WHY AND UNDER WHAT CONDITIONS ARE PEOPLE MORE LIKELY TO BUY BRAND NAMES RATHER THAN THEIR GENERIC COUNTERPARTS?

BY

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INTRODUCTION

Over the past years the world economy has been integrated through various economic reforms and changes in the world market. Everyday, countries enter into agreements that integrate rather than disparate their economy, this phenomenon has been referred to as globalization by some scholars. Within this type of economy, which is highly competitive it has become apparent that there is a need for producers to distinguish their products so that the consumer recognizes them.

Many scholars have supplied different definitions of brands, however there seems to be a common theme throughout the meanings, as Kotler et al (1995) states, a 'brand is a name, term, sign, symbol or design, or a combination of these intended to identify the goods or services of one seller or group of sellers and to differentiate them from those of competitors'. This definition is complete and accurate and explains the nature and role of brands in the marketing mix.

Blackett and Boad (1999) trace the word brand to the old 'Norse' word 'brandr', which meant to burn. This was applied to the marking of livestock to show ownership and distinguish the one set of cattle from another. The main purpose of branding was to identify ownership or origin.

THE ECONOMICS OF BRANDING: Consumer Information Theory

Brands have considerable power in the market place, and it is this power that is explained, within the discipline of Consumer Information Theory, which is a branch of Consumer Choice in Microeconomics. From this area of economics, there exist a valid explanation as to why people are more likely to buy brands. Since branding has become so strong and powerful these days; hardly any product is unbranded, therefore, this paper considers the conditions under which consumers buy branded products, rather than their generic counterparts.

PNG and Reitman (1995) observed that consumers are of the opinion that branding is a function of quality, so unbranded products offer lower prices at the cost of quality; the converse holds for branded products. Given this fact, sellers are more likely to brand products, since this is indicative of the quality of the product. The idea that consumers think this way is based on information available to them, therefore the theory suggest that an individual will prefer to buy branded products rather than their generic counterparts. The idea behind this theory is that generic counterparts avoid the responsibilities that branding assumes. Consumer Information Theory predicts that consumers know that this relationship exist and will use this as an avenue to vouch their satisfaction or dissatisfaction with the product.

On the supply-side, branding plays a major role; Riordian (1986) states that branding is a central part of the marketing mix under promotion. Products, without brands are highly homogenous, for product differentiation, brands are used to highlight

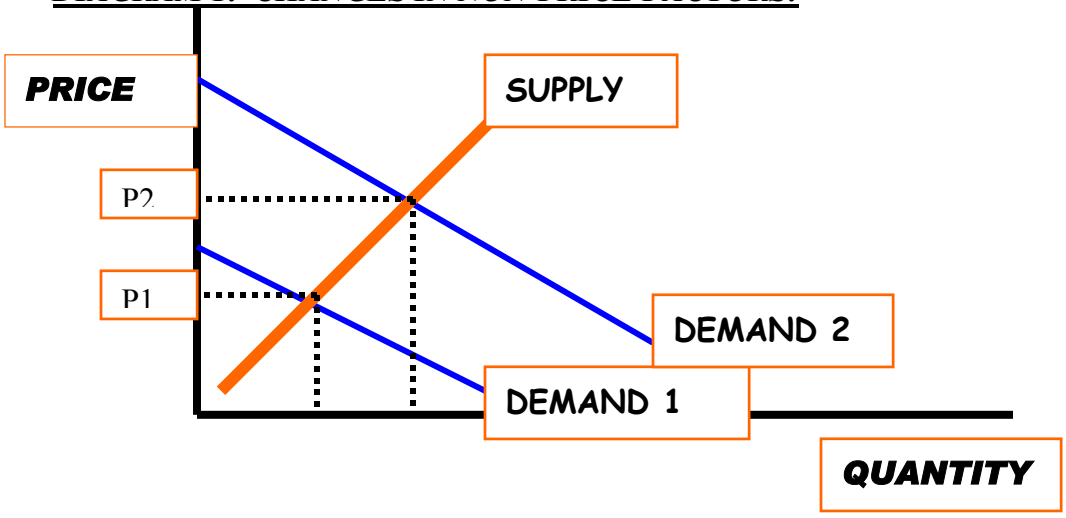
heterogeneous aspects of goods and services. Within the consumer information theory, when brands are used for this purpose, they act as a tool that promotes the product. This promotion is through:

1. Brand loyalty
2. Identification of products (psychological connection)
3. Tangible and Intangible Symbolism.

Principles of marketing have identified a decisive role for the psychology of branding which is imbedded in consumer information theory. For example, many consumers suffer from post-purchase dissonance (regretting the purchase of a certain good or service, after it was bought). Within the context of market segmentation, it is recommended that firms differentiate their products, since studies have shown that branding is one way to lessen the effects of this phenomenon, since branding creates a 'comfort zone' as it relates to quality assurance and product satisfaction. On the other hand generic brands do not possess this characteristic and are assumed to be 'risky purchases', hence consumers are more likely to regret purchases after the fact, and in some extreme cases, may not purchase the unbranded product at all.

