It is noteworthy that Bain, in his authoritative examination of product differentiation in 20 manufacturing industries, found advertising to be the most important source of product differentiation in the consumer good industries in his sample. Distribution policies are also important where forward integration in prevalent, while customer services and product design play contributing but relatively minor roles.

For typical consumer goods industries, then, a persistently high level of advertising expenditures can be viewed in two ways:

a) If firms behave reasonably, high levels of advertising indicate that the product is differentiable. In this sense, advertising is a symptom of differentiation.

b) The high level of advertising is itself an important determinant of the level of differentiation which is realized by established firms vis-à-vis potential entrants. In this sense, advertising is a source of product differentiation.

Provided that firms act reasonably, observed advertising expenditures provide a useful measure of the extent of product differentiation. We write reasonably rather than rationally since, in an oligopolistic market, rational policies are not unambiguous. What is rational policy for the group acting in concert is not rational policy for the individual firm expecting to gain a march on its rivals. It is quite possible, moreover, that rivalry via advertising among established firms is carried to the point of diminishing returns in terms of group profit rates. However, even in this case, the result of extensive advertising rivalry may be to permit the achievement of higher future profits for the group by raising entry barriers.

### THE EFFECT OF ADVERTISING ON ENTRY BARRIERS

Although advertising is only one source of product differentiation, it is especially important in a number of consumer goods industries where it has a strong direct impact on entry barriers.[8] In these industries, new entrants generally are forced to sell at a price below the established brands or else incur heavy selling costs. This explains the phenomenon of unbranded products selling at prices substantially below those of highly advertised products even where there is little "real" difference between them. On this account, established firms can set prices above existing cost levels, including advertising and other selling expenses, without inducing entry.

Product differentiation via advertising affects entry barriers in three ways, each of which is analogous to the other determinants of overall entry barriers. First, high prevailing levels of advertising create additional costs for new entrants which exist at all levels of output. Because of buyer inertia and loyalty, more advertising messages per prospective customer must be supplied to induce brand switching as compared with repeat buying. Since the market which prospective entrants must penetrate is made up largely of consumers who have purchased existing products, advertising costs per customer for new entrants will be higher than those of existing firms who are maintaining existing market positions. Moreover, the costs of penetration are likely to increase as output expands and customers more inert or loyal need to be reached.[9] This effect of advertising creates an absolute cost advantage for established producers, since they need not incur penetration costs.

In addition, the effect of advertising on firm revenues is subject to economies of scale which result from the increasing effectiveness of advertising messages per unit of output as well as from decreasing costs for each advertising message purchased. The first source of economies will exist whenever the effect of advertising on consumer decisions is sufficiently important that a threshold level of advertising is required for a firm to stay in the market and maintain its current market share. In such a situation, larger firms have the advantage of being able to spread this cost over more units of output and thereby spend less per unit sold. This advantage creates economies of scale at the firm level, since an established firm does not have to spend twice as much on advertising to

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[8] Ibid., 114–143.

[9] These penetration costs depend on past as well as current advertising outlays by established firms. The importance of past outlays is examined by Kristian S. Palda who concludes that "distributed lag models both give a better fit to the Pinkham data and forecast better than he models which do not incorporate lagged effects." *The Measurement of Cumulative Advertising Effects* (Prentice-Hall, 1964), 94.