

3. SELF-REGULATION IN ADVERTISING

3.1 INTRODUCTION

‘Advertising’ involves the dissemination of information about an organisation, product, service, or idea through the mass media (eg television, radio, newspapers, magazines, billboards etc) by a particular sponsor (the advertiser).

A key feature of advertising is that the advertiser does not communicate directly with the customer. Rather, the advertiser communicates via the mass media. Typically, this means that:

- the information is provided not only to potential consumers of the product, but also other sections of the community that may have no interest in the product; and
- there is no opportunity for immediate feedback from the consumer.

This distinguishes advertising from ‘direct marketing’ which involves greater targeting of potential consumers, and approaching those potential consumers directly to generate an expression of interest or a sale. This provides an opportunity for suppliers to obtain direct feedback from individual consumers on the nature of their preferences. Direct marketing is discussed further in Chapter 4.

3.2 DESCRIPTION OF THE MARKET

3.2.1 Demand for advertising

The demand for advertising originates from consumer demand for accurate information on goods and services.

As discussed in Chapter 2, in order to make informed decisions, consumers need to know not only their own preferences, but also the prices, performance, and availability of all goods and services they might want to consume. In reality, however, it is simply too costly for consumers to seek to:

- acquire all of the information they would require to make fully rational decisions. This is discussed further in sections 3.2.2 and 3.2.3. The existence of this ‘bounded rationality’

provides advertisers with the scope to engage in ‘persuasive’ advertising to influence consumer preferences, or even deceive consumers); and

- determine the prices, performance, and availability of all goods and services they may want to consume.

The information provided by advertising has the potential to reduce all of these costs to a significant extent. It can assist consumers to clarify their preferences, identify the prices and availability of products that can potentially satisfy those preferences, and help consumers evaluate the performance of those products and determine when they should replace those products with new, improved versions.

A key feature of advertising is that it is not normally purchased separately by the consumer. Rather, it is an information service that is provided by the firm at the expense of consumers of the firm’s products. When consumers decide to purchase a product, they are also in effect deciding to purchase the advertising information that has been supplied by the firm to promote that product. The cost of the product includes a portion of the cost of funding the advertising that was used to promote the firm’s products.

Similarly, when an individual chooses to consume the information provided by the media (eg free to air TV, radio broadcast, newspapers, or magazines) they are also in effect deciding to consume the advertising information disseminated by that media. The revenue raised by selling advertising space is in effect used to subsidise the cost of supplying the other information disseminated in the media.

As a result, demand for the advertising of a particular firm is determined by the combined demand for the firm’s product and the advertising itself.

Since there are costs to consumers associated with the assimilation of information, they tend to be willing to pay more for that information when it is supplied in an enjoyable form. As a result, there is a degree of complementarity in demand for information and demand for entertainment. This helps explain the presence of both ‘entertaining’ advertising and the packaging of advertising with entertaining programs.

Advertising is of course not the only potential source of information on product price, performance and availability.

Another important source of such information is the consumer’s own consumption experience. Indeed, the quality and performance of certain goods and services can really only be determined after they have been purchased and used.

The costs of such experimentation can vary considerably over different types of goods and services. For example, the costs of experimentation tend to be higher for products that are either essential to the consumer's health and wellbeing, or comprise a high proportion of their budget. These include financial services such as life and home insurance and health related products such as pharmaceutical products. For such products, the financial and non-pecuniary costs to the consumer from an inappropriate product choice are very high. By contrast, the costs of experimentation tend to be much lower for lower cost products that are 'discretionary' purchases.

Individual consumers can reduce their costs of experimentation by relying on information provided by other consumers, or surveys of other consumers' views, or other more aggregate signals of consumer views of product quality such as:

- brand names and company reputation (ie consumers tend to equate more popular brand names and more reputable firms with higher quality products); and
- the price of the product (ie consumers tend to equate higher product prices with higher product quality).

3.2.2 Supply of advertising

The magnitude of the potential costs that consumers face when trying to identify the price, performance and availability of the goods and services they wish to consume has important implications for firms.

In particular, it provides firms with a significant incentive to supply consumers with 'informative' advertising aimed at outlining the types, prices and performance of the goods and services those firms are able to supply. Firms, particularly new firms, or firms selling new and improved products, cannot simply sit back and expect consumers to locate them.

In view of the 'bounded rationality' of consumers, however, firms also have the incentive and ability to engage in 'persuasive' advertising which is aimed at influencing the preferences of consumers for products. Such 'persuasive' advertising can take a number of forms. For example, it can range from advertisements that are intended to help consumers to clarify their preferences, through to advertisements intended to mislead or deceive the consumer as to the price or performance of the product. In an effort to gain public attention, there is also a risk that persuasive advertising can be presented in a form that certain sections of the community find offensive. The external costs that such misleading, deceptive, and offensive advertising impose on consumers and society are discussed further in section 3.2.3.

Advertising is used extensively by virtually all types of firms in Australia ranging from small retailers through to large multinational firms.

Advertising is most prevalent in product markets where there are large numbers of firms supplying differentiated products (ie in markets characterised by ‘monopolistic’ competition and ‘heterogenous’ products). In such markets, firms tend to engage in non-price forms of competition such as advertising, packaging, product branding, and the development of firm reputation. The reluctance of such firms to engage in price competition in these markets is related to the tendency of consumers, in the presence of uncertainty, to use product price as a signal of product quality. Rather than increase sales, a reduction in price has the potential to reduce sales by signalling to consumers that the product is of lower quality.

Advertising is of course not the only means that firms have available for promoting their products. Rather, it is only one of several methods that firms can use to promote and market their products. Other important promotional tools include direct marketing and direct selling, sales promotion, publicity and public relations. Over the last decade, there has been an increasing trend among companies to implement systems of ‘integrated marketing communications’ that seek to co-ordinate all of the promotional and marketing methods that influence community perceptions of the firm’s reputation and its product brands.

3.2.3 Nature of market failure(s)

Asymmetric information

As discussed in Chapter 2, one of the major reasons why markets, such as the market for advertising, fail to operate efficiently is the presence of asymmetric information between firms and consumers.

