Study questions: Advertising

Basic References
Advertising and market structure: Sutton (1991, chs. 3), Bresnahan (1992), Schmalensee (1986), Shapiro (1982)
Informative advertising: Tirole (1988, sect. 7.3), Grossman and Shapiro (1984), Milgrom and Roberts (1986)
Marketing viewpoints: Farris and Albion (1980)

I. Advertising and market structure

a. Recall the Sutton argument. It assumes symmetry among all the firms in the market. What is advertising's effect on market structure?

b. Now assume (as Shapiro (1982) argues) that advertising overcomes informational hurdles for new brands. What are advertising's potential effects on market structure?

II. Informative advertising

a. How do consumer preferences in the Grossman and Shapiro (1984) and Milgrom and Roberts (1986) papers differ? What information do consumers lack in the two models?

Where do the two models fit in?

Prefs → Infor. ↓	Horizontal diff'n	Vertical diff'n
Search good		
Exper. good		

Describe models of advertising which would fall into the other boxes.

b. Grossman–Shapiro (GS) Model

- What is the extensive form of the game considered by GS? How does it differ from Sutton's model?
- What is advertising's effect on market structure?

- GS distinguish between four different effects of advertising (pg. 75). Which of these effects are relevant for the Milgrom–Roberts model?

c. Milgrom–Roberts (MR) Model

- When would firms engage in advertising?
- Note the distinction between the *nondiscriminating* signal (advertising) and the *discriminating* signal (price).

  For additional discussion of this distinction, see Bernheim and Bagwell (1996), Bernheim and Redding (1995). In general, non-discriminatory signals are only employed when the *single-crossing property* fails. It fails when

  $$\frac{\partial \pi(P, H, H)}{\partial P} = \frac{\partial \pi(P, L, H)}{\partial P}$$

  which is the tangency condition when positive amounts of advertising are employed in equilibrium.

IV. Marketing views of advertising

Marketers have focused on advertising's effects on the vertical makeup of the retail sector (i.e., the relation between upstream manufacturers and downstream retailers). An interesting literature has tried to explain the stylized fact that retailer and manufacturer margins are *inversely* related, or a corollary that highly advertised brands yield the lowest retail margins. This insight is mostly attributable to Steiner (1977); see Lal and Narasimhan (1996) for a formalization. Farris and Albion (1980, pp. 27–30) provides a nice summary.

xa. What does Steiner assume about consumer preferences?

b. In general, Steiner implies that manufacturer advertising intensifies retailer competition. What implications follow from this?

References

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