Grab Them Before They Go Generic: Habit Formation and the Emerging Middle Class*

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Abstract

The "emerging middle class" has become a force of great economic importance in consumer markets around the globe. This paper examines the impact of a substantial rise in Brazil's living standards on the development of the country's large soft-drink market, during a six-year period which saw unprecedented growth in the share of generic soda brands. We propose a random-coefficient logit model in which unobserved household heterogeneity is captured by two features: the household's socioeconomic standing and its habit state. In particular, we allow socially mobile households to develop either a "premium brand habit" or a "frugal habit." We estimate the model using data sources that capture both social mobility and market outcomes. Our results indicate that the arrival of many new consumers, who have not yet developed persistent consumption patterns, provides fertile ground for the growth of generic producers. Persistence in preferences also provides strong justification for Coca-Cola Co's decision to abruptly cut prices in mid 1999. An estimated model variant that does not allow for persistent preferences provides much weaker support for this price cut.

Keywords: emerging middle class, social mobility, differentiated-product demand, habit formation, generics, competitive fringe, premium brands

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