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Economic Mysteries Explained!

Or why \$3 gas is only a minor inconvenience. People spend less when they have less money, so companies must target ads to match a consumer's ability to pay

by [Greg Blonder](#)

Advertising may win hearts and minds, but in hard economic times, it can't pry open wallets. So, rather than fighting the coming economic slowdown, companies will need to learn how to better target ads to match a consumer's ability to pay. Here's how to think about a solution.

Let's start with Algebra I and all those annoying word problems from high school. You know, the ones where a 100-gallon tank of water is draining at 3 gallons per minute while filling at 2 gallons a minute, and you have to figure out how much water remains after 10 minutes?

What matters isn't the answer, but the principle: If you drain a tank faster than it fills, eventually the tank will run dry. Fill more quickly, and eventually it will overflow. Or, as the wise but jaded Mr. Micawber advised in Dickens' *David Copperfield*: "Annual income twenty pounds, annual expenditure nineteen pounds nineteen and six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery."

HOW MUCH CAN PEOPLE SPEND?

Unfortunately, consumers rarely know their yearly expenses or disposable incomes ahead of time. But psycho-economic studies show that humans are, nevertheless, intuitively rational economic animals, and they rely unconsciously on judicious approximations to manage their financial lives. The evidence shows that, especially during times of economic uncertainty, most people tend to compare their average rate of spending to their average hourly income. (In venture capital terms, our personal "burn rate.") This is a simple idea, but one with profound consequences for businesses, consumers, and advertisers.

The U.S. median family income is approximately \$48,200 a year, according to the Census Bureau. That's \$5.50 per hour before taxes, or \$4 per hour after taxes—assuming disposable income of approximately \$35,000. Which means, day in, day out, an average American family can't spend more than \$4 an hour and still keep its head above water.

Now let's break our family's spending into four categories: cheap thrills, affordable purchases, occasional treats, and rare extravagances. Cheap thrills are bought whenever the mood arises; they won't break the bank. Affordable purchases can be acquired now and then; basically they are in equilibrium with hourly income. Occasional treats are exactly that. Just don't overindulge. And extravagant expenses should be avoided at all costs.

Here's how we can expect this behavior to play out (just a bit of plain arithmetic, some double-counting, lots of rounding, and no algebra). But the results are sometimes usefully counterintuitive:

Cheap thrills (less than \$1/hour)

- Cable television may run \$50 per month, but with three people watching 4 hours a day, it's cheap entertainment at 15¢ an hour.
- A new T-shirt isn't a bad deal. At \$25 for the shirt, worn once a week for 15 hours a day, until it wears out in 4 years. This works out to less than a penny an hour. Why not buy two?
- A diamond ring, though a completely unproductive use of capital and frequently purchased when couples have the least disposable income, ends up costing only a penny or two an hour over a 20-year marriage. It's not really a luxury, at least over the long haul—provided you don't get divorced.

Affordable (\$1 to \$3/hour)

- A cigarette—15¢ each, for a 10-minute nicotine fix—costs about \$1 an hour.
- Internet access—\$30/month for an hour and a half a day—also about \$1 an hour.
- A newspaper—at a dollar for 30 minutes of reading—comes to \$2 an hour.
- An apartment—\$1,500 a month with utilities—ends up costing just \$2 an hour. Good thing the median family has \$4 an hour to spend, but keeping a roof over your head leaves only \$2 an hour for the rest of the day.
- Gasoline, if you pay \$3/gallon, get 25 mpg, and drive at an average speed of 30 mph, comes to approximately \$3.50 an hour (\$7 an hour in an SUV).