PNG and Reitman (1995) predict that consumers are willing to buy generic products, under the condition that the goods and services in question are easy to inspect and relatively inexpensive to sample. Also, the consumers with higher incomes tend to buy more branded products than agents with lower incomes, since the allocation of time is limited for the former group and so they are less willing to experiment and prefer to pay for quality. This is important to the theory since according to Wolinsky (1983) time is an input in consumption; hence purchases tend to reflect the value-added of these products. Branding provides an additional benefit to the purchaser that is incorporated into the pricing mechanism of the product, hence there is a cost associated when a product is branded. A combination of these non-price factors will affect the demand curve, which in turn affects the price of the product; the diagram below shows how price is affected by differences through branding.

DIAGRAM 1: CHANGES IN NON-PRICE FACTORS:



In diagram 1 above, how changes in branding may affect prices is shown. It may result in a shift of the demand curve (from demand 1 to demand 2, which will increase prices form P1 to P2). Diagram one is trying to depict that since price is a function of quality; this too provides the consumer with information that is contained in the market price.

Formal branding maybe unnecessary in certain instances, and generic brands will provide a cheaper alternative, with little or no repercussions on quality. That is, the nature or characteristic of the product can result in branding being obsolete. For example, agricultural products, being sold in a market would not need branding, and will just be an unnecessary cost to the supplier, which may be transferred to the prices.

Ehrlich and Fisher (1982) analyzed the determinants of advertising expenditures, that is, a derived demand function for advertising by firms was deduced. This analysis was aided by the idea of 'brand premium', that is, since advertising affects the demand for goods because it lowers the gap between the market price received by the seller and the full price paid by the buyer. This highlights the idea behind the information cost, used in the consumer information theory. The equation below presents the 'brand premium' in a mathematical form:

$$\Pi_{ij} = P_i + w_j l_{ij} \quad \text{BRAND PREMIUM}$$

Where Π_{ij} is the full price borne by the buyer j of a given brand i. P_i is nominal price, l measures the expected length of time spent per unit good and w represents the buyers' opportunity cost of time.

Within the realm of consumer information theory, a wedge is created between the nominal price received by the seller and the full price borne by the buyer. The difference is the information cost. Information costs are incurred in the form of expenditures of time and investment in knowledge. This information cost will help consumers to decide whether it is worthwhile to buy branded products rather than their generic counterparts, since the information cost is related to the quality of the product, that is, there is a positive relationship between quality and information cost. (Although evidence shows that such a relationship can be biased and inconsistent). All consumers prefer higher to lower quality but they differ in their willingness to pay for quality. Wolinsky (1991) states that the availability of product specific information plays a central role in security the existence of equilibrium the information. In equilibrium the information has no value to the consumer. In markets, consumers obtain specific information causally. The acquisition of quality information is frequently through branding.

Branding relates to firm specific advertising, there it creates a 'natural monopoly' and purchasers of branded products are seeking this kind of uniqueness that brands provide. Generic products are indicative of a market structure such as perfect competition. Economic theory suggest that the latter structure is more efficient and is conducive to the consumers' welfare, while the former structure satisfies the supplier and provides him with super profits at the expense of consumer welfare. From will consumers

prefer branded products to their generic counterparts? Consumer information theory outlines the conditions that answer this question, we will consider the welfare analysis of the two structures below.

WELFARE ANALYSIS: BRANDING AND MARKET STRUCTURES

If we determine the amount of output that maximized a consumer's utility, the problem could be state as:

max u(x) + y
such that y = ù − c(x)
Here ù is the consumer's intial endowment of the y-good.
The first-order condition is
u'(x) = c'(x) . ..... Equation 1.
CONCLUSION: So the competitive market results in the same level of production and consumption as does maximizing utlity. Why?

$$c(x) - c(0) = \int_0^x c'(x)\, d(x) \quad \text{..... Equation 2.}$$

Hence choosing x to maximize utility minus costs (Equation 2) is equivalent to choosing x maximize the area under the demand curve and above the supply curve, this is similar to Equation 1.

