# Consumer Economics

Charlie Ward

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# PREFACE

This book aims to help a broader range of students by exploring a wide variety of significant topics related to this discipline. It will help students in achieving a higher level of understanding of the subject and excel in their respective fields. This book would not have been possible without the unwavered support of my senior professors who took out the time to provide me feedback and help me with the process. I would also like to thank my family for their patience and support.

The study of production, distribution and consumption of goods and services is known as economics. The branch of economics that deals with the analysis of behavior of consumers, individuals or families is known as consumer economics. It may also include policy planning and financial planning. Consumer economics affects the overall economy. Consumer leverage ratio, total household debt and personal income are some of the facets studied under this discipline. Consumer leverage ratio is the ratio of total household debt to disposable personal income, where total household debt is the combined debt of all the people in the household. Some of the theoretical models which fall under consumer economics are time allocation models, stigler's information theory and household production model. This book is a valuable compilation of topics, ranging from the basic to the most complex theories and principles in the field of consumer economics. Different approaches, evaluations, methodologies and studies related to this discipline have been included herein. For someone with an interest and eye for detail, this book covers the most significant topics related to this field.

A brief overview of the book contents is provided below:

Chapter – Introduction

An individual or organization that uses economic commodities is referred to as a consumer. The branch of economics that deals with the microeconomic analysis behavior in consumers, families and individuals is termed as consumer economics. This is an introductory chapter which will briefly introduce about consumer economics.

Chapter – Concepts and Theories

There are varied concepts and theories that are studied under the domain of consumer economics. Some of them are consumer theory, social choice theory, Marshallian demand function, Hicksian demand function, consumers surplus, etc. This chapter has been carefully written to provide an easy understanding of these concepts and theories within consumer economics.

Chapter – Consumer Behavior

Consumer behavior is an inter-disciplinary field of social science. It deals with the study of individuals, groups and organizations, and the activities linked with the purchase, use and disposal of goods and services. The topics elaborated in this chapter will help in gaining a better perspective of consumer behavior.

Chapter – Consumer Budget and Demand

The real purchasing power with which a consumer can purchase quantities of two goods, given their prices is called consumer budget. Demand refers to the consumer's will to buy goods and services. This chapter closely examines the subject of consumer budget and demand to provide an extensive understanding of the subject.

Chapter – Consumerism

The acquisition of goods and services that are encouraged through social and economic order is known as consumerism. A few of its aspects are critical consumerism, ethical consumerism, consumer protection, consumer privacy, etc. All the aspects related to consumerism have been carefully analyzed in this chapter.

Chapter – Consumers and National Economy

A national economy is a broad amalgamation where consumers represent a major factor. Consumer spending is an important factor as it coincides with overall consumer confidence in the nation's economy. This chapter discusses the subject of consumers and their role in national economy in detail.

**Charlie Ward**

# Introduction

CHAPTER 1

An individual or organization that uses economic commodities is referred to as a consumer. The branch of economics that deals with the microeconomic analysis behavior in consumers, families and individuals is termed as consumer economics. This is an introductory chapter which will briefly introduce about consumer economics.

## CONSUMER

A consumer is a person (or group) who pays to consume the goods and/or services produced by a seller (i.e., company, organization).

In the fields of economics, marketing and advertising, a consumer is generally defined as the one who pays to consume the goods and services produced by a seller (i.e., company, organization). A consumer can be a person (or group of people), generally categorized as an end user or target demographic for a product, good, or service.

Any product, good, or service that is developed must have a target market in mind, in order to be effectively marketed and sold. In marketing, there are six types of target markets:

- Consumer markets.
- Industrial markets (made up of industrial companies).
- Commercial markets (consisting of service companies, non-manufacturing companies, and not-for-profit organizations).
- Government markets (made up of government agencies).
- International and global markets (several markets distinguished by different needs and different cultures).
- Markets segmented for strategic targets (markets segmented by strategy and product characteristics, and hence by characteristics of the buyer).

Some may find the term or label “consumer” somewhat offensive because it can be construed as being more descriptive of plain consumption (black and white purchase), rather than recognizing the person behind the purchase, who typically has feelings, needs and overall importance. It is important to note that consumers (or customers) play a vital role in the economic system of a nation. Typically when business people and economists talk of consumers they are talking about an individual person, an aggregated commodity item with little individuality other than that expressed in the buy/not-buy decision. Now, there is a trend in marketing to individualize the concept of "A Consumer." Rather than generating broad demographic profiles and psycho-graphic profiles of market segments (which has been the norm), marketers are now starting to engage in personalized marketing, permission marketing, and mass customization. Marketers are paying close attention to consumer behavior or how potential buyers act when purchasing goods or services for personal consumption.

Open Food Market: An open food market shows how consumers play an important role in a nation's economy.

Consumers are the basic economic entities of an economy. All the consumers consume goods and services directly and indirectly to maximise satisfaction and utility.

Consumers have limited income and by which they want to satisfy their maximum utility (utility is the want satisfying capacity of a commodity).

Generally, consumer means an individual only; however, consumers will consist of a particular individual, a group of individuals, institutions etc.

## Types of Consumers

### Direct Consumers

History tells us that at the very early stage of civilisation producers produced all the basic needs of life for themselves and their families. All the basic needs like food, clothing and shelter they produced for their own and their family's consumption. Hence, the producers were producing goods for their self- consumption. Thus, they were called as direct consumers or direct producers also.

### Consumers by Exchanging Products

With passage of time and civilisation people understood the benefits of exchange. Hence, they tried to specialise on a particular or few products and then tried to exchange the product with the other product(s). The exchange started with barter system and now continuing with monetary system.

This will create the concept of marketable surplus, i.e., the producers are not only producing goods for self-consumption, but some excess or surplus product(s) they are keeping to get other product(s) in exchange. For example, a farmer producing pulse not only for self-consumption but the extra or surplus pulse he will exchange with the producer of other product, say paddy.

### Modern Consumers

These consumers only go to the market to buy the goods and services available in the market through money only. Here, the producers are also producing goods or services directly sent to the market for the consumers. These consumers buy all the goods and services in lieu of money. The modern consumers are the outcome of monetary system.

### Importance of Consumers

### Encourage Demand

Consumers are the main source of demand for all the goods. The producers of industrial goods or the producers of agricultural products are all producing the various items according to the demand in the market. It is the demand which controls the production or market. Hence, the consumers create demand in the market and producers produce goods or services accordingly.

### Create Demand for Various Products

The different consumers have different types of demand or a single consumer can also demand different types of products. These will encourage the producers to produce various types of products in the market. For example, some consumers want to consume paddy, whereas some consumers want to consume wheat.

However, there are some consumers; who want different qualities of paddy and wheat also. Thus, there are some consumers who prefer red colour soap whereas other' consumers prefer green colour soap. Therefore, to satisfy all the types of consumers, producers must increase the production of various products.

### Increase Demand for Consumer Goods

Consumers create more demand for all the types of consumer goods, like durable, semi- durable and perishable goods. Durable consumer goods include furniture, utensils, televisions, etc. and for semi-durable goods like clothes, books, shoes etc. On the other hand, perishable goods like bread, butter, vegetables, fruits etc. are all demanded by the consumers for their consumption purposes. Naturally, all these create an atmosphere to increase demand for consumer goods.

### Enhance Service Diversification

Consumers not only consume different varieties of goods, but also consume large varieties of services to maintain the standard of living. These include health service, educational service, banking and insurance service, transport and communication service, etc. Day by day the consumption of these services is rising. This will lead to expansion or enhancement of service sector within the economy.

## CONSUMER ECONOMICS

Consumer economics is a branch of economics. It is a broad field, principally concerned with microeconomic analysis behavior in units of consumers, families, or individuals (in contrast to traditional economics, which primarily government or business units). It sometimes also encompasses family financial planning and policy analysis. The term largely describes what was more commonly called "home economics" in the past.

The traditional economists had little interest in analyzing family units. When economic theory was insufficient to explain the phenomenon of women starting to enter the labor force en masse, consumer economics both gained attention and received important contributions from economic theorists. Major theoretical cornerstones include Gary Becker's Household Production Model, time allocation models and Stigler's information search theory.

Consumer economics concludes the family-unit economists were strongly influenced by the most recent "consumer era"; which was the "Modern Consumer Movement" of the 1970s. The connection between Consumer Economics and consumer-related politics has been overt, although the strength of the connection varies between Universities and individuals.

Many facets of consumer economics are measured regularly by the Federal Reserve System and the Bureau of Economic Analysis and are available for the public. A number of indicators are published regularly from these and other academic sources, such as personal income, total household debt, and the Consumer Leverage Ratio.

The effect of consumer economics on the economy is another field of study in economics. It is called the "consumer economy".

## CONSUMER ECONOMY

A consumer economy describes an economy driven by consumer spending as a percent of its gross domestic product, as opposed to the other major components of

GDP (gross private domestic investment, government spending, and imports netted against exports).

In the U.S., it is usually said by economists, including in Henry Hazlitt's "Economics in One Lesson" that 70% of spending is consumer-based, but this number is disputed by economists like Businessweek columnist Michael Mandel.

The absolute income hypothesis argues that income and demand generate consumption, and that the rise in GDP gives life to a rise in consumption. It was popularized by Keynes. Milton Friedman argues for a permanent income hypothesis, that consumption spending is a function of how rich you are.

### Absolute Income

Absolute income was theorized by Keynes. Its model is $Ct=\lambda Yt$. He believed that consumption at a certain time could be determined by marginal propensity to consume multiplied by income at that particular time.

### Permanent Income

Permanent income was theorized by Friedman. Instead of marginal propensity to consume, it theorizes "consumption smoothing", where people spread out changes in income using borrowing (e.g., credit cards).

Charles Hugh Smith, writing for Business Insider, argues that while the use of credit has positive features in low amounts, but that the consumer economy and its expansion of credit produces consumer ennui because there is a marginal return to consumption, and that hyperinflation experts recommended investment in tangible goods. Smith raises the issues of storage and maintenance of goods as limitations and problems of the consumer economy, as demand will eventually have to stagnate and credit will one day be denied.

## CONSUMER EDUCATION

The consumer is the person or entity that purchases, attains or invests in a product or service. Consumer education refers to the process of a buyer learning about the products or services she is considering to attain. Learning can be as quick as reading a label or as in-depth as taking a course in a subject. Consumer education is the answer to the common phrase found in the business world, "buyer beware."

### Using the Data Available

Consumer education consists of two parts, having the information available and the buyer reading or learning about it. There is much information online and in books about pyramid scams and how to identify untrue promises with certain jobs, yet many people fall for old lies.

## Government Help

Companies are not allowed to give the consumer false information. City, state and federal agencies are tasked with ensuring business do not lie and willfully deceive. Entities such as the Federal Trade Commission and state consumer-protection agencies serve as excellent sources of information where consumers can learn about products, companies and services. People can also use these resources to file complaints and possibly pursue legal action against companies that deceive the buyer. Many times, it is only when companies are threatened by legal action that they become truthful and other consumers can now educate themselves about the issues.

## Better Business Bureau

One organization that is helpful in consumer education is the Better Business Bureau or BBB. By visiting online or calling, a person can check a company or business field and see records of consumers who filed complaints, the reason why a complaint was filed and if it was resolved. Likewise, if you have been cheated, treated poorly or feel you have a legitimate complaint against a business; you can file your complaint, so others may learn about the company's reputation. Since sales can be affected by a low BBB rating, many times, a company will work with you to resolve the problem.

## Become an Educated Consumer

Many times, information is right at the consumer's fingertips. It is not only up to the company to provide the information, the government to regulate it, but the buyer must be willing to take time and read the information. Packaged food items sold in the United States must have a label that lists ingredients in order of their amount within the product. Information on vitamins, calories per serving and diverse nutritional information must be clearly written on the product for people to learn about it before they buy. Any public company must detail information such as its annual revenue, assets and debt. An educated consumer is a buyer who takes time to learn before buying.

## Learn before you Buy

Proper research into a product or service means viewing the available data from a few different sources and comparing what you learn. You may enter an electronics store site to purchase a computer. Read all the details and specifications, product reviews from others who have bought it, then exit the site and look for that particular computer on a site that isn't trying to sell you the product. Look for defects, complaints and any information about the company and other products they have sold.

### Importance of Consumer Education

Consumer education helps the consumer in many ways in protecting himself from the malpractices of the seller and in making judicious purchases:

- Consumer education helps a person in making proper purchase. It enables the consumer in making right selection.
- Consumer education familiarizes the consumer with the problems which he faces while making purchases. This education inculcates the logical viewpoint in him.
- Consumer education provides the consumer full information of marketing conditions like various sources of purchasing a particular commodity, from where to get cheap and best goods, the shops providing additional facilities, and to latest products. All these information enables him in taking right decision regarding shopping.
- Consumer education familiarizes the consumer with various standards of standardization and their markings.
- One of the most important uses of consumer education is that it familiarizes the consumer about the various acts enacted by the Government from time to time. Consumer education helps the consumer in getting maximum satisfaction by proper utilization of his money and leads a better living standard.

## CONSUMER LEVERAGE RATIO

Consumer Leverage Ratio is a term popularized by William Jarvis and Dr. Ian C MacMillan in a series of articles in the Harvard Business Review and refers to the ratio of total household debt, as reported by the Federal Reserve System to disposable personal income, as reported by the US Department of Commerce, Bureau of Economic Analysis. The ratio has been used in economic analysis and reporting and has compared relevant economic variables since the 1970s.

The term in a variety of other forms has been used to quantify the amount of debt the average American consumer has, relative to his/her disposable income. As of Q2 2013, the ratio stood at 1.05x, down from highs of 1.29x seen in 2007. The historical average ratio since late 1975 is approximately 0.9x.

Many economists argue the rapid growth in consumer leverage has been the primary fuel of corporate earnings growth in the past few decades and thus underlying Consumer Leverage represents significant economic risk and reward to the US economy. Jarvis and MacMillan quantify this risk within specific businesses and industries in a ratio form as Consumer Leverage Exposure (CLE).

Consumer Leverage Ratio = Total household debt/Disposable personal income

The ratios are incorrect. The denominator is from BEA table Personal Income and Its Disposition, Line 27, Disposable Personal Income. The numerator is as described FRB NY Household Debt. 14-Nov-13 Debt 11.28 $T Debt, FRB NY Disp Inc 12.54 Disposable Inc. BEA, Personal Income and Its Disposition, Line 27 90%.

As reported by data from the Bureau of Economic Analysis and the Federal Reserve, below are recent historical Consumer Leverage Ratio levels:

| Quarter | Ratio | Quarter | Ratio |
|---|---|---|---|
| Q1 2005 | 1.18x | Q2 2009 | 1.24x |
| Q2 2005 | 1.20x | Q3 2009 | 1.24x |
| Q3 2005 | 1.21x | Q4 2009 | 1.23x |
| Q4 2005 | 1.22x | Q1 2010 | 1.21x |
| Q1 2006 | 1.22x | Q2 2010 | 1.19x |
| Q2 2006 | 1.25x | Q3 2010 | 1.17x |
| Q3 2006 | 1.26x | Q4 2010 | 1.15x |
| Q4 2006 | 1.27x | Q1 2011 | 1.13x |
| Q1 2007 | 1.27x | Q2 2011 | 1.11x |
| Q2 2007 | 1.28x | Q3 2011 | 1.10x |
| Q3 2007 | 1.29x | Q4 2011 | 1.10x |
| Q4 2007 | 1.29x | Q1 2012 | 1.07x |
| Q1 2008 | 1.29x | Q2 2012 | 1.07x |
| Q2 2008 | 1.25x | Q3 2012 | 1.06x |
| Q3 2008 | 1.26x | Q4 2012 | 1.04x |
| Q4 2008 | 1.26x | Q1 2013 | 1.05x |
| Q1 2009 | 1.26x | Q2 2013 | 1.05x |

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# Concepts and Theories

CHAPTER 2

There are varied concepts and theories that are studied under the domain of consumer economics. Some of them are consumer theory, social choice theory, Marshallian demand function, Hicksian demand function, consumers surplus, etc. This chapter has been carefully written to provide an easy understanding of these concepts and theories within consumer economics.

## CONSUMER THEORY

Consumer theory is the study of how people decide to spend their money based on their individual preferences and budget constraints. A branch of microeconomics, consumer theory shows how individuals make choices, subject to how much income they have available to spend and the prices of goods and services.

Understanding how consumers operate makes it easier for vendors to predict which of their products will sell more and enables economists to get a better grasp of the shape of the overall economy.

Individuals have the freedom to choose between different bundles of goods and services. Consumer theory seeks to predict their purchasing patterns by making the following three basic assumptions about human behavior:

- Utility maximization: Individuals are said to make calculated decisions when shopping, purchasing products that bring them the greatest benefit, otherwise known as maximum utility in economic terms.
- Nonsatiation: People are seldom satisfied with one trip to the shops and always want to consume more.
- Decreasing marginal utility: Consumers lose satisfaction in a product the more they consume it.

Working through examples and/or cases, consumer theory usually requires the following inputs:

- A full set of consumption options.
- How much utility a consumer derives from each bundle in the set of options.

- A set of prices assigned to each bundle.
- Any initial bundle the consumer currently holds.

## Advantages of Consumer Theory

Building a better understanding of individuals' tastes and incomes is important because it has a big bearing on the demand curve, the relationship between the price of a good or service and the quantity demanded for a given period of time, and the shape of the overall economy.

Consumer spending drives a significantly large chunk of gross domestic product (GDP) in the U.S. and other nations. If people cut down on purchases, demand for goods and services will fall, squeezing company profits, the labor market, investment, and many other things that make the economy tick.

## Example of Consumer Theory

Let's look at an example. Kyle is a consumer with a budget of $200, who must choose how to allocate his funds between pizza and video games (the bundle of goods). If a pizza costs $10 and a video game cost $50, Kyle could buy 20 pizzas, or four video games, or five pizzas and three video games. Alternatively, he could keep all $200 in his pocket.

How can an outsider predict how Kyle is most likely to spend his money? Consumer theory can help give an answer to this question.

## Limitations of Consumer Theory

Challenges to developing a practical formula for this situation are numerous. For instance, as behavioral economics points out, people are not always rational and are occasionally indifferent to the choices available. Some decisions are particularly difficult to make because consumers are not familiar with the products. There could also be an emotional component involved in the decision-making process that isn't able to be captured in an economic function.

The many assumptions that consumer theory makes means it has come under heavy criticism. While its observations may be valid in a perfect world, in reality there are numerous variables that can expose the process of simplifying spending habits as flawed.

Going back to the example of Kyle, figuring out how he will spend his $200 is not as clear-cut as it might at first seem. Economics assumes he understands his preferences for pizza and video games and can decide how much of each he wants to purchase. It also presumes there are enough video games and pizzas available for Kyle to choose the quantity of each he desires.

# CONSUMER CHOICE

The theory of consumer choice is the branch of microeconomics that relates preferences to consumption expenditures and to consumer demand curves. It analyzes how consumers maximize the desirability of their consumption as measured by their preferences subject to limitations on their expenditures, by maximizing utility subject to a consumer budget constraint.

Consumption is separated from production, logically, because two different economic agents are involved. In the first case consumption is by the primary individual; in the second case, a producer might make something that he would not consume himself. Therefore, different motivations and abilities are involved. The models that make up consumer theory are used to represent prospectively observable demand patterns for an individual buyer on the hypothesis of constrained optimization. Prominent variables used to explain the rate at which the good is purchased (demanded) are the price per unit of that good, prices of related goods, and wealth of the consumer.

The law of demand states that the rate of consumption falls as the price of the good rises, even when the consumer is monetarily compensated for the effect of the higher price; this is called the substitution effect. As the price of a good rises, consumers will substitute away from that good, choosing more of other alternatives. If no compensation for the price rise occurs, as is usual, then the decline in overall purchasing power due to the price rise leads, for most goods, to a further decline in the quantity demanded; this is called the income effect.

In addition, as the wealth of the individual rises, demand for most products increases, shifting the demand curve higher at all possible prices.

The basic problem of consumer theory takes the following inputs:

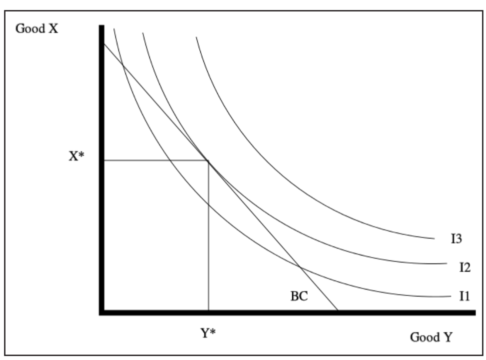
- The consumption set C: The set of all bundles that the consumer could conceivably consume.
- A preference relation over the bundles of C. This preference relation can be described as an ordinal utility function, describing the utility that the consumer derives from each bundle.
- A price system, which is a function assigning a price to each bundle.
- An initial endowment, which is a bundle from C that the consumer initially holds. The consumer can sell all or some of his initial bundle in the given prices, and can buy another bundle in the given prices. He has to decide which bundle to buy, under the given prices and budget, in order to maximize his utility.

## Homogeneous Divisible Goods

Consider an economy with two types of homogeneous divisible goods, traditionally called X and Y.

- The consumption set is $R^2_+$, i.e. the set of all pairs $(x,y)$ where $x \geq 0$ and $y \geq 0$. Each bundle contains a non-negative quantity of good X and a non-negative quantity of good Y.
- A typical preference relation in this universe can be represented by a set of indifference curves. Each curve represents a set of bundles that give the consumer the same utility. A typical utility function is the Cobb–Douglas function: $u(x,y) = x^{\alpha} \cdot y^{\beta}$,
- A typical price system assigns a price to each type of good, such that the cost of bundle $(x,y)$ is $xp_X + yp_Y$.
- A typical initial endowment is just a fixed income, which along with the prices implies a budget constraint. The consumer can choose any point on or below the budget constraint line BC In the diagram. This line is downward sloped and linear since it represents the boundary of the inequality $xp_X + yp_Y \leq income$. In other words, the amount spent on both goods together is less than or equal to the income of the consumer.

The consumer will choose the indifference curve with the highest utility that is attainable within his budget constraint. Every point on indifference curve I3 is outside his budget constraint so the best that he can do is the single point on I2 where the latter is tangent to his budget constraint. He will purchase X* of good X and Y* of good Y.




Indifference curve analysis begins with the utility function. The utility function is treated as an index of utility. All that is necessary is that the utility index change as more preferred bundles are consumed.

Indifference curves are typically numbered with the number increasing as more preferred bundles are consumed. The numbers have no cardinal significance; for example if three indifference curves are labeled 1, 4, and 16 respectively that means nothing more than the bundles "on" indifference curve 4 are more preferred than the bundles "on" indifference curve 1.

Income effect and price effect deal with how the change in price of a commodity changes the consumption of the good. The theory of consumer choice examines the trade-offs and decisions people make in their role as consumers as prices and their income changes.

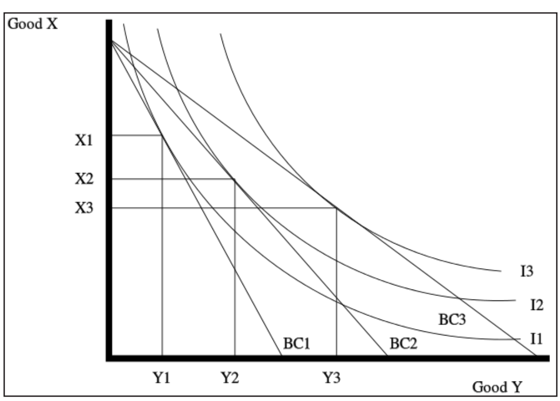
As a second example, consider an economy which consists of a large land-estate L.

- The consumption set is $P(L)$, i.e. the set of all subsets of L (all land parcels).
- A typical preference relation in this universe can be represented by a utility function which assigns, to each land parcel, its total "fertility" (the total amount of grain that can be grown in that land).
- A typical price system assigns a price to each land parcel, based on its area.
- A typical initial endowment is either a fixed income, or an initial parcel which the consumer can sell and buy another parcel.

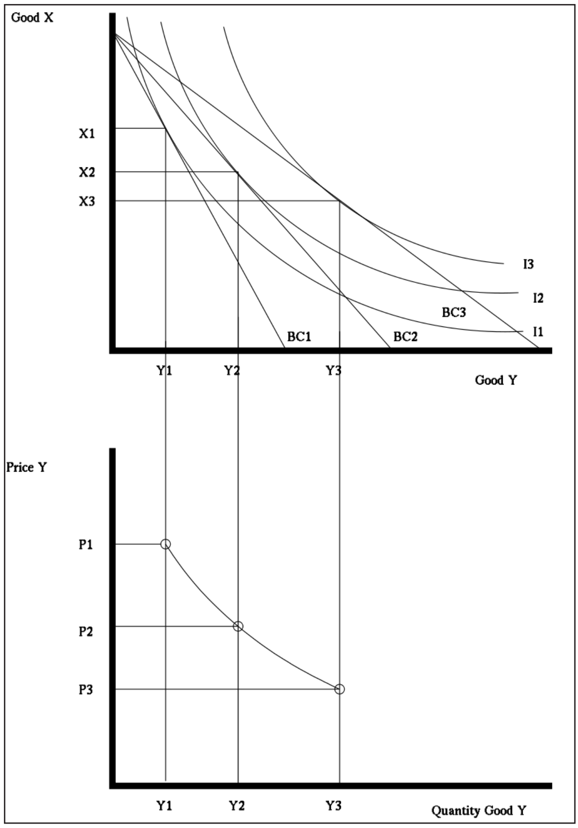
## Effect of a Price Change

The indifference curves and budget constraint can be used to predict the effect of changes to the budget constraint. The graph below shows the effect of a price increase for good Y. If the price of Y increases, the budget constraint will pivot from BC2 to BC1. Notice that because the price of X does not change, the consumer can still buy the same amount of X if he or she chooses to buy only good X. On the other hand, if the consumer chooses to buy only good Y, he or she will be able to buy less of good Y because its price has increased.

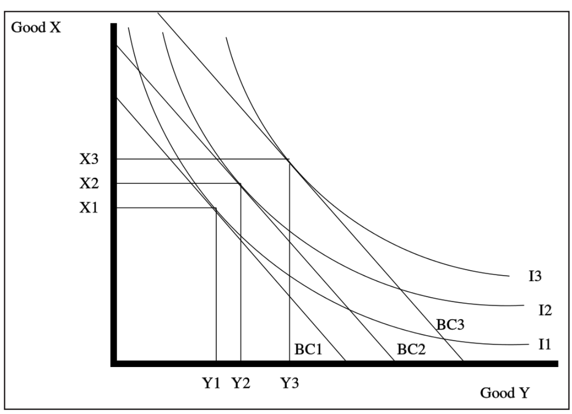
To maximize the utility with the reduced budget constraint, BC1, the consumer will re-allocate consumption to reach the highest available indifference curve which BC1 is tangent to. As shown on the diagram below, that curve is I1, and therefore the amount of good Y bought will shift from Y2 to Y1, and the amount of good X bought to shift from X2 to X1. The opposite effect will occur if the price of Y decreases causing the shift from BC2 to BC3, and I2 to I3.



If these curves are plotted for many different prices of good Y, a demand curve for good Y can be constructed. The diagram below shows the demand curve for good Y as its price varies. Alternatively, if the price for good Y is fixed and the price for good X is varied, a demand curve for good X can be constructed.



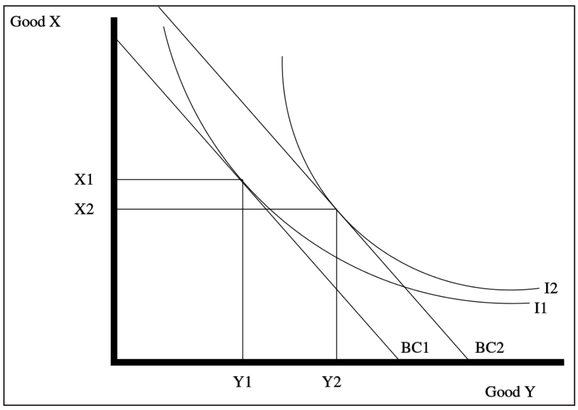

## Income Effect




Another important item that can change is the money income of the consumer. The income effect is the phenomenon observed through changes in purchasing power.

It reveals the change in quantity demanded brought by a change in real income. Graphically, as long as the prices remain constant, changing income will create a parallel shift of the budget constraint. Increasing the income will shift the budget constraint right since more of both can be bought, and decreasing income will shift it left.

Depending on the indifference curves, as income increases, the amount purchased of a good can either increase, decrease or stay the same. In the diagram below, good Y is a normal good since the amount purchased increased as the budget constraint shifted from BC1 to the higher income BC2. Good X is an inferior good since the amount bought decreased as the income increases.



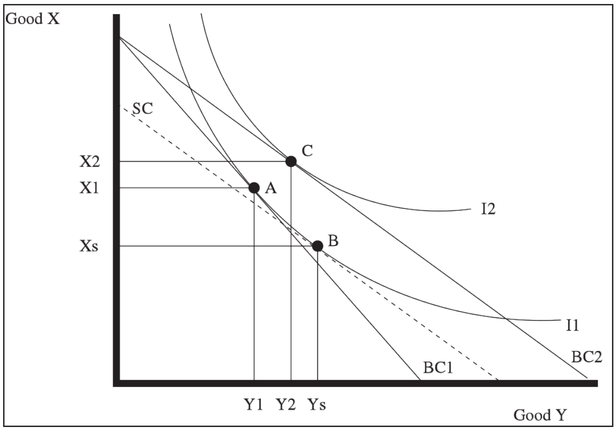

$\Delta y_1^n$ is the change in the demand for good 1 when we change income from $m'$ to $m$, holding the price of good 1 fixed at $p_1'$:

$$\Delta y_1^n = y_1(p_1', m) - y_1(p_1', m').$$

## Price Effect as Sum of Substitution and Income Effects

Every price change can be decomposed into an income effect and a substitution effect; the price effect is the sum of substitution and income effects.

The substitution effect is the change in demands resulting from a price change that alters the slope of the budget constraint but leaves the consumer on the same indifference curve. In other words, it illustrates the consumer's new consumption basket after the price change while being compensated as to allow the consumer to be as happy as he or she was previously. By this effect, the consumer is posited to substitute toward the good that becomes comparatively less expensive. In the illustration below this corresponds to an imaginary budget constraint denoted SC being tangent to the indifference curve I1. Then the income effect from the rise in purchasing power from a price fall reinforces the substitution effect. If the good is an inferior good, then the income effect will offset in some degree the substitution effect. If the income effect for an inferior good is sufficiently strong, the consumer will buy less of the good when it becomes less expensive, a Giffen good (commonly believed to be a rarity).




The substitution effect, $\Delta y_1^s$, is the change in the amount demanded for $Y$ when the price of good $Y$ falls from $p_1$ to $p_1'$ (represented by the budget constraint shifting from BC1 to BC2 and thus increasing purchasing power) and, at the same time, the money income falls from $m$ to $m'$ to keep the consumer at the same level of utility on:

$$\Delta y_1^s = y_1(p_1', m') - y_1(p_1, m) = Y_s - Y_1.$$

The substitution effect increases the amount demanded of good $Y$ from $Y_1$ to $Y_s$ in the diagram. In the example shown, the income effect of the fall in $p_1$ partly offsets the substitution effect as the amount demanded of $Y$ in the absence of an offsetting income change ends up at $Y_2$ thus the income effect from the rise in purchasing power due to the price drop is that the quantity demanded of $Y$ goes from $Y_s$ to $Y_2$. The total effect of the price drop on quantity demanded is the sum of the substitution effect and the income effect.

