and Kasturi, 2008). High company profitability increases financial stability in the country (Claeys and Schoors, 2007). Also, in terms of bank assets, banks with higher profitability may be more resistant and resilient to external environmental risks, as they have more to lose (Keeley, 1990). However, it should be noted that the view that financial stability impacts economic growth has been criticized by many researchers. Tornell and Westermann (2008) have argued that countries characterized by occasional financial crises enjoy greater economic growth than countries with stable financial systems. Therefore, it cannot be stated with complete certainty that the profitability of banks impacts economic growth of a country, through promoting financial stability.

The second channel through which bank profitability can impact economic growth is competition. Low competition in the banking industry increases banks' profits (Goddard, Molyneux and Wilson, 2004), but raises financing barriers for companies (Beck, Demirgüç-Kunt and Maksimovic, 2004). Therefore, when the banking sector is characterized by a high number of banks which are in constant competition with each other, then we see facilitated lending to finances businesses that make up the economy of such country, among others. This is considered to provide a boost for business development, and by default it affects a country's economic growth.

Therefore, advertising not only positively affects the profitability of financial institutions, especially banks, but it can also be used as a tool through which the banks build relationships with their customers, improve their image and thus can reduce the perceived risks (Callcott and Lee, 1994; Fugate, 1998). This means that it has been scientifically argued that the bank's image and profitability go hand in hand, and nothing like advertising can positively influence both together (Worcester, 1997; Lun, 2004). In addition, there is a strong positive relationship between profitability and advertising intensity of an bank (Bloch, 1974). This means that there are many studies which prove that advertising has a long-term effect on company sales and thus also on their profitability (Neriove and Waugh, 1961), (Telser, 1962), (Palda, 1964), (Lambin, 1970), and (Peles, 1971).

In terms of our specific case, the banking sector in Kosovo is considered to be a success story. The first post-war bank was established in 2000, and since then the banking system in Kosovo has only grown further. In all sector analyzes so far, it is quite clear

that the banking sector in Kosovo is increasing its profitability day by day, and is becoming stable in the face of economic developments in the region and the world. The banking sector in Kosovo is stable, it has a high level of liquidity, and is quite profitable. Such performance can only be considered to be a positive factor in the overall development and growth of the local economy. In addition, banks in Kosovo are always ranked in the group of companies with highest spending on advertising.

3.2. *Data used in the study of the effects of advertising spending on bank profitability*

When analyzing the advertising spending -profit relationship, eight out of ten existing banks in Kosovo were included in our case, as follows: ProCredit Bank, Raiffeisen Bank, NLB Bank, BPB, Banka Ekonomike, Banka Kombetare Tregtare, KEP Bank, and TEB Bank. The analysis covers the period 2011-2018.

Regarding bank profitability in the period 2011-2018, and referring to Table 2, we can say that during this period the banking sector was characterized by good financial performance while maintaining a high level of profitability. From what is visible in the table, it is worth noting the decline by 48.7 percent^o in banking sector profitability in year 2012. This decrease was due to the slowdown in the annual growth of total revenues and it should also be mentioned that three of the eight banks and bank branches, which operated in Kosovo throughout 2012, recorded negative performance. Further, it should be noted that 2015 is the year when the banking sector in Kosovo recorded the highest value of profit recorded since the beginning of the sector's operation (94.7 million euros). This increase came as a result of significant reductions in spending in the banking sector. Further to this, throughout 2016, 2017, and 2018 the banking sector continued to be characterized by good financial performance, maintaining a high level of profitability.

Table 2. Net profit of the banking sector in Kosovo (2011-2018), (in million euros)

Years	2011	2012	2013	2014	2015	2016	2017	2018
Net profit	37.0	18.5	26.0	60.1	94.7	75.5	85.4	88.0

Source: CBK Annual Reports (2011-2018), and CBK monthly bulletins

Regarding advertising in the banking sector in Kosovo, from a general analysis we can say that all banks included in the study have a separate budget for advertising. As advertisements for banking services are quite frequent, especially in television media, this has created the perception that banks spend a lot on advertising banking products and services.

Referring to Table 3 we can see that 2011 and 2012 are the two years when advertising spending was the highest compared to all other subsequent years of the study period (in 2011, advertising spending in the banking sector was € 6.8 million and in year 2012, it was at € 7.2 million). Further on, advertising spending continually decreases, such that in 2018 these expenditures were twice as low than they were in 2011 (2018: € 3.2 million).