Monopolies choose not only output levels, but also other dimensions of the products they produce. This statement is made in relation to brands creating a natural monopoly, hence in what follows we consider product quality, that is, imperfect information about quality contributes to an excessive variety of products differentiated by observable characteristics. The calculations will highlight this:

$W(x,q) = u(x,q) - c(x,q)$ .....Equation 3 : Social Objective Function

The monopolist maximizes profits :

$\max\ p(x,q)x - c(x,q).$

The first - order conditions for this problem are :

$p(x_m, q_m) + [\partial p(x_m, q_m)/\partial x]x_m = \partial c(x_m, q_m)/\partial x$.....Equation 4

$[\partial p(x_m, q_m)/\partial q]x_m = \partial c(x_m, q_m)/\partial q$.....Equation 5

The derivative of Equation 3 at (x_m, q_m) is :

$\partial W(x_m, q_m)/\partial x = [\partial u(x_m, q_m)/\partial x] - \partial c(x_m, q_m)/\partial x$

$\partial W(x_m, q_m)/\partial q = [\partial u(x_m, q_m)/\partial q] - \partial c(x_m, q_m)/\partial q$

Upon substituting form the first - order conditions, equation 4 and equation 5 :

$\partial W(x_m, q_m)/\partial x = -[\partial p(x_m, q_m)/\partial x]x_m > 0$.....Equation 6

$\partial W(x_m, q_m)/\partial q = \partial u(x_m, q_m)/\partial q - [\partial p(x_m, q_m)/\partial q]x_m$.....Equation 7

Equation 6 tells us that, holding quality fixed, the monopolist produces too little ouptut, relative tothe social optimum.

Equation 7 tells us that changes in welfare due to quality is ambigious.

The mathematical rigor of the previous sections shows that conditions under which consumers are more likely to buy brand names than their generic counterparts depends on how the presence or absence of brands changes the market structure in which the product belongs, this will in turn change the welfare effects of the purchase, and consumer information theory states that consumers know this information is available at a cost. According to the findings above, branding will create a monopoly, which has adverse effects on the welfare of the consumer, the converse holds true for generic products, if consumers are willing to pay the information cost to know the changes in welfare due to purchases of branded or unbranded products, then consumers may prefer to generic products *ceteris paribus.*

In addition to the above analysis there a body of literature within consumer information theory that states that branding is not essential, Belleflamme et al (2000) follows Tirole (1988) and shows that there are three forces that oppose product differentiation (branding):

i. The absence of price competition through legal or technical reasons
ii. The location of demand, that is, whether consumers are dispersed or concentrated in a particular area will dictate whether branding is necessary.
iii. Positive externalities, that is, positive outcomes form one firm's production process that affects another firm, other than through the workings of the price mechanism.

Belleflamme et al (2000) used a consumer information theory model to show that the demand for differentiated products is a derived demand that is constructed from the utility function of a representative consumer with a taste for variety. This approach of identifying the importance or branding is a development from a simplistic description of individual demand.

The quality of products in a market depends on how consumers acquire information, branding plays a key role in the dissemination of information to consumers, hence it a requirement by most consumers. Since future demand is a function of current prices, it is not strange that consumers will prefer to purchase branded products to their generic counterparts as they rely on the current information to make future choices, and brands are the main determinants of current prices, information, and the efficient allocation of time, because branding acts a signal of quality.

Within the pitfalls of consumer information theory, Landes (1987) suggest that branding be viewed from a legal perspective, specifically as it relates to trademark law. Property right is a legally enforceable power to exclude others from using a resource without need to contract with them. A trademark is a word, symbol or other signifier used to distinguish goods or services produced by different firms.

Klein et al (1981) is of the opinion that economics considers brand names to be private devices which ensures contractual arrangements are adhered to without the presence of a third party. Consumer information theory uses contract-enforcement mechanisms to ensure that brand loyalty and contractual arrangements are enforceable without the intervention of a third party.

CONCLUSION

The idea behind consumer information theory is not that consumers are fully aware of all the events in the market to the extent that they can verbalize the actions of firms verbatim, but to show that actions such as branding as a form of sales promotion is a form of investment, which makes deception less likely on the part of the firm. In conclusion it can be argued that consumer information theory has presented us with a body of literature that highlights specific conditions under which people are more likely to buy brand names than their generic counterparts.

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