Advertising Contests

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Abstract

This paper considers two competing firms selling different products who race to dominate the market. In this environment, the standard herding archetype is adopted where buyers arrive sequentially and must decide on which one of the two goods to purchase with only observing a private signal and the history of past purchases. The firms invest in advertising resources that determine the private signal distribution of the buyers. The paper characterizes the optimal firms' advertising levels and its impact on consumer welfare. It's shown that as the intensity of competition increases consumers end up being worse off as their signal distrbutions become less informative, potentially leaving consumers with completely uninformative signals. Thus implicating that advertising is harmful and wasteful, at least from the perspective of consumers' welfare.