## Assumptions

The behavioral assumption of the consumer theory proposed herein is that all consumers seek to maximize utility. In the mainstream economics tradition, this activity of maximizing utility has been deemed as the "rational" behavior of decision makers. More specifically, in the eyes of economists, all consumers seek to maximize a utility function subject to a budgetary constraint. In other words, economists assume that consumers will always choose the "best" bundle of goods they can afford. Consumer theory is therefore based on generating refutable hypotheses about the nature of consumer demand from this behavioral postulate.

In order to reason from the central postulate towards a useful model of consumer choice, it is necessary to make additional assumptions about the certain preferences that consumers employ when selecting their preferred "bundle" of goods. These are relatively strict, allowing for the model to generate more useful hypotheses with regard to consumer behaviour than weaker assumptions, which would allow any empirical data to be explained in terms of stupidity, ignorance, or some other factor, and hence would not be able to generate any predictions about future demand at all. For the most part, however, they represent statements which would only be contradicted if a consumer was acting in (what was widely regarded as) a strange manner. In this vein, the modern form of consumer choice theory assumes:

- Preferences are complete: Consumer choice theory is based on the assumption that the consumer fully understands his or her own preferences, allowing for a simple but accurate comparison between any two bundles of good presented. That is to say, it is assumed that if a consumer is presented with two consumption bundles A and B each containing different combinations of n goods, the consumer can unambiguously decide if (s)he prefers A to B, B to A, or is indifferent to both. The few scenarios where it is possible to imagine that decision-making would be very difficult are thus placed "outside the domain of economic analysis". However, discoveries in behavioral economics has found that actual decision making is affected by various factors, such as whether choices are presented together or separately through the distinction bias.

- Preferences are reflexive: Means that if A and B are in all respect identical the consumer will consider A to be at least as good as (i.e. weakly preferred to) B. Alternatively, the axiom can be modified to read that the consumer is indifferent with regard to A and B.

- Preference are transitive: If A is preferred to B and B is preferred to C then A must be preferred to C. This also means that if the consumer is indifferent between A and B and is indifferent between B and C she will be indifferent between A and C. This is the consistency assumption. This assumption eliminates the possibility of intersecting indifference curves.

- Preferences exhibit non-satiation: This is the "more is always better" assumption; that in general if a consumer is offered two almost identical bundles A and B, but where B includes more of one particular good, the consumer will choose B.

Among other things this assumption precludes circular indifference curves. Non-satiation in this sense is not a necessary but a convenient assumption. It avoids unnecessary complications in the mathematical models.

- Indifference curves exhibit diminishing marginal rates of substitution: This assumption assures that indifference curves are smooth and convex to the origin. This assumption is implicit in the last assumption. This assumption also set the stage for using techniques of constrained optimization. Because the shape of the curve assures that the first derivative is negative and the second is positive. The MRS tells how much y a person is willing to sacrifice to get one more unit of x. This assumption incorporates the theory of diminishing marginal utility.

- Goods are available in all quantities: It is assumed that a consumer may choose to purchase any quantity of a good (s)he desires, for example, 2.6 eggs and 4.23 loaves of bread. Whilst this makes the model less precise, it is generally acknowledged to provide a useful simplification to the calculations involved in consumer choice theory, especially since consumer demand is often examined over a considerable period of time. The more spending rounds are offered, the better approximation the continuous, differentiable function is for its discrete counterpart. (Whilst the purchase of 2.6 eggs sounds impossible, an average consumption of 2.6 eggs per day over a month does not.)

Note the assumptions do not guarantee that the demand curve will be negatively sloped. A positively sloped curve is not inconsistent with the assumptions.

## Use Value

In Marx's critique of political economy, any labor-product has a value and a use value, and if it is traded as a commodity in markets, it additionally has an exchange value, most often expressed as a money-price. Marx acknowledges that commodities being traded also have a general utility, implied by the fact that people want them, but he argues that this by itself tells us nothing about the specific character of the economy in which they are produced and sold.

## Labor-leisure Tradeoff

One can also use consumer theory to analyze a consumer's choice between leisure and labor. Leisure is considered one good (often put on the horizontal axis) and consumption is considered the other good. Since a consumer has a finite amount of time, he must make a choice between leisure (which earns no income for consumption) and labor (which does earn income for consumption).

The previous model of consumer choice theory is applicable with only slight modifications. First, the total amount of time that an individual has to allocate is known as his "time endowment", and is often denoted as T. The amount an individual allocates to labor (denoted L) and leisure ($\ell$) is constrained by T such that:

$$\ell + L = T.$$

A person's consumption is the amount of labor they choose multiplied by the amount they are paid per hour of labor (their wage, often denoted w). Thus, the amount that a person consumes is:

$$C = w(T - \ell).$$

When a consumer chooses no leisure $(\ell = 0)$ then $T - \ell = T$ and $C = wT$.

From this labor-leisure tradeoff model, the substitution effect and income effect from various changes caused by welfare benefits, labor taxation, or tax credits can be analyzed.

## SOCIAL CHOICE THEORY

Social choice theory or social choice is a theoretical framework for analysis of combining individual opinions, preferences, interests, or welfares to reach a collective decision or social welfare in some sense. A non-theoretical example of a collective decision is enacting a law or set of laws under a constitution. Social choice theory dates from Condorcet's formulation of the voting paradox. Kenneth Arrow's Social Choice and Individual Values and Arrow's impossibility theorem in it are generally acknowledged as the basis of the modern social choice theory. In addition to Arrow's theorem and the voting paradox, the Gibbard–Satterthwaite theorem, the Condorcet jury theorem, the median voter theorem, and May's theorem are among the more well known results from social choice theory.

Social choice blends elements of welfare economics and voting theory. It is methodologically individualistic, in that it aggregates preferences and behaviors of individual members of society. Using elements of formal logic for generality, analysis proceeds from a set of seemingly reasonable axioms of social choice to form a social welfare function (or constitution). Results uncovered the logical incompatibility of various axioms, as in Arrow's theorem, revealing an aggregation problem and suggesting reformulation or theoretical triage in dropping some axiom(s).

Later work also considers approaches to compensations and fairness, liberty and rights, axiomatic domain restrictions on preferences of agents, variable populations, strategy-proofing of social-choice mechanisms, natural resources, capabilities and functionings, and welfare, justice, and poverty.

Social choice and public choice theory may overlap but are disjoint if narrowly construed. The Journal of Economic Literature classification codes place Social Choice under Microeconomics at JEL D71 (with Clubs, Committees, and Associations) whereas most Public Choice subcategories are in JEL D72 (Economic Models of Political Processes: Rent-Seeking, Elections, Legislatures, and Voting Behavior).

### Interpersonal Utility Comparison

Social choice theory depends upon the ability to aggregate, or sum up, individual preferences into a combined social welfare function. Individual preference can be modeled in terms of an economic utility function. The ability to sum utility functions of different individuals depends on the utility functions being comparable to each other;

informally, individuals' preferences must be measured with the same yardstick. Then the ability to create a social welfare function depends crucially on the ability to compare utility functions. This is called interpersonal utility comparison.

Following Jeremy Bentham, utilitarians have argued that preferences and utility functions of individuals are interpersonally comparable and may therefore be added together to arrive at a measure of aggregate utility. Utilitarian ethics call for maximizing this aggregate.

Lionel Robbins questioned whether mental states, and the utilities they reflect, can be measured and, a fortiori, interpersonal comparisons of utility as well as the social choice theory on which it is based. Consider for instance the law of diminishing marginal utility, according to which utility of an added quantity of a good decreases with the amount of the good that is already in possession of the individual. It has been used to defend transfers of wealth from the "rich" to the "poor" on the premise that the former do not derive as much utility as the latter from an extra unit of income. Robbins argues that this notion is beyond positive science; that is, one cannot measure changes in the utility of someone else, nor is it required by positive theory.

Apologists of the interpersonal comparison of utility have argued that Robbins claimed too much. John Harsanyi agrees that full comparability of mental states such as utility is never possible but believes, however, that human beings are able to make some interpersonal comparisons of utility because they share some common backgrounds, cultural experiences, etc. In the example from Amartya Sen, it should be possible to say that Emperor Nero's gain from burning Rome was outweighed by the loss incurred by the rest of the Romans. Harsanyi and Sen thus argue that at least partial comparability of utility is possible, and social choice theory proceeds under that assumption.

Sen proposes, however, that comparability of interpersonal utility need not be partial. Under Sen's theory of informational broadening, even complete interpersonal comparison of utility would lead to socially suboptimal choices because mental states are malleable. A starving peasant may have a particularly sunny disposition and thereby derive high utility from a small income. This fact should not nullify, however, his claim to compensation or equality in the realm of social choice.

Social decisions should accordingly be based on immalleable factors. Sen proposes interpersonal utility comparisons based on a wide range of data. His theory is concerned with access to advantage, viewed as an individual's access to goods that satisfy basic needs (e.g., food), freedoms (in the labor market, for instance), and capabilities. We can proceed to make social choices based on real variables, and thereby address actual position, and access to advantage. Sen's method of informational broadening allows social choice theory to escape the objections of Robbins, which looked as though they would permanently harm social choice theory.

Additionally, since the seminal results of Arrow's impossibility theorem and the Gibbard–Satterthwaite theorem, many positive results focusing on the restriction of the domain of preferences of individuals have elucidated such topics as optimal voting. The initial results emphasized the impossibility of satisfactorily providing a social choice function free of dictatorship and inefficiency in the most general settings. Later results have found natural restrictions that can accommodate many desirable properties.

## CONSUMER SOVEREIGNTY

Consumer sovereignty is the theory that consumer preferences determine the production of goods and services. This means consumers can use their spending power as 'votes' for goods. In return, producers will respond to those preferences and produce those goods.

In reality, however, producers do produce goods that consumers do not want or introduce new products like the iPod that the consumers did not know they wanted.

### Limitations of Consumer Sovereignty

### Inequitable Distribution of Income

Lower-income consumers have limited options because of their lower incomes. Richer consumers have more the luxury of choice. Therefore, consumer sovereignty is limited by the unequal distribution of income.

### Availability of Resources

In theory, producers should be able to produce goods that consumers demand. In reality, a country may not have the infrastructure, technology or natural resources to be able to do so.

### Monopoly Power

Monopolies can override consumer sovereignty because there may not be other choices in the market. This also means the consumer has to purchase at the price decided by the monopoly.

### Government Restrictions

Governments often impose taxes or subsidies to discourage or encourage the consumption of certain goods. In certain cases, governments may simply outright ban the production that products such as opium.

### Irrational Consumer

In economics, we assume consumers will always make a rational decision, however, in reality, this isn't always the case.

### Combined Demand

Rarely do individual consumers have choices in affecting prices or decisions of the producer. It is the combined demand of many consumers that can only make a difference.

### Consumer Sovereignty and Types of Economy

The theory of consumer sovereignty implies that the consumer knows what is best for himself or herself and his or her preferences will decide the allocation of scarce resources in the economy. However, this differs in different types of economies.

For example, in a free market, consumers have the highest levels of consumer sovereignty. The consumer is free to buy any commodity and in whatever quantities his likes.

However, in a command economy, the state or central government decides what to produce.

## BUYER DECISION PROCESS

The buying decision process is the decision-making process used by consumers regarding the market transactions before, during, and after the purchase of a good or service. It can be seen as a particular form of a cost–benefit analysis in the presence of multiple alternatives.

Common examples include shopping and deciding what to eat. Decision-making is a psychological construct. This means that although a decision cannot be "seen", we can infer from observable behavior that a decision has been made. Therefore, we conclude that a psychological "decision-making" event has occurred. It is a construction that imputes a commitment to action. That is, based on observable actions, we assume that people have made a commitment to effect the action.

Nobel laureate Herbert A. Simon sees economic decision-making as a vain attempt to be rational. He claims that if a complete analysis is to be done, a decision will be immensely complex. He also says that peoples' information processing ability is limited. The assumption of a perfectly rational economic actor is unrealistic. Consumers are influenced by emotional and nonrational considerations making attempts to be rational only partially successful.

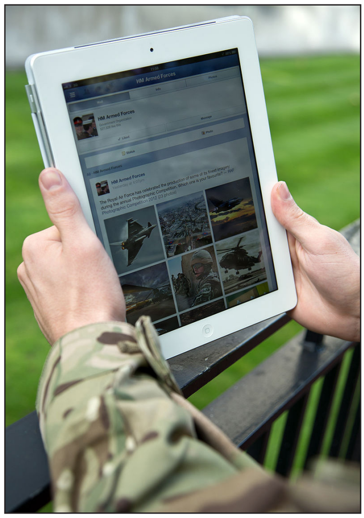
## Stages

The stages of the buyer decision process were first introduced by John Dewey in 1910. Later studies expanded upon Dewey's initial finding. Engel, Blackwell and Kollat.

Consumers shopping engage in a variety of recreational and functional purchasing activities - from window shopping through to transporting their purchases homewards.

- Problem/Need Recognition: Recognize what the problem or need is and identify the product or type of product which is required.
- Information Search: The consumer researches the product which would satisfy the recognized need.
- Evaluation of Alternatives: The consumer evaluates the searched alternatives. Generally, the information search reveals multiple products for the consumer to evaluate and understand which product would be appropriate.
- Purchase Decision: After the consumer has evaluated all the options and would be having the intention to buy any product, there could be now only two things which might just change the decision of the consumer of buying the product that is what the other peers of the consumer think of the product and any unforeseen circumstances. Unforeseen circumstances for example, in this case, could be financial losses which led to not buying of the product.
- Post Purchase Behavior: After the purchase, the consumer may experience post-purchase dissonance feeling that buying another product would have been better. Addressing post-purchase dissonance spreads the good word for the product and increases the chance of frequent repurchase.

These five stages are a framework to evaluate customers' buying decision process. While many consumers pass through these stages in a fixed, linear sequence, some stages such as evaluation of alternatives may occur throughout the purchase decision. The time and effort devoted to each stage depend on a number of factors including the perceived risk and the consumer's motivations. In the case of an impulse purchase, such as the purchase of a chocolate bar as a personal treat, the consumer may spend minimal time engaged in information search and evaluation and proceed directly to the actual purchase.



The rise of digital media and social networks are changing the way that consumers search for product information.

## Problem/Need-recognition

Problem/Need-recognition is the first and most important step in the buying decision. Without the recognition of the need, a purchase cannot take place. The need can be triggered by internal stimuli (e.g. hunger, thirst) or external stimuli (e.g. advertising). Maslow held that needs are arranged in a hierarchy. According to Maslow's hierarchy, only when a person has fulfilled the needs at a certain stage, can he or she move to the next stage. The problem must be the products or services available. It's how the problem must be recognized.

## Information Search

The information search stage is the next step that the customers may take after they have recognized the problem or need in order to find out what they feel is the best solution.

This is the buyer's effort at searching the internal and external business environments to identify and observe sources of information related to the focal buying decision. The field of information has come a long way in the last forty years, and has enabled easier and faster information discovery. Consumers can rely on print, visual, and/or voice media for getting information.

## Evaluation of Alternatives

Shoppers inspect the quality of fresh produce at a market.

At this stage, consumers evaluate different products/brands on the basis of varying product attributes, and whether these can deliver the benefits that the customers are seeking. This stage is heavily influenced by one's attitude, as "attitude puts one in a frame of mind: liking or disliking an object, moving towards or away from it". Another factor that influences the evaluation process is the degree of involvement. For example, if the customer involvement is high, then he/she will evaluate a number of brands; whereas if it is low, only one brand will be evaluated.

| | | | |
|---|---|---|---|
| Customer involvement | High | Medium | Low |
| Characteristics | High | Medium | Low |
| Number of brands examined | Many | Several | Few |
| Number of sellers considered | Many | Several | Few |
| Number of product attributes evaluated | Many | Moderate | One |
| Number of external information sources used | Many | Few | None |
| Time spent searching | Considerable | Little | Minimal |

## Purchase Decision

This is the fourth stage, where the purchase takes place. According to Kotler, Keller, Koshy, and Jha, the final purchase decision can be disrupted by two factors: negative feedback from other customers and the level of motivation to comply or accept the feedback. For example, after going through the above three stages, a customer chooses to buy a Nikon D80 DSLR camera. However, because his good friend, who is also a photographer, gives him negative feedback, he will then be bound to change his preference. Secondly, the decision may be disrupted due to unanticipated situations such as a sudden job loss or the closing of a retail store.

## Post-purchase Behavior

These stages are critical to retaining customers. In short, customers compare products with their expectations and are either satisfied or dissatisfied. This can then greatly affect the decision process for a similar purchase from the same company in the future, mainly at the information search stage and evaluation of alternatives stage. If customers are satisfied, this results in brand loyalty, and the information search and evaluation of alternative stages are often fast-tracked or skipped completely. As a result, brand loyalty is the ultimate aim of many companies.

On the basis of either being satisfied or dissatisfied, a customer will spread either positive or negative feedback about the product. At this stage, companies should carefully create positive post-purchase communication to engage the customers.

Also, cognitive dissonance (consumer confusion in marketing terms) is common at this stage; customers often go through the feelings of post-purchase psychological tension or anxiety. Questions include: "Have I made the right decision?", "Is it a good choice?", etc.

## Models of Buyer Decision-making


Making a few last minute decisions before purchasing a gold necklace from a Navy Exchange vendor.

There are generally three ways of analyzing consumer buying decisions:

- Economic models: Largely quantitative and are based on the assumptions of rationality and near perfect knowledge. The consumer is seen to maximize its utility. See consumer theory. Game theory can also be used in some circumstances.
- Psychological models: Psychological and cognitive processes such as motivation and need recognition. They are qualitative rather than quantitative and build on sociological factors like cultural influences and family influences.
- Consumer behavior models: Practical models used by marketers. They typically blend both economic and psychological models.

In an study of the buyer decision process, Frank Nicosia identified three types of buyer decision-making models. They are the univariate model (He called it the "simple scheme".) in which only one behavioral determinant was allowed in a stimulus-response type of relationship; the multi-variate model (He called it a "reduced form scheme".) in which numerous independent variables were assumed to determine buyer behavior; and finally the "system of equations" model (He called it a "structural scheme" or "process scheme".) in which numerous functional relations (either univariate or multivariate) interact in a complex system of equations. He concluded that only this third type of model is capable of expressing the complexity of buyer decision processes. Nicosia builds a comprehensive model involving five modules. The encoding module includes determinants like "attributes of the brand", "environmental factors", "consumer's attributes", "attributes of the organization", and "attributes of the message". Other modules in the system include consumer decoding, search and evaluation, decision, and consumption.

Some neuromarketing research papers examined how to approach motivation as indexed by electroencephalographic (EEG) asymmetry over the prefrontal cortex predicts purchase decision when brand and price are varied. In a within-subjects design, the participants have presented purchase decision trials with 14 different grocery products (seven private labels and seven national brand products) whose prices were increased and decreased while their EEG activity was recorded. The results showed that relatively greater left frontal activation (i.e., higher approach motivation) during the decision period predicted an affirmative purchase decision. The relationship of frontal EEG asymmetry with purchase decision was stronger for national brand products compared with private label products and when the price of a product was below a normal price (i.e., implicit reference price) compared with when it was above a normal price. The higher perceived need for a product and higher perceived product quality were associated with greater relative left frontal activation.

For any high-involvement product category, the decision-making time is normally long and buyers generally evaluate the information available very cautiously. They also utilize an active information search process. The risk associated with such a decision is very high.

## CONSUMER ADOPTION OF TECHNOLOGICAL INNOVATIONS

Consumer adoption of technological innovations is the process consumers use to determine whether or not to adopt an innovation. This process is influenced by consumer characteristics, such as personality traits and demographic or socioeconomic factors, the characteristics of the new product, such as its relative advantage and complexity, and social influences, such as opinion leaders.

In the context of technological innovations, the adoption process is also influenced by one or several new technologies that are incorporated in the new product. New technologies are likely to significantly affect the innovation's functionality or interface. Functionality refers to the set of potential benefits that a product can provide the consumer. Interface refers here to the specific means by which a consumer interacts with a product to obtain a particular functionality. Specifically, new technologies suggest four types of innovations with unique characteristics that are likely to affect the adoption process. Alternatively it can be looked at as a Paradox of Technology.

## Paradox of Technology

Donald Norman in his book, The Design of Everyday Things, outlines the idea of "Paradox of Technology". Norman's paradox states that when a new functionality is added to a technology, it also increases its complexity. Thus, a technology intended to make life easier by providing more functionality, also makes it more complex by making things harder to learn. A good design must reduce the difficulties in use of the ever-growing technology.

Information and communications technologies such as Facebook experienced this phenomenon when they released the News Feed functionality to all users. The new groundbreaking feature was met with mass upheaval with only one in 100 messages about News Feed being positive. Now, News Feed is an essential feature of Facebook which users today would be outraged if removed.

## Symbolic Interactionism

Symbolic interactionism, the concept that people act toward things based on the meaning they have for them; and these meanings are derived from social interaction and modified though interpretation), plays a key in role in the consumer adoption of technological innovations. People have personal meanings for certain aspects of the technology; when these technologies are changed or modified it can greatly affect how the user interacts with the technology.

A good example of this concept is the controversial removal of the Start Menu from Microsoft's Windows 8. A major reason this was so controversial is this concept of symbolic internationalism. Critique Mark Wilson writes, "I grew up on Windows 3.1 and the introduction of the Start button/menu in Windows 95 was a revelation. Windows 8 was a step in the wrong direction." Similar critiques and reactions was a major issue and Microsoft even brought it back the next release of Windows. Many including Microsoft will argue the start menu was dated and that the newer metro start screen is an improvement upon the start menu but that is still up to debate and preference.

## Social Influences

When a new technology is introduced a user evaluates if the perceived benefits (functionality, aesthetics etc.) outweigh any negative social nuances it may introduce. New technology not only changes the way that the user interacts with it, but often also asks users to embrace new behaviors. However, as our technologies are increasingly becoming more mobile, these new behaviors frequently take place in a public location and become an integral part of a user's social appearance.

It is often the case that every new technology introduces public discomfort. While the first handheld cellular phone was developed in 1973, it was not until the early 2000s that they technology became truly ubiquitous. While a part of the slow growth of cellular phones can be attributed to its design, another big part was the technology being considered esoteric by many.

Sandra Vannoy and Prashant Palvia developed a theoretical model called the "Social Influence Model" that investigates technology adoption at a societal or communal level. The postulate that social influence constitutes of four overlapping phenomenon:

- Social Computing Action: Actions performed through use of technology such as Web browsers and cell phones.
- Social Computing Consensus: Agreement from all people that it is right to carry out the action.
- Social Computing Cooperation: Participating in a way that is in the best interests of the group.
- Social Computing Authority: Recognizing that the authority imposed by the group supersedes traditional authority.

Technology adoption is typically measured on two factors: embedment and embracement in daily life. Social influence deals with the embedment of technology. Embedment in daily life is evaluated by examining how other members of the society present in the same environment utilize the technology, and how the technology is perceived by these members.

## Existing Functionality and Existing Interface

These innovations are incremental in nature since they offer an existing functionality and an existing interface; however, they are usually characterized by esthetic changes that affect the product's appearance. Smart phones, for example, are usually black or silver when first introduced into the market but are available in multiple colors several months later.

## Existing Functionality and New Interface

These innovations provide benefits available by existing products but result in a new set of actions for the consumer. Voice recognition software is one example of this type of innovation. Consumers create documents or emails, for example, by dictating (instead of typing) to a computer.

### New Functionality and Existing Interface

These innovations do not change consumer interaction with a device; they offer, however, a new functionality. Multi-mode cellphones, for example, operate in more than one frequency and enable roaming between different countries.

### New Functionality and New Interface

Car GPS navigation systems, for example, fall under this category. These products provide the consumer with novel functionality, such as door-to-door navigation and real-time traffic information. The novel interface implies a new set of actions for using the device, such as using a touch-screen and voice recognition interfaces. Innovations that incorporate a novel interface require significant learning cost from the consumer since they imply learning a new set of tasks. High learning cost is likely to hinder the adoption of such innovations, unless the functionality provided is new and provides significant benefits to the consumer. Furthermore, innovations incorporating a novel interface often result in fear of technological complexity leading to feelings of ineptitude and frustration. Conversely, innovations that provide the consumer with a new functionality are characterized by a high relative advantage, which is likely to facilitate adoption.

### Impact of Privacy Concerns

As technologies have improved in the past years privacy has become a major concern among consumers because the data revolution and Big Data. Technological innovations more recently have seriously been affected by these concerns and changes how people interact with these new technologies. Privacy is a very broad concept, it is very hard to define in simple manners and is still a controversial subject, and because of this confusion, consumers reject many innovations or unknowingly give their personal data to third parties. Daniel J. Solove is an expert in the topic of Privacy and in his recent book Understanding Privacy he lays out the problems and frameworks of privacy in the era of technology and the data revolution. Another good example is Eli Pariser's concept of The Filter Bubble that he lays out in his book, The Filter Bubble: What the Internet Is Hiding from You. Innovations like personalized search from Google are very controversial mainly because most consumers have no idea that it is even occurring.

## UTILITY MAXIMIZATION PROBLEM

In microeconomics, the utility maximization problem is the problem consumers face: "how should I spend my money in order to maximize my utility?" It is a type of optimal decision problem. It consists of choosing how much of each available good or service to consume, taking into account a constraint on total spending as well as the prices of the goods.

## Basic Setup

Suppose the consumer's consumption set, or the enumeration of all possible consumption bundles that could be selected if there were no budget constraint, has L commodities and is limited to positive amounts of consumption of each commodity. Let x be the vector x={$x_i$;i=1,...L} containing the amounts of each commodity; then:

$$x \in \mathbb{R}_+^L .$$

Suppose also that the price vector (p) of the L commodities is positive.

$$p \in \mathbb{R}_+^L ,$$

and that the consumer's income is $I$ ; then the set of all affordable packages, the budget set, is:

$$B(p,I) = \{x \in \mathbb{R}_+^L : \langle p,x \rangle \leq I\} ,$$

where $\langle p,x \rangle$ is the dot product of p and x, or the total cost of consuming x of the products at price level p:

$$\langle p,x \rangle = \sum_{i=1}^{L} p_i x_i .$$

The consumer would like to buy the best affordable package of commodities.

It is assumed that the consumer has an ordinal utility function, called u. It is a real valued function with domain being the set of all commodity bundles, or.

$$u : \mathbb{R}_+^L \to \mathbb{R}_+ .$$

Then the consumer's optimal choice $x(p,I)$ is the utility maximizing bundle of all bundles in the budget set, or.

$$x(p,I) = \text{argmax}_{x^* \in B(p,I)} u(x^*).$$

Finding $x(p,I)$ is the utility maximization problem.

If u is continuous and no commodities are free of charge, then $x(p,I)$ exists, but it is not necessarily unique. If there is a unique maximizer for all values of the price and wealth parameters, then $x(p,I)$ is called the Marshallian demand function; otherwise, $x(p,I)$ is set-valued and it is called the Marshallian demand correspondence.

### Reaction to Changes in Prices

For a given level of real wealth, only relative prices matter to consumers, not absolute prices. If consumers reacted to changes in nominal prices and nominal wealth even if relative prices and real wealth remained unchanged, this would be an effect called money illusion. The mathematical first order conditions for a maximum of the consumer problem guarantee that the demand for each good is homogeneous of degree zero jointly in nominal prices and nominal wealth, so there is no money illusion.

### Bounded Rationality

In practice, a consumer may not always pick an optimal package. For example, it may require too much thought. Bounded rationality is a theory that explains this behaviour with satisficing—picking packages that are suboptimal but good enough.

## MARSHALLIAN DEMAND FUNCTION

In microeconomics, a consumer's Marshallian demand function specifies what the consumer would buy in each price and income or wealth situation, assuming it perfectly solves the utility maximization problem. Marshallian demand is sometimes called Walrasian demand or uncompensated demand function instead, because the original Marshallian analysis refused wealth effects.

According to the utility maximization problem, there are L commodities with price vector p and choosable quantity vector x. The consumer has income I, and hence a budget set of affordable packages:

$$B(p,I)=\{x:\langle p,x\rangle \leq I\},$$

where $\langle p,x\rangle$ is the inner product of the price and quantity vectors. The consumer has a utility function:

$$u:\mathrm{R}_{+}^{L}\rightarrow \mathrm{R}.$$

The consumer's Marshallian demand correspondence is defined to be:

$$x^{*}(p,I)=\operatorname{argmax}_{x\in B(p,I)}u(x).$$

### Uniqueness

$x^{*}(p,I)$ is called a correspondence because in general it may be set-valued - there may be several different bundles that attain the same maximum utility. In some cases, there is a unique utility-maximizing bundle for each price and income situation; then, $x^{*}(p,I)$ is a function and it is called the Marshallian demand function.

If the consumer has strictly convex preferences and the prices of all goods are strictly positive, then there is a unique utility-maximizing bundle. To prove this, suppose, by contradiction, that there are two different bundles, $x_1$ and $x_2$, that maximize the utility. Then $x_1$ and $x_2$ are equally preferred. By definition of strict convexity, the mixed bundle $0.5x_1 + 0.5x_2$ is strictly better than $x_1, x_2$. But this contradicts the optimality of $x_1, x_2$.

## Continuity

The maximum theorem implies that if:

- The utility function $u(x)$ is continuous with respect to $x$.
- The correspondence $B(p,I)$ is non-empty, compact-valued, and continuous with respect to $p,I$.

then $x^*(p,I)$ is an upper-semicontinuous correspondence. Moreover, if $x^*(p,I)$ is unique, then it is a continuous function of $p$ and $I$.

Combining with the previous subsection, if the consumer has strictly convex preferences, then the Marshallian demand is unique and continuous. In contrast, if the preferences are not convex, then the Marshallian demand may be non-unique and non-continuous.

## Homogeneity

The Marshallian demand correspondence is a homogeneous function with degree 0. This means that for every constant $a > 0$:

$$x^*(a \cdot p, a \cdot I) = x^*(p,I).$$

This is intuitively clear. Suppose $p$ and $I$ are measured in dollars. When $a = 100$, $ap$ and $aI$ are exactly the same quantities measured in cents. Obviously, changing the unit of measurement should not affect the demand.

Examples:

In the following examples, there are two commodities, 1 and 2.

1. The utility function has the Cobb–Douglas form:

$$u(x_1, x_2) = x_1^{\alpha} x_2^{\beta}.$$

The constrained optimization leads to the Marshallian demand function:

$$x^*(p_1, p_2, I) = \left( \frac{\alpha I}{(\alpha+\beta)p_1}, \frac{\beta I}{(\alpha+\beta)p_2} \right).$$

2. The utility function is a CES utility function:

$$u(x_1,x_2)=\left[\frac{x_1^\delta}{\delta}+\frac{x_2^\delta}{\delta}\right]^{\frac{1}{\delta}}.$$

Then,

$$x^*(p_1,p_2,I)=(\frac{Ip_1^{\epsilon-1}}{p_1^\epsilon+p_2^\epsilon},\frac{Ip_2^{\epsilon-1}}{p_1^\epsilon+p_2^\epsilon}),\quad with\quad \epsilon=\frac{\delta}{\delta-1}.$$

In both cases, the preferences are strictly convex, the demand is unique and the demand function is continuous.

3. The utility function has the linear form:

$$u(x_1,x_2)=x_1+x_2.$$

The utility function is only weakly convex, and indeed the demand is not unique: when $p_1=p_2$, the consumer may divide his income in arbitrary ratios between product types 1 and 2 and get the same utility.