In particular, firms have access to much more accurate information on the price, performance and availability of their products than consumers. This provides firms with an opportunity to increase their sales through the provision of ‘informative’ advertising.

At the same time, however, it also provides scope for firms to engage in misleading and deceptive advertising. That is, firms have the option of either reducing existing information asymmetries through the provision of ‘informative’ advertising, or by using ‘persuasive’ advertising to create new, or to exacerbate existing information asymmetries. Advertising, like other forms of information, has the character of an ‘experience’ good. That is, it is difficult to judge the quality of information provided simply by looking at it. Rather, it is

typically necessary to ‘consume’ that information prior to being able to determine its accuracy.

By contrast, firms have much less accurate information about the preferences of their consumers for particular types of products and advertising campaigns. Unlike direct marketing, advertising does not provide a firm with a direct means of obtaining feedback from a consumer on their preferences other than via the price mechanism. That is, the most direct and immediate feedback that advertisers receive on consumer preferences in relation to their products and advertising campaigns is via their sales figures.

Advertisers can of course gain some idea of the preferences of their consumers through less direct and immediate methods such as consumer surveys and the nature of the complaints they receive either directly, or via the Advertising Standards Bureau. The procedures followed by the ASB when processing complaints are outlined in section 3.3.6.

Externalities

Although advertising can be an important source of information that works to improve the overall efficiency of product markets, it has also been criticised for the external costs it imposes on consumers and the wider community. These external costs include the costs of providing misleading and offensive advertising.

The ability of advertisers to engage in misleading advertising is limited to some extent by a number of factors including:

- Other sources of information available to consumers. As noted above, advertising is not the only source of product information available to consumers. Consumers can also obtain product information from other consumers, consumer organisations, and their own consumption experience. The existence of these other sources of information limits the extent to which advertisers can mislead consumers.
- Potential damage to an advertiser’s reputation. Advertisers, particularly those making repeat sales of products to consumers, incur significant amounts of expenditure to develop their reputations as reliable suppliers.
- Competition between advertisers. Each advertiser has an incentive to refute the deceptive advertising claims of their competitors.
- The potential for legal action by consumers.

However, the incentive and ability of consumers, and other advertisers, to detect and take action against misleading advertising is also limited by a number of factors including:

- The nature of the advertising. A sufficiently ‘inventive’ advertisement can mislead consumers while making it extremely difficult for those consumers and advertisers that are adversely affected to prove in a court of law that they have been misled.
- The delays associated with non-price competition.
- The ‘bounded rationality’ of consumers.
- The reluctance of consumers to admit they have been deceived (ie the existence of ‘cognitive dissonance’).

Advertising can also produce external benefits for some sections of the community. For example, consumers who base their decisions heavily on advertising by a firm in effect have their costs of acquiring that information subsidised by other consumers of the product whose decisions were not heavily influenced by that advertising. These spillovers arise due to the practical difficulties and costs associated with determining the values that consumers attach to the advertising of the product as opposed to the product itself, and charging consumers for those differences.

Consumers of ‘free to air’ television and radio broadcasts, newspapers and magazines that are funded by advertising revenue also have the potential to reap external benefits from the advertising expenditure of firms. In general, the magnitude of those external benefits will be greater:

- the lesser the extent to which that advertising detracts from their enjoyment of the television or radio broadcast, or the other information provided in the newspaper or magazine; and
- the lower their expenditure on the advertised goods and services (ie the smaller the contribution they make to funding the cost of that advertising).

The advertising expenditure of one firm can also produce benefits that spill over onto other firms. For example, it can result in a consumer deciding to purchase the product of another firm that is either producing a substitutable or a complementary product. Where two firms produce complementary products, there may be scope for internalising those external benefits by jointly funding advertising campaigns that promote both the product and its complement (eg combined advertising of washing machines and recommended brands of washing powder).

Public good nature of advertising

Advertising, like all forms of information, also exhibits the features of a public good, and this tends to reduce the efficiency with which the market for advertising operates.

That is, it is often difficult to exclude individuals who have not paid for advertising expenditure from enjoying the benefits of that advertising (non-excludability), and the consumption of advertising by one individual does not diminish the potential benefits available to other consumers of advertising ('jointness' or 'non-rivalry' in consumption).

Market failure due to imperfect competition

The supply of advertising typically involves three main entities:

- the advertiser, who funds the advertising;
- the in-house or external advertising agency that develops the advertising campaign; and
- the media operators who disseminate the advertising.

In most product markets, there are large numbers of highly competitive advertisers. However, the overall efficiency with which the advertising market operates can be reduced by the presence of imperfect competition in some product markets and the major media markets, as well as the significant economies of scale in advertising.

Advertising is both a potential source of increased competition between firms supplying heterogeneous products, and a potential means for firms to artificially differentiate their products in order to reduce competition.

The existence of advertising is itself an indication of the lack of perfect competition. In the presence of perfect competition, an individual firm does not have an incentive to advertise. Although a successful advertising campaign would increase demand for the output of the industry, it would be of very little benefit to the individual firm that advertised. In effect, the benefits produced by that advertising would be spread over the large number of small firms in the industry. That is, the advertising by one firm would produce an external benefit for all firms. Advertising would only be profitable if all of the firms in the industry banded together to engage in a joint advertising campaign.

Failure to achieve certain social objectives

In view of the pervasive nature of advertising, and its potential not only to misinform, but to actually alter individual's preferences, advertising has been the subject of a great deal of controversy and criticism. In particular, persuasive advertising has been criticised on the grounds that it:

- exploits certain groups of the community, particularly children, the old and the infirmed, who have less experience and/or sound knowledge in order to evaluate products, or to critically analyse the persuasive nature of an advertising campaign;
- perpetuates social stereotypes, particularly in relation to women; and
- encourages materialism (ie it suggests that the acquisition of goods and services leads to happiness, suggests that material possessions are symbols of social status and will lead to greater social acceptance, popularity).

