Research Note

Advertising Competition Under Consumer Inertia

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We construct a multistage game-theoretic model of advertising and price competition in a differentiated products duopoly, in which proportions of consumers exhibit latent inertia in favor of repeat purchase. Advertising simultaneously plays the dual role in reducing such inertia through awareness and enhancing perceived brand value (persuasion). We derive the advertising price cross-effects and provide a theoretical reconciliation of the long-standing debate in the marketing literature regarding the impact of advertising on price sensitivity. We characterize the nature of equilibria under symmetry and show that when a large proportion of consumers exhibit inertial tendencies, then a multiplicity of equilibria exists. Marketing implications and comparative statics are discussed.

Numerical simulations for asymmetric firms are presented, wherein we show that advertising is not a useful competitive tool for small firms. However, advertising spending by the large firm provides a halo effect for the average prices in the category, which has a positive externality on the small firm’s profits. In the absence of the small brand advertising, larger brand shares encourage firms to allocate higher expenditures on advertising to enhance the perceived value of their brand, which in turn shore up the average prices in the industry from which all firms benefit.

(Consumer Inertia; Duopoly; Advertising Competition; Game Theory)

1. Introduction

Models of advertising competition and its effects on consumer behavior and market performance have two broad schools. One looks at advertising as a channel that provides valuable information to consumers, enabling them to make rational choices by reducing informational product differentiation. The other school views advertising as a device that persuades consumers by means of intangible and/or psychic differentiators. It creates differentiation among products (Comanor and Wilson 1974), which at times may not be real (Tirole 1990). This is especially true for most “feel” products, such as beer, cigarettes, soft drinks, perfumes, etc.

However, advertising in the extant literature plays a predominantly unidimensional role. For instance, the large body of literature on informative advertising looks at it as a tool for information dissemination, announcing a brand’s existence, available locations, important attributes, price, quality, etc. (namely, Nelson 1970, 1974; Butters 1977; Grossman and Shapiro 1984). On the other hand, the literature on persuasive advertising, which is relatively scarce, uses advertis-