Advertising expenses are just one of the items included in administrative expenses in

the financial statements of banks. From an analysis of the ratio of such expenditures we see that advertising expenditures account for only 5.7 percent of administrative expenditures and only 3 percent of total expenditures of the banking sector in Kosovo. Such percentages reveal that insignificant importance is given to advertising in this sector. Thus, banks focus on spending money in other areas leaving advertising with the least investment. It is worth noting that in 2018, advertising spending accounts for only 1.9 percent of the total spending of the banking sector in Kosovo. The best situation was recorded in 2013, where advertising spending accounted for 8.2 percent of administrative expenditures and 3.7 percent of total expenditures of the banking sector in Kosovo.

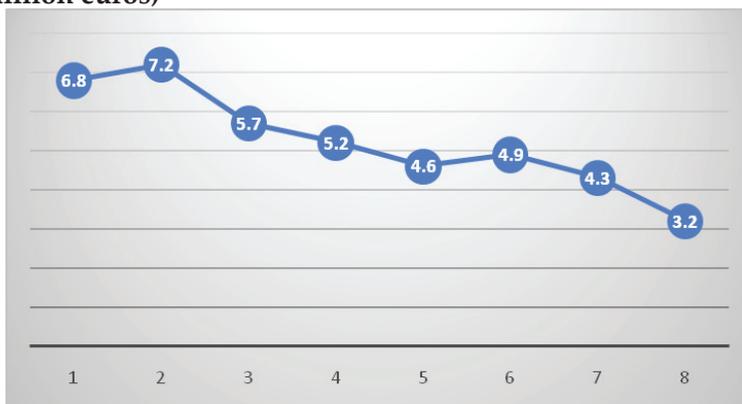
Table 3. Advertising Spending in the banking sector in Kosovo (2011-2018), (in million euros)

Years	2011	2012	2013	2014	2015	2016	2017	2018
Total expenses in the banking sector	198.8	224.6	152.2	184.2	143.5	155.6	155.8	164.5
Administrative expenses in the banking sector	97.2	102.4	69.5	86.3	74.7	94.1	94.4	108.8
Advertising expenditures in the banking sector	6.8	7.2	5.7	5.2	4.6	4.9	4.3	3.2
Advertising expenses as a percentage of total expenses	3.4%	3.2%	3.7%	2.8%	3.2%	3%	2.7%	1.9%
Advertising expenses as a percentage of administrative expenses	6.9%	7%	8.2%	6%	6.15%	5.2%	4.5%	2.9%

Source: CBK Annual Reports (2011-2018), Annual Reports of banks included in the study (2011-2018), author's calculations

The trend of advertising spending in the banking sector in Kosovo for the period 2011-2018 is best illustrated through Chart 2, where it is clearly visible that such spending shows a downward trend.

Chart 2. Trend of advertising spending in the banking sector in Kosovo (2011-2018), (in million euros)



Source: Annual Reports of banks included in the study (2011-2018), author's calculations

3.3. Study Methodology of the Relationship Between Advertising Spending and Bank Profitability

Based on a literature review, a hypothesis was formulated which will be tested by performing the following procedure.

H1: Advertising spending of banks in Kosovo have a positive effect on the profitability of banks.

Initially, fixed-effect and random-effect models will be assessed, followed by the Hausman test to select which of the two models used supports the data under consideration. The Hausman test is also done in order to identify the model based on which results are interpreted.

The dependent and independent variables were entered into a logarithmic regression. The reasons for using the natural logarithm of a continuous positive variable instead of its form in a regression analysis are as follows:

- From an economic point of view, the interpretation of marginal effects in the case of log transformed variables is elasticity.
- Log transformed variables are less sensitive to extreme observations which can affect the estimated regression coefficients yielding shifted and often misleading results.
- Log transforming variables helps to increase the probability for a variable to have a normal distribution and also for the error term of a regression to have such distribution, which is one of the assumptions of classical linear regression.