3.3 PRESENT SYSTEM OF SELF-REGULATION

3.3.1 Background

The current system of self-regulation governing advertising standards commenced operation in 1998 when the newly created Advertising Standards Board (ASB) and Advertising Claims Board (ACB) began dealing with complaints regarding the content of advertisements.

The new system of self-regulation was introduced to replace the old system that was terminated on 31 December 1996 when the Media Council of Australia (MCA) disbanded itself and the existing advertising codes and regulations. As part of the shake up the Advertising Standards Council (ASC) — the body responsible for determining complaints about advertisements — was also disbanded. This was prompted by the ACCC's revocation of the authorisation in respect of the MCA's system of accrediting advertising agencies and its system of advertising standards.

It is interesting to note that neither the collective media boycotts implemented by FACTS, FARB and APB to give force to decisions of the ASC, nor the existence of collective pre-vetting or pre-clearance procedures for advertisements through FACTS, FARB and APB, attracted any adverse action by the ACCC although these might both be considered to be anticompetitive practices. The ACCC revoked both authorisations because the public benefit, if any, did not outweigh the detriment caused by the loss of competition arising from

the accreditation system and the MCA's system of advertising codes. Pre-vetting of advertisements is still conducted by FACTS, FARB and APB as before.

3.3.2 Objectives of the Code

The stated objective of the AANA's Advertiser Code of Ethics (the 'Code') is to ensure that advertisements are legal, decent, honest and truthful and that they have been prepared with a sense of obligation to the consumer and society and a fair sense of responsibility to competitors.

3.3.3 Development of the Code

The new system of self-regulation is the result of a lengthy period of consultation between the advertising industry, government and consumer representatives.

Following the MCA's decision to disband its scheme, the Government convened a series of meetings to derive a replacement scheme for the MCA scheme. In attendance were the major industry associations, consumer representatives, government officials and legal experts, although not all of these groups attended all of the meetings. These included representatives of the Australian Association of National Advertisers (AANA), the Advertising Federation of Australia, the Australian Publishers Bureau, the Australian Broadcasting Authority, the Federation of Australian Commercial Television Stations, the Communications Law Centre, the Federation of Australian Radio Broadcasters, the National Women's Media Centre, the Australian Consumers Association (ACA), the ACCC, the Department of Communications and the Arts, the Federal Bureau of Consumer Affairs, and the Office of the Minister for Small Business and Consumer Affairs.

The model that forms the basis of the current system of self-regulation was proposed by the AANA.

The model was criticised by the ACA as lacking effective sanctions, broad public accountability, and a specified commitment to monitoring and reviewing the scheme.

Women's groups (especially the Women's Media Centre) were also concerned with the issue of portrayal of people in advertising. An argued lack of coverage has drawn critical comment, particularly from women's groups, but also from those concerned with depictions relating to the weight of persons. Such coverage as exists in the AANA Code prohibits material offensive to community standards and discrimination or vilification on the basis of sex and other grounds. However, the AANA Code does not address the issue of portrayal of

people as specifically as the Canadian or New Zealander advertising codes which were offered as examples by the Women's Media Centre.

The ACCC also pressured the AANA to set a specific date and terms of reference for a review of the scheme and sought, along with the ACA, representation on the Advisory Committee but this was refused for various reasons.

3.3.4 Code Coverage

Scope of the Code

For the purposes of the Code, the term 'advertisement' is defined to mean:

'... matter which is published or broadcast, other than via the Internet, direct mail or point of sale, in all of Australia or in a substantial section of Australia, for payment of other valuable consideration, and which draws the attention of the public, or a segment of it, to a product, service, person, organisation or line of conduct in a manner calculated to promote or oppose directly or indirectly that product, service, person, organisation or line of conduct'.

As such, the Advertising Standards Code covers a wide range of advertising services and advertised products.

Membership of AANA

AANA represents the marketing and advertising interests of a diverse range of manufacturing and service industries and has recently broadened its membership criteria to include agencies and other service providers. The combined advertising expenditure of AANA member organisations represents approximately 80 per cent of Australia's annual expenditure on national main media advertising.¹

According to the AANA, flexible membership criteria creates the opportunity for advertisers to work jointly with agencies and other service providers in developing policies and positions on issues of common industry interest.

There are three membership options available:

- Ordinary Membership, which encompasses the full range of benefits for advertisers;
- Service Provider Membership, which delivers similar benefits for agencies and other service providers; and

¹ http://www.aana.com.au/about/f_about.htm

- Associate Membership, which provides a variety of information services for advertisers and service providers, with less focus on policy development and discounted services.

Membership in all three forms requires the advertiser/agency to abide by the Code of Ethics.

3.3.5 Overview of the Code

The Code is very brief and comprises two main sections.

Section 1 of the Code, which is administered by the Advertising Claims Board, states that advertisements:

- shall comply with Commonwealth law and the law of the relevant State or Territory;
- shall not be misleading or deceptive or be likely to mislead or deceive;
- shall not contain a misrepresentation which is likely to cause damage to the business or goodwill of a competitor;
- shall not exploit community concerns in relation to protecting the environment by presenting or portraying distinctions in products or services advertised in a misleading way, or in a way which implies a benefit to the environment which the products or services do not have;
- shall not make claims about the Australian origin or content of products advertised in a manner which is misleading.

Section 2 of the Code, which is administered by the Advertising Standards Board, states that advertisements:

- shall not portray people or depict material in a way which discriminates against or vilifies a person or section of the community on account of race, ethnicity, nationality, sex, age, sexual preference, religion, disability or political belief;
- shall not present or portray violence unless it is justifiable in the context of the product or service advertised;
- shall treat sex, sexuality and nudity with sensitivity to the relevant audience and, where appropriate, the relevant programme time zone;
- for any product which is meant to be used or purchased by children shall not contain anything which is likely to cause alarm or distress to those children;
- shall only use language which is appropriate in the circumstances and strong or obscene language shall be avoided;

- shall not depict material contrary to prevailing community standards on health and safety.

3.3.6 Operation of the Code

Complaint handling and dispute resolution procedures

To lodge a complaint about a possible breach of Section 2 of the Code, consumers need to write to the ASB outlining their concerns and describing the subject advertisement.