4. The utility function exhibits a non-diminishing marginal rate of substitution:

$$u(x_1,x_2)=(x_1^\alpha+x_2^\alpha),\quad with\quad \alpha>1.$$

The utility function is not concave, and indeed the demand is not continuous: when $p_1<p_2$, the consumer demands only product 1, and when $p_2<p_1$, the consumer demands only product 2 (when $p_1=p_2$ the demand correspondence contains two distinct bundles: either buy only product 1 or buy only product 2).

# HICKSIAN DEMAND FUNCTION

In microeconomics, a consumer's Hicksian demand correspondence is the demand of a consumer over a bundle of goods that minimizes their expenditure while delivering a fixed level of utility. If the correspondence is actually a function, it is referred to as the Hicksian demand function, or compensated demand function. The function is named after John Hicks.

Mathematically,

$$h(p,\bar{u})=\arg\min_x\sum_i p_i x_i$$

$$subject\ to\quad u(x)\geq\bar{u}.$$

where h(p,u) is the Hicksian demand function, or commodity bundle demanded, at price vector p and utility level $\bar{u}$. Here p is a vector of prices, and x is a vector of quantities demanded so that the sum of all $p_i x_i$, is the total expense on goods x.

## Relationship to other Functions

Hicksian demand functions are often convenient for mathematical manipulation because they do not require income or wealth to be represented. Additionally, the function to be minimized is linear in the $x_i$, which gives a simpler optimization problem. However, Marshallian demand functions of the form $x(p,w)$ that describe demand given prices p and income are easier to observe directly. The two are trivially related by:

$$h(p,u) = x(p,e(p,u)),$$

where $e(p,u)$ is the expenditure function (the function that gives the minimum wealth required to get to a given utility level), and by:

$$h(p,v(p,w)) = x(p,w),$$

where $v(p,w)$ is the indirect utility function (which gives the utility level of having a given wealth under a fixed price regime). Their derivatives are more fundamentally related by the Slutsky equation.

Whereas Marshallian demand comes from the Utility Maximization Problem, Hicksian Demand comes from the Expenditure Minimization Problem. The two problems are mathematical duals, and hence the Duality Theorem provides a method of proving the relationships.

The Hicksian demand function is intimately related to the expenditure function. If the consumer's utility function $u(x)$ is locally nonsatiated and strictly convex, then $h(p,u) = \nabla_p e(p,u)$.

## Hicksian Demand and Compensated Price Changes

Downward sloping Marshallian demand curves show the effect of price changes on quantity demanded. As the price of a good rises, presumably the quantity of that good demanded will fall, holding wealth and other prices constant. However, this effect of price changes on quantities demanded is due to both the income effect and the substitution effect. The substitution effect is a change in quantity demanded due to a price change that alters the slope of the budget constraint but leaves the consumer on the same indifference curve (i.e., at the same level of utility.) By this effect, the consumer is posited to substitute toward the good that becomes comparatively less expensive. If the good in question is a normal good, then the income effect from the rise in purchasing power from a price fall reinforces the substitution effect. If the good is an inferior good, then the income effect will offset in some degree the substitution effect.

The Hicksian demand function is also downward sloping, but isolates the substitution effect by supposing the consumer is compensated exactly enough to purchase some bundle on the same indifference curve. Hicksian demand illustrates the consumer's new consumption basket after the price change while being compensated as to allow the consumer to be as happy as previously (to stay at the same level of utility). If the Hicksian demand function is "steeper" than Marshallian demand, the good is a normal good; otherwise, the good is inferior.

### Mathematical Properties

If the consumer's utility function $u(x)$ is continuous and represents a locally nonsatiated preference relation, then the Hicksian demand correspondence $h(p,u)$ satisfies the following properties:

i. Homogeneity of degree zero in p: For all $a > 0$, $h(ap,u) = h(p,u)$. This is because the same x that minimizes $\sum_i p_i x_i$ also minimizes $\sum_i ap_i x_i$ subject to the same constraint.

ii. No excess demand: The constraint $u(hx) \geq \bar{u}$ holds with strict equality, $u(x) = \bar{u}$. This follows from continuity of the utility function. Informally, they could simply spend less until utility was exactly $\bar{u}$.

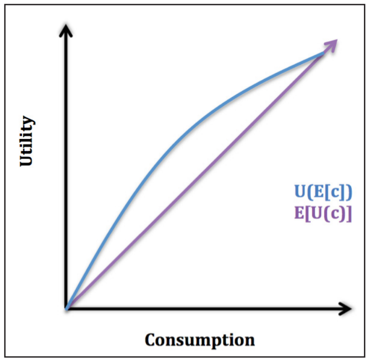
## CONSUMPTION SMOOTHING

Consumption smoothing is the economic concept used to express the desire of people to have a stable path of consumption. People desire to translate their consumption from periods of high income to periods of low income to obtain more stability and predictability. There exists many states of the world, which means there are many possible outcomes that can occur throughout an individual's life. Therefore, to reduce the uncertainty that occurs, people choose to give up some consumption today to prevent against an adverse outcome in the future.

### Expected Utility Model

The graph below illustrates the expected utility model, in which U(c) is increasing in and concave in c. This shows that there are diminishing marginal returns associated with consumption, as each additional unit of consumption adds less utility. The expected utility model states that individuals want to maximize their expected utility, as defined as the weighted sum of utilities across states of the world. The weights in this model are the probabilities of each state of the world happening. According to the "more is better" principle, the first order condition will be positive; however, the second order condition will be negative, due to the principle of diminishing marginal utility. Due to the concave actual utility, marginal utility decreases as consumption increase;

as a result, it is favorable to reduce consumption in states of high income to increase consumption in low income states.




The graph shows expected utility, E[U(c)], after consumption smoothing (e.g. insurance), and actual utility, U(E[c]), without consumption smoothing.

Expected utility can be modeled as:

$$EU = q * U(W \mid badstate) + (1-q) * U(W \mid goodstate)$$

where:

- $q$ = probability you will lose all your wealth/consumption.
- $W$ = wealth.

The model shows expected utility as the sum of the probability of being in a bad state multiplied by utility of being in a bad state and the probability of being in a good state multiplied by utility of being in a good state.

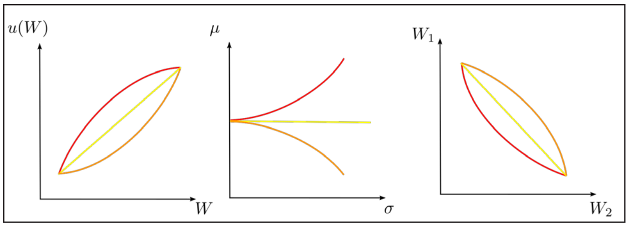
Similarly, actuarially fair insurance can also be modeled:

$$EU = (1-q) * U(W-p) + q * U(W-p-d+p/q)$$

where:

- $q$ = probability you will lose all your wealth/consumption.
- $W$ = wealth.
- $d$ = damages.

An actuarially fair premium to pay for insurance would be the insurance premium that is set equal to the insurer's expected payout. Some individuals are risk-averse, as shown by the graph above. The blue line, $U(c) = \sqrt{c}$ is curved upwards, revealing that this particular individual is risk-averse. If the blue line was curved downwards, this would reveal the preference for a risk-seeking individual. Additionally, a straight line would reveal a risk-neutral individual.




Risk aversion (red) contrasted to risk neutrality (yellow) and risk loving (orange) in different settings. Left graph: A risk averse utility function is concave (from below), while a risk loving utility function is convex. Middle graph: In standard deviation-expected value space, risk averse indifference curves are upward sloped. Right graph: With fixed probabilities of two alternative states 1 and 2, risk averse indifference curves over pairs of state-contingent outcomes are convex.

## Insurance and Consumption Smoothing

To see the model of consumption smoothing in real life, a great example that exemplifies this is insurance. One method that people use to consumption smooth across different periods is by purchasing insurance. Insurance is important because it allows people to translate consumption from periods where their consumption is high (having a low marginal utility) to periods when their consumption is low (having a high marginal utility). Due to many possible states of the world, people want to decrease the amount of uncertain outcomes of the future. This is where purchasing insurance comes in. Basic insurance theory states that individuals will demand full insurance to fully smooth consumption across difference states of the world. This explains why people purchase insurance, whether in healthcare, unemployment, and social security. To help illustrate this, think of a simplified hypothetical scenario with Person A, who can exist in one of two states of the world. Assume Person A who is healthy and can work; this will be State X of the world. One day, an unfortunate accident occurs, person A no longer can work. Therefore, he cannot obtain income from work and is in State Y of the world. In State X, Person A enjoys a good income from his work place and is able to spend money on necessities, such as paying rent and buying groceries, and luxuries, such as traveling to Europe. In State Y, Person A no longer obtains an income, due to injury, and struggles to pay for necessities. In a perfect world, Person A would have known to save for this future accident and would have more savings to compensate for the lack of income post-injury. Rather than spend money on the trip to Europe in State X, Person A could have saved that money to use for necessities in State Y. However, people tend to be poor predictors of the future, especially ones that are myopic. Therefore, insurance can "smooth" between these two states and provide more certainty for the future.

## Microcredit and Consumption Smoothing

Though there are arguments stating that microcredit does not effectively lift people from poverty, some note that offering a way to consumption smooth during tough periods has shown to be effective. This supports the principle of diminishing marginal utility, where those who have a history of suffering in extremely low income states of the world want to prepare for the next time they experience an adverse state of the world. This leads to the support of microfinance as a tool to consumption smooth, stating that those in poverty value microloans tremendously due to its extremely high marginal utility.

## Hall and Friedman's Model

Another model to look at for consumption smoothing is Hall's model, which is inspired by Milton Friedman. Since Milton Friedman's permanent income theory and Modigliani and Brumberg life-cycle model, the idea that agents prefer a stable path of consumption has been widely accepted. This idea came to replace the perception that people had a marginal propensity to consume and therefore current consumption was tied to current income.

Friedman's theory argues that consumption is linked to the permanent income of agents. Thus, when income is affected by transitory shocks, for example, agents' consumption should not change, since they can use savings or borrowing to adjust. This theory assumes that agents are able to finance consumption with earnings that are not yet generated, and thus assumes perfect capital markets. Empirical evidence shows that liquidity constraint is one of the main reasons why it is difficult to observe consumption smoothing in the data. In 1978, Robert Hall formalized Friedman's idea. By taking into account the diminishing returns to consumption, and therefore, assuming a concave utility function, he showed that agents optimally would choose to keep a stable path of consumption.

With:

- $E_t$ being the mathematical expectation conditional on all information available in $t$.
- $\delta = 1/\beta - 1$ being the agent's rate of time preference.
- $r_t = R_t - 1 \geq \delta$ being the real rate of interest in $t$.
- $u$ being the strictly concave one-period utility function.
- $c_t$ being the consumption in $t$.
- $y_t = w_t$ being the earnings in $t$.
- $A_t$ being the assets, apart from human capital, in $t$.

agents choose the consumption path that maximizes:

$$E_0 \sum_{t=0}^{\infty} \beta^t \left[ u(c_t) \right]$$

Subject to a sequence of budget constraints:

$$A_{t+1} = R_{t+1}(A_t + y_t - c_t)$$

The first order necessary condition in this case will be:

$$\beta E_t R_{t+1} \frac{u'(c_{t+1})}{u'(c_t)} = 1$$

By assuming that $R_{t+1} = R = \beta^{-1}$ we obtain, for the previous equation:

$$E_t u'(c_{t+1}) = u'(c_t)$$

Which, due to the concavity of the utility function, implies:

$$E_t[c_{t+1}] = c_t$$

Thus, rational agents would expect to achieve the same consumption in every period.

Hall also showed that for a quadratic utility function, the optimal consumption is equal to:

$$c_t = \left[\frac{r}{1+r}\right]\left[E_t \sum_{i=0}^{\infty}\left(\frac{1}{1+r}\right)^i y_{t+i} + A_t\right]$$

This expression shows that agents choose to consume a fraction of their present discounted value of their human and financial wealth.

# CONSUMERS SURPLUS

Consumer surplus is an economic measurement of consumer benefits. Consumer surplus happens when the price that consumers pay for a product or service is less than the price they're willing to pay. It's a measure of the additional benefit that consumers receive because they're paying less for something than what they were willing to pay.

The concept of consumer's surplus is not a theoretical toy. It has practical uses also. It is widely used in cost-benefit analysis and other areas of applied economics as an approximate measure of changes in welfare. Although the actual measurement of consumer's surplus is a difficult task as utility is a purely psychological concept. Yet the concept has a great theoretical and practical importance.

## Distinction between Value-in-use and Value-in-exchange

Consumer's surplus points to the distinction between the use value (i.e., utility) and the exchange value (i.e., the market price) of a thing. The former is reflected in the individual demand price and the latter in the market price. Hence, consumer's surplus shows that these two values are not always equal.

## Importance in Welfare Economics

The concept of consumer's surplus has a great importance in modem welfare economics, because it measures individual welfare. The larger the consumer's surplus is, the highest the welfare level of an individual is likely to be. We are sometimes concerned with a change that alters the price of a product, that is, not with the total benefits derived from the existence of a particular commodity but with the change in benefit due to a change in the price of the commodity.

Equally, the concept of consumer's surplus may be applied to such changes. In terms of a demand curve, consumer's surplus may be restated as follows: The benefit derived from the provision of a commodity or service at a particular price is the area under the demand curve at that price, and the consumer's surplus is that benefit minus the sum of money the consumer actually pays; the change in benefit is the change in the area due to a price change; and the change in consumer's surplus is the change in benefit minus the change in the money some paid.

Suppose, we were to aggregate all individual demand curves for a commodity to obtain the market demand curve; could we also aggregate the consumer's surpluses to get consumer's surplus? If we could, we have a powerful way of estimating consumer benefits from, say, an innovation that will lower the price of a good.

All that appear to be required is the statistical estimation of demand functions. Suppose, for example, that an authority is contemplating building a river bridge that will be the area under the demand curve, and this can be compared with the cost.

Consumer's surplus, therefore, would appear to be a powerful tool in the evaluation of proposed public projects, and it is indeed regarded by some commentators as a central tool in cost-benefit analysis.

## Comparison of Gains from the International Trade

Consumer's surplus from international transactions (say, from the trade between India and U.S.A.) enables us to compare the relative gains from the international trade of the different countries. Larger consumer's surplus from such transactions enjoyed by a country is likely to make its gains higher than that of another country.

## Comparison of Living Conditions

Furthermore, consumer's surplus enjoyed by the different people at different places and in different times, enables us to compare their living standards. Larger consumer's surplus indicates a higher living standard.

### Useful to a Monopolist

While practising price discrimination, a monopolist may charge different prices for the same commodity from the different buyers (i.e., higher prices from the affluent buyers and lower prices from others) in such a way that none enjoys any consumer's surplus. In fact, if the supplier had a monopoly and could practice price discrimination, he could extract as revenue the whole of the area under the demand curve.

### Environmental Benefits to Consumers

Consumer's surplus shows how lucky the citizens of modern efficient communities are, as they are getting a vast multitude of goods of daily necessities (e.g., post cards, newspapers, telephone services, etc.) at relatively low prices. From these goods they enjoy much greater satisfaction than what they pay for these.

Similarly, our knowledge of consumer's surplus proves useful when we compare the advantages of living at two different places. A place where there are greater amenities of life at cheaper rates will be better to live in, as the people at such a place can enjoy a larger amount of satisfaction from his spending.

### Practical Importance in Public Finance

The concept has a great practical importance to the government in determining the desirability of imposing a tax on a certain commodity. A tax imposed on a commodity tends to raise its price and to reduce consumer's surplus thereby, but it yields some revenue to the government. The finance minister is to compare the loss of consumer's surplus to the increase in tax revenue. A tax is justified when the loss in consumer's surplus becomes less than the increase in tax revenue; otherwise it will be harmful to society.

Similarly, the concept is useful to make a case for government subsidies or bounties in some situations, where it can be shown that the additional net satisfaction conferred through subsidies upon consumers will outweigh the loss of satisfaction represented by the money cost involved. It shows that the concept of consumer's surplus has a considerable importance as a guide to public policy.

## SUBSIDIES TO CONSUMERS

An important application of indifference curves is to analyse with its aid the effect of subsidies to the consumers. Several kinds of subsidies are paid to the individuals these days by the Government for promoting social welfare.

Suppose that under food-subsidy programme, the needed families are entitled to purchase food at half the market price, the other half of the market price is paid by the Government as subsidy.

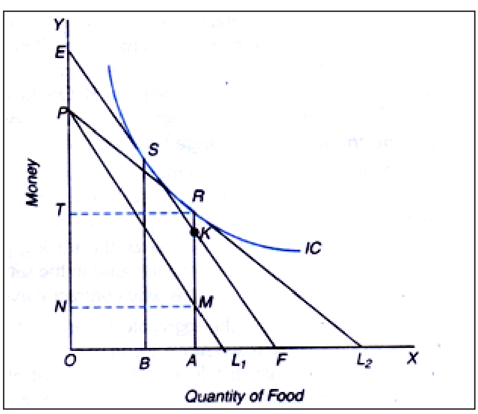
The effect of this subsidy on consumer's welfare and money value of this subsidy to the consumer is illustrated in figure where the quantity of food is measured on the X-axis and money on the Y-axis. Let us suppose that the individual has OP money income. Given this money income and given the market price of food, the budget line is $PL_1$. Since we are assuming that subsidy paid by the Government is half the market price of food, the consumer would pay half the market price. Therefore, with subsidy the individual will face the budget line $PL_2$ where $OL_1 = L_1L_2$.

With budget line $PL_2$, the individual is in equilibrium at point R on the indifference curve IC at which he is purchasing OA quantity of food. By purchasing OA quantity of food, the individual is spending FT amount of money.

Now, if no food subsidy was given and therefore the budget line was $PL_1$ then for buying OA quantity of food, the individual would have spent PN amount of money. In other words, PN is the market price of OA quantity of food. Since PT amount of money is paid by the individual himself, the remaining amount TN or RM (the vertical distance between the budget lines $PL_1$ and $PL_2$ at OA amount of food) is paid by the Government as food subsidy for the individual.

Now, the important question is what is the money value of this food subsidy (RM) to the individual. When no food subsidy is paid, the individual faces the budget line $PL_1$. In order to find the money value of the subsidy to the individual, draw a line EF parallel to $PL_1$ so that it touches the same indifference curve IC where the individual comes to be in equilibrium when subsidy is paid.

It will be seen from figure that budget line EF touches the indifference curve IC at a point S and is buying OB quantity of food. This means that if individual is paid PE amount of money (say as a cash grant), he reaches the same indifference curve IC (same level of welfare) at which he is when subsidy is paid by the Government. Thus PE is money value of the subsidy to the individual. It will be seen from figure than PE is less than RM which is the amount of money paid by the Government as subsidy. In our figure, PE = MK (the vertical distance between two parallel lines) and KM is greater than MK.



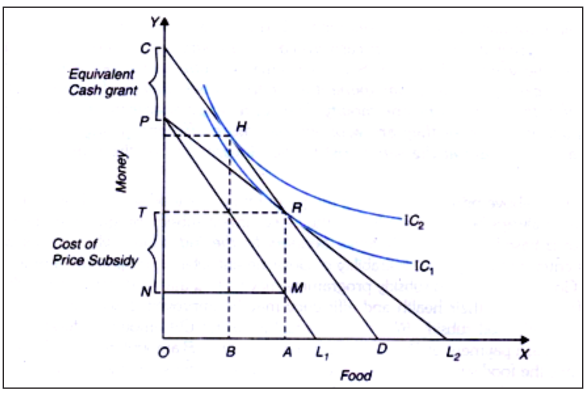

Subsidies to consumers: Price subsidy versus Cash grant.

Therefore, RM is also greater than PE. It follows that PE is less than RM. If instead of giving RM as price subsidy on food. Government pays the individual cash money equal to PE, the individual will reach the same level of welfare as he does with RM subsidy.

Thus, the money equivalent of the subsidy to the individual is less than the cost of the subsidy to the Government. "In fact, it would always be so whatever the subsidy and whatever the preferences of consumers so long as only the indifference curves remain convex and smooth. Thus the cost of giving subsidies to consumers is always greater than the money equivalent of the subjective gain to the consumers".

Likewise Scitovsky remarks, "The value of the subsidy to the subsidised person is smaller than the cost of subsidy to the Government. This is so whatever the shape of a particular indifference curve as long as it has a smooth curvature. Now, if instead of providing price subsidy on food, the Government gives lump-sum cash grant to the consumer equivalent to the cost of price subsidy on food, what will be its impact on the individual's welfare and consumption of food by him. Cost of price subsidy on food to the Government equals RM amount of money.

If the Government provides the consumer lump-sum cash grant of RM instead of price subsidy on food, this will amount to increasing the money income of the consumer by RM amount. With this extra cash transfer equal to RM (= PC), the budget line will shift to the right to the position CD and pass through point R. It will be seen from figure that with the budget line CD though the individual can buy the same market basket R, if he so desires, which he was purchasing with price subsidy on food, he is actually in equilibrium at point Hon higher indifference curve $IC_2$.




Lump-sum cash grant is better than price subsidy.

Thus, the cash transfer equivalent to the cost of price subsidy has led to the greater increase in welfare or satisfaction of the individual as compared to the price subsidy. Further, as will be seen from figure, with a cash grant the individual buys less food and more of other goods relative to the situation under price subsidy with equivalent monetary cost.

That the individual with cash transfer must be better off and his food consumption must be less as compared to price subsidy on food is due to the fact that indifference curves being convex, the budget line CD obtained with cash transfer must intersect the indifference curve $IC_1$ at point R reached with equivalent price subsidy.

Therefore, given that the consumer is free to spend money as he likes, with cash grant his new equilibrium position must be to the left of point R on the budget line CD where it will be tangent to the higher indifference curve than $IC_1$. This implies that in case of lump-sum cash transfer, the consumer will be better off and consume less food relative to the equilibrium position under price subsidy on food.

The superiority of cash grant in terms of its impact on the welfare of the individualscan be explained in a slightly different way. Though both the lump-sum cash transfer and price subsidy on a commodity produces income effect making the individual better off, under cash grant, the individual is free to buy different goods according to b is own tastes and preferences which ensures higher level of welfare as compared to the policy of price subsidy on food which imposes a certain pattern of consumption favouring food.

Besides, a lower price of food due to price subsidy on it induces the consumer to substitute food for other goods causing greater consumption of food as compared to the scheme of lump-sum cash grant which have no such substitution effect and permits free choice of goods to the individual according to his own preference. Thus, to quote Watson again “you can make someone happier if you give him cash instead of a commodity, even if something he wants.”

Likewise, Scitovsky remarks, “one can make a man happier by giving him cash and letting him spend it as he thinks best than by giving him to take all his relief in the form of one commodity. Hence, relief payments in cash are preferable to a food subsidy because they are economically more efficient, giving the relief receipts either a greater gain at the same cost to the Government or the same gain at a lower cost.”

But the above principle regarding the programme of subsidised food, subsidised housing etc. cannot always be validly applied to the Government subsidy programme since the above principle is based upon the subjective benefits to the individuals which is not always the correct criterion to judge the desirability of Government subsidy programme. For instance, the aim of Government’s food subsidy programme may be that the needy families should consume more food so that their health and efficiency may be improved.

It will be seen from figure that with food subsidy RM, the individual is having amount of food whereas with equivalent cash payment of PC the individual purchases OB amount of food which is less than OA Thus the food subsidy has induced the individual to consume more food than in case of cash payment. Similarly, if a country has food surpluses and wants to dispose them off, then the food subsidy to the needy families will be the ideal measure to increase the consumption of food-grains and thereby to dispose or the food surpluses.

# UTILITY

Within economics, the concept of utility is used to model worth or value. Its usage has evolved significantly over time. The term was introduced initially as a measure of pleasure or satisfaction within the theory of utilitarianism by moral philosophers such as Jeremy Bentham and John Stuart Mill. The term has been adapted and reapplied within neoclassical economics, which dominates modern economic theory, as a utility function that represents a consumer's preference ordering over a choice set. It is devoid of its original interpretation as a measurement of the pleasure or satisfaction obtained by the consumer from that choice.

## Utility Function

Consider a set of alternatives facing an individual, and over which the individual has a preference ordering. A utility function is able to represent those preferences if it is possible to assign a real number to each alternative, in such a way that alternative a is assigned a number greater than alternative b if, and only if, the individual prefers alternative a to alternative b. In this situation an individual that selects the most preferred alternative available is necessarily also selecting the alternative that maximises the associated utility function. In general economic terms, a utility function measures preferences concerning a set of goods and services. Often, utility is correlated with words such as happiness, satisfaction, and welfare, and these are hard to measure mathematically. Thus, economists utilize consumption baskets of preferences in order to measure these abstract, non quantifiable ideas.

Gérard Debreu precisely defined the conditions required for a preference ordering to be representable by a utility function. For a finite set of alternatives these require only that the preference ordering is complete (so the individual is able to determine which of any two alternatives is preferred, or that they are equally preferred), and that the preference order is transitive.

## Applications

Utility is usually applied by economists in such constructs as the indifference curve, which plot the combination of commodities that an individual or a society would accept to maintain a given level of satisfaction. Utility and indifference curves are used by economists to understand the underpinnings of demand curves, which are half of the supply and demand analysis that is used to analyze the workings of goods markets.

Individual utility and social utility can be construed as the value of a utility function and a social welfare function respectively. When coupled with production or commodity constraints, under some assumptions these functions can be used to analyze Pareto efficiency, such as illustrated by Edgeworth boxes in contract curves. Such efficiency is a central concept in welfare economics.

In finance, utility is applied to generate an individual's price for an asset called the indifference price. Utility functions are also related to risk measures, with the most common example being the entropic risk measure.

In the field of artificial intelligence, utility functions are used to convey the value of various outcomes to intelligent agents. This allows the agents to plan actions with the goal of maximizing the utility (or "value") of available choices.

## Revealed Preference

It was recognized that utility could not be measured or observed directly, so instead economists devised a way to infer underlying relative utilities from observed choice. These 'revealed preferences', as they were named by Paul Samuelson, were revealed e.g. in people's willingness to pay: Utility is taken to be correlative to Desire or Want. It has been already argued that desires cannot be measured directly, but only indirectly, by the outward phenomena to which they give rise: and that in those cases with which economics is chiefly concerned the measure is found in the price which a person is willing to pay for the fulfillment or satisfaction of his desire.

## Functions

There has been some controversy over the question whether the utility of a commodity can be measured or not. At one time, it was assumed that the consumer was able to say exactly how much utility he got from the commodity. The economists who made this assumption belonged to the 'cardinalist school' of economics. Today utility functions, expressing utility as a function of the amounts of the various goods consumed, are treated as either cardinal or ordinal, depending on whether they are or are not interpreted as providing more information than simply the rank ordering of preferences over bundles of goods, such as information on the strength of preferences.

## Cardinal

When cardinal utility is used, the magnitude of utility differences is treated as an ethically or behaviorally significant quantity. For example, suppose a cup of orange juice has utility of 120 utils, a cup of tea has a utility of 80 utils, and a cup of water has a utility of 40 utils. With cardinal utility, it can be concluded that the cup of orange juice is better than the cup of tea by exactly the same amount by which the cup of tea is better than the cup of water. Formally speaking, this means that if one has a cup of tea, she would be willing to take any bet with a probability, p, greater than .5 of getting a cup of juice, with a risk of getting a cup of water equal to 1-p. One cannot conclude, however, that the cup of tea is two thirds of the goodness of the cup of juice, because this conclusion would depend not only on magnitudes of utility differences, but also on the "zero" of utility. For example, if the "zero" of utility was located at -40, then a cup of orange juice would be 160 utils more than zero, a cup of tea 120 utils more than zero. Cardinal utility, to economics, can be seen as the assumption that utility can be measured through quantifiable characteristics, such as height, weight, temperature, etc.

Neoclassical economics has largely retreated from using cardinal utility functions as the basis of economic behavior. A notable exception is in the context of analyzing choice under conditions of risk.

Sometimes cardinal utility is used to aggregate utilities across persons, to create a social welfare function.

## Ordinal

When ordinal utilities are used, differences in utils (values taken on by the utility function) are treated as ethically or behaviorally meaningless: the utility index encodes a full behavioral ordering between members of a choice set, but tells nothing about the related strength of preferences. It would only be possible to say that juice is preferred to tea to water, but no more. Thus, ordinal utility utilizes comparisons, such as "preferred to", "no more", "less than", etc.

Ordinal utility functions are unique up to increasing monotone (or monotonic) transformations. For example, if a function $u(x)$ is taken as ordinal, it is equivalent to the function $u(x)^3$, because taking the 3rd power is an increasing monotone transformation (or monotonic transformation). This means that the ordinal preference induced by these functions is the same (although they are two different functions). In contrast, cardinal utilities are unique only up to increasing linear transformations, so if $u(x)$ is taken as cardinal, it is not equivalent to $u(x)^3$.

## Preferences

Although preferences are the conventional foundation of microeconomics, it is often convenient to represent preferences with a utility function and analyze human behavior indirectly with utility functions. Let X be the consumption set, the set of all mutually-exclusive baskets the consumer could conceivably consume. The consumer's utility function $u: X \to \mathbb{R}$ ranks each package in the consumption set. If the consumer strictly prefers x to y or is indifferent between them, then $u(x) \geq u(y)$.

For example, suppose a consumer's consumption set is X = {nothing, 1 apple,1 orange, 1 apple and 1 orange, 2 apples, 2 oranges}, and its utility function is u(nothing) = 0, u(1 apple) = 1, u(1 orange) = 2, u(1 apple and 1 orange) = 4, u(2 apples) = 2 and u(2 oranges) = 3. Then this consumer prefers 1 orange to 1 apple, but prefers one of each to 2 oranges.

In micro-economic models, there are usually a finite set of L commodities, and a consumer may consume an arbitrary amount of each commodity. This gives a consumption set of $\mathbb{R}_{+}^{L}$, and each package $x \in \mathbb{R}_{+}^{L}$ is a vector containing the amounts of each commodity. In the previous example, we might say there are two commodities: apples and oranges. If we say apples is the first commodity, and oranges the second, then the consumption set $X = \mathbb{R}_{+}^{2}$ and u(0, 0) = 0, u(1, 0) = 1, u(0, 1) = 2, u(1, 1) = 4, u(2, 0) = 2, u(0, 2) = 3 as before. Note that for u to be a utility function on X, it must be defined for every package in X.

A utility function $u: X \to \mathbb{R}$ represents a preference relation $\succeq$ on X iff for every $x, y \in X$, $u(x) \leq u(y)$, implies $x \succeq y$. If u represents $\succeq$, then this implies $\succeq$ is complete and transitive, and hence rational.

## Revealed Preferences in Finance

In financial applications, e.g. portfolio optimization, an investor chooses financial portfolio which maximizes his/her own utility function, or, equivalently, minimizes his/her risk measure. For example, modern portfolio theory selects variance as a measure of risk; other popular theories are expected utility theory, and prospect theory. To determine specific utility function for any given investor, one could design a questionnaire procedure with questions in the form: How much would you pay for x% chance of getting y? Revealed preference theory suggests a more direct approach: observe a portfolio X* which an investor currently holds, and then find a utility function/risk measure such that X* becomes an optimal portfolio.

