

Effect of advertising on market competition in the pharmaceutical market

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Abstract: The dramatic increases in direct-to-consumer pharmaceutical advertising expenditures in recent years have fueled many debates on ethical and economic grounds. Industrial organization economics theories suggested that advertising could have an entry-deterrence effect. Previous studies did not adequately address the effect of advertising on product quality. A study of the effect of advertising on entry and product quality will facilitate better understanding of the effect of advertising on pharmaceutical expenditure and public welfare, and inform future policy on pharmaceutical advertising.

Using advertising expenditure and product entry data for eight therapy areas from 1995 to 2001, this study has three objectives. First, it examined whether total advertising expenditures increased barriers of entry to the pharmaceutical markets. Two types of entry decisions (creative and uncreative new product entry) were evaluated as a function of advertising activities by existing competitors and market competitiveness. Second, existing products' strategic response to new product entry was evaluated in consideration of patent life and market conditions. Third, the presence of a first-mover advantage in pharmaceutical advertising was examined by comparing the advertising elasticity of demand of new and existing products while controlling for market competitiveness and possible brand loyalty factors.

The presence of a significant entry deterrence effect on creative investigational product entry but not uncreative entry suggested that there is an asymmetry of quality uncertainty faced by creative and uncreative new product entries. Advertising may discourage firms to develop creative products that are distinctively different from existing products because doing so made them less likely to earn rents from the advertising of existing products. The strategic effect of advertising was weak. Firms did not adjust their advertising in response to entry, and they would continue to advertise as long as the direct effect of advertising on their own product sales was favorable. Effectiveness of advertising was sensitive to the level of competitors' advertising activities. There was no evidence of a first-mover advantage in the effect of advertising on product sales.

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