The Board's assessment procedures allow for the advertiser to comment on the apparent breach before any decision is made. Advertisers whose commercial is subject to public complaint will be contacted directly by the Advertising Standards Bureau on behalf of the ASB. The advertiser is invited to comment with specific reference to any apparent contravention of Section 2 of the Code and is asked to provide a copy of the relevant advertising material. If there is no response from the advertiser within a nominated period, the Board still may proceed to consider the complaint.

Should the complaint be upheld, the advertiser is then invited to withdraw or modify the subject commercial. If the advertiser responds within the allocated time period, their response is included in the Case Report that is prepared for immediate publication and public notification through Media Releases that are posted on the Board's web site.

By contrast, if the advertiser chooses not to modify or discontinue an advertisement in line with a determination, the Board may forward its case report to the appropriate government agencies and media proprietors. To date, however, this has not occurred.

To lodge a complaint about a possible breach of Section 1 of the Code, a written submission is required together with a filing fee.

Once a complaint has been accepted by the ACB, the advertiser that has potentially breached the code is advised of the complaint and is asked to provide copies of the advertisement in question and a substantial written response to the complaint. The complainant is also required to lodge an indemnity plus a fee to cover costs which is set to reflect the complexity of the case and the amount of material to be considered.

A panel of three registered lawyers is then convened to determine whether the advertisement breaches the law by reference to Section 1 of the Code and/or Australian Law. The lawyers are chosen from a register of legal practitioners who have certified to holding a current practising certificate and having experience and expertise in the area of advertising and/or trade practices law. The ACB is required to make its determinations publicly available, in addition to being published by the ASB.

The ACB's assessment allows for further submissions to be made by both the complainant and the advertiser, and the ACB is required to issue a written determination within 15 business days of receiving its final submission in relation to the complaint.

As indicated in Table 1, of the 1,458 complaints received by the AANA in 1998 that concerned taste and decency issues, most related to television advertising followed by print and radio advertising. Anecdotal evidence suggests that complaints regarding taste and decency issues were mainly upheld where they also related to other issues within the Code of Ethics, such as safety or the portrayal of women.

Table 1: Media attracting complaints, 1998

<i>Medium</i>	<i>Number of complaints</i>
Television	1226
Print	156
Radio	29
Outdoor	28
Cinema	9
Other	10
TOTAL	1458

Source: Advertising Standards Bureau (1999).

As indicated in Table 2, the issue attracting most public concern was the portrayal of people (38.8 per cent of complaints). Predictably, the majority of complaints upheld by the ASB also involved this issue. Other important sources of complaint included the portrayal of sex/sexuality/nudity, health and safety issues and the portrayal of violence.

Table 2: Issues attracting complaint, 1998

<i>Issue</i>	<i>Per cent of advertisements for ASB resolution ^a</i>
Portrayal of people	38.80
Portrayal of sex/sexuality/nudity	31.54
Health and safety	20.19
Portrayal of violence	12.61
Use of language	6.30
Concern for children	5.99
Other	13.56

^a some advertisements raised more than one issue hence the addition of the percentages listed exceeds 100.

Source: Advertising Standards Bureau (1999).

Portrayal is a complex issue. It can relate to matters such as stereotyping, denigration, depiction as a sex object and gender equity. There has been pressure on the AANA to expand this area of its Code of Ethics, with the Canadian and New Zealand codes being cited as preferred examples. More importantly, perhaps, the AANA Code of Ethics has been framed so as to reflect those aspects of conduct or behaviour proscribed by existing law. The Code addresses issues of portrayal reflected in the law. The AANA has indicated that an expansion of the Code to address portrayal issues in the manner proposed by the Women's Media Centre would require going beyond what the law proscribes. The ANNA is concerned that this would result in anticompetitive behaviour, which is something which the AANA has stated it will not embrace.

As indicated in Table 3, of all the complaints received by the ASB in 1998, the majority were dismissed and many were deemed to be outside the ASB's charter and were instead referred to the advertiser or appropriate regulating body. Only 73 complaints were upheld by the Board. The Bureau claims that in almost every case, the advertiser has endorsed the ASB's role by voluntarily providing the ASB with requested materials and responses to public complaints. In every case where the ASB has upheld the complaint, the advertiser has voluntarily discontinued or modified the advertisement.

Table 3: Outcome of complaints, 1998

<i>Outcome of complaints</i>	<i>Number of complaints received</i>
Determined: complaint dismissed	927
Outside charter	382
Current for ASB resolution at end of year	76
Determined: complaint upheld	73
TOTAL	1458

Source: Advertising Standards Bureau (1999).

Although other complaints were dismissed because they were found not to breach the Code of Ethics, the ASB passed on critical comments in a number of case reports, relaying these comments to complainants and advertisers. As well, three advertisements were deemed beyond the scope of the ASB's charter. Two of these were submitted to the Federation of Australian Commercial Television Stations (FACTS)² for review under its classification authority, and one to the Australian Competition and Consumer Commission for legal advice.

² FACTS Code of Conduct addresses issues regarding the placement, frequency and timing of advertisements and programming on television, but does not address issues relating to the content of advertisements.

The AANA claims to have media support for its scheme, evidenced by its participation in a national public awareness campaign, involving television, radio and print media. In response to the advertising, the volume of complaints to the ASB has more than doubled.

The complaints mechanisms associated with the scheme appear easily accessible to the general public and all complaints considered by the ASB are done so at no cost to the complainant. Furthermore, extensive advertising on television, radio and in the print media has ensured more people are now aware of the complaints procedures. The Advertising Standards Bureau has stated that the volume of complaints made to the ASB has more than doubled since the scheme was advertised to the public.

From an industry point of view, the system allows competitors to resolve disputes in a cost-effective manner by avoiding expensive legal proceedings. While the voluntary system of funding precludes onerous compliance costs.

Advertisements that are found to breach the code are only ruled against after the fact, reducing the production cost disincentive. It can be argued that it is in the advertiser's interests to produce offensive advertisements to attract greater publicity.