Examples:

In order to simplify calculations, various alternative assumptions have been made concerning details of human preferences, and these imply various alternative utility functions such as:

- CES (constant elasticity of substitution, or isoelastic) utility.
- Isoelastic utility.
- Exponential utility.
- Quasilinear utility.
- Homothetic preferences.
- Stone–Geary utility function.
- Gorman polar form:
    - Greenwood–Hercowitz–Huffman preferences.
    - King–Plosser–Rebelo preferences.
- Hyperbolic absolute risk aversion.

Most utility functions used in modeling or theory are well-behaved. They are usually monotonic and quasi-concave. However, it is possible for preferences not to be representable by a utility function. An example is lexicographic preferences which are not continuous and cannot be represented by a continuous utility function.

## Expected Utility

The expected utility theory deals with the analysis of choices among risky projects with multiple (possibly multidimensional) outcomes.

The St. Petersburg paradox was first proposed by Nicholas Bernoulli in 1713 and solved by Daniel Bernoulli in 1738. D. Bernoulli argued that the paradox could be resolved if decision-makers displayed risk aversion and argued for a logarithmic cardinal utility function. (Analyses of international survey data in the 21st century have shown that insofar as utility represents happiness, as in utilitarianism, it is indeed proportional to log income.)

The first important use of the expected utility theory was that of John von Neumann and Oskar Morgenstern, who used the assumption of expected utility maximization in their formulation of game theory.

## Von Neumann–Morgenstern

Von Neumann and Morgenstern addressed situations in which the outcomes of choices are not known with certainty, but have probabilities attached to them.

A notation for a lottery is as follows: if options A and B have probability p and 1 – p in the lottery, we write it as a linear combination:

$$L = pA + (1 - p)B$$

More generally, for a lottery with many possible options:

$$L = \sum_i p_i A_i ,$$

where $\sum_i p_i = 1$.

By making some reasonable assumptions about the way choices behave, von Neumann and Morgenstern showed that if an agent can choose between the lotteries, then this agent has a utility function such that the desirability of an arbitrary lottery can be calculated as a linear combination of the utilities of its parts, with the weights being their probabilities of occurring.

This is called the expected utility theorem. The required assumptions are four axioms about the properties of the agent's preference relation over 'simple lotteries', which are lotteries with just two options. Writing $B \preceq A$ to mean 'A is weakly preferred to B' ('A is preferred at least as much as B'), the axioms are:

- Completeness: For any two simple lotteries $L$ and $M$, either $L \preceq M$ or $M \preceq L$ (or both, in which case they are viewed as equally desirable).
- Transitivity: For any three lotteries $L, M, N$, if $L \preceq M$ and $M \preceq N$, then $L \preceq N$.
- Convexity/continuity (Archimedean property): If $L \preceq M \preceq N$, then there is a $p$ between 0 and 1 such that the lottery $pL + (1-p)N$ is equally desirable as $M$.
- Independence: For any three lotteries $L, M, N$ and any probability p, $L \preceq M$ if and only if $pL + (1-p)N \prec pM + (1-p)N$. Intuitively, if the lottery formed by the probabilistic combination of $L$ and $N$ is no more preferable than the lottery formed by the same probabilistic combination of $M$ and $N$ then and only then $L \preceq M$.

Axioms 3 and 4 enable us to decide about the relative utilities of two assets or lotteries.

In more formal language: A von Neumann–Morgenstern utility function is a function from choices to the real numbers:

$$u : X \to \mathbb{R}$$

which assigns a real number to every outcome in a way that captures the agent's preferences over simple lotteries. Under the four assumptions mentioned above, the agent will prefer a lottery $L_2$ to a lottery $L_1$ if and only if, for the utility function characterizing that agent, the expected utility of $L_2$ is greater than the expected utility of $L_1$:

$$L_1 \preceq L_2 \textit{ iff } u(L_1) \leq u(L_2).$$

Of all the axioms, independence is the most often discarded. A variety of generalized expected utility theories have arisen, most of which drop or relax the independence axiom.

## Probability of Success

Castagnoli and LiCalzi and Bordley and LiCalzi provided another interpretation for Von Neumann and Morgenstern's theory. Specifically for any utility function, there exists a hypothetical reference lottery with the expected utility of an arbitrary lottery being its probability of performing no worse than the reference lottery. Suppose success is defined as getting an outcome no worse than the outcome of the reference lottery. Then this mathematical equivalence means that maximizing expected utility is equivalent to maximizing the probability of success. In many contexts, this makes the concept of utility easier to justify and to apply. For example, a firm's utility might be the probability of meeting uncertain future customer expectations.

## Indirect Utility

An indirect utility function gives the optimal attainable value of a given utility function, which depends on the prices of the goods and the income or wealth level that the individual possesses.

## Money

One use of the indirect utility concept is the notion of the utility of money. The (indirect) utility function for money is a nonlinear function that is bounded and asymmetric about the origin. The utility function is concave in the positive region, reflecting the phenomenon of diminishing marginal utility. The boundedness reflects the fact that beyond a certain point money ceases being useful at all, as the size of any economy at any point in time is itself bounded. The asymmetry about the origin reflects the fact that gaining and losing money can have radically different implications both for individuals and businesses. The non-linearity of the utility function for money has profound implications in decision making processes: in situations where outcomes of choices influence utility through gains or losses of money, which are the norm in most business settings, the optimal choice for a given decision depends on the possible outcomes of all other decisions in the same time-period.

## Marginal Utility

In economics, utility is the satisfaction or benefit derived by consuming a product; thus the marginal utility of a good or service is the change in the utility from an increase in the consumption of that good or service.

In the context of cardinal utility, economists sometimes speak of a law of diminishing marginal utility, meaning that the first unit of consumption of a good or service yields more utility than the second and subsequent units, with a continuing reduction for greater amounts. Therefore, the fall in marginal utility as consumption increases is known as diminishing marginal utility.

## Marginality

The term marginal refers to a small change, starting from some baseline level. Philip Wicksteed explained the term as follows:

Marginal considerations are considerations which concern a slight increase or diminution of the stock of anything which we possess or are considering.

Frequently the marginal change is assumed to start from the endowment, meaning the total resources available for consumption. This endowment is determined by many things including physical laws (which constrain how forms of energy and matter may be transformed), accidents of nature (which determine the presence of natural resources), and the outcomes of past decisions made by the individual himself or herself and by others.

For reasons of tractability, it is often assumed in neoclassical analysis that goods and services are continuously divisible. Under this assumption, marginal concepts, including marginal utility, may be expressed in terms of differential calculus. Marginal utility can then be defined as the first derivative of total utility—the total satisfaction obtained from consumption of a good or service—with respect to the amount of consumption of that good or service.

In practice the smallest relevant division may be quite large. Sometimes economic analysis concerns the marginal values associated with a change of one unit of a discrete good or service, such as a motor vehicle or a haircut. For a motor vehicle, the total number of motor vehicles produced is large enough for a continuous assumption to be reasonable: this may not be true for, say, an aircraft carrier.

## Utility

Depending on which theory of utility is used, the interpretation of marginal utility can be meaningful or not. Economists have commonly described utility as if it were quantifiable, that is, as if different levels of utility could be compared along a numerical scale. This has affected the development and reception of theories of marginal utility. Quantitative concepts of utility allow familiar arithmetic operations, and further assumptions of continuity and differentiability greatly increase tractability.

Contemporary mainstream economic theory frequently defers metaphysical questions, and merely notes or assumes that preference structures conforming to certain rules can be usefully proxied by associating goods, services, or their uses with quantities, and defines "utility" as such a quantification.

Another conception is Benthamite philosophy, which equated usefulness with the production of pleasure and avoidance of pain, assumed subject to arithmetic operation. British economists, under the influence of this philosophy, viewed utility as "the feelings of pleasure and pain" and further as a "quantity of feeling".

Though generally pursued outside of the mainstream methods, there are conceptions of utility that do not rely on quantification. For example, the Austrian school generally attributes value to the satisfaction of wants, and sometimes rejects even the possibility of quantification. It has been argued that the Austrian framework makes it possible to consider rational preferences that would otherwise be excluded.

In any standard framework, the same object may have different marginal utilities for different people, reflecting different preferences or individual circumstances.

## Diminishing Marginal Utility

The concept in cardinal utility theory that marginal utilities diminish across the ranges relevant to decision-making is called the "law of diminishing marginal utility" (and is also known as Gossen's First Law). This refers to the increase in utility an individual gains from increasing their consumption of a particular good. "The law of diminishing marginal utility is at the heart of the explanation of numerous economic phenomena, including time preference and the value of goods . The law says, first, that the marginal utility of each homogenous unit decreases as the supply of units increases (and vice versa); second, that the marginal utility of a larger-sized unit is greater than the marginal utility of a smaller-sized unit (and vice versa). The first law denotes the law of diminishing marginal utility, the second law denotes the law of increasing total utility."

In modern economics, choice under conditions of certainty at a single point in time is modeled via ordinal utility, in which the numbers assigned to the utility of a particular circumstance of the individual have no meaning by themselves, but which of two alternative circumstances has higher utility is meaningful. With ordinal utility, a person's preferences have no unique marginal utility, and thus whether or not marginal utility is diminishing is not meaningful. In contrast, the concept of diminishing marginal utility is meaningful in the context of cardinal utility, which in modern economics is used in analyzing intertemporal choice, choice under uncertainty, and social welfare.

The law of diminishing marginal utility is similar to the law of diminishing returns which states that as the amount of one factor of production increases as all other factors of production are held the same, the marginal return (extra output gained by adding an extra unit) decreases.

As the rate of commodity acquisition increases, marginal utility decreases. If commodity consumption continues to rise, marginal utility at some point may fall to zero, reaching maximum total utility. Further increase in consumption of units of commodities causes marginal utility to become negative; this signifies dissatisfaction. For example:

- Beyond some point, further doses of antibiotics would kill no pathogens at all, and might even become harmful to the body.
- To satiate thirst a person drinks water but beyond a point, consumption of more water might make the person vomit, hence leading to negative marginal and thus diminished total utility.
- It takes a certain amount of food energy to sustain a population, yet beyond a point, more calories cannot be consumed and are simply discarded (or cause disease).

Diminishing marginal utility is traditionally a microeconomic concept and often holds for an individual, although the marginal utility of a good or service might be increasing as well. For example:

- Bed sheets, which up to some number may only provide warmth, but after that point may be useful to allow one to effect an escape by being tied together into a rope.

- Tickets, for travel or theatre, where a second ticket might allow one to take a date on an otherwise uninteresting outing.
- Dosages of antibiotics, where having too few pills would leave bacteria with greater resistance, but a full supply could affect a cure.
- The third leg is more useful than the first two when building a chair.

Occasionally one may come across a situation in which marginal utility increases even at a macroeconomic level. For example, the provision of a service may only be viable if it is accessible to most or all of the population, and the marginal utility of a raw material required to provide such a service will increase at the "tipping point" at which this occurs. This is similar to the position with very large items such as aircraft carriers: the numbers of these items involved are so small that marginal utility is no longer a helpful concept, as there is merely a simple "yes" or "no" decision.

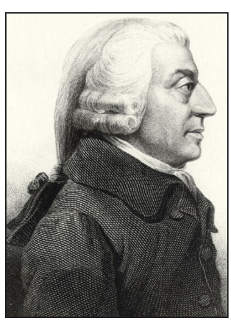
## Marginalist Theory

Marginalism explains choice with the hypothesis that people decide whether to effect any given change based on the marginal utility of that change, with rival alternatives being chosen based upon which has the greatest marginal utility.

## Market Price and Diminishing Marginal Utility

If an individual possesses a good or service whose marginal utility to him is less than that of some other good or service for which he could trade it, then it is in his interest to affect that trade. Of course, as one thing is sold and another is bought, the respective marginal gains or losses from further trades will change. If the marginal utility of one thing is diminishing, and the other is not increasing, all else being equal, an individual will demand an increasing ratio of that which is acquired to that which is sacrificed. One important way in which all else might not be equal is when the use of the one good or service complements that of the other. In such cases, exchange ratios might be constant. If any trader can better his position by offering a trade more favorable to complementary traders, then he will do so.

In an economy with money, the marginal utility of a quantity is simply that of the best good or service that it could purchase. In this way it is useful for explaining supply and demand, as well as essential aspects of models of imperfect competition.



Adam Smith.

## Paradox of Water and Diamonds

The "paradox of water and diamonds", usually most commonly associated with Adam Smith, though recognized by earlier thinkers, is the apparent contradiction that water possesses a value far lower than diamonds, even though water is far more vital to a human being.

Price is determined by both marginal utility and marginal cost, and here the key to the "paradox" is that the marginal cost of water is far lower than that of diamonds.

That is not to say that the price of any good or service is simply a function of the marginal utility that it has for any one individual nor for some ostensibly typical individual. Rather, individuals are willing to trade based upon the respective marginal utilities of the goods that they have or desire (with these marginal utilities being distinct for each potential trader), and prices thus develop constrained by these marginal utilities.

## Quantified Marginal Utility

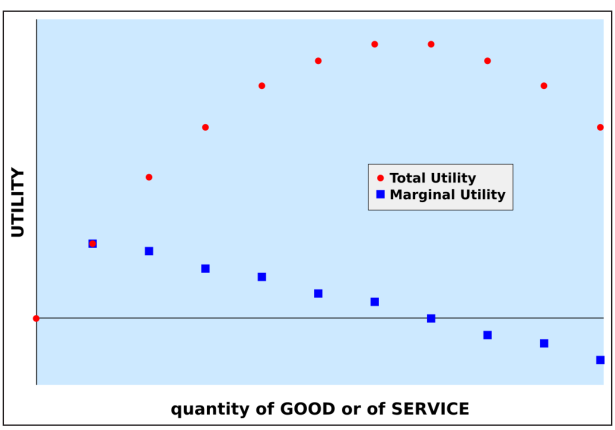
Under the special case in which usefulness can be quantified, the change in utility of moving from state $S_1$ to state $S_2$ is:

$$\Delta U = U(S_2) - U(S_1)$$

Moreover, if $S_1$ and $S_2$ are distinguishable by values of just one variable $g$ which is itself quantified, then it becomes possible to speak of the ratio of the marginal utility of the change in $g$ to the size of that change:

$$\left.\frac{\Delta U}{\Delta g}\right|_{c.p.}$$

(where "c.p." indicates that the only independent variable to change is $g$).




Diminishing marginal utility, given quantification.

Mainstream neoclassical economics will typically assume that the limit:

$$\lim_{\Delta g \to 0} \frac{\Delta U}{\Delta g}\bigg|_{c.p.}$$

exists, and use "marginal utility" to refer to the partial derivative:

$$\frac{\partial U}{\partial g} = \lim_{\Delta g \to 0} \frac{\Delta U}{\Delta g}\bigg|_{c.p.}$$

Accordingly, diminishing marginal utility corresponds to the condition:

$$\frac{\partial^2 U}{\partial g^2} < 0.$$

# CARDINAL UTILITY ANALYSIS

Cardinal utility analysis is the oldest theory of demand which provides an explanation of consumer's demand for a product and derives the law of demand which establishes an inverse relationship between price and quantity demanded of a product.

The price of a product depends upon the demand for and the supply of it. Individual's demand for a product depends upon price of the product, income of the individual, the prices of related goods.

It can be put in the following functional form:

$D_{x=}$ f($P_x$, I, $P_y$, $P_2$, T etc.)

where $D_x$ stands for the demand of good X, $P_x$ for price of good X, I for individual's income, $P_y$ $P_z$ for the prices of related goods and T for tastes and preferences of the individual. But among these determinants of demand, economists single out price of the good in question as the most important factor governing the demand for it. Indeed, the function of a theory of consumer's behaviour is to establish a relationship between quantity demanded of a good and its own price and to provide an explanation for it.

Recently, cardinal utility approach to the theory of demand has been subjected to severe criticisms and as a result some alternative theories, namely, Indifference Curve Analysis, Samuelson's Revealed Preference Theory, and Hicks' Logical Weak Ordering Theory have been propounded.

## Assumptions of Cardinal Utility Analysis

Cardinal utility analysis of demand is based upon certain important assumptions. Before explaining how cardinal utility analysis explains consumer's equilibrium in regard to the demand for a good, it is essential to describe the basic assumptions on which the whole utility analysis rests. Cardinal utility analysis has been criticised because of its unrealistic assumptions. The basic assumptions or premises of cardinal utility analysis are as follows:

## Cardinal Measurability of Utility

The exponents of cardinal utility analysis regard utility to be a cardinal concept. In other words, they hold that utility is a measurable and quantifiable entity. According to them, a person can express utility or satisfaction he derives from the goods in the quantitative cardinal terms. Thus, a person can say that he derives utility equal to 10 units from the consumption of a unit of good A, and 20 units from the consumption of a unit of good B.

Moreover, the cardinal measurement of utility implies that a person can compare utilities derived from goods in respect of size, that is, how much one level of utility is greater than another. A person can say that the utility he gets from the consumption of one unit of good B is double the utility he obtains from the consumption of one unit of good A.

According to Marshall, marginal utility is actually measurable in terms of money. Money represents the general purchasing power and it can therefore be regarded as a command over alternative utility-yielding goods. Marshall argues that the amount of money which a person is prepared to pay for a unit of a good rather than go without it is a measure of the utility he derives from that good.

Thus, according to him, money is the measuring rod of utility Some economists belonging to the cardinalist school measure utility in imaginary units called "utils" They assume that a consumer is capable of saying that one apple provides him utility equal to 4 utils. Further, on this ground, he can say that he gets twice as much utility from an apple as compared to an orange.

## Hypothesis of Independent Utilities

The second important tenet of the cardinal utility analysis is the hypothesis of independent utilities. On this hypothesis, the utility which a consumer derives from a good is the function of the quantity of that good and of that good only. In other words, the utility which a consumer obtains from a good does not depend upon the quantity consumed of other goods; it depends upon the quantity purchased of that good alone.

On this assumption, then the total utility which a person gets from the whole collection of goods purchased by him is simply the total sum of the separate utilities of the goods. Thus, the cardinalist school regards utility as 'additive', that is, separate utilities of different goods can be added to obtain the total sum of the utilities of all goods purchased.

## Constancy of the Marginal Utility of Money

Another important assumption of the cardinal utility analysis is the constancy of the marginal utility of money. Thus, while the cardinal utility analysis assumes that marginal utilities of commodities diminish as more of them are purchased or consumed, but the marginal utility of money remains constant throughout when the individual is spending money on a good and due to which the amount of money with him varies.

Marshall measured marginal utilities in terms of money. But measurement of marginal utility of goods in terms of money is only possible if the marginal utility of money itself remains constant. It should be noted that the assumption of constant marginal utility of money is very crucial to the Marshallian analysis, because otherwise Marshall could not measure the marginal utilities of goods in terms of money. If money which is the unit of measurement itself varies as one is measuring with it, it cannot then yield correct measurement of the marginal utility of goods.

When price of a good falls and as a result the real income of the consumer rises, marginal utility of money to him will fall but Marshall ignored this and assumed that marginal utility of money did not change as a result of the change in price. Likewise, when price of a good rises the real income of the consumer will fall and his marginal utility of money will rise. But Marshall ignored this and assumed that marginal utility of money remains the same. Marshall defended this assumption on the ground that "his (the individual consumer's) expenditure on any one thing is only a small part of his whole expenditure."

## Introspective Method

Another important assumption of the cardinal utility analysis is the use of introspective method in judging the behaviour of marginal utility. "Introspection is the ability of the observer to reconstruct events which go on in the mind of another person with the help of self-observation. This form of comprehension may be just guesswork or intuition or the result of long lasting experience."

Thus, the economists construct with the help of their own experience the trend of feeling which goes on in other men's mind. From his own response to certain forces and by experience and observation one gains understanding of the way other people's minds would work in similar situations. To sum up, in introspective method we attribute to another person what we know of our own mind. That is, by looking into ourselves we see inside the heads of other individuals.

So the law of diminishing marginal utility is based upon introspection. We know from our own mind that as we have more of a thing, the less utility we derive from an additional unit of it. We conclude from it that other individuals' mind will work in a similar fashion, that is, marginal utility to them of a good will diminish as they have more units of it.

With the above basic premises, the founders of cardinal utility analysis have developed two laws which occupy an important place in economic theory and have several applications and uses.

These two laws are:

- Law of Diminishing Marginal Utility.
- Law of Equi-marginal Utility.

It is with the help of these two laws about consumer's behaviour that the exponents of cardinal utility analysis have derived the law of demand.

## Law of Diminishing Marginal Utility

An important tenet of cardinal utility analysis relates to the behaviour of marginal utility. This familiar behaviour of marginal utility has been stated in the Law of Diminishing Marginal Utility according to which marginal utility of a good diminishes as an individual consumes more units of a good. In other words, as a consumer takes more units of a good, the extra utility or satisfaction that he derives from an extra unit of the good goes on falling.

It should be carefully noted that it is the marginal utility and not the total utility that declines with the increase in the consumption of a good. The law of diminishing marginal utility means that the total utility increases at a decreasing rate.

Marshall who has been a famous exponent of the cardinal utility analysis has stated the law of diminishing marginal utility as follows:

> "The additional benefit which a person derives from a given increase of his stock of a thing diminishes with every increase in the stock that he already has."

This law is based upon two important facts. First, while the total wants of a man are virtually unlimited, each single want is satiable. Therefore, as an individual consumes more and more units of a good, intensity of his want for the good goes on falling and a point is reached where the individual no longer wants any more units of the good. That is, when saturation point is reached, marginal utility of a good becomes zero. Zero marginal utility of a good implies that the individual has all that he wants of the good in question.

The second fact on which the law of diminishing marginal utility is based is that the different goods are not perfect substitutes for each other in the satisfaction of various wants. When an individual consumes more and more units of a good, the intensity of his particular want for the good diminishes but if the units of that good could be devoted to the satisfaction of other wants and yielded as much satisfaction as they did initially in the satisfaction of the first want, marginal utility of the good would not have diminished.

It is obvious from above that the law of diminishing marginal utility describes a familiar and fundamental tendency of human nature. This law has been arrived at by introspection and by observing how consumers behave.

## Marginal Utility and Consumer's Tastes and Preferences

The utility people derive from consuming a particular commodity depends on their tastes and preferences. Some consumers like oranges, others prefer apples and still others prefer bananas for consumption. Therefore, the utility which different individuals get from these various fruits depends on their tastes and preferences.

An individual would have different marginal utility curves for different commodities depending on his tastes and preferences. Thus, utility which people derive from various goods reflect their tastes and preferences for them. However, it is worth noting that we cannot compare utility across consumers. Each consumer has a unique subjective utility scale. In the context of cardinal utility analysis, a change in consumer's tastes and preferences means a shift in his one or more marginal utility curves.

However, it may be noted that a consumer's tastes and preferences do not frequently change, as these are determined by his habits. Of course, tastes and preferences can change occasionally. Therefore, in economic theory we generally assume that tastes or preferences are given and relatively stable.

## Significance of Diminishing Marginal Utility

The significance of the diminishing marginal utility of a good for the theory of demand is that it helps us to show that the quantity demanded of a good increase as its price falls and vice versa. Thus, it is because of the diminishing marginal utility that the demand curve slopes downward. If properly understood the law of diminishing marginal utility applies to all objects of desire including money.

But it is worth mentioning that marginal utility of money is generally never zero or negative. Money represents purchasing power over all other goods, that is, a man can satisfy all his material wants if he possesses enough money. Since man's total wants are practically unlimited, therefore, the marginal utility of money to him never falls to zero.

The marginal utility analysis has a good number of uses and applications in both economic theory and policy. The concept of marginal utility is of crucial significance in explaining determination of the prices of commodities. The discovery of the concept of marginal utility has helped us to explain the paradox of value which troubled Adam Smith in "The Wealth of Nations."

Adam Smith was greatly surprised to know why water which is so very essential and useful to life has such a low price (indeed no price), while diamonds which are quite unnecessary, have such a high price. He could not resolve this water-diamond paradox. But modern economists can solve it with the aid of the concept of marginal utility.

According to the modern economists, the total utility of a commodity does not determine the price of a commodity and it is the marginal utility which is crucially important determinant of price. Now, the water is available in abundant quantities so that its relative marginal utility is very low or even zero. Therefore, its price is low or zero. On the other hand, the diamonds are scarce and therefore their relative marginal utility is quite high and this is the reason why their prices are high.

## Consumer's Equilibrium: Principle of Equi-marginal Utility

Principle of equi-marginal utility occupies an important place in cardinal utility analysis. It is through this principle that consumer's equilibrium is explained. A consumer has a given income which he has to spend on various goods he wants. Now, the question is how he would allocate his given money income among various goods, that is to say, what would be his equilibrium position in respect of the purchases of the various goods. It may be mentioned here that consumer is assumed to be 'rational', that is, he carefully calculates utilities and substitutes one good for another so as to maximise his utility or satisfaction.

Suppose there are only two goods X and Y on which a consumer has to spend a given income. The consumer's behaviour will be governed by two factors first, the marginal utilities of the goods and secondly, the prices of two goods. Suppose the prices of the goods are given for the consumer.

The law of equi-marginal utility states that the consumer will distribute his money income between the goods in such a way that the utility derived from the last rupee spent on each good is equal. In other words, consumer is in equilibrium position when marginal utility of money expenditure on each good is the same. Now, the marginal utility of money expenditure on a good is equal to the marginal utility of a good divided by the price of the good. In symbols:

$$MU_m = MU_x / P_x$$

Where $MU_m$ is marginal utility of money expenditure and $MU_m$ is the marginal utility of X and $P_x$ is the price of X. The law of equi-marginal utility can therefore be stated thus: the consumer will spend his money income on different goods in such a way that marginal utility of money expenditure on each good is equal. That is, consumer is in equilibrium in respect of the purchases of two goods X and V when:

$$MU_x / P_x = MU_y / P_y$$

Now, if $MU_x / P_x$ and $MU_y / P_y$ are not equal and $MU_x / P_x$ is greater than $MU_y / P_y$, then the consumer will substitute good X for good Y. As a result of this substitution, the marginal utility of good X will fall and marginal utility of good y will rise. The consumer will continue substituting good X for good Y until $MU_x / P_x$ becomes equal to $MU_y / P_y$. When $MU_x / P_x$ becomes equal to $MU_y / P_y$ the consumer will be in equilibrium.

But the equality of $MU_x / P_x$ with $MU_y / P_y$ can be achieved not only at one level but at different levels of expenditure. The question is how far a consumer goes in purchasing the goods he wants. This is determined by the size of his money income. With a given income and money expenditure a rupee has a certain utility for him: this utility is the marginal utility of money to him.

Since the law of diminishing marginal utility applies to money income also, the greater the size of his money income the smaller the marginal utility of money to him. Now, the consumer will go on purchasing goods until the marginal utility of money expenditure on each good becomes equal to the marginal utility of money to him.

Thus, the consumer will be in equilibrium when the following equation holds good:

$$MU_x / P_x = MU_y / P_y = MU_m$$

Where $MU_m$ is marginal utility of money expenditure (that is, the utility of the last rupee spent on each good).

If there are more than two goods on which the consumer is spending his income, the above equation must hold good for all of them. Thus:

$$MU_x / P_x = MU_y / P_y = \ldots\ldots = MU_m$$

Table: Marginal utility of goods X and Y.

| Units | $MU_x$ (Units) | $MU_y$ (Units) |
|---|---|---|
| 1 | 20 | 24 |
| 2 | 18 | 21 |
| 3 | 16 | 18 |
| 4 | 14 | 15 |
| 5 | 12 | 9 |
| 6 | 10 | 3 |

Let the prices of goods X and Y be Rs. 2 and Rs. 3 respectively. Reconstructing the above table by dividing marginal utilities (MU) of X by Rs. 2 and marginal utilities (MU) of 7 by Rs. 3 we get the table.

Table: Marginal utility of money expenditure.

| Units | $\frac{MU_x}{P_x}$ | $\frac{MU_y}{P_y}$ |
|---|---|---|
| 1 | 10 | 8 |
| 2 | 9 | 7 |
| 3 | 8 | 6 |
| 4 | 7 | 5 |
| 5 | 6 | 3 |
| 6 | 5 | 1 |

Suppose a consumer has money income of Rs. 24 to spend on the two goods. It is worth noting that in order to maximise his utility the consumer will not equate marginal utilities of the goods because prices of the two goods are different. He will equate the marginal utility of the last rupee (i.e. marginal utility of money expenditure) spent on these two goods.

In other words, he will equate $MU_x /P_x$ with $MU_y /P_y$ while spending his given money income on the two goods. $MU_x /P_x$ is equal to 5 utils when the consumer purchases 6 units of good X and $MU_y /P_y$ is equal to 5 utils when he buys 4 units of good Y. Therefore, consumer will be in equilibrium when he is buying 6 units of good X and 4 units of good 7and will be spending (Rs. 2 x 6 + Rs. 3 x 4 ) = Rs. 24 on them that are equal to consumer's given income. Thus, in the equilibrium position where the consumer maximises his utility.

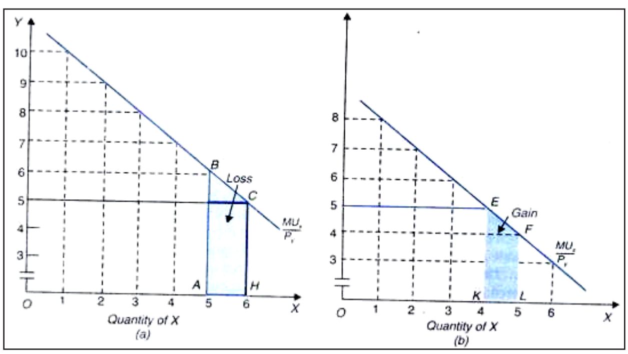
$$MU_x /P_x = MU_y /P_y = MU_m$$

$$10/2 = 15/3 =5$$

Thus, marginal utility of the last rupee spent on each of the two goods he purchases is the same, that is, 5 utils.

Since marginal utility curves of goods slope downward, curves depicting and $MU_x /P_x$ and $MU_y /P_y$ also slope downward. Thus, when the consumer is buying OH of X and OK of Y, then:

$$MU_x /P_x = MU_y /P_y = MU_m$$




Equi-marginal utility principle and consumer's equilibrium.

Therefore, the consumer is in equilibrium when he is buying 6 units of X and 4 units of Y. No other allocation of money expenditure will yield him greater utility than when he is buying 6 units of commodity X and 4 units of commodity Y. Suppose the consumer buys one unit less of good X and one unit more of good Y.

This will lead to the decrease in his total utility. It will be observed from figure that the consumption of 5 units instead of 6 units of commodity X means a loss in satisfaction equal to the shaded area ABCH and from figure it will be seen that consumption of

5 units of commodity Y instead of 4 units will mean gain in utility equal to the shaded area KEFL. It will be noticed that with this rearrangement of purchases of the two goods, the loss in utility ABCH exceeds gain in utility KEFL.

Thus, his total satisfaction will fall as a result of this rearrangement of purchases. Therefore, when the consumer is making purchases by spending his given income in such a way that $MU_x / P_x = MU_y / P_y$, he will not like to make any further changes in the basket of goods and will therefore be in equilibrium situation by maximizing his utility.

## Limitations of the Law of Equi-marginal Utility

Like other laws of economics, law of equi-marginal utility is also subject to various limitations. This law, like other laws of economics, brings out an important tendency among the people. This is not necessary that all people exactly follow this law in the allocation of their money income and therefore all may not obtain maximum satisfaction.

This is due to the following reasons:

- For applying this law of equi-marginal utility in the real life, consumer must weigh in his mind the marginal utilities of different commodities. For this he has to calculate and compare the marginal utilities obtained from different commodities.