4. Empirical findings

Before starting with an analysis of the variables used in this study, the Pearson correlation coefficient was calculated. The interpretation of correlation bond strength is made according to Dunn (2001), who recommends that a correlation coefficient below 0.20 indicates a very weak, almost negligible correlation. A correlation coefficient in the values between 0.20 - 0.39, is a weak but significant correlation. A correlation coefficient in the values between 0.40 - 0.59 is considered to be a moderate correlation which means stable relationships. Then, a correlation coefficient between 0.60 - 0.79 indicates a strong correlation between the variables, while the correlation coefficient 0.80 - 1.00 indicates a very strong dependency relationship between the variables. In the case of the correlation between variables for advertising spending made by banks make and their profitability, we are dealing with a Pearson correlation coefficient of 0.681 which can be interpreted as a strong correlation between the variables.

The regression assessment (between advertising spending and bank profitability) included 64 observations, divided into 8 companies included in the analysis. According to the Hausman test the best regression resulted to be the one with random effects. Table 4 presents the detailed results on regression with random effects model.

Table 4. Random effects model of the impact of advertising spending on the profitability of banks

Number of observations = 64		Wald chi2(1) = 74.18		Prob > chi2 = 0.0000		
Number of groups = 8						
R2	within = 0.1468	between = 0.9162	overall = 0.6693			
PROFIT	Coef.	Std. Err.	z	P> z 	[95% Conf. Interval]	
ADVS	1.574267	.182786	8.61	0.000	1.216013	1.932521
cons	-5.031066	2.365038	-2.13	0.033	-9.666455	-.3956768

Regarding the determinability coefficient, Table 4 shows that 66.93 percent of the variation of change in the profitability of banks is explained by the change in advertising spending incurred by banks. Or if we put it more simply, 66.93 percent of banks' profitability is explained by advertising spending, while the rest is explained by factors that have an impact on the bank's profitability but are not included in this research. Regarding the marginal effect, as per results of the analysis it can be said that if advertising spending incurred by banks increases by 1 percent, the profitability of banks increases by 1,574 percent. Advertising spending is significant or have explanatory capabilities in banks' profitability, as this variable has a 0 percent chance of error.

The results of analysis performed in this section support the hypothesis of this paper. Advertising spending incurred by banks has a positive effect on the bank profitability. This finding supports the indirect effects of advertising on a country's economy.

Conclusions

This study was undertaken with the aim of analyzing the economic impact of advertising in the Republic of Kosovo. The aim was achieved through (1) an analysis of the direct effects of advertising on the economy (the impact of advertising on company sales and the impact of advertising on customer brand loyalty); and (2) an analysis of the indirect effects of advertising on the economy (the impact of advertising on company profitability).

The results of the study show that advertising has a positive impact on the economy of Kosovo, both directly as well as indirectly.

1. Advertising has a positive impact on the sales of companies in Kosovo, in almost all sectors, influencing better performance in terms of sales - in general - for such companies which spend more on advertising over the same period of time. In addition, in the banking sector, advertising manages to positively affect customer brand loyalty, through a positive impact on customer orientation and a positive change in customer perceptions on the bank.
2. Advertising also positively affects the economy indirectly through a positive

impact on the profitability of companies. Specifically, the analysis of the impact of advertising on the banks' profitability in Kosovo has shown a strong correlation between advertising spending and bank profitability. In general, banks that spend more on advertising show better financial performance compared to other banks, in addition, a significant percentage of the change in banks' profitability is explained by the change in banks' spending in advertising.

Given the role and importance of advertising within a company, but also for the economy in general, it is important especially now in the face of the economic crisis the country is going through as a result of the COVID-19 pandemic that companies do not give up advertising as it usually occurs when faced with financial crises. The state should financially support banks and supermarkets in particular, as the largest advertisers in Kosovo, to ensure they do not refrain from advertising in an effort to save or transfer money to other items which the company mistakenly considers as more important.

On the other hand, companies themselves should consider alternatives before refraining from advertising. Like for example, if a company spends a lot on TV commercials, then in times of crisis it is appropriate to transfer funds to new digital media which are more cost effective. For example, instead of broadcasting an advertisement on TV, it can be broadcast on social networks. Or instead of sending catalogs door-to-door, they should be sent via e-mail, etc. In addition, spending on billboards, radio or newspaper advertising may need to be reconsidered since when coping with COVID-19 consumer behavior has changed and as a result billboards are less visible - as people spend more time at home, and in addition, there are less and less readers of magazines and newspapers as the world is moving towards the online system.

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