Furthermore, an advertisement can be in circulation for a significant period of time before it can be appropriately judged by the ASB and with many advertisements finishing their print run or airplay in a very short time, often complaints cannot be heard in time.

Penalties for non-compliance with the code

The authority of the ASB rests entirely with the industry's voluntary adherence to self-determined standards. Neither the ASB nor the AANA have the power to sanction advertisers who fail to comply with the Code of Ethics.

However, a monthly report tabling the ASB's decisions is produced by the AANA for the purpose of discouraging advertisers from breaching the Code of Ethics for fear of negative publicity. The publication also allows interested parties to clearly understand the reasons behind each decision. Decisions made by the ASB and any media releases are published under the headings:

- complaint dismissed;
- advertising modified or discontinued; or
- advertising referred to government agency.

3.3.7 Administration of the Code

Organisation responsible for administration of the Code

The self-regulatory system is now managed by Advertising Standards Bureau Ltd and is funded voluntarily through Australian Advertising Standards Council Ltd.

The Australian Standards Bureau Ltd administers the national voluntary system of self-regulation through the Advertising Standards Board and the Advertising Claims Board. The ASB was launched on 28 August 1997 and began dealing with complaints in January 1998 and the ACB was established in November 1998.

The role of the ASB is to maintain standards of taste and decency in advertising while taking account of prevailing community attitudes. Complaints received by the ASB are assessed against section 2 of the Code of Ethics.

The ASB does not consider complaints about issues such as truth, accuracy or the legality of advertisements, label directions, or advertisements for products where a specific industry code applies, such as alcohol and slimming products³. In addition, it will not consider:

- trivial issues;
- local advertising;
- advertising that is the subject of litigation or an order by a court or government agency;
- unlawful business practices;
- advertising which has been withdrawn or discontinued before challenge; and
- highly technical issues especially where the parties to assist do not provide experts.

Complementing the ASB, the ACB assesses complaints involving issues of truth, accuracy, and legality of advertising, against section 1 of the Code. The role of the ACB is to provide an alternative dispute resolution scheme to deal with claims that might otherwise lead to litigation. Although primarily intended to resolve disputes between competitors, the ACB can also deal with complaints from any other person, group or government agency that there has been a breach of Section 1 of the Code.

³ These issues are dealt with under the *Trade Practices Act 1974* or under industry specific codes.

Procedures for monitoring, reviewing and amending the Code

When the Advertising Standards Bureau commenced operations in January 1998, the AANA agreed to review its operations after twelve months. This review was made in November 1999 with the assistance of an independent academic. No changes to procedures or operations were recommended.

Funding

All complaints considered by the ASB are dealt with on a cost free basis. As a result the self-regulatory scheme relies on the industry members to fund its operations.

Funding is derived from a voluntary levy of 0.035 per cent of gross media billings of advertisers, and is usually collected and remitted on their behalf by advertising agencies and media buying agencies. Funds collected from the levy are exclusively applied to the self-regulatory system and are kept separate from AANA funds.

All payments are sourced to the Australian Advertising Standards Council Limited, which is the sole body that manages the funds necessary for the self-regulatory system.

The funding system has been designed with a view to ensuring that:

- the funds collected from the levy are exclusively applied to the self-regulation system;
- the confidentiality of the gross billings of agencies and media buyers is preserved;
- the determination of a complaint against an advertisement has no correlation with the advertiser's support or otherwise of the levy.

The AANA has sought to achieve these objectives through:

- the establishment of a separate funding company;
- the appointment of an independent firm of auditors; and
- the outsourcing of the entire financial management of the funding arrangements to an independent firm of accountants who are subject to legal obligations of confidentiality.

Unlike the ASB, the ACB operates on a user pays basis with the complainant bearing the cost of the proceedings. However, the ACB's secretariat support is provided by the ASB which is funded by the voluntary levy.

3.3.8 Other Regulations Affecting the Industry

The previous regulatory regime also featured industry specific codes, such as the Cigarette Advertising Code (which has since been replaced by legislation), the Therapeutic Goods Advertising Code, the Slimming Code and the Alcoholic Beverages Advertising Code.

These codes still remain in force today but after the demise of the MCA responsibility for their administration was passed on to the relevant industries. The AANA maintains that a close working relationship is in place with the relevant industry associations so as to ensure neither overlap nor gaps exist between the various codes. However it should be noted that while the advertisers of alcoholic beverages for example, are regulated by a strong industry association there are other industries, such as the weight loss/slimming industry, that are without strong, cohesive organisations.

Further advertising regulation is enforced by the administration of other statutory or industry bodies. Classification of print and cinema material falls within the responsibility of the Office of Film and Literature Classification. Placement, and to some extent, content of advertisements on television and radio, are regulated by way of enforceable codes of practice through FACTS, SBS and FARB under the auspices of the Australian Broadcasting Authority. Furthermore, issues of truth and accuracy of advertising are regulated by law through State and Commonwealth Government agencies of fair-trading and consumer affairs.

3.4 FEATURES OF THE MARKET THAT MAKE SELF-REGULATION MORE OR LESS EFFECTIVE

3.4.1 Overall effectiveness in addressing market failure(s)

As outlined below, the potential sources of market failure identified in section 3.2.3 influence both the incentive and the ability of advertisers to develop, implement, and operate effective systems of self-regulation.

Asymmetric information

As noted in section 3.2.3, the existence of asymmetric information can reduce the efficiency with which the markets for both products and advertising operate. Advertisers are likely to have much better information on the quality of their products than consumers and the existence of that asymmetric information can reduce the efficiency with which the markets for those advertised products operate. Although this provides advertisers with an incentive to

supply consumers with informative advertising, it also provides an opportunity for advertisers to engage in misleading advertising.

The risk of misleading advertising, and the potentially adverse effects it can have on consumers, firm reputation and the sales of competing firms, provides an incentive for advertisers to engage in both individual and collective forms of self-regulation.