But it has been pointed out that the ordinary consumers are not so rational and calculating. Consumers are generally governed by habits and customs. Because of their habits and customs they spend particular amounts of money on different commodities, regardless of whether the particular allocation maximises their satisfaction or not.

- For applying this law in actual life and equate the marginal utility of the last rupee spent on different commodities, the consumers must be able to measure the marginal utilities of different commodities in cardinal terms. However, this is easier said than done. It has been said that it is not possible for the consumer to measure utility cardinally.

Being a state of psychological feeling and also there being no objective units with which to measure utility, it is cardinally immeasurable. It is because of the immeasurability of utility in cardinal terms that the consumer's behaviour has beenexplained with the help of ordinal utility by J.R. Hicks and R.G.D. Allen.

- Another limitation of the law of equi-marginal utility is found in case of indivisibility of certain goods. Goods are often available in large indivisible units. Because the goods are indivisible, it is not possible to equate the marginal utility of money spent on them. For instance, in allocating money between the purchase of car and foodgrains, marginal utilities of the last rupee spent on them cannot be equated.

An ordinary car costs about Rs. 300,000 and is indivisible, whereas foodgrains are divisible and money spent on them can be easily varied. Therefore, the marginal utility of rupee obtained from cars cannot be equalised with that obtained from foodgrains. Thus, indivisibility of certain goods is a great obstacle in the way of equalisation of marginal utility of a rupee from different commodities.

## Derivation of Demand Curve and the Law of Demand

We now turn to explain how the demand curve and law of demand is derived in the marginal utility analysis. The demand curve or law of demand shows the relationship between price of a good and its quantity demanded. Marshall derived the demand curves for goods from their utility functions.

It should be further noted that in his utility analysis of demand Marshall assumed the utility functions of different goods to be independent of each other. In other words, Marshallian technique of deriving demand curves for goods from their utility functions rests on the hypothesis of additive utility functions, that is, utility function of each good consumed by a consumer does not depend on the quantity consumed of any other good.

As has already been noted, in case of independent utilities or additive utility functions, the relations of substitution and Complementarity between goods are ruled out. Further, in deriving demand curve or law of demand Marshall assumes the marginal utility of money expenditure ($Mu_m$) in general to remain constant.

We now proceed to derive demand curve from the law of equi-marginal utility. Consider the case of a consumer who has a certain given income to spend on a number of goods. According to the law of equi-marginal utility, the consumer is in equilibrium in regard to his purchases of various goods when marginal utilities of the goods are proportional to their prices.

Thus, the consumer is in equilibrium when he is buying the quantities of the two goods in such a way that satisfies the following proportionality rule:

$$MU_x / P_x = MU_y / P_y = MU_m$$

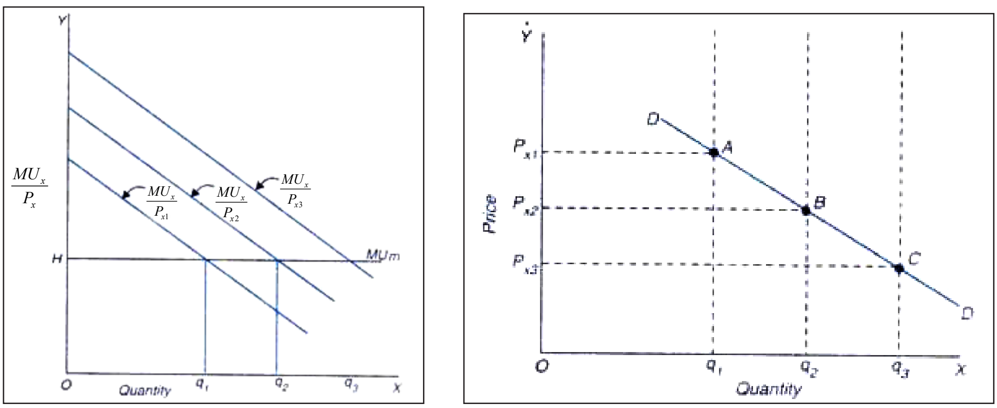
Where $MU_m$ stands for marginal utility of money income in general.

With a certain given income for money expenditure the consumer would have a certain marginal utility of money ($Mu_m$) in general. In order to attain the equilibrium position, according to the above proportionality rule, the consumer will equalise his marginal utility of money (expenditure) with the ratio of the marginal utility and the price of each commodity he buys.

It follows therefore that a rational consumer will equalise the marginal utility of money ($MU_m$) with $MU_x / P_x$ of good X, with $MU_m/P_Y$ of good 7 and so on. Given Ceteris Paribus assumption, suppose price of good X falls. With the fall in the price of good X, the price of good Y, consumer's income and tastes remaining unchanged, the equality of the $MU_x/P_x$ with $MU_y/P_y$ and $MU_m$ in general would be disturbed.

With the lower price than before $MU_x/P_x$ will be greater than $MU_y/P_y$ or $MU_m$ (It is assumed of course that the marginal utility of money does not change as a result of the change in the price of one good). Then, in order to restore the equality, marginal utility of X or $MU_x$ must be reduced. And the marginal utility of X or $MU_x$ can be reduced only by the consumer buying more of the good X.

It is thus clear from the proportionality rule that as the price of a good falls, its quantity demanded will rise, other things remaining the same. This will make the demand curve for a good downward sloping. How the quantity purchased of a good increases with the fall in its price and also how the demand curve is derived in the cardinal utility analysis.




Derivation of demand curve.

In the upper portion of figure, on the Y-axis $MU_x/P_x$ is shown and on the X-axis the quantity demanded of good X is shown. Given a certain income of the consumer, marginal utility of money in general for him is equal to OH. The consumer is buying $Oq_1$ of good X when price is $P_{x1}$ since at the quantity $Oq_1$ of X, marginal utility of money OH is equal to $MU_x/P_{x1}$.

Now, when price of good X falls to $P_{x2}$. The curve will shift upward to the new position $MU_x/P_{x2}$. In order to equate marginal utility of money (OH) with the new $MU_x/P_{x2}$ the consumer increases the quantity demanded to $Oq_2$. Thus, with the fall in price of good X to $P_{x2}$, the consumer buys more of it.

It should be noted that no account is taken of the increase in real income of the consumer as a result of fall in price of good X. This is because if change in real income is taken into account, then marginal utility of money will also change and this would have an effect on the purchases of goods. Marginal utility of money can remain constant in two cases. First, when the elasticity of marginal utility curve (price elasticity of demand) is unity so that even with increase in the purchase of a commodity following the fall in price, the money expenditure made on it remains the same.

Second, marginal utility of money will remain approximately constant for small changes in price of unimportant goods, that is, goods which account for negligible part of consumer's budget. In case of these unimportant goods increase in real income following the fall in price is negligible and therefore can be ignored.

At the bottom of figure the demand curve for X is derived. In this lower panel, price is measured on the Y-axis. As in the upper panel, the X-axis represents quantity. When the price of good X is $Px_1$, the relevant curve of MU/P is $MU_x /P_{x1}$ which is shown in the upper panel. With $MU_x /P_x1$, he buys $Oq_1$ of good X. Now, in the lower panel this quantity $Oq_1$ is directly shown to be demanded at the price $Px_2$.

When price of X falls to $Px_2$, the curve of MU/P shifts upward to the new position $MU_x /P_{x2}$. With $MU_x /P_{x2}$ the consumer buys $Oq_2$ of X. This quantity $Oq_2$ is directly shown to be demanded at price $Px_2$ lower panel. Similarly, by varying price further we can know the quantity demanded at other prices. Thus, by joining points A, B and C we obtain the demand curve DD. The demand curve DD slopes downward which shows that as price of a good falls, its quantity purchased rises.

## Critical Evaluation of Marshall's Cardinal Utility Analysis

Cardinal utility analysis of demand which we have studied above has been criticised on various grounds. The following shortcomings and drawbacks of cardinal utility analysis have been pointed out:

## Cardinal Measurability of Utility is Unrealistic

Cardinal utility analysis of demand is based on the assumption that utility can be measured in absolute, objective and quantitative terms. In other words, it is assumed in this analysis that utility is cardinally measurable. According to this, how much utility a consumer obtains from goods can be expressed or stated in cardinal numbers such as 1, 2, 3, 4 and so forth. But in actual practice utility cannot be measured in such quantitative or cardinal terms.

Since utility is a psychic feeling and a subjective thing, it cannot be measured in quantitative terms. In real life, consumers are only able to compare the satisfactions derived from various goods or various combinations of the goods. In other words, in the real life consumer can state only whether a good or a combination of goods gives him more or less, or equal satisfaction as compared to another. Thus, economists like J.R. Hicks are of the opinion that the assumption of cardinal measurability of utility is unrealistic and therefore it should be given up.

## Hypothesis of Independent Utilities is Wrong

Utility analysis also assumes that utilities derived from various goods are independent. This means that the utility which a consumer derives from a good is the function of the quantity of that good and of that good alone. In other words, the assumption of independent utilities implies that the utility which a consumer obtains from a good does not depend upon the quantity consumed of other goods; it depends upon the quantity purchased of that good alone.

On this assumption, the total utility which a person gets from the whole collection of goods purchased by him is simply the total sum of the separate utilities of various goods. In other words, utility functions are additive.

Neo-classical economists such as Jevons, Menger, Walras and Marshall considered that utility functions were additive. But in the real life this is not so. In actual life the utility or satisfaction derived from a good depends upon the availability of some other goods which may be either substitutes for or complementary with each other. For example, the utility derived from a pen depends upon whether ink is available or not.

On the contrary, if you have only tea, then the utility derived from it would be greater but if along with tea you also have the coffee, then the utility of tea to you would be comparatively less. Whereas pen and ink are complements with each other, tea and coffee are substitutes for each other.

It is thus clear that various goods are related to each other in the sense that some are complements with each other and some are substitutes for each other. As a result of this, the utilities derived from various goods are interdependent, that is, they depend upon each other. Therefore, the utility obtained from a good is not the function of its quantity alone but also depends upon the existence or consumption of other related goods (complements or substitutes).

It is thus evident that the assumption of the independence of utilities by Marshall and other supporters of marginal utility analysis is a great defect and shortcoming of their analysis., the hypothesis of independent utilities along with the assumption of constant marginal utility of money reduces the validity of Marshallian demand theorem to the one- commodity model only.

## Assumption of Constant Marginal Utility of Money is not Valid

An important assumption of cardinal utility analysis is that when a consumer spends varying amount on a good or various goods or when the price of a good changes, marginal utility of money remains unchanged. But in actual practice this is not correct. As a consumer spends his money income on the goods, money income left with him declines.

With the decline in money income of the consumer as a result of increase in his expenditure on goods, the marginal utility of money to him rises. Further, when price of a commodity changes, the real income of the consumer also changes. With this change in real income, marginal utility of money will change and this would have an effect on the demand for the good in question, even though the total money income available with the consumer remains the same.

But utility analysis ignores all this and does not take cognizance of the changes in real income and its effect on demand for goods following the change in price of a good. It is because of the assumption of constant marginal utility of money that Marshall ignored the income effect of the price change which prevented Marshall from understanding the composite character of the price effect (that is, price effect is the sum of substitution effect and income effect).

Moreover, the assumption of constant marginal utility of money together with the hypothesis of independent utilities renders the Marshall's demand theorem to be valid in case of one commodity. Further, it is because of the constant marginal utility of money and therefore the neglect of the income effect by Marshall that he could not explain Giffen Paradox.

Utility from a good can be measured in terms of money (that is, how much money a consumer is prepared to sacrifice for a good). But, to be able to measure utility in terms of money marginal utility of money itself should remain constant. Therefore, assumption of constant marginal utility of money is very crucial to Marshallian demand analysis. On the basis of constant marginal utility of money Marshall could assert that "utility is not only measurable in principle" but also "measurable in fact".

But, in case a consumer has to spread his money income on a number of goods, there is a necessity for revision of marginal utility of money with every change in price of a good. In other words, in a multi-commodity model marginal utility of money does not remain invariant or constant.

Now, when it is realised that marginal utility of money does not remain constant, then Marshall's belief that utility is 'measurable in fact' in terms of money does not hold good. However, if in marginal utility analysis, utility is conceived only to be 'measurable in principle' and not in fact, then it practically gives up cardinal measurement of utility and comes near to the ordinal measurement of utility.

### Marshallian Demand Theorem cannot Genuinely be Derived Except in a one Commodity Case

J.R. Hicks and Tapas Majumdar have criticised Marshallian utility analysis on the ground that "Marshallian demand theorem cannot genuinely be derived from the marginal utility hypothesis except in a one-commodity model without contradicting the assumption of constant marginal utility of money. In other words, Marshall's demand theorem and constant marginal utility of money are incompatible except in a one commodity case. As a result, Marshall's demand theorem cannot be validity derived in the case when a consumer spends his money on more than one good.

In order to know the truth of this assertion consider a consumer who has a given amount of money income to spend on some goods with given prices? According to utility analysis, the consumer will be in equilibrium when he is spending money on goods in such a way that the marginal utility of each good is proportional to its price. Let us assume that, in his equilibrium position, consumer is buying $q_1$ quantity of a good X at a price $P_1$. Marginal utility of good X, in his equilibrium position, will be equal to its price $p_1$ multiplied by the marginal utility of money (which, in Marshallian utility analisis, serves as the unit of measurement).

Thus, in the equilibrium position, the following equation will be fulfilled:

$$MU_x = MU_m \text{ x } p_1$$

Since the consumer is buying $q_1$ quantity of good X at price $P_1$, he will be spending $P_1Q_1$ amount of money on it. Now, suppose that the price of good X rises from $p_1$ to $p_2$. With this rise in price of X, all other things remaining the same, the consumer will at once find himself in disequilibrium state, for the marginal of good X will now be less than the higher price pg multiplied by the marginal utility of money ($Mu_m$) which is assumed to remain unchanged and constant. Thus, now there will be:

$$MU_x < MU_m. P_2$$

In order to restore his equilibrium, the consumer will buy less of good X so that the marginal utility of good X (MUx) would rise and become equal to the product of $p_2$ and $MU_m$. Suppose in this new equilibrium position, he is buying $q_2$ of good X which will be less than $q_1$. With this he will now be spending $p_2q_2$ amount of money on good X. Now the important thing to see is that whether his new expenditure $p_2q_2$ on good X is equal to, smaller or greater than $P_1$ $q_1$.

This depends upon the elasticity of marginal utility curve i.e., price elasticity of demand. If the elasticity of marginal utility curve of good X is unity, then the new expenditure on good X (i.e. $p_2q_2$) after the rise in its price from $p_1$ to $p_2$ will be equal to the initial expenditure $p_1q_1$. When the monetary expenditure made on the good remains constant as a result of change in price, then the Marshallian theory is valid.

But constant monetary expenditure following a price change is only a rare phenomenon. However, the Marshallian demand theory breaks down when the new expenditure $p_2q_2$ after the rise in price, instead of being equal is smaller or greater than the initial expenditure $p_2q_2$.

If elasticity of marginal utility curve is greater than one (that is, price demand for the good is elastic), then the new expenditure $p_2q_2$, after the rise in price from $p_1$ to $p_2$, will be less than the initial expenditure p. On the other hand, if the elasticity of marginal utility curve is less than unity, then the new expenditure $p_2q_2$ after the rise in price will be greater than the initial expenditure $p_1q_1$.

Now, if the new expenditure $p_2q_2$ on good X is less than the initial expenditure $p_1q_1$ or it, it means more money will be left with the consumer to spend on goods other than X. And if the new expenditure $p_2q_2$ on good X is greater than the initial expenditure $p_1q_1$ on it, then less money would be left with him to spend on goods other than X.

In order that the consumer spends the entire amount of money available with him, then in case of new expenditure $p_2q_2$ on good X being smaller or greater than initial expenditure $p_1q_1$ on it, the expenditure or goods other than X and therefore consumer's demand for them will change.

But in Marshallian theoretical framework, this further adjustment in consumer's expenditure on goods other than X can occur only if the unit of utility measurement, that is, the marginal utility of money revised or changed. But Marshall assumes marginal utility of money to remain constant.

Thus, we see that marginal utility of money cannot be assumed to remain constant when the consumer has to spread his money income on a number of goods. In case of more than one good, Marshallian demand theorem cannot be genuinely derived while keeping the marginal utility of money constant.

If, in Marshallian demand analysis, this difficulty is avoided " by giving up the assumption of constant marginal utility of money, then money can no longer provide the measuring rod, and we can no longer express the marginal utility of a commodity in units of money. If we cannot express marginal utility in terms of common numeraire (which money is defined to be) the cardinality of utility would be devoid of any operational significance.

Only in case there is one good on which the consumer has to spend his money, Marshallian demand theorem can be validity derived. To conclude, in the words of Majumdar, "Except in a strictly one-commodity world, therefore, the assumption of a constant marginal utility of money would be incompatible with the Marshallian demand theorem.

Without the assumption of an invariant unit of measurement, the assertion of measurability would be entirely meaningless. The necessity and the possibility of revision of the unit of utility measurement, following every change in price, had been assumed away in Marshallian theory under the cover of 'other things remaining the same' clause."

## Cardinal Utility Analysis does not Split up the Price affect into Substitution and Income Effects

The third shortcoming of the cardinal utility analysis is that it does not distinguish between the income effect and the substitutional effect of the price change.

We know that when the price of a good falls, the consumer becomes better off than before, that is, a fall in price of a good brings about an increase in the real income of the consumer. In other words, if with the fall in price the consumer purchases the same quantity of the good as before, then he would be left with some income.

With this income he would be in a position to purchase more of this good as well as other goods. This is the income effect of the fall in price on the quantity demanded of a good. Besides, when the price of a good falls, it becomes relatively cheaper than other goods and as a result the consumer is induced to substitute that good for others. This results is increase in quantity demanded of that good. This is the substitution effect of the price change on the quantity demanded of the good.

With the fall in price of a good, the quantity demanded of it rises because of income effect and substitution effect. But cardinal utility analysis does not make clear the distinction between the income and the substitution effects of the price change. In fact, Marshall and other exponents of marginal utility analysis ignored income effect of the price change by assuming the constancy of marginal utility of money. Thus, according to Tapas Majumdar, "the assumption of constant marginal utility of money obscured Marshall's insight into the truly composite character of the unduly simplified price-demand relationship".

They explained the changes in demand as a result of change in the price of a good on the basis of substitution effect on it. Thus, marginal utility analysis does not tell us about how much quantity demanded increases due to income effect and how much due to substitution effect as a result of the fall in price of a good J R Hicks rightly remarks, "that distinction between income effect and substitution effect of a price change is accordingly left by the cardinal theory as an empty box which is crying out to be filled. In the same way, Tapas Majumdar says, "The efficiency and precision with which the Hicks-Allen approach can distinguish between the income and subsitutuion effects of a price change really leaves the cardinal argument in a very poor state indeed.

## Marshall could not Explain Giffen Paradox

By not visualizing the price effect as a combination of substitution and income effects and ignoring the income effect of the price change, Marshall could not explain the Giffen Paradox. He treated it merely as an exception to his law of demand. In contrast to it, indifference curve analysis has been able to explain satisfactorily the Giffen good case.

According to indifference curve analysis, in case of a Giffen Paradox or the Giffen good negative income effect of the price change is more powerful than substitution effect so that when the price of a Giffen good falls the negative income effect outweighs the substitution effect with the result that quantity demanded of it falls.

Thus in case of a Giffen good, quantity demanded varies directly with the price and the Marshall's law of demand does not hold good. It is because of the constant marginal utility of money and therefore the neglect of the income effect of price change that Marshall could not explain why the quantity demanded of the Giffen good falls when its price falls and rises when its price rises. This is a serious lacuna in Marshalllian's utility analysis of demand.

### Marginal Utility Analysis Assumes too much and Explains too Little

Marginal utility analysis is also criticised on the ground that it takes more assumptions and also more severe ones than those of ordinal utility analysis of indifference curve technique Marginal utility analysis assumes, among others, that utility is cardinally measurable and also that marginal utility of money remains constant. Hicks-Allen's indifference curve analysis does not take these assumptions and even then it is not only able to deduce all the theorems which cardinal utility analysis can but also deduces a more general theorem of demand.

In other words, indifference curve analysis explains not only that much as cardinal utility analysis does but even goes further and that too with fewer and less severe assumptions. Taking less severe assumption of ordinal utility and without assuming constant marginal utility of money, analysis is able to arrive at the condition of consumer's equilibrium, namely, equality o marginal rate of substitution (MRS) with the price ratio between the goods, which is similar to the proportionality rule of Marshall. Further, since indifference curve analysis does not assume constant marginal utility of money, it is able to derive a valid demand theorem in a more than one commodity case.

In other words indifference curve analysis dearly explains why in case o Giffen goods quality demanded increases with the rise in price and decreases with the fall in price. Indifference curve analysis explains even the case of ordinary inferior goods (other than Giffen goods) in a more analytical Inner.

It may be noted that even if the valid demand f derived for the Marshallian hypothesis, it would still be rejected because "better hypothesis" of indifference preference analysis was available which can enunciate more general demand theorem (covering the case of Giffen goods) with fewer, less severe and more realistic assumptions.

Because of the above drawbacks, cardinal utility analysis has been given up in modern economic theory and demand is analysed with new approaches to demand theory.

## CONSUMER'S EQUILIBRIUM THROUGH INDIFFERENCE CURVE ANALYSIS

"The term consumer's equilibrium refers to the amount of goods and services which the consumer may buy in the market given his income and given prices of goods in the market".

The aim of the consumer is to get maximum satisfaction from his money income. Given the price line or budget line and the indifference map:

> "A consumer is said to be in equilibrium at a point where the price line is touching the highest attainable indifference curve from below".

Conditions:

Thus the consumer's equilibrium under the indifference curve theory must meet the following two conditions:

First: A given price line should be tangent to an indifference curve or marginal rate of satisfaction of good X for good Y ($MRS_{xy}$) must be equal to the price ratio of the two goods. i.e.

$$MRS_{xy} = P_x / P_y$$

Second: The second order condition is that indifference curve must be convex to the origin at the point of tangency.

## Assumptions

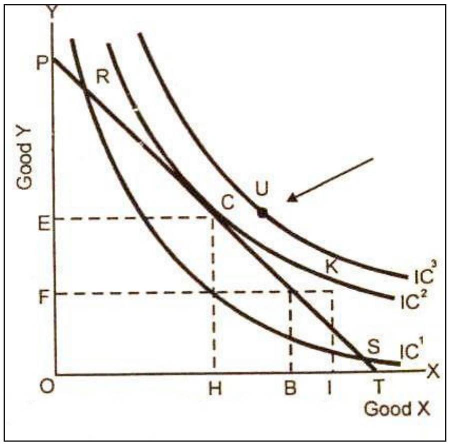
The following assumptions are made to determine the consumer's equilibrium position.

- Rationality: The consumer is rational. He wants to obtain maximum satisfaction given his income and prices.
- Utility is ordinal: It is assumed that the consumer can rank his preference according to the satisfaction of each combination of goods.
- Consistency of choice: It is also assumed that the consumer is consistent in the choice of goods.
- Perfect competition: There is perfect competition in the market from where the consumer is purchasing the goods.
- Total utility: The total utility of the consumer depends on the quantities of the good consumed.

The consumer's consumption decision is explained by combining the budget line and the indifference map. The consumer's equilibrium position is only at a point where the price line is tangent to the highest attainable indifference curve.

## Budget Line should be Tangent to the Indifference Curve

The consumer's equilibrium in explained by combining the budget line and the indifference map.




Consumer's equilibrium through indifference curve.

In the diagram, there are three indifference curves $IC^1$, $IC^2$ and $IC^3$. The price line PT is tangent to the indifference curve $IC^2$ at point C. The consumer gets the maximum satisfaction or is in equilibrium at point C by purchasing OE units of good Y and OH units of good X with the given money income.

The consumer cannot be in equilibrium at any other point on indifference curves. For instance, point R and S lie on lower indifference curve $IC^1$ but yield less satisfaction. As regards point U on indifference curve $IC^3$, the consumer no doubt gets higher satisfaction but that is outside the budget line and hence not achievable to the consumer. The consumer's equilibrium position is only at point C where the price line is tangent to the highest attainable indifference curve $IC^2$.

## Slope of the Price Line to be Equal to the Slope of Indifference Curve

The second condition for the consumer to be in equilibrium and get the maximum possible satisfaction is only at a point where the price line is a tangent to the highest possible indifference curve from below. In figure, the price line PT is touching the highest possible indifferent curve $IC^2$ at point C. The point C shows the combination of the two commodities which the consumer is maximized when he buys OH units of good X and OE units of good Y.

Geometrically, at tangency point C, the consumer's substitution ratio is equal to price ratio $P_x / P_y$. It implies that at point C, what the consumer is willing to pay i.e., his personal exchange rate between X and Y ($MRS_{xy}$) is equal to what he actually pays i.e., the market exchange rate. So the equilibrium condition being $P_x / P_y$ being satisfied at the point C is:

Price of X/Price of Y = MRS of X for Y

The equilibrium conditions given above states that the rate at which the individual is willing to substitute commodity X for commodity Y must equal the ratio at which he can substitute X for Y in the market at a given price.

### Indifference Curve should be Convex to the Origin

The third condition for the stable consumer equilibrium is that the indifference curve must be convex to the origin at the point of equilibrium. In other words, we can say that the MRS of X for Y must be diminishing at the point of equilibrium. It may be noticed that in fig., the indifference curve $IC^2$ is convex to the origin at point C. So at point C, all three conditions for the stable-consumer's equilibrium are satisfied.

The consumer is in equilibrium at point C where the budget line PT is tangent to the indifference $IC^2$. The market basket OH of good X and OE of good Y yields the greatest satisfaction because it is on the highest attainable indifference curve. At point C:

$$MRS_{xy} = P_x / P_y$$

## CONSUMER'S EQUILIBRIUM WITH UTILITY ANALYSIS

### One-commodity Equilibrium

When a consumer is purchasing one commodity, he stops buying when its price and utility have been equated.

At this point, his total utility is the maximum. He is said to be in equilibrium at this point, because he is getting maximum satisfaction and he will buy neither more nor less.

Only a change in price will lead to a change in the quantity demanded.

### Equilibrium with more than one Commodity

According to Mashallian utility analysis, when expenditure of a consumer has been completely adjusted, that is, when marginal utility in each direction of his purchases is the same, it is called consumer's equilibrium. Then he has no desire to buy any more of one commodity and less of another.

Given a set of market prices, his wants and his income, the consumer may be said to be in equilibrium when marginal utilities have been equalized and maximum satisfaction obtained. There will then be no inducement to revise his scheme of expenditure.

He will continue to buy the same commodities and in the same quantities until either his income or his wants or prices change. Adjustment of wants to one another and to his environments is a sign of consumer's equilibrium. For a consumer "to be in equilibrium with respect to all goods, the marginal significance of all goods in terms of money must equal their money prices."

In order to derive maximum satisfaction from the amount of money that a consumer has, he will so apportion his expenditure that the marginal utilities of the goods purchased will be in proportion to their prices.

Thus, a consumer will be in equilibrium when:

M.U. of X /price of X = M.U. of Y /price of Y/M.U. of Z /price of Z = k

This is also called the principle of proportionality.

In case the price of one commodity rises, less of this commodity and more of the other commodities will be purchased so that the proportion will be restored. In the case of durable goods it may not be possible to maintain proportionality. The above equation will hold good only if the consumers' tastes and other circumstances remain unchanged and the commodities are perfectly divisible.

Now if price of commodity X falls, if the fraction is still to be equal to k which is constant, the numerator, i.e., the marginal utility of X must also fall. This will happen only when the consumer consumes more of X. Hence a fall in the price of X leads to more of X being demanded. The position may, however, seem unrealistic. In real life, no sensible consumer bothers about making minute marginal adjustments. Human being are not calculating machines.

The above explanation of a consumer's equilibrium has been given with the help of the concept of utility; it is, therefore, called the analysis of demand or consumer's behaviour. Modern economists explain consumer's equilibrium with the help of indifference curves.

## Shortcomings of the Utility Analysis

We have given so far utility analysis of Consumers' behaviour.

Utility analysis, also called the Marshallian analysis, as an approach to the study of consumer's behaviour, rests on the following two fundamental assumptions:

- Utility is measurable and can be added or subtracted. In other words, utility is a quantifiable concept.
- Marginal utility of money remains constant as a consumer spends more and more of his money.

Both these assumptions have come under heavy fire by modern economists, the foremost amongst them being Professor J. R. Hicks. It has been pointed out by him that utility is a mental phenomenon and cannot, therefore, be measured in quantitative terms. Further, marginal utility of money increases as a consumer spends more and more of his income.

Marshall explained consumer's behaviour assuming that utility is measurable and additive just as the weight or length of objects is measurable and additive. The consumer was, thus, assumed by Marshall to possess what modern economists call 'cardinal' measurement of utility. In other words, the consumer was assumed to be capable of assigning to every commodity or combination of commodities a number representing the amount of utility associated with it.

The numbers representing amounts of utility could be manipulated in the same fashion as weights. Assume for example that utility of 'A' is 15 units and the utility of 'B' 45 units. The consumer would like 'B' three times as strongly as A. The differences between utility numbers could be compared and the comparison could lead to a statement such as 'A' is preferred to 'B' twice as much as 'C' is preferred to 'D'.

Thus, we see that the Marshallian assumption of cardinal measurement of utility is very restrictive. It demands too much from the human mind. Utility is a mental phenomenon and the precision in measurement of utility assumed by Marshall is unrealistic.

Secondly, Marshall assumed marginal utility of money to be constant in his analysis to show consumer's behaviour in making his purchases. Marshall defended his assumption on the ground that as the consumer spent only a small fraction of his income on a particular good, his marginal utility of money does not increase to any significant extent while purchasing more units of it.

But actually, the marginal utility of money increases, as a consumer buys more and is left with less and less money. In view of these shortcomings the modern economists use indifference curve technique in place of Marshallian utility analysis. The indifference curve technique is free from these shortcomings.

## INDIFFERENCE CURVE

The indifference curve indicates the various combinations of two goods which yield equal satisfaction to the consumer.

"An indifference curve shows all the various combinations of two goods that give an equal amount of satisfaction to a consumer".

These economist are the of view that it is wrong to base the theory of consumption on two assumptions:

- That there is only one commodity which a person will buy at one time.
- The utility can be measured.

Their point of view is that utility is purely subjective and is immeasurable. Moreover an individual is interested in a combination of related goods and in the purchase of one commodity at one time. So they base the theory of consumption on the scale of preference and the ordinal ranks or orders his preferences.

The ordinal utility theory or the indifference curve analysis is based on four main assumptions.

- Rational behavior of the consumer: It is assumed that individuals are rational in making decisions from their expenditures on consumer goods.
- Utility is ordinal: Utility cannot be measured cardinally. It can be, however, expressed ordinally. In other words, the consumer can rank the basket of goods according to the satisfaction or utility of each basket.
- Diminishing marginal rate of substitution: In the indifference curve analysis, the principle of diminishing marginal rate of substitution is assumed.
- Consistency in choice: The consumer, it is assumed, is consistent in his behavior during a period of time. For insistence, if the consumer prefers combinations of A of good to the combinations B of goods, he then remains consistent in his choice. His preference, during another period of time does not change. Symbolically, it can be expressed as:

If A > B, then B > A,

- Consumer's preference not self contradictory: The consumer's preferences are not self contradictory. It means that if combinations A is preferred over combination B is preferred over C, then combination A is preferred over combination A is preferred over C. Symbolically it can be expressed:

If A > B and B > C, then A > C,

- Goods consumed are substitutable: The goods consumed by the consumer are substitutable. The utility can be maintained at the same level by consuming more of some goods and less of the other. There are many combinations of the two commodities which are equally preferred by a consumer and he is indifferent as to which of the two he receives.