The magnitude of that incentive to engage in self-regulation depends partly on the nature and extent of the information asymmetry between advertisers and consumers. In general, the greater the information asymmetry, the greater the potential scope for firms to provide misleading information, and the greater the potential damage such misleading information can inflict on the sales of competing firms.

Although the existence of asymmetric information provides an incentive for advertisers to self-regulate, the nature and extent of that asymmetric information also limits the ability of advertisers to develop, implement and operate effective systems of self-regulation.

In order to develop, implement, and operate effective systems of self-regulation, advertisers need to have accurate information on the extent to which consumers, other producers, and the wider community benefit from, or are adversely affected by, the nature and extent of their advertising. In particular, they need accurate information on the nature and extent of market failure in the market for advertising.

Although an advertiser may have much better information on the quality of its products than consumers, it may not possess particularly accurate information on the nature and extent of the costs that misleading or offensive advertising may impose on consumers, other producers, and the wider community.

The existence of asymmetric information not only provides advertisers with an opportunity to engage in misleading and offensive advertising, it also provides an opportunity for consumers to mislead advertisers as to the extent to which they are adversely affected by misleading and offensive advertising.

In general, the more complex the nature of the market failure, the greater the potential information asymmetry between advertisers, consumers and the wider the community, the more difficult it is for advertisers to self-regulate. As discussed further in section 3.4.2, the nature and extent of that asymmetric information will depend on the nature of the advertised product, and the nature of the advertising used to promote that product.

The main sources of information for advertisers on the potential costs arising from misleading or offensive advertising include:

- the complaints process, which can provide information on the number and nature of the complaints received;
- the views provided by representatives of consumer and community organisations; and
- surveys of consumer and community satisfaction on the standard of advertising.

The availability of accurate information on the nature and extent of costs arising from misleading or offensive information therefore depends on the:

- extent to which all stakeholders that have an interest in the reduction of misleading and offensive advertising play an active role in the development and operation of the advertising standards;
- the extent to which advertisers maintain good relations with those stakeholders; and
- the existence of an effective system for processing complaints.

As a result, it is likely that the effectiveness of the present system of advertising self-regulation has been reduced to some extent by the strained relationship that currently exists between the ASB and the main consumer associations.

As discussed in section 3.4.4, even if advertisers do have accurate information on the nature and extent of market failure, their incentive and ability to reduce that market failure will depend on the extent of commonality between the interests of advertisers, consumers and the wider community.

Externalities

The nature and extent of the external costs arising from advertising also influences the incentive and ability of advertisers to develop, implement and operate effective systems of self-regulation.

In general, the incentive for advertisers to group together to engage in collective self-regulation will be greater:

- the greater the external costs arising from misleading or offensive advertising; and
- the greater the extent to which those external costs adversely affect other advertisers in the group.

For example, the incentive for advertisers to engage in effective self-regulation is much greater in those cases where the misleading advertisement of one advertiser only adversely affects the consumers of that product and other advertisers of substitutable goods. In this case, there is likely to be a relatively strong incentive for advertisers to group together to self-regulate advertising of that product. As discussed further in section 3.4.4, the magnitude of that incentive is also dependent on the extent to which the interests of the consumers of that product are representative of the interests of the general community.

By contrast, the incentive for advertisers to engage in effective self-regulation is much lower in those cases where the external costs of a misleading or offensive product advertisement predominantly spill over onto other sections of the community. In this case, the advertisers of that product will have little incentive to group together to self-regulate unless those other adversely affected sections of the community are able to bring pressure to bear on those advertisers via the legal system or by encouraging consumer boycotts of the product.

In addition to influencing the incentive to engage in effective self-regulation, the nature and extent of the external costs arising from market failure also influences the ability of advertisers to set up and operate an effective system of self-regulation.

Although the incentive for effective self-regulation increases as the external costs arising from market failure become greater and more widespread across the community, so too does:

- the magnitude of the administrative costs that the self-regulatory body will have to incur to internalise those external costs;
- the scope for adversely affected individuals and firms to ‘free ride’ on the benefits of self-regulation; and
- the risk that the failure of self-regulation will impose significant welfare costs on the community.

Public goods

Like advertising, the self-regulation of advertising also exhibits the features of a public good. As outlined above, it can be difficult to exclude some individuals who do not contribute towards the costs of self-regulation from enjoying the benefits of that self-regulation. In addition, one individual’s consumption of the benefits of self-regulated advertising does not reduce the benefits available to other potential consumers.

This public good nature of advertising self-regulation also limits the ability of advertisers to set up effective systems of self-regulation.

Unlike the Government, advertisers do not have the option of raising revenue to finance their regulatory activities through general taxation. Rather, they need to recoup the cost of self-regulation by charging consumers higher prices for advertised products.

As a result, advertisers engaged in self-regulation may have significant difficulties raising sufficient revenue and attracting the resources necessary to provide an optimal level of provision of that public good. Similarly, consumer associations may have difficulty attracting the finances and resources they need to effectively represent the interests of their members. In addition, advertisers are likely to experience difficulties developing efficient and equitable means of charging their members and the consumers of their products for the costs of self-regulation due to the lack of information on the social costs arising from misleading or offensive advertising.

Imperfect competition

The nature and extent of imperfect competition in both the markets for advertised products and advertising is also an important factor that influences both the incentive and ability of advertisers to engage in self-regulation. This is discussed further in section 3.4.3.

Failure to achieve certain social policy objectives

As indicated in section 3.3.6, most complaints received by the ASB relate to the portrayal of people as opposed to misleading advertising.

Such complaints tend to be much more difficult to resolve satisfactorily under a system of regulation since community views on what constitutes offensive advertising and the appropriate portrayal of people differ across individuals and advertisers. The implications of those differences in consumer and advertiser views for the effectiveness of self-regulation are discussed further in section 3.4.4.

3.4.2 Product related factors influencing effectiveness

Both the incentive and the ability of advertisers to develop and operate an effective system of self-regulation are affected by the nature of the advertised product and the nature of the advertising used to promote that product.

Importance of the product to consumers

The importance of advertising to consumers varies considerably across the products advertised.