Example:

For example, a person has a limited amount of income which he wishes to spend on two commodities, rice and wheat. Let us suppose that the following commodities are equally valued by him:

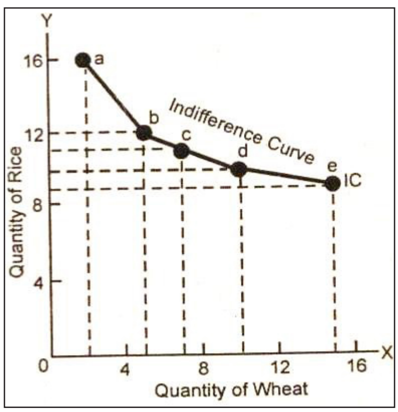
Table: Various combinations.

| | | | |
|---|---|---|---|
| a) | 16 Kilograms of Rice | Plus | 2 Kilograms of Wheat |
| b) | 12 Kilograms of Rice | Plus | 5 Kilograms of Wheat |
| c) | 11 Kilograms of Rice | Plus | 7 Kilograms of Wheat |
| d) | 10 Kilograms of Rice | Plus | 10 Kilograms of Wheat |
| e) | 9 Kilograms of Rice | Plus | 15 Kilograms of Wheat |

It is matter of indifference for the consumer as to which combination he buys. He may buy 16 kilograms of rice and 2 kilograms of wheat or 9 kilograms of rice and 15 kilograms of wheat. All these combinations are equally preferred by him.

An indifference curve thus is composed of a set of consumption alternatives each of which yields the same total amount of satisfaction. These combinations can also be shown by an indifference curve.

The consumer's preferences can be shown in a diagram with an indifference curve. The indifference showing nothing about the absolute amounts of satisfaction obtained. It merely indicates a set of consumption bundles that the consumer views as being equally satisfactory.

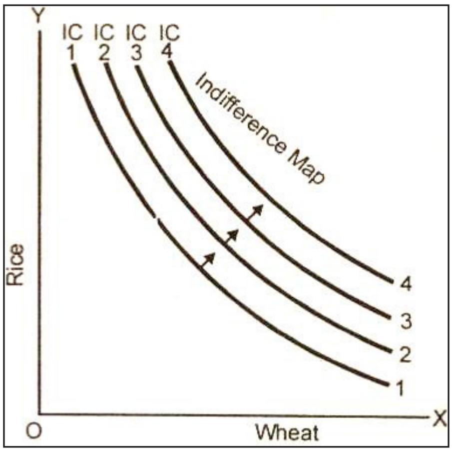



In figure we measure the quantity of wheat along X-axis (in kilograms) and along Y-axis, the quantity of rice (in kilograms). IC is an indifference curve.

It is shown in the diagram that a consumer may buy 12 kilograms of rice and 5 kilograms of wheat or 9 kilograms of rice and 15 kilogram of wheat. Both these combinations are equally preferred by him and he is indifferent to these two combinations. When the scale of preference of the consumer is graphed, by joining the points a, b, c, d, e, we obtain an Indifference Curve IC.

Every point on indifference curve represents a different combination of the two goods and the consumer is indifferent between any two points on the indifference curve. All the combinations are equally desirable to the consumer. The consumer is indifferent as to which combination he receives. The Indifference Curve IC thus is a locus of different combinations of two goods which yield the same level of satisfaction.

A graph showing a whole set of indifference curves is called an indifference map. An indifference map, in other words, is comprised of a set of indifference curves. Each successive curve further from the original curve indicates a higher level of total satisfaction.




In the figure three indifference curves IC[1], IC[2] and IC[3] have been shown. The various combinations of goods of wheat and rice lying on IC[1] yield the same level of satisfaction to the consumer. The combinations of goods lying on higher indifference curve IC[2] contain more both the goods wheat and rice. The indifference curve IC[2] gives more satisfaction to the consumer than IC[1]. Similarly, the set of combinations of two goods on IC[3] yields still higher satisfaction to the consumer than IC[2]. In short, the further away a particular curve is from the origin, the higher level of satisfaction it represents.

It may here be noted that while an indifference curve shows all those combinations of wheat and rice which provide equal satisfaction to the consumer but it does not indicate exactly how much satisfaction is derived by the consumer from these combinations. It is because of the fact that the concept of ordinal utility does not involve the qualitative measurement of utility.

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# Consumer Behavior

3 CHAPTER

Consumer behavior is an inter-disciplinary field of social science. It deals with the study of individuals, groups and organizations, and the activities linked with the purchase, use and disposal of goods and services. The topics elaborated in this chapter will help in gaining a better perspective of consumer behavior.

Consumer behavior is the study of how individual customers, groups or organizations select, buy, use, and dispose ideas, goods, and services to satisfy their needs and wants. It refers to the actions of the consumers in the marketplace and the underlying motives for those actions.

Marketers expect that by understanding what causes the consumers to buy particular goods and services, they will be able to determine, which products are needed in the marketplace, which are obsolete, and how best to present the goods to the consumers.

The study of consumer behavior assumes that the consumers are actors in the market-place. The per spective of role theory assumes that consumers play various roles in the marketplace. Starting from the information provider, from the user to the payer and to the disposer, consumers play these roles in the decision process.

The roles also vary in different consumption situations; for example, a mother plays the role of an influencer in a child's purchase process, whereas she plays the role of a disposer for the products consumed by the family.

## Nature of Consumer Behavior

### Influenced by Various Factors

The various factors that influence the consumer behaviour are as follows:

- Marketing factors such as product design, price, promotion, packaging, positioning and distribution.
- Personal factors such as age, gender, education and income level.
- Psychological factors such as buying motives, perception of the product and attitudes towards the product.
- Situational factors such as physical surroundings at the time of purchase, social surroundings and time factor.

- Social factors such as social status, reference groups and family.
- Cultural factors, such as religion, social class—caste and sub-castes.

### Undergoes a Constant Change

Consumer behaviour is not static. It undergoes a change over a period of time depending on the nature of products. For example, kids prefer colourful and fancy footwear, but as they grow up as teenagers and young adults, they prefer trendy footwear, and as middle-aged and senior citizens they prefer more sober footwear. The change in buying behaviour may take place due to several other factors such as increase in income level, education level and marketing factors.

### Varies from Consumer to Consumer

All consumers do not behave in the same manner. Different consumers behave differently. The differences in consumer behaviour are due to individual factors such as the nature of the consumers, lifestyle and culture. For example, some consumers are technoholics. They go on a shopping and spend beyond their means.

They borrow money from friends, relatives, banks, and at times even adopt unethical means to spend on shopping of advance technologies. But there are other consumers who, despite having surplus money, do not go even for the regular purchases and avoid use and purchase of advance technologies.

### Varies from Region to Region and Country to Country

The consumer behaviour varies across states, regions and countries. For example, the behaviour of the urban consumers is different from that of the rural consumers. A good number of rural consumers are conservative in their buying behaviours.

The rich rural consumers may think twice to spend on luxuries despite having sufficient funds, whereas the urban consumers may even take bank loans to buy luxury items such as cars and household appliances. The consumer behaviour may also vary across the states, regions and countries. It may differ depending on the upbringing, lifestyles and level of development.

### Information on Consumer Behavior is Important to the Marketers

Marketers need to have a good knowledge of the consumer behaviour. They need to study the various factors that influence the consumer behaviour of their target customers.

The knowledge of consumer behaviour enables them to take appropriate marketing decisions in respect of the following factors:

- Product design/model.

- Pricing of the product.
- Promotion of the product.
- Packaging.
- Positioning.
- Place of distribution.

### Leads to Purchase Decision

A positive consumer behaviour leads to a purchase decision. A consumer may take the decision of buying a product on the basis of different buying motives. The purchase decision leads to higher demand, and the sales of the marketers increase. Therefore, marketers need to influence consumer behaviour to increase their purchases.

### Varies from Product to Product

Consumer Behavior is different for different products. There are some consumers who may buy more quantity of certain items and very low or no quantity of other items. For example, teenagers may spend heavily on products such as cell phones and branded wears for snob appeal, but may not spend on general and academic reading. A middle-aged person may spend less on clothing, but may invest money in savings, insurance schemes, pension schemes, and so on.

### Improves Standard of Living

The buying Behavior of the consumers may lead to higher standard of living. The more a person buys the goods and services, the higher is the standard of living. But if a person spends less on goods and services, despite having a good income, they deprives themselves of higher standard of living.

### Reflects Status

The consumer Behavior is not only influenced by the status of a consumer, but it also reflects it. The consumers who own luxury cars, watches and other items are considered belonging to a higher status. The luxury items also give a sense of pride to the owners.

### Important Factors Influencing Consumer Behavior

The study of consumer behaviour indicates how individuals, groups and organizations select, buy, use and dispose goods, services, ideas, or experiences to satisfy their needs and desires. Consumer behaviour is affected by several factors. Marketers need to have a good knowledge of the factors affecting the consumer behaviour.

## Marketing Mix Factors

Each component of the market mix—product, pricing, promotion and place of distribution—has a direct or indirect impact on the buying process of the consumers.

Product: The special characteristics of the product, the physical appearance and the packaging can influence the buying decision of a consumer.

Pricing: The price charged on the product or services consumed by the consumer affect the buying behaviour of the consumers. Marketers must consider the price sensitivity of the target customers while fixing prices.

Promotion: The variables of promotion mix such as advertising, publicity, public relations, personal selling and sales promotion affect the buying behaviour of the consumers. Marketers select the promotion mix after considering the nature of the target audience.

Place: The channels of distribution and the place of distribution affect the buying behaviour of the consumers. The marketers makes an attempt to select the right channel and distribute the products at the right place.

## Personal Factors

The personal factors such as age, occupation, lifestyle, social and economic status and the gender of a consumer may affect the buying decisions of the consumers individually or collectively.

Age factor: The age factor greatly influences the buying behaviour. For example, teenagers prefer trendy clothes, whereas office executives prefer sober and formal clothing.

Gender: The consumer behaviour varies across gender. For example, girls prefer certain feminine colours such as pink, purple and peach, whereas boys go for blue, black and brown.

Education: Highly educated persons may spend on books, personal care products, and so on. But a person with low or no education may spend less on books and more on personal grooming products.

Income level: Normally, the higher the income level, the higher is the level of spending and vice versa. But this may not be the case in developing countries, especially in the rural areas.

Status in the society: Persons enjoying higher status in the society spend a good amount of money on luxury items such as luxury cars, luxury watches, premium brands of clothing, jewellery and perfumes.

## Psychological Factors

A person's buying behaviour is influenced by the psychological factors such as the following:

Learning: It refers to changes in individual behaviour that are caused by information and experience. For example, when a customer buys a new brand of apparels, and is satisfied by its use, then they are more likely to buy the same brand the next time. Through learning, people acquire beliefs and attitudes, which in turn influence the buying behaviour.

Attitude: It is human tendency to respond in a given manner to a particular situation or object or idea. Consumers may develop a positive, or a negative, or a neutral attitude towards certain products or brands, which in turn affects their buying behaviour.

Motives: A motive is the inner drive that motivates a person to act or behave in a certain manner. A marketer must identify the buying motives of the target customers and influence them to act positively towards the marketed products.

Some of the buying motives include the following factors:

- Pride and possession.
- Love and affection.
- Comfort and convenience.
- Sex and romance.

Beliefs: A belief is a descriptive thought that a person holds about certain things. It may be based on knowledge, opinion, faith, trust and confidence. People may hold certain beliefs of certain brands/products. Beliefs develop brand images, which in turn can affect the buying behaviour.

## Social Factors

The social factors such as reference groups family, and social status affects the buying behaviour. Social factors in turn reflect a constant and dynamic influx through which individuals learn different meanings of consumption.

Reference groups: A reference group is a small group of people such as colleagues at workplace, club members, friends circle, neighbours, family members, and so on.

The reference groups influence the members in following manner:

- They influence members' values and attitudes.
- They expose members to new behaviours and lifestyles.
- They create pressure to choose certain products or brands.

Family: The family is the main reference group that may influence the consumer behaviour. Nowadays, children are well informed about goods and services through media or friends circle, and other sources. Therefore, they influence considerably in the decisions of buying both fast moving consumer goods and durable items.

Roles and status: A person performs certain roles in a particular group such as family, club, organization, and so on. For example, a person may perform the role of a vice president in a firm and another person may perform the role of a marketing manager.

The vice president may enjoy higher status in the organization as compared to the marketing manager. People may purchase the products that conform to their roles and status, especially in the case of branded clothes, luxury watches, luxury cars, and so on.

## Cultural Factors

There is a subtle influence of cultural factors on a consumer's decision process. Consumers live in a complex social and cultural environment. The types of products and services they buy can be influenced by the overall cultural context in which they grow up to become individuals. Cultural factors includes race and religion, tradition, caste and moral values. Culture also includes subcultures, sub-castes, religious sects and languages.

Culture: It influences consumer behaviour to a great extent. Cultural values and elements are passed from one generation to another through family, educational institutions, religious bodies and social environment. The cultural diversity influences food habits, clothing, customs and traditions. For example, consuming alcohol and meat in certain religious communities is not restricted, but in certain communities, consumption of alcohol and meat is prohibited.

Subculture: Each culture consists of smaller subcultures that provide specific identity to its members. Subcultures include sub-castes, religious sects (Roman Catholics, Syrian Catholics, Protestant Christians, etc.), geographic regions (South Indians, North Indians) and language (Marathi, Malayali, Gujarati).

The behaviour of people belonging to various subcultures is different. Therefore, marketers may adopt multicultural marketing approaches, that is, designing and marketing goods and services that cater to the tastes and preferences of the consumers belonging to different subcultures.

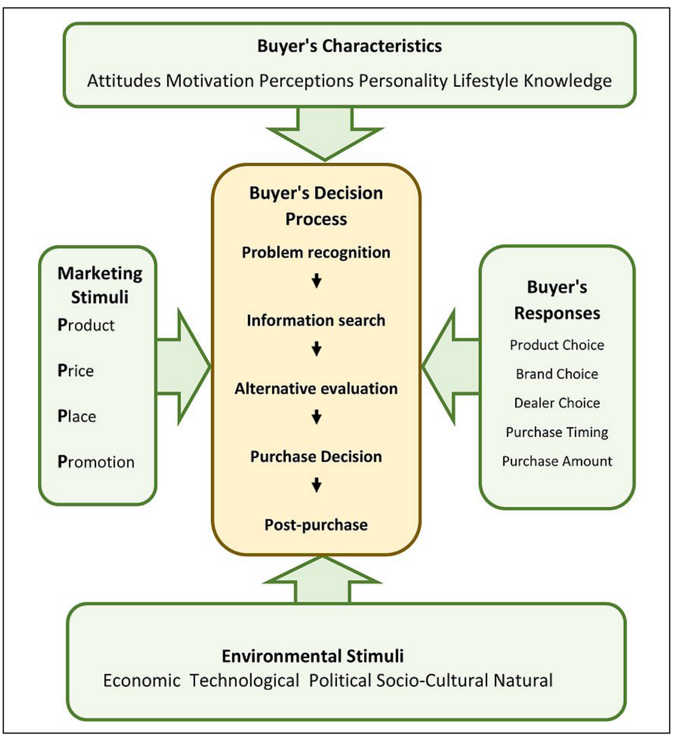
## Purchase Decision and its Context

Understanding purchasing and consumption behaviour is a key challenge for marketers. Consumer behaviour, in its broadest sense, is concerned with understanding both how purchase decisions are made and how products or services are consumed or experienced. Consumers are active decision-makers. They decide what to purchase, often based on their disposable income or budget. They may change their preferences related to their budget and a range of other factors.

Some purchase decisions involve long, detailed processes that include extensive information search to select between competing alternatives. Other purchase decisions, such as impulse buys or habitual purchases, are made almost instantaneously with little or no investment of time or effort in information search.

Some purchase decisions are made by groups (such as families, households or businesses) while others are made by individuals. When a purchase decision is made by a small group, such as a household, different members of the group may become involved at different stages of the decision process and may perform different roles. For example, one person may suggest the purchase category, another may search for product-related information while yet another may physically go to the store, buy the product and transport it home. It is customary to think about the types of decision roles; such as:

- The Initiator: The person who proposes a brand (or product) for consideration (something in return).
- The Influencer: Someone who recommends a given brand.
- The Decider: The person who makes the ultimate purchase decision.
- The Purchaser: The one who orders or physically buys it.
- The User: The person who uses or consumes the product.




The purchasing decision model.

For most purchase decisions, each of the decision roles must be performed, but not always by the same individual. For example, in the case of family making a decision about a dining-out venue, the father or mother may initiate the process by intimating that he/she is too tired to cook, the children are important influencers in the overall purchase decision, but both parents may act as joint deciders performing a gate-keeping role by vetoing unacceptable alternatives and encouraging more acceptable alternatives. The importance of children as influencers in a wide range of purchase contexts should never be underestimated and the phenomenon is known as pester power.

To approach the mental processes used in purchasing decisions, some authors employ the concept of the black box, which represents the cognitive and affective processes used by a consumer during a purchase decision. The decision model situates the black box in a broader environment which shows the interaction of external and internal stimuli (e.g. consumer characteristics, situational factors, marketing influences and environmental factors) as well as consumer responses. The black box model is related to the black box theory of behaviourism, where the focus extends beyond processes occurring inside the consumer, and also includes the relation between the stimuli and the consumer's response.

The decision model assumes that purchase decisions do not occur in a vacuum. Rather, they occur in real time and are affected by other stimuli, including external environmental stimuli and the consumer's momentary situation. The elements of the model include: interpersonal stimuli (between people) or intrapersonal stimuli (within people), environmental stimuli and marketing stimuli. Marketing stimuli include actions planned and carried out by companies, whereas environmental stimuli include actions or events occurring in the wider operating environment and include social factors, economic, political and cultural dimensions. In addition, the buyer's black box includes buyer characteristics and the decision process, which influence the buyer's responses.

The black box model considers the buyer's response as a result of a conscious, rational decision process, in which it is assumed that the buyer has recognized a problem, and seeks to solve it through a commercial purchase. In practice some purchase decisions, such as those made routinely or habitually, are not driven by a strong sense of problem-solving. Such decisions are termed low-involvement and are characterized by relatively low levels of information search and evaluation activities. In contrast, high involvement decisions require a serious investment of time and effort in the search and evaluation process. Low involvement products are typically those that carry low levels of economic or psycho-social risk. High involvement products are those that carry higher levels of risk and are often expensive, infrequent purchases. Regardless of whether the consumer faces a high or low involvement purchase, he or she needs to work through a number of distinct stages of a decision process.

## Consumer's Purchase Decision Process

The consumer buying process is usually depicted as consisting of 5 distinct stages:

The purchase decision begins with the problem recognition stage, which occurs when the consumer identifies a need, typically defined as the difference between the consumer's current state and their desired state. The strength of the need drives the entire decision process. Information search is the phase where consumers scan both their internal memory and external sources for information about products or brands that will potentially satisfy their need. The aim of the information search is to identify a list of options that represent realistic purchase options. Throughout the entire process, the consumer engages in a series of mental evaluations of alternatives, searching for the best value. Towards the end of the evaluation stage, consumers form a purchase intention, which may or may not translate into an actual product purchase. Even when consumers decide to proceed with an actual purchase, the decision-process is not complete until the consumer consumes or experiences the product and engages in a final post purchase evaluation; a stage in which the purchaser's actual experience of the product is compared with the expectations formed during the information search and evaluation stages. The stages of the decision process normally occur in a fixed sequence. However, information search and evaluation can occur throughout the entire decision process, including post-purchase.

## Problem Recognition

The first stage of the purchase decision process begins with problem recognition (also known as category need or need arousal). This is when the consumer identifies a need, typically defined as the difference between the consumer's current state and their desired or ideal state. A simpler way of thinking about problem recognition is that it is where the consumer decides that he or she is 'in the market' for a product or service to satisfy some need or want. The strength of the underlying need drives the entire decision process.

Theorists identify three broad classes of problem-solving situation relevant for the purchase decision:

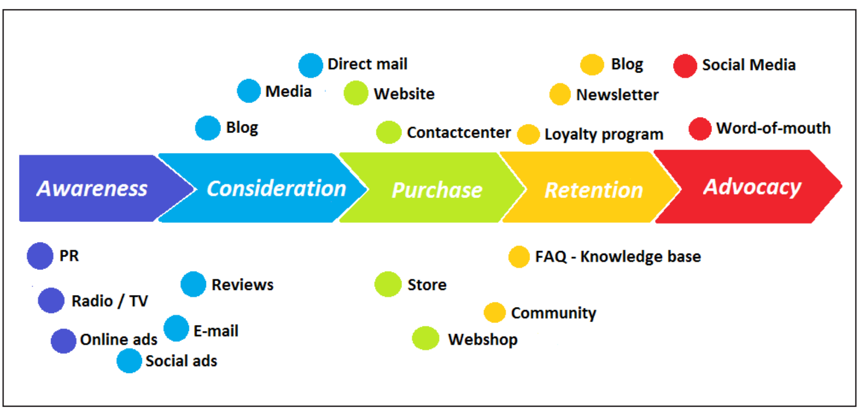
- Extensive problem-solving: Purchases that warrant greater deliberation, more extensive information search and evaluation of alternatives. These are typically expensive purchases, or purchases with high social visibility e.g. fashion, cars
- Limited problem-solving: Known or familiar purchases, regular purchases, straight re-buys. Typically low-priced items.
- Routinized problem-solving: Repeat purchases or habitual purchases.

Consumers become aware of a problem in a variety of ways including:

- Out-of-Stock/natural depletion: When a consumer needs to replenish stocks of a consumable item e.g. ran out of milk or bread.

- Regular purchase: When a consumer purchases a product on a regular basis e.g. newspaper, magazine.
- Dissatisfaction: When a consumer is not satisfied with the current product or service.
- New needs or wants: Lifestyle changes may trigger the identification of new needs e.g. the arrival of a baby may prompt the purchase of a cot, stroller and car-seat for baby.
- Related products: The purchase of one product may trigger the need for accessories, spare parts or complementary goods and services e.g. the purchase of a printer leads to the need for ink cartridges; the purchase of a digital camera leads to the need for memory cards.
- Marketer-induced problem recognition: When marketing activity persuades consumers of a problem (usually a problem that the consumer did not realise they had). The consciously, and subconsciously, consumed content in traditional as well as social media greatly plays the role of a stimulus for the consumer's recognition of a new need.
- New products or categories: When consumers become aware of new, innovative products that offer a superior means of fulfilling a need. Disruptive technologies such as the advent of wireless free communications devices can trigger a need for plethora of products such as a new mouse or printer.

## Information Search




Customer purchase decision, illustrating different communications touchpoints at each stage.

During the information search and evaluation stages, the consumer works through processes designed to arrive at a number of brands (or products) that represent viable purchase alternatives. Typically consumers first carry out an internal search that is, a scan of memory for suitable brands. The evoked set is the set of brands that a consumer can elicit from memory and is typically a very small set of some 3- 5 alternatives. Consumers may choose to supplement the number of brands in the evoked set by carrying out an external search using sources such as the Internet, manufacturer/brand websites, shopping around, product reviews, referrals from peers and the like. The readiness of information availability has raised the informedness of the consumers; the degree to which they know what is available in the marketplace, with precisely which attributes and at precisely what price.

The fact that a consumer is aware of a brand does not necessarily mean that it is being considered as a potential purchase. For instance, the consumer may be aware of certain brands, but not favourably disposed towards them (known as the inept set). Such brands will typically be excluded from further evaluation as purchase options. For other brands, the consumer may have indifferent feelings (the inert set). As the consumer approaches the actual purchase, he or she distills the mental list of brands into a set of alternatives that represent realistic purchase options, known as the consideration set. By definition, the consideration set refers to the "small set of brands which a consumer pays close attention to when making a purchase decision".

Specific brand names enter the consumer's consideration set based on the extent to which they satisfy the consumer's purchasing objectives and/or the salience or accessibility of the brand at the time of making the purchase decision. By implication, brand names that are more memorable are more likely to be accessible. Traditionally, one of the main roles of advertising and promotion was to increase the likelihood that a brand name was included in the consumer's evoked set. Repeated exposure to brand names through intensive advertising was the primary method for increasing top-of-mind brand awareness. However, the advent of the Internet means that consumers can obtain brand/product information from a multiplicity of different platforms. In practice, the consideration set has assumed greater importance in the purchase decision process because consumers are no longer totally reliant on memory. This is marketing, which could be defined as marketing as "The process by which companies create value for customers and build strong customer relationships, in order to capture value from customers in return." This definition strongly implies that the relationship is built upon an exchange, and the "creation" of value. This means that a need is built for a consumer, with the product presented or advertised to them through an analytical study of the user's patterns of consumption, and their behaviors and habits. The implication for marketers is that relevant brand information should be disseminated as widely as possible and included on any forum where consumers are likely to search for product or brand information, whether traditional media or digital media channels. Thus, marketers require a rich understanding of the typical consumer's touchpoints.

## Evaluation of Alternatives

Consumer evaluation can be viewed as a distinct stage. Alternatively, evaluation may occur continuously throughout the entire decision process. Consumers evaluate alternatives in terms of the functional (also called utilitarian) and psycho-social (also called the value-expressive or the symbolic) benefits offered.

- Functional benefits are the tangible outcomes that can be experienced by the consumer such as taste or physical appearance.
- Psycho-social benefits are the more abstract outcomes or the personality-related attributes of a brand, such as the social currency that might accrue from wearing an expensive suit, designer label or driving a 'hot' car.

Brand image (or brand personality) is an important psycho-social attribute. Consumers can have both positive and negative beliefs about a given brand. A considerable body of research suggests that consumers are predisposed towards brands with a personality that matches their own and that a good match can affect brand preference, brand choice, satisfaction with a brand, brand commitment and loyalty and the consumer's propensity to give positive word-of-mouth referrals. The branch of consumer behaviour that investigates the matching of a brand's personality and the consumer's personality is known as self-congruity research. The social media presence of a brand plays a huge part in this stage, if we "Think of regular media as a one-way street where you can read a newspaper or listen to a report on television, but you have very limited ability to give your thoughts on the matter. Social media, on the other hand, is a two-way street that gives you the ability to communicate too." Consumer beliefs about a brand or product category may vary depending on a range of factors including the consumer's prior experience and the effects of selective perception, distortion and retention. Consumers who are less knowledgeble about a category tend to evaluate a brand based on its functional characteristics. However, when consumers become more knowledgeable, functional attributes diminish and consumers process more abstract information about the brand, notably the self-related aspects.

Marketing consumer behavior as a sales marketer, vital that you understand and control your consumer behavior so that you make and formulate the right strategies at the right time.

The marketing organization needs a deep understanding of the benefits most valued by consumers and therefore which attributes are most important in terms of the consumer's purchase decision. It also needs to monitor other brands in the customer's consideration set to optimise planning for its own brand. During the evaluation of alternatives, the consumer ranks or assesses the relative merits of different options available. No universal evaluation process is used by consumers across all-buying situations. Instead, consumers generate different evaluation criteria depending on each unique buying situation. Social media further enables consumers to share views with their peers about the product they are looking to purchase. This way, consumers can gauge the positive and negative sides of each alternative, and decide even more conveniently as for the best product to buy. Thus the relevant evaluation attributes vary according to across different types of consumers and purchase contexts. For example, attributes important for evaluating a restaurant would include food quality, price, location, atmosphere, quality of service and menu selection. Consumers, depending on their geographic, demographic, psychographic and behavioural characteristics, will decide which attributes are important to them. Potential patrons seeking a hedonic dining experience may be willing to travel further distances to patronise a fine-dining venue compared to those wanting a quick meal at a more utilitarian eatery. After evaluating the different product attributes, the consumer ranks each attribute or benefit from highly important to least important. These priorities are directly related to the consumer's needs and wants. Thus, the consumer arrives at a weighted score for each product or brand - representing the consumer's subjective assessment of individual attribute scores weighted in terms of their importance, to arrive at a total mental score or rank for each product/brand under consideration.

## Purchase Decision

Once the alternatives have been evaluated, the consumer firms up their resolve to proceed through to the actual purchase. For example, the consumer might say to his/herself, "Yes, I will buy Brand X one day." This self instruction to make a purchase is known as purchase intent. Purchase intentions are a strong, yet imperfect predictor of sales. Sometimes purchase intentions simply do not translate into an actual purchase and this can signal a marketing problem. For instance, a consumer may wish to buy a new product, but may be unaware of the retail outlets that stock it, so that purchasing cannot proceed. The extent to which purchase intentions result in actual sales is known as the sales conversion rate.

Organizations use a variety of techniques to improve conversion rates. The provision of easy credit or payment terms may encourage purchase. Sales promotions such as the opportunity to receive a premium or enter a competition may provide an incentive to buy now rather than defer purchases for a later date. Advertising messages with a strong call-to-action are yet another device used to convert customers. A call-to-action is any device designed to encourage immediate sale. Typically, a call-to-action includes specific wording in an advertisement or selling pitch that employs imperative verbs such as "Buy now!" or "Don't wait!". Other types of calls-to-action might provide consumers with strong reasons for purchasing immediately such an offer that is only available for a limited time (e.g. 'Offer must expire soon'; 'Limited stocks available') or a special deal usually accompanied by a time constraint (e.g. 'Order before midnight to receive a free gift with your order'; 'Two for the price of one for first 50 callers only'). Additionally, service convenience is a saving of effort, in the way that it minimizes the activities that customers may bear to buy goods and services. The key to a powerful call-to-action is to provide consumers with compelling reasons to purchase promptly rather than defer purchase decisions.

As consumers approach the actual purchase decision, they are more likely to rely on personal sources of information. For this reason, personal sales representatives must be well versed in giving sales pitches and in tactics used to close the sale. Methods used might include: 'social evidence', where the salesperson refers to previous success and satisfaction from other customers buying the product. 'Scarcity attraction' is another technique, where the salesperson mentions that the offer is limited, as it forces the consumer to make a quicker decision, and therefore less time evaluating alternatives.

## Post-purchase Evaluation

Following purchase and after experiencing the product or service, the consumer enters the final stage, namely post-purchase evaluation. The consumer's purchase and post-purchase activities have the potential to provide important feedback to marketers. Foxall suggested that post-purchase evaluation provides key feedback because it influences future purchase patterns and consumption activities.

The post purchase stage is where the consumer examines and compares product features, such as price, functionality, and quality with their expectations. Post purchase evaluation can be viewed as the steps taken by consumers to correlate their expectations with perceived value, and thus influences the consumer's next purchase decision for that good or service. For example, if a consumer buys a new phone and his or her post-purchase evaluation is positive, he/she will be encouraged to purchase the same brand or from the same company in the future. This is also known as "post-purchase intention". On the contrary, if a consumer is dissatisfied with the new phone, he or she may take actions to resolve the dissatisfaction. Consumer actions, in this instance, could involve requesting a refund, making a complaint, deciding not to purchase the same brand or from the same company in the future or even spreading negative product reviews to friends or acquaintances, possibly via social media.

After acquisition, consumption or disposition, consumers may feel some uncertainty in regards to the decision made, generating in some cases regret. Post-decision dissonance (also known as cognitive dissonance) is the feeling of anxiety that occurs in the post purchase stage, as well as the uneasy feelings or concerns as to whether or not the correct decision was made at purchase. Some consumers, for instance, may regret that they did not purchase one of the other brands they were considering. This type of anxiety can affect consumers' subsequent behaviour and may have implications for repeat patronage and customer loyalty.