For example, accurate information on the quality of products that are essential to health and well-being is far more important to consumers than accurate information on non-essential products. Similarly, the wider community places much greater importance on the sensitive treatment of certain social issues than others (eg the importance of protecting children, avoiding perpetuating gender stereotypes and portrayal of excessive violence etc).

As a result, the potential welfare losses arising from misleading advertising, and hence the incentive to self-regulate, tends to vary considerably across advertised products and different forms of advertising. In particular, the greatest potential inequities will arise from:

- misleading advertising of products that are essential to the welfare of a large proportion of the community; and
- advertising that offends the general community's more widely and strongly held views on public morality.

Expected economic life of the product

The demand for advertising, and hence the demand for some form of regulation of advertising, is much higher for products that have a relatively long economic life and account for a significant proportion of the consumer's budget.

For example, consider the case of expensive consumer durable goods and services such as cars, houses, and life insurance. Misleading advertising of such goods and services can impose significant costs on those consumers who choose to consume a product that they later discover to be deficient. As a result, consumers tend to demand more accurate information in relation to the prices and performance of these durable goods and services. This increases the incentive for self-regulation of advertising. It also increases demand for other alternative sources of information, thereby reducing the scope for misleading advertising.

Complexity of the product

The complexity of the advertised product, and the advertising used to promote that product, both influence the nature and extent of the information asymmetries that exist between advertisers, consumers and the wider community, and hence the incentive for advertisers to self-regulate. The more complex the advertised product, and the advertising used to promote it, the greater the potential for consumers to be misled, and the greater the potential benefits from self-regulation.

At the same time, however, the complexity of advertising and the advertised product also tend to constrain the ability of advertisers to self-regulate. In particular, it makes it difficult for consumers and advertisers to detect and prove instances of misleading advertising.

For example, where complex forms of persuasive advertising are used to promote products that produce intangible benefits, it can be very difficult for consumers and other advertisers to prove they have been misled, and to quantify the magnitude of the cost that they have incurred.

Similarly, where a product has complex effects on the welfare of consumers and the wider community (for example, complex effects on the health of consumers or the quality of the physical or social environment), neither advertisers nor consumers of that product may have a particularly good idea of its effects. This will tend to reduce the effectiveness of self-regulation unless the authority responsible for the operation of the Code:

- comprises individuals who are able to supply information on the complex effects that advertising can have on the wider community (for example, representatives of consumer, welfare and environmental groups as well as the government);
- consults regularly with those sections of the community that are able to provide such information; and
- makes appropriate adjustments to the self-regulatory arrangements.

Availability of substitutes and magnitude of product switching costs

The availability of substitutable goods and services has a number of complex effects on the effectiveness of self-regulation as a means of improving the efficiency and equity with which markets work.

Consider first the case where an advertiser falsely claims that its product is superior to the wide range of other highly substitutable products being marketed by their competitors.

The existence of those closely substitutable products will constrain the ability of the advertiser to mislead consumers to some extent, since those consumers can compare the product against its substitutes, and advertisers of those substitute products will seek to refute those misleading claims.

However, if the misleading advertisement is successful, it will create a much larger change in patterns of consumption than would have occurred if there were few close substitutes. In particular, by distorting consumer choice between closely substitutable consumer goods and

services, a ‘successful’ misleading advertisement may result in a much greater loss in economic efficiency.

As a result, self-regulation of advertising will tend to be more effective in improving the economic efficiency with which product markets work in those cases where it reduces the extent of misleading advertising between goods and services that are relatively close substitutes in consumption.

Now consider the case where the degree of substitution between the product that is the subject of misleading advertising and other products is relatively low either due to the nature of the product, or the existence of large product switching costs. In this case, few consumers are likely to change their patterns of consumption unless the claims are wildly exaggerated, or they possess very little accurate information on the relative merits of alternative products.

As a result, if the value that individuals place on those products is also relatively low, then the extent of potential reduction in economic efficiency and equity is likely to be correspondingly low.

By contrast, if the value that consumers place on those products is relatively high, the misleading advertising may still result in a significant reduction in social welfare. That is, misleading advertising of relatively important goods and services that have few close substitutes still has the potential to cause significant inequities and reductions in the welfare of the community. However, in such cases, it may be more difficult for consumers and other advertisers to prove that the advertisement is misleading due to the fundamental differences between the products.

The extent of product heterogeneity also influences the extent to which advertisers and consumers share a common interest in reducing the extent of misleading and offensive advertising. This issue is discussed further in section 3.4.4.

Technological innovation

The rapid pace of technological change is resulting in the continual emergence of new and improved products, and improved means of disseminating and accessing product information.

These technological changes have the potential both to increase certain information asymmetries and reduce others.

For example, the continual emergence of new, ‘high technology’ products tends to increase information asymmetries between the suppliers of those products and consumers who may

have little knowledge of the potential benefits of those new products. This increases the scope for potentially misleading advertising and the need for some form of self-regulation.

By contrast, advances in technology are also offering improved sources of information on the price and performance of goods and services, and lower costs methods of acquiring that information and those products. The Internet provides consumers with an unprecedented, relatively inexpensive, means of accessing information on the prices and performance of readily identifiable products, and ordering those products.

3.4.3 Impact of nature and extent of competition between firms on effectiveness

The nature and extent of competition between advertisers and advertised products also has important implications for both the incentive and ability of advertisers to develop and implement effective self-regulation.

Number and size of firms in the domestic market

As noted above, the domestic market for advertising is characterised by a large number of advertisers varying in size from small retailers to large multinationals, and the members of AANA are responsible for approximately 80 per cent of Australia's annual expenditure on national main media advertising. By contrast, the media market, used to disseminate advertising, is dominated by a small number of large firms.

The extent of imperfect competition in the main media markets has had, and continues to have, an important influence on the development of an effective system of regulating advertising.

This is because the self-regulation of advertising can be both a potential source of increased competition between firms, and a potential source of reduced competition.

By reducing the instances of misleading and offensive advertising, self-regulation has the potential to improve the extent of fair trading and hence the overall efficiency of both the markets for advertising and advertised products.