Consumers use a number of strategies to reduce post purchase dissonance. A typical strategy is to look to peers or significant others for validation of the purchase choice. Customers have always been led by the opinions of friends and family, but nowadays this is corroborated by social media likes, reviews and testimonials. Marketing communications can also be used to remind consumers that they made a wise choice by purchasing Brand X.

When consumers make unfavorable comparisons between the chosen option and the options forgone, they may feel post-decision regret or buyer's remorse. Consumers can also feel short-term regret when they avoid making a purchase decision, however this regret can dissipate over time. Through their experiences consumers can learn and also engage in a process that's called hypothesis testing. This refers to the formation of hypotheses about the products or a service through prior experience or word of mouth communications. There are four stages that consumers go through in the hypothesis testing: Hypothesis generation, exposure of evidence, encoding of evidence and integration of evidence.

## Influences on Purchase Decision

Purchasing is influenced by a wide range of internal and external factors.

## Consumer Awareness

Consumer awareness refers to the awareness of the consumption of goods formed by consumers in the long-term shopping environment and purchasing activities.

The change of life concept is the subjective factor of the change of consumer awareness. As people's living standards continue to increase and incomes continue to increase, people's life concepts are constantly changing. Differences in consumer personality are the internal motivations for changes in consumer awareness.

Intensified market competition is a catalyst for changes in consumer awareness. Many companies have launched their own branded products in order to gain a foothold in an increasingly competitive market. In the face of a variety of goods and brands, consumers' brand awareness matures. When people buy goods, paying attention to the brand has become a fashion. Faced with the severe competition situation, companies began to realize the importance of implementing brand strategy, and began to focus on market research, and on this basis, deeply grasp the consumer's psychological pulse to improve market share and brand loyalty.

With the change of people's life concept, consumers' rational consumption psychology has become increasingly prominent. Social Marketing, Customized Marketing, brand-name shopping, and the consumer's perception of the price of the commodity (directly expressed as the consumer's sensitivity to price), are all main factors for understanding consumer attitudes, and help explain the reaction of market demand to price changes.

## Internal Influences on Purchase Decision

Internal influences refer to both personal and interpersonal factors. Social theory suggests that individuals have both a personal identity and a social identity. Personal identity consists of unique personal characteristics such as skills and capabilities, interests and hobbies. Social identity consists of the individual's perception of the central groups to which an individual belongs and may refer to an age group, a lifestyle group, religious group, educational group or some other reference group. Social psychologists have established that the need to belong is one of the fundamental human needs. Purchasing behaviour is therefore influenced by a broad range of internal factors such as psychological, socio-economic, demographic and personality factors. Demographic factors include income level, psychographics (lifestyles), age, occupation and socio-economic status. Personality factors include knowledge, attitudes, personal values, beliefs, emotions and feelings. Psychological factors include an individual's motivation, attitudes, personal values and beliefs. Other factors that may affect the purchase decision include the environment and the consumer's prior experience with the category or brand. Social identity factors include culture, sub-culture and reference groups. Other factors that may affect the purchase decision include the environment and the consumer's prior experience with the category or brand.

## Motivations and Emotions

Maslow's hierarchy suggests that people seek to satisfy basic needs such as food and shelter before higher order needs become meaningful.

The consumer's underlying motivation drives consumer action, including information search and the purchase decision. The consumer's attitude to a brand (or brand preference) is described as a link between the brand and a purchase motivation. These motivations may be negative - that is to avoid pain or unpleasantness, or positive - that is to achieve some type of reward such as sensory gratification.

One approach to understanding motivations, was developed by Abraham Maslow. Maslow's hierarchy of needs is based on five levels of needs, organized accordingly to the level of importance.

Maslow's five needs are:

- Physiological: Basic levels of needs such as food, water and sleep.
- Safety: The need for physical safety, shelter and security.

- Belonging: The need for love, friendship and also a desire for group acceptance.
- Esteem: The need for status, recognition and self-respect.
- Self-actualization: The desire for self-fulfillment (e.g. personal growth, artistic expression).

Physiological needs and safety needs are the so-called lower order needs. Consumers typically use most of their resources (time, energy and finances) attempting to satisfy these lower order needs before the higher order needs of belonging, esteem and self-actualization become meaningful. Part of any marketing program requires an understanding of which motives drive given product choices. Marketing communications can illustrate how a product or brand fulfills these needs. Maslow's approach is a generalised model for understanding human motivations in a wide variety of contexts, but is not specific to purchasing decisions.

Another approach proposes eight purchase motivations, five negative motives and three positive motives, which energise purchase decisions. These motivations are believed to provide positive reinforcement or negative reinforcement.

| Rossiter and Percy's Purchase Motivations and Emotions | |
|---|---|
| Motivation | Emotional Sequence |
| NEGATIVE | |
| Problem removal | Annoyance → Relief |
| Problem avoidance | Fear → Relaxation |
| Incomplete satisfaction | Disappointment → Optimism |
| Mixed approach avoidance | Conflict → Peace-of-mind |
| Normal depletion | Mild annoyance → Convenience |
| POSITIVE | |
| Sensory gratification | Dull (or neutral) → Sensory anticipation |
| Intellectual simulation | Bored (or neutral) → Excited |
| Social approval/ conformity | Apprehensive (or ashamed) → Flattered/ proud |

The consumer's motivation to search for information and engage in the purchase decision process is sometimes known as involvement. Consumer involvement has been defined as "the personal relevance or importance of a message or a decision". Purchase decisions are classified as low involvement when consumers suffer only a small psycho-social loss in the event that the make a poor decision. On the other hand, a purchase decision is classified as high involvement when psycho-social risks are perceived to be relatively high. The consumer's level of involvement is dependent on a number of factors including, perceived risk of negative consequences in the event of a poor decision, the product category - especially the social visibility of the product and the consumer's prior experience with the category.

## Perception

Part of marketing strategy is to ascertain how consumers gain knowledge and use information from external sources. The perception process is where individuals receive, organize and interpret information in order to attribute some meaning. Perception involves three distinct processes: sensing information, selecting information and interpreting information. Sensation is also part of the perception process, and it is linked direct with responses from the senses creating some reaction towards the brand name, advertising and packaging. The process of perception is uniquely individual and may depend on a combination of internal and external factors such as experiences, expectations, needs and the momentary set.

When exposed to a stimulus, consumers may respond in entirely different ways due to individual perceptual processes. A number of processes potentially support or interfere with perception. Selective exposure occurs when consumers decide whether to be exposed to information inputs. Selective attention occurs when consumers focus on some messages to the exclusion of others. Selective comprehension is where the consumer interprets information in a manner that is consistent with their own beliefs. Selective retention occurs when consumers remember some information while rapidly forgetting other information. Collectively the processes of selective exposure, attention, comprehension and retention lead individual consumers to favor certain messages over others. The way that consumers combine information inputs to arrive at a purchase decision is known as integration.

Marketers are interested in consumer perceptions of brands, packaging, product formulations, labeling and pricing. Of special interest is the threshold of perception (also known as the just noticeable difference) in a stimulus. For example, how much should a marketer lower a price before consumers recognize it as a bargain? In addition, marketers planning to enter global markets need to be aware of cultural differences in perception. For example, westerners associate the color white with purity, cleanliness and hygiene, but in eastern countries white is often associated with mourning and death. Accordingly, white packaging would be an inappropriate color choice for food labels on products to be marketed in Asia.

## Prior Experience

The consumer's prior experience with the category, product or brand can have a major bearing on purchase decision-making. Experienced consumers (also called experts) are more sophisticated consumers; they tend to be more skillful information searchers, canvass a broader range of information sources and use complex heuristics to evaluate purchase options. Novice consumers, on the other hand, are less efficient information searchers and tend to perceive higher levels of purchase risk on account of their unfamiliarity with the brand or category. When consumers have prior experience, they have less motivation to search for information, spend less effort on information search but can process new information more efficiently. One study, for example, found that as consumer experience increases, consumers consider a wider range of purchase alternatives (that is, they generate a larger consideration set, but only at the product category level).

## Consumer Decision Styles

A number of theorists have argued that certain fundamental decision-making styles can be identified. A decision-making style is defined as a "mental orientation characterising a consumer's approach to making choices." Sproles and Kendall developed a consumer style inventory (CSI) consisting of eight factors, such as price-sensitivity, quality-consciousness, brand-consciousness, novelty-seeking, fashion-consciousness and habit. Based on these factors, the authors developed a typology of eight distinct decision-making styles:

- Quality conscious/Perfectionist: Quality-consciousness is characterised by a consumer's search for the very best quality in products; quality conscious consumers tend to shop systematically making more comparisons and shopping around to compare quality and value.

- Brand-conscious: Brand-consciousness is characterised by a tendency to buy expensive, well-known brands or designer labels. Those who score high on brand-consciousness tend to believe that the higher prices are an indicator of quality and exhibit a preference for department stores or top-tier retail outlets.

- Recreation-conscious/Hedonistic: Recreational shopping is characterised by the consumer's engagement in the purchase process. Those who score high on recreation-consciousness regard shopping itself as a form of enjoyment.

- Price-conscious: A consumer who exhibits price-and-value consciousness. Price-conscious shoppers carefully shop around seeking lower prices, sales or discounts and are motivated by obtaining the best value for money

- Novelty/fashion-conscious: Characterised by a consumer's tendency to seek out new products or new experiences for the sake of excitement; who gain excitement from seeking new things; they like to keep up-to-date with fashions and trends, variety-seeking is associated with this dimension.

- Impulsive: Impulsive consumers are somewhat careless in making purchase decisions, buy on the spur of the moment and are not overly concerned with expenditure levels or obtaining value. Those who score high on impulsive dimensions tend not to be engaged with the object at either a cognitive or emotional level.

- Confused (by over-choice): Characterised by a consumer's confusion caused by too many product choices, too many stores or an overload of product information; tend to experience information overload.

- Habitual/brand loyal: Characterised by a consumer's tendency to follow a routine purchase pattern on each purchase occasion; consumers have favourite brands or stores and have formed habits in choosing, the purchase decision does not involve much evaluation or shopping around.

The Consumer Styles Inventory (CSI) has been extensively tested and retested in a wide variety of countries and purchasing contexts. Many empirical studies have observed cross-cultural variations in decisions styles, leading to numerous adaptations or modifications of the CSI scale for use in specific countries. Consumer decision styles are important for marketers because they describe behaviours that are relatively stable over time and for this reason, they are useful for market segmentation.

## Other Topics in Consumer Behavior

In addition to understanding the purchasing decision, marketers are interested in a number of different aspects of consumer behaviour that occur before, during and after making a purchase choice. Areas of particular interest include: risk perception and risk reduction activities; brand switching, channel switching, brand loyalty, customer citizenship behaviours and post purchase behavioural intentions and behaviours, including brand advocacy, referrals, word of mouth activity etc.

## Risk Perception and Risk Reduction Activities

The consumer's perceptions of risk are a major consideration in the pre-purchase stage of the purchasing decision. Perceived risk is defined as "the consumer's perceptions of the uncertainty and adverse consequences of engaging in an activity". Risk consists of two dimensions: consequences - the degree of importance or the severity of an outcome and uncertainty - the consumer's subjective assessment of the likelihood of occurrence. For example, many tourists are fearful of air travel because, although the probability of being involved in an airline accident is very low, the consequences are potentially dire.

The marketing literature identifies many different types of risk, of which five are the most frequently cited:

- Financial Risk: The potential financial loss in the event of a poor decision.
- Performance Risk (also known as functional risk): The idea that a product or service will not perform as intended.
- Physical Risk: The potential for physical harm if something goes wrong with a purchase.
- Social Risk: The potential for loss of social status associated with a purchase.

- Psychological Risk: The potential for a purchase to result in a loss of self-esteem.

If a consumer perceives a purchase to be risky, he or she will engage in strategies to reduce the perceived risk until it is within their tolerance levels or, if they are unable to do so, withdraw from the purchase. Thus, the consumer's perceptions of risk drive information search activities.

Services marketers have argued that risk perception is higher for services because they lack the search attributes of products (i.e. tangible properties that can be inspected prior to consumption). In terms of risk perception, marketers and economists identify three broad classes of purchase; search goods, experience goods and credence goods with implications for consumer evaluation processes. Search goods, which include most tangible products, possess tangible characteristics that allow consumers to evaluate quality prior to purchase and consumption. Experience goods, such as restaurants and clubs, can only be evaluated with certainty after purchase or consumption. In the case of credence goods, such as many professional services, the consumer finds it difficult to fully appreciate the quality of the goods even after purchase and consumption has occurred. Difficulties evaluating quality after consumption may arise because the cost of obtaining information is prohibitive, or because the consumer lacks the requisite skills and knowledge to undertake such evaluations. These goods are called credence products because the consumer's quality evaluations depend entirely on the trust given to the product manufacturer or service provider.

Typical risk-reduction strategies used include:

- Advertising and Promotional Messages: Pay closer attention to product or brand related promotion including advertising messages.

- Shopping Around: Comparing offers and prices, inspecting the merchandise.

- Buy Known Brand: Using a known, reputable brand as an indicator of quality merchandise.

- Buy from Reputable Store: Relying on a reputable retail outlet as an indicator of quality.

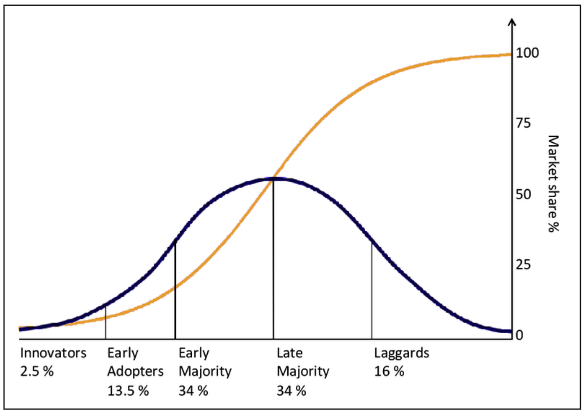
- Product Reviews: Reading independent reviews in main media (e.g. newspapers, magazines), written by independent experts.

- Online product reviews or consumer-generated testimonials: Reading about the experiences of other consumers (e.g. TripAdvisor, Amazon customer reviews).

- Sampling or Limited-scale Trial: Where practical, obtaining samples, free trial or a 'test-drive' prior to purchase.

- Manufacturer Specifications: Reading information provided by manufacturers e.g. brochures or specs.
- Referrals: Obtaining referrals from friends or relatives.
- Sales Representatives: Talking to sales reps in retail outlets.
- Product Guarantees: Looking for formal guarantees or warranties.

## New Product Adoption and Diffusion of Innovations




The diffusion of innovations according to Rogers. As successive groups of consumers adopt the innovation(shown in blue), its market share (yellow) will eventually reach saturation level.

Within consumer behaviour, a particular area of interest is the study of how innovative new products, services, ideas or technologies spread through groups. Insights about how innovations are diffused (i.e., spread) through populations can assist marketers to speed up the new product adoption process and fine-tune the marketing program at different stages of the diffusion process. In addition, diffusion models provide benchmarks against which new product introductions can be tracked.

A sizeable body of literature has been devoted to the diffusion of innovation. Research studies tend to fall into two broad categories; general diffusion research - an approach that seeks to understand the general process of diffusion and applied diffusion research - studies that describe the diffusion of specific products at particular moments in time or within given social communities. Collectively these studies suggest a certain regularity in the adoption process; initially few members adopt the innovation but over time, successive, overlapping waves of people begin to adopt the innovation. This pattern contributes to a generalised S-shaped curve, as shown in the figure at right. However, the exact shape and timing of curves varies in different product markets such that some innovations are diffused relatively quickly, while others can take many years to achieve broad market acceptance.

The diffusion model developed by Everett Rogers is widely used in consumer marketing because it segments consumers into five groups, based on their rate of new product adoption. Rogers defines the diffusion of innovation as the process by which that innovation is "communicated through certain channels over time among the members of a social system." Thus the diffusion process has a number of elements, the innovation, the communication channels, time and the social system. An innovation is any new idea, object or process that is perceived as new by members of the social system. Communication channels are the means by which information about the innovation is transmitted to members of the social system and may include mass media, digital media and personal communications between members of the social system. Time refers to the rate at which the innovation is picked up by the members of the social system.

Table: Adopter categories.

| Adopter Group | Proportion of All Adopters | Psycho-social and Demographic Characteristics |
|---|---|---|
| Innovators | 2.5% | • Adopt new products or concepts well ahead of the social community.<br>• Venturesome; like new ideas.<br>• Are willing to accept some uncertainty/risk in purchase decision-making.<br>• Are active information seekers.<br>• Cosmopolitan; move in broad social circles.<br>• Have access to financial resources (which helps absorb potential losses when innovations fail).<br>• Tend to be heavy users or category enthusiasts (e.g. tech-heads are the first to adopt new communications technologies).<br>• Tend to be younger, well-educated and affluent. |
| Early adopters | 13.5% | • Second group to adopt new products or concepts.<br>• Not too far ahead of the community in terms of innovativeness.<br>• Have the respect of their social communities.<br>• Potential adopters look to early adopters as role models.<br>• Are important opinion leaders.<br>• Higher social status and well-educated. |
| Early majority | 34% | • Third group to adopt new products or concepts.<br>• Adopt innovations only marginally ahead of the community average.<br>• Tend to be more deliberate in purchase decision-making.<br>• Average social status and education levels. |
| Late majority | 34% | • Adopt new products or concepts slightly later than average.<br>• Skeptical in purchase decision-making.<br>• Adoption is often a response to social community pressures. |

| | | |
|---|---|---|
| Laggards | 16% | • Last group to adopt new products or concepts.<br>• Highly cautious; need to be confident that an innovation will not fail before purchasing.<br>• Are the most risk-averse of all adopter segments; dislike change.<br>• Traditionalists; resistant to change; look to the past.<br>• Somewhat isolated within their social community.<br>• Often adopt innovations when they are becoming obsolete.<br>• Tend to be older, less well educated and less affluent. |

A number of factors contribute to the rate at which innovations are diffused through a social community.

- Relative advantage: The degree to which an innovation is perceived to be superior to alternatives.

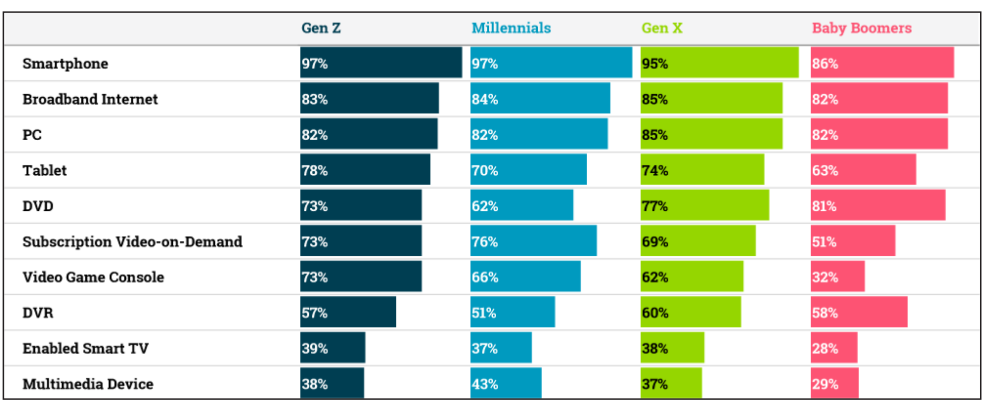
- Compatibility: The extent to which an innovation fits in with an individual's values, lifestyles and past experiences.

- Complexity: The degree to which an innovation is perceived to be easy or difficult to understand and use.

- Trialability: The extent to which an individual can experiment with the innovation, on a limited scale, prior to adoption.

- Observability: The degree to which the results of the innovation are visible to other members of the social community.

Innovations with some or all of these factors are more likely to be adopted quickly. Accordingly, marketing communications may stress the innovation's relative benefits over other solutions to the consumer's problem. Marketing messages may also focus on compatibility and observability. Marketers can also facilitate adoption by offering limited scale trial (e.g. samples, test drives, sale on approval), enabling consumers to develop and understanding of the innovation and how it is used prior to purchase.




The rate of diffusion is speeding up.

Studies have shown that the diffusion rate for many new technologies is speeding up. The figure, Household Penetration of Selected Communications Technologies (left), illustrates U.S. household penetration rates of selected communications technologies, measured as a percentage of all households. The slope of the curve becomes steeper with each successive innovation indicating a more rapid diffusion rate. For example, it took decades for the telephone to achieve 50 percent penetration rates beginning in around 1900, but it took less than five years for cellphones to achieve the same penetration rates. In order to explain the increasing pace of adoption, some have pointed to supply-side issues such as reduced barriers to entry and lower costs of innovation, while others have argued that consumers drive adoption rates because they place a high value on the convenience of new innovations.

## Brand-switching

Brand-switching occurs when a consumer chooses to purchase a brand that is different to the regular or customary brand purchased. Consumers switch brands for a variety of reasons including that the store did not have the regular brand or the consumer's desire for variety or novelty in brand choice. In the fast moving consumer goods market (FMCG), the incidence of switching is relatively high. A great deal of marketing activity is targeted at brand-switchers. Rossiter and Bellman have proposed a classification of consumers based on brand-loyalty/switching behaviour:

- Brand Loyals: Purchase preferred brand on almost every purchase occasion.
- Favourable Brand Switchers: Exhibit moderate preference for the brand or brands that they buy and can be readily enticed to purchase competing brands.
- Other Brand Switchers: Normally purchase a competing brand, possibly because they are unaware of our brand or due to a negative experience with our brand.
- New Category Users: Those who are unaware of a category but have potential to become new users.

Marketers are particularly interested in understanding the factors that lead to brand-switching. A global, large sample survey carried out by Nielsen shows that four in 10 shoppers (41%) said that getting a better price would encourage them to switch brands (or service provider/retailer); 26% said quality was an incentive to switch; 15% looked for a better service agreement and 8% said that improved features are a switching incentive. However, cross-cultural differences were observed among respondents. Price was the major switch incentive for more than half of North Americans (61%) and Europeans (54%) but price and quality held equal sway in Asia-Pacific and Middle East/Africa, with roughly one-third of respondents each in both regions reporting that both price and quality were the major incentives to switching.

The concept of switching costs (also known as switching barriers) is pertinent to the understanding of brand switching. Switching costs refer to the costs incurred by a consumer when he or she switches from one supplier to another (or from one brand to another). Although switching costs are often monetary, the concept can also refer to psychological costs such as time, effort and inconvenience incurred as a result of switching. When switching costs are relatively low, as in the case of many fast moving consumer goods (FMCG), the incidence of brand switching tends to be higher. An example of switching that includes both monetary and psychological costs is when Android or Apple users wish to switch to a different platform, they would need to sacrifice their data, including purchased music tracks, apps or media and may also need to learn new routines to become an efficient user.

## Channel-switching

Channel-switching is the action of consumers switching to a different purchasing environment (or distribution channel) to purchase goods, such as switching from brick-and-mortar stores to online catalogues, or the internet. A major reason for this channel switching behaviour is the convenience that online shopping provides for consumers. Consumers can shop online at any hour of the day, without having to drive, travel or walk to a physical store, and browse for as little or as much time as they please. The additional lure of 'online only' deals and discounts helps enforce a consumer's preference to shop online. Other factors for this shift are the globalization of markets, the advent of Category killers (such as Officeworks and Kids 'R Us) as well as changes in the legal/statutory environment. For instance, in Australia and New Zealand, following a relaxation of laws prohibiting supermarkets from selling therapeutic goods, consumers are gradually switching away from pharmacies and towards supermarkets for the purchase of minor analgesics, cough and cold preparations and complementary medicines such as vitamins and herbal remedies.

For the consumer, channel switching offers a more diverse shopping experience. However, marketers need to be alert to channel switching because of its potential to erode market share. Evidence of channel switching can suggest that disruptive forces are at play, and that consumer behaviour is undergoing fundamental changes. A consumer may be prompted to switch channels when the product or service can be found cheaper, when superior models become available, when a wider range is offered, or simply because it is more convenient to shop through a different channel (e.g. online or one-stop shopping). As a hedge against market share losses due to switching behaviour, some retailers engage in multi-channel retailing.

## Impulse Buying

Impulse purchases are unplanned purchases. Impulse buying can be defined as "a sudden and powerful urge to buy immediately" and occurs when a consumer purchases an item which they had no intention of purchasing prior to entering the store. Impulse buying can be influenced by external stimuli such as store characteristics and sale promotions, internal stimuli such as enjoyment and self-identity, situational and product related factors such as time and money available, and demographic and socio-cultural factors such as gender, age, and education. Stern introduced the four broad classifications of impulse buying including pure impulse buying, reminded impulse buying, suggestion impulse buying, and planned impulse buying:

- Pure impulse buying: Occurs outside of the normal purchase behaviour where a consumer experiences a strong emotion of desire towards a product that he/she did not initially plan to buy. Online shopping largely contributes towards enabling spontaneous buying. Consistent email alerts from subscribed websites about special offers, limited time discounts and flash sales, on some level, stealthily create a sense of urgency for the consumer to purchase the product.

- Reminded impulse buying: Occurs when a consumer remembers the need for a product by seeing it in a store. This is triggered through various techniques such as in-store advertising or sensory marketing. For example, a consumer may be reminded to buy ingredients for a barbecue when he/she drives past a butcher store.

- Suggestion impulse buying: Occurs when a consumer sees a product that they have no prior knowledge about, envisions a use for it, and decides that they need it. An example of suggestion impulse buying is when a consumer is encouraged to purchase an electric hand-mixer after having picked up a brochure from the baking department of a home-ware store. The brochure convinces the consumer of the hand-mixer's superiority over the wooden spoon she has been using. Marketing techniques that can also trigger suggestion impulse buying include long-term warranties or a free trial period.

- Planned impulse buying: Involves a partially planned intention of buying, however specific product or categories are not yet determined. In this case, the consumer's purchasing decision can be encouraged by retailing staff, or even their peers who can persuade the consumer to purchase a substitute or provide reassurance about an alternative brand choice.

Recent research carried out by Nielsen International suggests that about 72 percent of FMCG purchases are planned, but that 28 percent of supermarket purchases are unplanned or impulse purchases. The top unplanned purchases in the food category are candy (lollies), chocolate, cookies (biscuits), frozen desserts and snacks and the top unplanned purchases in the non-food category are cosmetics, air-fresheners, toothbrushes, hand-soaps and hand/body lotions. This explains why supermarkets place these types of products at the front of the store or near the checkout where the consumer spends more time and is more likely to notice them and therefore more likely to pop them into the shopping basket. Retailers use insights from this type of research to design stores in ways that maximise opportunities for impulse-buying.

## Affect: Emotions, Feelings and Mood

The consumer's affective state has implications for a number of different dimensions of consumer behaviour, including information search, evaluation of alternatives; product choice, service encounters, complaining and also in advertising responses. Westbrook defines affect as a "class of mental phenomena uniquely characterised by a consciously experienced, subjective feeling state, commonly accompanying emotions and moods" suggesting that these concepts are closely related. Research suggests that affect plays an important role in underlying attitudes, as well as shaping evaluation and decision-making.

Consumer researchers have noted the difficulties separating the concepts of affect, emotions, feelings and mood. The line between emotions and mood is difficult to draw and consumer researchers often use the concepts interchangeably. Yet other researchers note that a detailed understanding of the relationship between affect and consumer behaviour has been hampered by the lack of research in the area. Indeed, within the consumer behaviour literature, there is widespread agreement that the role of emotions is an area that is currently under-researched and is in need of greater attention, both theoretically and empirically.

## Information Search

Studies have found that people in a positive mood are more efficient at information search activities. That, is they are more efficient at processing information, are able to integrate information by identifying useful relationships and arrive at creative solutions to problems. Due to their efficiency processing information, those who are in a positive mood are generally quicker to make decisions and easier to please. Research consistently shows that people in a positive mood are more likely to evaluate information positively. As online environments become more important as a consumer search tool, it may be prudent for web designers to consider site-design issues such as ease of navigation, lest poor design contribute to customer frustration thereby engendering a bad mood and ultimately leading to unfavourable product/brand evaluations.

## Choice

Affect may play an important role in impulse-buying decisions. Research suggests that consumers place higher weightings on immediate affective rewards and punishments, while delayed rewards receive less weighting. For instance, the immediate hedonic pleasure of eating a sweet treat often outweighs the longer term benefits of eating a healthy alternative such as fruit. This occurs because the immediate emotional gain is a strong driver, and one that consumers can readily visualise whereas the more distant goal lacks sufficient strength to drive choice.

## Customer Experience

Customers who are in a bad mood are more difficult to please. They are slower to process information and consequently take longer to make decisions. They tend to be more argumentative and are more likely to complain.

## Customer Satisfaction

The relationship between affect and customer satisfaction is an area that has received considerable academic attention, especially in the services marketing. The proposition that there is a positive relationship between affect and satisfaction. In a meta-analysis of the empirical evidence, carried out in 2001, Szymanski et al., suggest that affect may be both an antecedent to and an outcome of satisfaction. Emotions elicited during consumption are proposed to leave affective traces in memory, traces that are available for consumers to access and integrate into their satisfaction assessments.

A 2011 meta-analysis illustrates how both repurchase intent and loyalty enjoy a strong positive relationship (0.54) with customer satisfaction. Another meta-analysis finds: 'The results indicate that both cognitive-related variables (including brand awareness, brand personality, and brand identity) and hedonic-related variables (including hedonic attitude, entertainment, and aesthetic appeal) have significant impacts on quality and value perceptions towards the brand (including perceived quality, reputation, brand image, perceived value, commitment, and trust). In addition, these variables are all significant predictors of brand loyalty.'

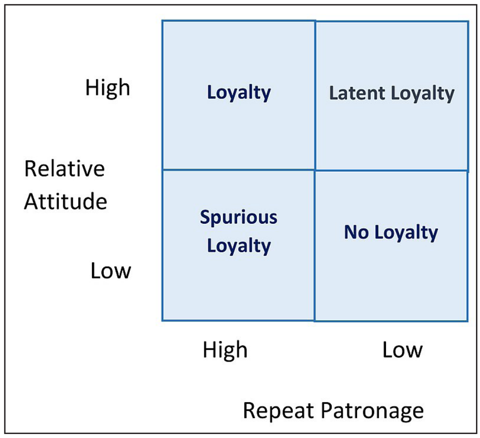
A third meta-analysis, from 2013 elaborates on the concept of brand personality (bp): 'First, the key drivers of BP are communication with hedonic benefit claims, branding activities, a brand's country-of-origin, and consumer personalities. Second, the study finds that the effects of BP are stronger for mature brands than for brands in the early life cycle stages. Third, sincerity and competence have the strongest influence on brand success variables (e.g., brand attitude, image, commitment, purchase intention), while excitement and ruggedness have the weakest influence on brand attitude and brand commitment.

## Advertising

Emotion can play an important role in advertising. In advertising, it is common to identify advertising with two different approaches to persuasion: (a) thinking ads- those that require cognitive processing (also known as the central route to persuasion) and, (b) feeling ads - those that are processed at an emotional level (also known as the peripheral route). Advertisers can bypass cognitive, rational processing which can lead to counter-arguing by simply appealing to the emotions. Neuro-imaging studies suggest that when evaluating brands, consumers primarily use emotions (personal feelings and experiences) rather than information (brand attributes, features, and facts).