At the same time, however, self-regulation of advertising also has the potential to reduce competition to some extent. No form of advertising self-regulation can be expected to operate as a perfect screen that reduces only misleading or offensive advertising. Self-regulation has the potential to screen out some useful information and adversely affect the relative competitive positions of some advertisers. This reduces the extent to which self-

regulation results in a net improvement in the efficiency of the markets for advertising and advertised products.

It is for this reason that considerable care needs to be exercised when determining which entities should be given the power to regulate advertising. As noted in section 3.3.1, the previous system of co-regulating advertising was disbanded due to industry concerns that media boycotts of misleading and offensive advertising would be considered to be anti-competitive if the ACCC withdrew the MCA's authorisation to operate a system of advertising standards.

Extent of non-price competition

Advertising is a key feature of product markets characterised by monopolistic competition between a large number of advertisers of relatively heterogeneous products. Indeed, advertising itself has the characteristics of a heterogeneous 'experience' good whose quality is difficult for consumers to determine prior to consumption.

As a result, there is significant scope for advertisers not only to mislead consumers as to the quality of the advertised product, but also to use misleading forms of advertising that make it more difficult for the consumer to determine the quality of the product.

Impact of globalisation and technological change

The globalisation of the world economy, coupled with the convergence in demographic cultural trends, and the emergence of the Internet, is resulting in an increase in global marketing and advertising.

Global marketing is more suited to some products than others. These include:

- products that can be marketed on the basis of visual appeal, thereby avoiding the problems of language translation;
- products that appeal to universal desires such as increased wealth;
- high technology and new products that are entering world markets for the first time;
- products with a nationalistic flavour (eg Swiss watches, French wine, German beer); and
- products that appeal to a market segment with universally similar tastes, interests, needs and values (eg marketing products to the world's elite).

The emergence of global marketing has a number of important implications for the effectiveness of self-regulation. In particular, it reduces the potential effectiveness of domestic legislation as a means of regulating advertising and increases the need for more effective systems of self-regulation that are capable of regulating the activities of offshore advertisers. It also requires effective co-ordination with those groups responsible for regulating advertising in other jurisdictions and the development of consistent international standards.

3.4.4 Commonality of producer and consumer interests and effectiveness

The effectiveness of self-regulation as a means of improving the efficiency and equity with which the market for advertising operates is also influenced by the extent to which both advertisers and the consumers of advertised products share a common interest in correcting the market failure.

Similarity of consumer interests

The incentive and ability of advertisers to develop, implement and operate an effective system of self-regulation depends on the extent to which all consumers and other individuals in the community affected by advertising share a common interest in reducing misleading and offensive advertising. That is, it depends on the extent to which those consumers and individuals share common views as to what constitutes misleading or offensive advertising and are affected in a similar manner by such advertising.

Consider what would happen if all consumers of advertised products shared the same views as to what constituted misleading or offensive advertising, and were all equally adversely affected by an instance of such advertising. In such a case, consumers would act not only in their own interests, but also in the interests of all other consumers and individuals in the community. Advertisers would also have little difficulty determining consumer views as to whether or not the advertisement was misleading or offensive, and the extent to which consumers are adversely affected since the views of one consumer would be representative of all consumers and other adversely affected individuals in the community.

In reality, however, consumer and community views as to what constitutes misleading and offensive advertising can differ considerably, and instances of such advertising tend to affect individuals to varying degrees. That is, there is considerable heterogeneity of advertising and advertised products in the eyes of consumers. This means that consumers who are acting in their own interests may not act in the interests of other consumers of the advertised product, or the wider community (eg in the case of cigarette and alcohol advertising).

This divergence of consumer interests tends to reduce the effectiveness of self-regulation as a means of reducing misleading and offensive advertising. In particular, it makes it much more difficult to:

- define what constitutes misleading and offensive advertising, since these concepts become much more subjective in nature;
- develop, monitor, and enforce objective advertising standards; and
- determine the extent to which the consumers and other individuals in the community are adversely affected by instances of misleading or offensive advertising.

These problems can be reduced to some extent by ensuring the authority responsible for the development and operation of the code of self-regulation includes individuals that are considered by consumers, consumer organisations, and the wider community, to be capable of representing their interests. This is difficult to achieve at the moment due to the strained nature of the relationship between the main consumer groups and the ASB.

Similarity of producer interests

The incentive and ability of advertisers to develop, implement and operate an effective system of self-regulation also depends on the extent to which all advertisers share common views as to what constitutes misleading or offensive advertising, and are adversely affected in a similar manner by such advertising.

If all producers shared the same views as to what constituted misleading or offensive information, and all were equally adversely affected by an instance of misleading or offensive advertising, then all advertisers would share a common interest in self-regulation.

In reality, however, producer views as to what constitutes misleading and offensive advertising can differ considerably and instances of misleading or offensive advertising can have quite different effects across advertisers. This heterogeneity of advertising and advertised products in the eyes of producers tends to reduce both the incentive and ability for advertisers to set up and operate an effective system of self-regulation. In particular, it makes it more difficult for advertisers to:

- define what constitutes misleading and offensive advertising, since these concepts become much more subjective in nature;
- develop, monitor, and enforce objective advertising standards; and
- determine the extent to which each advertiser has been adversely affected by instances of misleading or offensive advertising.

Once again, these problems can be reduced to some extent by ensuring the regulatory authority responsible for the development and operation of the code of self-regulation includes individuals that are considered by advertisers to be capable of representing their interests.

Overlap of consumer and producer interests

A further factor influencing the ability of advertisers to develop and operate an effective system of self-regulation is the extent to which the interests of consumers and producers overlap.

In general, the greater the extent of overlap between consumer and producer interests, the greater the ability of advertisers to develop and operate an effective system of self-regulation.

As noted above, there is considerable scope for both consumer and producer interests to diverge due to differences in views on what constitutes misleading or offensive advertising, and differences in the extent to which individuals and advertisers are adversely affected by such advertising. Inevitably, this tends to reduce the potential overlap between consumer and producer interests, thereby reducing the effectiveness of self-regulation.