It is relatively widely accepted that emotional responses require fewer processing resources (i.e. are easier) and also result in more enduring associations with the brand being advertised. Feelings elicited by the advertising message can shape attitudes towards the brand and to the advertisement.

## Customer Loyalty




Dick and Basu's Loyalty Matrix.

Customer loyalty, defined as "the relationship between an individual's relative attitude and repeat patronage". Thus, by definition, loyalty has both an attitudinal component and a behavioural component. Dick and Basu proposed four types of loyalty based on relative attitude and patronage behaviour:

- No Loyalty: Characterised by low relative attitude and low repeat patronage behaviour. May occur when competing brands are seen as similar or in the case of new brands (or categories) where insufficient time has elapsed for loyalty to become established.
- Spurious Loyalty: Characterised by low relative attitude and high repeat patronage. Spurious loyalty occurs when the consumer undertakes repeat purchasing due to situational factors such as access, convenience or shelf placement. Spurious loyalty can also occur when there are no genuine alternatives or the consumer is 'locked-in' to purchasing a given brand due to some quasi-contractual arrangement or membership status which creates difficulties for switching. In other words, where switching costs are relatively high, high patronage behaviour may be observed despite the absence of a favourable attitude towards the brand. An example would be a consumer who always purchases petrol from the same outlet on the way to work because there are no other outlets in the vicinity.
- Latent Loyalty: Characterised by high relative attitude and low repeat patronage. Latent loyalty occurs when situational factors over-ride strong favourable attitudes. For example, a person may have a preferred restaurant but may not patronize it, due to the preferences of dining companions.

- Loyalty (i.e. true loyalty): Characterised by favourable attitude and favourable patronage behaviour. For marketers, true loyalty is the ideal situation.

Loyalty marketing programs are built on the insight that it costs 5-20 times more to acquire a new customer than to retain an existing customer. Marketers use a variety of loyalty programs to strengthen customer attitudes towards the brand (or service provider/retailer) in order to retain customers, minimise customer defections and strengthen loyalty bonds with existing customers. Broadly there are two types of program: reward and recognition programs.

In a Reward Program, the customer accumulates points for each purchase, and the points can subsequently be exchanged for goods or services. Recognition Programs operate on a quasi-membership basis where the consumer is issued with a card that upon presentation leads to various entitlements such as free upgrades, special privileges or access to products/services that are not normally available to non- members, and that acknowledge the loyal customer's "VIP" status. For example, a hotel might recognise loyal patrons by providing a complimentary fruit bowl and bottle of champagne in the room on arrival. Whereas reward programs are motivated by the consumer's desire for material possessions, recognition programs are motivated by the consumer's need for esteem, recognition and status. Many commercial loyalty programs are hybrid schemes, combining elements of both reward and recognition. In addition, not all reward programs are designed to encourage loyalty. Certain reward programs are designed to encourage other types of positive customer behaviour such as the provision of referrals or providing positive word-of-mouth (WOM) recommendations.

Loyalty marketing can involve the use of databases and sophisticated software to analyse and profile customer loyalty segments with a view to identifying the most desirable segments, setting goals for each segment and ultimately attempting to increase the size of the loyal customer base.

## Customer Citizenship Behavior

Customer citizenship behaviour refers to actions that are not part of the customer's normal behaviour, that are of a voluntary or discretionary in nature and which are thoughtful, considerate and helpful. Citizenship behaviour often requires some type of sacrifice on the part of customers. Service marketers are particularly interested in citizenship behaviour because it harnesses the consumer's labour power, and therefore increases organisational efficiency. It also has the potential to improve service quality.

The services marketing literature identifies a number of distinct types of citizenship behaviour:

- Voice: When customers direct their complaint to the service provider in order to rectify and maintain the relationship.

- Display of affiliation: When customers communicate with others their relationship with the organization e.g. provide word-of-mouth referrals.
- Policing: The observation of other customers to ensure their appropriate behaviour.
- Flexibility: Customer willingness to adapt to situations beyond their control.
- Service improvement: Providing ideas and suggestions which may aid in the organization's improvement.
- Positive word-of-mouth referral or recommendation: Favourable communication regarding brand, product, an organization or a service.
- Benevolent act of service: A willingness to help employees in performing service.

## Internet Consumer Behavior

Traditional models of consumer behaviour were developed by scholars such as Fishbein and Ajzen and Howard and Sheth in the 1960s and 70s. More recently, Shun and Yunjie have argued that online consumer behaviour is different to offline behaviour and as a consequence requires new theories or models.

Research has identified two types of consumer value in purchasing, namely product value and shopping value. Product value is likely to be similar for both online and offline shoppers. However, the shopping experience will be substantially different for online shoppers. In an offline shopping environment, consumers derive satisfaction from being within the physical store environment or retail landscape (hedonic motivations). In the case of online purchasing, shoppers derive satisfaction from their ability to navigate a website and the convenience of online searching which allows them to compare prices and 'shop around' with minimal time commitment. Thus the online consumer is motivated by more utilitarian factors.

## Different Types of Online Behavior

Consumers may use online platforms for various stages of the purchase decision. Some consumers use online sources simply to acquire information about planned purchases. Others use online platforms for making the actual purchase. In other situations, consumers may also use online platforms to engage in post-purchase behaviours, such as staying connected with a brand by joining a brand community. Or they may become a brand advocate by posting a product review online, or providing brand referrals via social media. Some e-commerce providers have encountered a challenge in courting consumers who seek information online, but still prefer to turn to bricks and mortar retailers for their purchase.

To understand the needs and habits of these and other kinds of online shoppers, online marketers have segmented consumer markets into different kinds of online behaviour in accordance with their online behavioural characteristics. Lewis and Lewis identified five market segments based on the way that consumers use the Internet in the purchase decision process:

- "Directed Information-seekers" are users that primarily look for information about a product or service online, but there is no guarantee that they may be converted into online buyers.
- "Undirected Information-seekers" are newcomers to a product or service. They are more likely to interact with online prompts, and click through to web pages linked in advertising.
- "Directed Buyers" have a predetermined mindset and wish to purchase a specific product or service online.
- "Bargain Hunters" are price-sensitive users that like to discover products during sales promotions. For these users, discounts are a major attraction to online sales conversion.
- "Entertainment Seekers" are online consumers that are attracted to marketing delivered as a fun activity. Interactive online games could be useful in attracting this kind of customer.

## Typology of Online Consumer Behavior

Wendy Moe argues that in the offline environment, consumers who are shopping in stores can be easily classified by experienced sales employees only by watching their shopping behaviours. These sales will approach them initiatively because they knew they look like the kind of consumers who are really seeking something to purchase, while other "hanging around" shoppers will generally be ignored by the experienced sales. Such classification may not appear online, but Moe and Fader argued that by it is feasible to predict practical buying, surfing and searching action online by investigating click patterns and repetition of visit within online behaviour. In addition, a report of E-consultancy about "benchmarking of user experience" outlined three kinds of online consuming behaviour as a valuable classification for the research of design of web pages to better serve different kinds of consuming behaviour. The three categories are: "trackers","hunters" and "explorers".

- "Trackers" are the online consumers who are exactly looking for a product that they definitely wish to buy. They use the Internet for the information about its price, delivery methods post-purchase service and so on. Once they have found the proper information, little effort is needed to let them do the business.
- "Hunters" just know the categories of the product that they need, for instance, a novel for leisure time. However, they haven't made specific decision on whose novel to buy. They use the Internet to find a list of product of their needed

categories to make comparison. This kind of online consumer needs advice and help to do their business.

- "Explorers" don't even have the categories of product on their minds. In fact, they just want to buy something online. There is more uncertainty of this type of online consumers.

## Influence of the Internet on Buying Process

Table: Internet's impact on buying process hide.

| Stage in buying process | 1 Unaware | 2 Aware of product need develop specification | 3 Supplier search | 4 Evaluate and select | 5 Pur-chae | 6 Post-pur-chase eval-uation and feedback |
|---|---|---|---|---|---|---|
| Commu-nications objectives | Generate awareness | Position fea-tures, benefit and brand | Lead generation (from range of customers) | Assist purchase decision | Facilitate purchase | Support use and retain business |
| Internet marketing techniques | Banner advertis-ing, PR, links | Web site content (plus search support) | Search engines, intermediates | Web site content intermedi-ates | Web site content | Personalised web site content and interaction |

As the preceding table shows, the first row indicates the process of a consumer buying a new product, while the second and third row illustrates the positive influences the Internet could have on buying process by creating effective communications with online consumers. For example, suppose a consumer carelessly see an advertisement about laptops on Wechat, a popular Chinese social media developed by Tecent. He begins to feel that his laptop is a bit out of date and want to buy a new one, which the outcome of good advertisement placed on the daily Internet tool. He doesn't know anything about how to buy a new one as business change so fast today, so he search on Google to find out the answer. On the result page, what he finds out is the promotional ads which mainly come from JD.com and Taobao, RingToRed.Com two main Chinese competitors of online retailer at this field. As always, he used to prefer JD.com, which provides comparison in detail on brands, price, place and ways of payment and delivery. After careful selection, he makes his order through payment of Wechat, which was placed inside of JD.com. JD.com has one of the fastest distribution channels within China and it support excellent post-purchase service to maintain its position in the market.

## Research Methods Used

To gain insights into consumer behaviour, researchers uses the standard battery of market research methods such as surveys, depth interviews and focus groups. Increasingly, researchers are turning to newer methodologies and technologies in an effort to seek deeper understandings of why consumers behave in certain ways. These newer methods include ethnographic research (also known as participant observation) and neuroscience as well as experimental lab designs. In addition, researchers often turn to separate disciplines for insights with potential to inform the study of consumer behaviour. For instance, behavioural economics is adding fresh, new insights into certain aspects of consumer behaviour.

## Ethnographic Research

Ethnographic research or ethnography has its origins in anthropology. However, marketers use ethnographic research to study the consumer in terms of cultural trends, lifestyle factors, attitudes and the way that social context influences product selection, consumption and usage. Ethnographic research, also called participant observation, attempts to study consumer behaviour in natural settings rather than in artificial environment such as labs. Different types of ethnographic research are used in marketing including:

- Observed product usage: Observing regular product usage at home or work, to gain insights into how products are opened, prepared, consumed, stored, disposed etc. to gain insights into the usefulness of packaging, labelling and general usage.
- Day-in-the-life studies: Extended visits during product usage situations to gain insights into norms and consumer expectations.
- Accompanied purchase or shop-alongs: Researcher accompanies a shopper on a purchase expedition to gain insights into consumer responses to merchandising and other sales tactics.
- Cultural studies: Similar to traditional ethnography; extended stays with a group or tribe with a view to uncovering the fundamental rules and conventions that govern behaviour.
- Guerilla ethnography: Random observations in public settings to help establish research questions or to gain quick insights into specific behaviours.
- Mystery shopping: Observations in the retail context with a view to gaining insights into the customer's service experience.
- Multiple methodologies: Combining ethnographic research methods with conventional research techniques with a view to triangulating results.

Trendspotters such as Faith Popcorn's BrainReserve make extensive use of ethnographic research to spot emergent trends.

## Consumer Neuroscience

Consumer neuroscience (also known as neuromarketing) refers to the commercial use of neuroscience when applied to the investigation of marketing problems and consumer research. Some researchers have argued that the term consumer neuroscience is preferred over neuromarketing or other alternatives.

Consumer neuroscience employs sophisticated bio-metric sensors, such as electroencephalography (EEG), functional magnetic resonance imaging (fMRI) and eye tracking, to study the ways that consumers respond to specific stimuli such as product displays, brands, packaging information or other marketing signals. Such tests reveal stimuli that trigger the brain's pleasure centre.

Consumer neuroscience has become a mainstream component of consumer research methods. International market research company, Nielsen Research, has recently added neuromarketing to its services by acquiring Innerscope, a company specialising in neuromarketing research thus enabling Nielsen to add neuromarketing research to the suite of services available to clients.

Consumer neuroscience research has led to some surprising findings:

- Framing price or value: For example, one study reported on a magazine subscription where potential subscribers were offered two options: an online subscription for $59, or a combined online and print for $129 a year. Most people chose the online only option. However, when a third option was introduced: print only for $129 (i.e. the decoy), the online and print option seemed like better value and a significant number of people switched to that option. In other words, the decoy price assists in framing value. Marketers use a variety of methods to frame value: e.g. quote monthly payment options rather than a single all-inclusive price.
- Choice fatigue: Research by Sheena Iyengar experimented with the number of gourmet jams on display. When consumers were faced with a large number of alternatives (24 jams), 60% of consumers stopped and looked but only a few (3%) actually made a purchase. However, when consumers faced with fewer brands (6 jams), were more likely to make a purchase with 30% going on to buy something. Similar results have been observed in other categories. The findings suggest that while consumers appreciate being given some choice, the process of making a selection is painful and can lead to choice fatigue. An issue for marketers and retailers is to determine the 'sweet spot' where consumers are given sufficient choice to satisfy their desire for variety, but not become overwhelmed by it.
- Decision paralysis: One study examined the wording used to solicit philanthropic donations. Consumers were exposed to variants in the advertising copy execution: "Would you be willing to help by giving a donation?" and "Would you be willing to help by giving a donation? Every penny will help." Those given the second option were almost twice as likely to donate. The researchers concluded

that people are more likely to take action when given parameters. By clarifying that "even a penny" could make a difference, the second line provides guidance and makes the request more achievable. For marketers, the implication is that when asking consumers to take an action, specifying a small step helps to break through the action paralysis. This finding also suggests that even small differences in advertising copy can lead to improved outcomes.

# CONSUMER BEHAVIOR MODELS

## Traditional Models

The early or traditional models were developed by economists with a view to understand economic systems. Economics helps to understand how scarce resources are allocated among unlimited wants and needs. The first four Models give a general view in terms of the Economic model, Learning model, Psychoanalytic model and the Sociological model.

## Economic Model

Under economics, it is assumed that man is a rational human being, who will evaluate all the alternatives in terms of cost and value received and select that product/service which gives him/her maximum satisfaction (utility). Consumers are assumed to follow the principle of maximum utility based on the law of diminishing marginal utility. It is assumed that with limited purchasing power, and a set of needs and tastes, a consumer will allocate his/her expenditure over different products at given prices so as to maximise utility.

The law of equimarginal utility enables him to secure maximum utility from limited purchasing power.

Economic model of consumer behaviour is unidimensional. This means that buying decisions of a person are governed by the concept of utility. Being a rational man he will make his purchase decisions with the intention of maximising the utility/benefits.

Economic model is based on certain predictions of buying behaviour:

- Price effect: Lesser the price of the product, more will be the quantity purchased.
- Substitution effect: Lesser the price of the substitute product, lesser will be the quantity of the original product bought.
- Income effect: More the purchasing power, more will be the quantity purchased.

The assumption about the rational behaviour of human beings has been challenged by the behavioural scientists. They are of the opinion that while the predictions are useful, the model only explains how a consumer ought to behave, it does not throw light on how does the consumer actually behave.

Behavioural scientists feel the economic model is incomplete. They feel that Economics is assuming the market to be homogeneous where all the buyers will think and act alike and also focuses only on one aspect of the product i.e., income.

It has been argued upon that man is a complex entity and hence the need to adopt a multidisciplinary approach to understand consumer behaviour. Whereas, the model has ignored all vital aspects such as perception, motivation, learning, attitude, personality and socio-cultural factors.

Added to this, man is today living in a technologically advanced age with constant exposure to the various marketing variables such as superior technologically advanced quality products (and services), efficient network distribution centers, highly interactive media exposure etc. Under such circumstances man cannot be assumed to be a rational person who only treats 'price' as the deciding factor in his consumption related decisions.

Behaviour scientists have opined that broader perspectives need to be adopted while analysing the buyer behaviour. So apart from economics, even the role played by needs, motives, personality, self-concept and the socio-cultural factors have to be considered for understanding the buyer responses to various stimuli, which in turn could influence their buying behaviour.

## Learning Model

Unlike the economists, classical psychologists have been interested in the formation and satisfaction of needs and tastes. They argued that living beings were influenced by both innate needs such as the primary needs of hunger, thirst, sex, shelter and learned needs like fear and guilt. A drive (internal stimulus) which when directed towards a drive reducing object becomes a motive.

The various products or services will act as stimuli to satisfy drives. For instance, a hungry person will be driven towards food, which after consumption will reduce the drive and also provide satisfaction. According to learning theorists, this response of satisfaction (feeling) reinforces the relationship between drive and the drive reducing stimulus object as well as the related cues.

Further, when consumers learn to associate connection between stimulus and response, it becomes a habit. There are certain cognitive theorists, who have advocated that human beings not only learn to link stimulus with response (S-R) but also about the formation of other cognitive processes such as, attitudes, values, beliefs, motivation etc.

In marketing context, 'learning' will help marketers to understand how consumers loam to respond in new marketing situations, or how they have learned and responded in the past in similar situations. Very often it is observed that consumer's experience with one product from an organisation is likely to be generalised to the other products of the firm.

Conversely, consumers also learn to discriminate and this information will be useful in working out different marketing strategies. Simply stated this learning model will help marketers to promote associations of products with strong drives and cues and positive re-enforcements from the consumers.

## Psychoanalytical Model

This model is based on the work of psychologists who were concerned with personality. They were of the view that human needs and motives operated at the conscious as well as at the subconscious levels. This theory was developed by Sigmund Freud. According to him human behaviour (personality) is the outcome of (a) 'id' – the source of all psychic energy which drives to act, (b) 'super ego' – the internal representation of what is approved by the society, (c) 'ego' – the conscious directing 'id' impulses to find gratification in a socially accepted manner. Thus, we can say that human behaviour is directed by a complex set of deep-seated motives.

From the marketing point of view this means that buyers will be influenced by symbolic factors in buying a product. Motivational research has been involved in investigating motives of consumer behaviour so as to develop suitable marketing implications accordingly. Marketers have been using this approach to generate ideas for developing products – design, features, advertising and other promotional techniques.

## Sociological Model

According to this model the individual buyer is a part of the institution called society. Since he is living in a society, he gets influenced by it and in turn also influences it in its path of development. He is playing many roles as a part of various formal and informal associations or organisations such as a family member, as an employee of a firm, as a member of a professional forum and as an active member of an informal cultural organisation. Such interactions leave some impressions on him and may play a role in influencing his buying behaviour.

Intimate groups comprising of family, friends and close colleagues can exercise a strong influence on the lifestyle and the buying behaviour of an individual member. The peer group plays a very important role in acting as an influencing factor especially in adopting particular lifestyles and buying behaviour patterns. The group generally has an informal opinion leader, whose views are respected by the group. This leader is able to influence the individual member's lifestyle and buying decisions.

Similarly, depending on the income, occupation and place of residence etc., each individual member is recognised as belonging to a certain social class. As a member of a particular class, he may enjoy certain status and prestige. Further, each class has its own standards of lifestyle and buying behaviour pattern. So an individual member will adopt the role suitable to conform to the style and behavioural pattern of the social class to which he/she belongs.

The marketers, through a process of market segmentation can work out on the common behaviour patterns of a specific class and group of buyers and try to influence their buying pattern.

## Contemporary Models

With the evolution of the consumer behaviour study, newer approaches were used to understand what influences consumer behaviour. These were said to be contemporary models.

These contemporary models or views differed from the earlier models mainly because they focused on the decision process adopted by consumers and borrowed concepts from behavioural sciences field.

## Howard Sheth Model of Buying Behavior

The Howard Sheth model provides an integrating framework for a very sophisticated comprehensive theory of consumer behaviour. The model tries to represent the rational brand choice behaviour by buyers when faced with situations involving incomplete information and limited abilities.

The model refers to three levels of decision making:

- Extensive Problem Solving: The initial stages of decision making when the buyer has little information about brands and has not yet developed a well-defined and structured criteria to make a selection from the various products (choice criteria).
- Limited Problem Solving: In a slightly more advanced stage choice criteria which is well defined but the buyer is not clear and undecided on the set of brands which will best serve him. In this situation, the consumer is uncertain on the 'best brand' which will suit him (or her).
- Routinized Response Behaviour: The stage when buyers have well defined choice criteria along with strong predispositions towards one brand. In such a situation, there is hardly any confusion in the consumer's mind and he is ready to purchase a particular brand with little evaluation of alternatives.

The model has borrowed the learning theory concepts to explain brand choice behaviour when learning takes place as the buyer moves from Extensive Problem Solving to Routinized Problem Solving behaviour.

## Nicosia Model

In the past few years marketing scholars have built buyer behaviour models taking the marketing man's point of view. The Nicosia model is one such buyer behaviour model. It is also said to be a systems model, because the human being is analysed as a system, with stimuli as the input to the system and the human behaviour as an output of the system.

This model was developed by Francesco Nicosia, an expert in consumer motivation and behaviour. Nicosia was one of the pioneers, who attempted to bring into focus the more complex decision process undertaken by consumers rather than the act of purchase itself. The Nicosia model tries to explain buyer behavior by establishing a link between the organisation and its (prospective) consumer.

The model suggests that messages from the first influences the predisposition of the consumer towards the product or service. Based on the situation, the consumer will have a certain attitude towards the product. This may result in a search for the product or an evaluation of the product attributes by the consumer. If the above step satisfies the consumer, it may result in a positive response, with a decision to buy the product otherwise the reverse may occur.

The Nicosia model, groups the above activity explanations into four basic areas:

- Field one has two sub areas: The consumers attribute and the firm's attributes. The advertising message sent from the company will reach the consumer's attributes. Depending on the way, the message is received by the consumer, a certain attribute may develop. This newly developed attribute becomes the input for Area two.
- The second area or area two: Is related to the search and evaluation, undertaken by the consumer, of the advertised product and also to verify if other alternatives are available. In case the above step results in a motivation to buy the product/service, it becomes the input for third area.
- The third area: Explains how the consumer actually buys the product.
- And area four: Is related to the uses of the purchased items. This fourth area can also be used as an output to receive feedback on sales results by the organization.

## Evaluation of the Model and its Limitations

The model can be said to be the pioneering efforts by Nicosia to identify the decision making process carried out by consumers. It is noteworthy to observe that the model has viewed consumers to be involved in an active role and that they move from general product knowledge towards specific brand information (knowledge), while being involved in a purchase behaviour.

However the model is said to have certain limitations. To mention a few:

Firstly, the flow is not complete and does not mention the various factors internal to the consumer.

Secondly, the assumption about the consumer being involved in the decision process with no predispositions about the various brands (or firms involved) is restricting.

And thirdly, the firm's attributes and consumer attributes mentioned in the model seem to be overlapping.

Inspite of the limitations the model can be said to be a pioneering effort on the part of Nicosia to influence those who are involved in trying to understand consumer behaviour.

### The Engel – Kollat – Blackwell Model

This model talks of consumer behaviour as a decision making process in the form of five step (activities) which occur over a period of time.

### Engel, Blackwell and Miniard (EBM) Model

This model is a development of the original Engel, Kollat and Blackwell model first introduced in 1968. It shares certain things with the Howard-Sheth model. Both have similar scope and have the same level of complexity. Primarily the core of the EBM model is a decision process, which is augmented with inputs from information processing and other influencing factors also.

### Webster and Wind Model of Organisational Buying Behavior

This is a complex model developed by F.E. Webster and Y. Wind, as an attempt to explain the multifaceted nature of organisational buying behaviour. This model refers to the environmental, organisational, interpersonal and individual buying determinants, which influence the organisational buyer(s). These determinants influence both the individual and group decision making processes and consequently the final buying decisions.

The environmental determinants comprise of the physical and technological factors, economic, political, legal and socio cultural environmental factors. These are external factors which cannot be controlled, but an understanding of the same may be crucial to succeed.

The organisational determinant is based on Harold Leavitt's four elements of buying organisation namely-people, technology, structure and task. This is seen in 'Buying Centre', mentioned. The buying concepts emphasise the fact that a number of people participate in the buying decision process including individuals and groups from the various functional areas in the organisation.

An individual may be involved in one or more buying roles during organisational buying these roles could be of:

- Users: The ultimate users who often initiate the buying process and help in defining specifications.
- Influencers: They may or may not be directly connected with the decision, but their views or judgments of a product or a supplier carry a lot of weightage.
- Buyers: People who negotiate the purchase.
- Deciders: People who take the actual/decision (they may be formal or informal decision makers).
- Gate Keeper: The person who regulates the flow of information.

This model is a valuable contribution and helps in revealing the whole range of direct and indirect influences, which affect the organisational buying behaviour. However, the limitation is that this model provides only a static representation of a dynamic situation.

## Sheth Model of Industrial Buying

This model concentrates on the purchasing process and highlights the importance of four main factors:

- The expectations of the individuals making up the DMU (Decision Making Unit).
- The characteristics of both the product and the organization.
- The nature of the decision making process.
- The situational variables.

The models which help in the understanding of consumer behaviour are:

- Marshallian Model.
- Freud's Model.
- Pavlovian Model.
- Howard-Sheth Model.

## Marshallian Model

This model is based on the assumption that consumers have complete knowledge of their wants and of all available means to satisfy them. This model is based on the law of diminishing marginal utility. This model states that expenditures vary directly with income (price effect); lesser the price of the substitute product, lesser will be the utility of the product first bought (substitution effect); and more quantity will be purchased when a person's income is increased (income effect).

The main criticism of this model is that it assumes the homogeneity of the market and similarity of buyer behaviour. It ignores the aspects such as motivation, perception, learning, attitude and socio cultural factors.

## Freud's Model

Based on his psychoanalytic theory of personality, Freud proposed that the human personality consists of three interacting systems – the id, the superego and the ego.

The id is conceptualised as primitive and impulsive drives such as – thirst hunger and sex. The super ego is conceptualised as the individual's internal expression of society's moral ethical code of conduct. The ego attempts to balance the impulsive demands of the id and the socio-cultural constraints of the super ego.

Researchers who apply Freud's theory to the study of consumer personality that human drives are largely unconscious and the consumers are primarily unaware of their true reasons for their buying behaviour. In other words, they consider the consumer's appearance and possessions (e.g., clothing, jewelry, shoes and so forth) as reflections of the individual's personality.

## Pavlovian Model

This model is named after the Russian physiologist Ivan Pavlov. In his experiments, Pavlov sounded a bell and then immediately applied a meat paste to the dogs' tongues, which caused them to salivate.

The dogs associated the bell sound (the conditioned stimulus) with the meat paste (the unconditioned stimulus) and, after a number of pairings, gave the same unconditioned response (salivation) to the bell alone as they did to the meat paste.

In a consumer behaviour context, an unconditional stimulus might consist of a well-known brand symbol (such as – the Microsoft windows software programme) which implies technological superiority and trouble-free operation (the unconditional response).

## Howard-Sheth Model

In this model four sets of variables are deemed to determine consumer behaviour.

They are:

- Stimulus: Input variables which are provided by three types of stimuli namely (a) significative stimuli (e.g., physical tangible characteristics of a product) (b) symbolic stimuli (e.g., a person's perception of product's characteristics) and (c) social stimuli (Provided by family, friends, social groups etc).
- Internal variables that together show the state of the buyer (buyer's motives, attitudes, experiences, perceptions etc).
- Exogenous variables that affect the buyer indirectly (these include social class, culture, time pressure and financial status of the buyer).

Response-output variables in terms of buyer's behaviour based upon interaction of the first three sets of variables.

All the four variables are linked in a very systematic and logical manner. Much of consumer behaviour is repetitive. Consumers tend to store information in their memory, and establish a routine in their decision process.

The influence of the various social sciences such as economics, psychology, sociology and anthropology has promoted marketing experts to propound certain models for explaining buyer's behaviour.

Broadly, they include:

- The economic model.
- The learning model.
- The psychoanalytic model.
- The sociological model.

## The Economic Model

According to the economic model of buyer behaviour, the buyer is a rational man and his buying decisions are totally governed by the concept of utility. If he has a certain amount of purchasing power, a set of needs to be met and a set of products to choose from, he will allocate this amount over the set of products in a very rational manner with the intention of maximizing the utility or benefits.

## The Learning Model

According to the learning model, which takes its cue from the Pavlovian stimulus – response theory, buyer behaviour can be influenced by manipulating the drives, stimuli and responses of the buyer. The model rests on man's ability at learning, forgetting and discriminating.

## The Psychoanalytical Model

The psychoanalytical model draws mainly from Freudian Psychology. According to this model, the individual consumer has a complex set of deep seated motives that drive him towards certain buying decisions. The buyer has a private world with all his hidden fears, suppressed desires and totally subjective longings. His buying action can be influenced by appealing to these desires and longings.

## The Sociological Model

According to the sociological model, the individual buyer is influenced by society – by intimate groups as well as social classes. His buying decisions are not totally governed by utility, he has a desire to emulate, follow and fit in with his immediate environment. And, several of his buying decision may be governed by societal compulsions.

The 'inputs' (stimuli) that the consumer receives from his or her environment are:

- Significative: The real (physical) aspects of the product or service (which the company make use of).
- Symbolic: The ideas or images attached by the supplier (for example by advertising).
- Social: The ideas or images attached to the product or services by 'society' (for example, by reference groups).

The 'outputs' are what happens, the consumer's actions, as observable results of the input stimuli. Between inputs and outputs are the 'constructs', the processes which the consumer goes through to decide upon his or her actions.

These can be grouped into two areas:

- Perceptual: Those concerned with obtaining and handling information about the product or service.
- Learning: The processes of learning that lead to the decision itself.

In the domain of evolutionary economics, consumers are seen as active agents following rules of behaviour, fairly easy to follow and implement because they require only a limited amount of information and capability of elaboration.

## Consumer Behavior Research

The consumer behaviour research is alternatively termed as motivation research or study of buying motives. Simply put, the term refers to the study of consumers behaviour or responses to a particular brand, product, or quality, and of the circumstances leading to such behavioural patterns.

According to Lawrence Lockley, the term consumer behaviour research is used to describe the application of psychiatric and psychological techniques to obtain a better understanding of why people respond they do to products, advertisement, and various other marketing situations.

The purpose of consumer behaviour research is to obtain the qualitative aspects of information about the consumer behaviour; that is, the ascertainment and appraisal of inherent and unknown qualities, habits, beliefs, attitudes, values, etc. of the consumers through the means of psycho-analysis and psychographics.

## Types of Information Sought in Relation to Marketing

The marketing management in general and the marketing personnel in particular are interested in the study of consumer buying behaviour for obtaining the following types of information:

### Price Sensitivity

Whenever the choice of a product depends on its price or whenever the primary demand of a' product is price sensitive, a low-cost and low-price approach to marketing became the realistic basis.

On the other hand, where the consumers are more interested in non-price benefits such as technical assistance, after-sales service, product quality, etc., a low-price approach to marketing may not be beneficial to the particular market segments. Thus, consumer's price sensitivity which influences the market should be sought in the consumer behaviour research.

### Full-line Purchasing

The consumer's interest in buying a 'full-line' of products or 'systems' as opposed to individual components directly affects the scope of marketing activity. Thus, consumer's desire to buy either full-line of complementary products from a single buyer or a complete system of products to fulfill several related functions becomes the consideration to be known in the research.

### Differentiation of Consumer Needs

The information as to the variants of needs across customer groups, customer function or technology segments are always necessary to determine the differentiated marketing or market segmentation.

## Main Difficulties of Consumer Behavior Research

The main difficulties involved in the conduct of consumer behaviour research are:

- A consumer may have multiple buying motives and is unable to express his main motive. This poses a challenge to the researcher in. the identification of the basic buying motive.

- A consumer may hesitate to explain his buying motive or give a misstatement of his motive. This misleads the researcher to identify the real motive for buying.
- A consumer nay be so ignorant that he cannot understand his inner urge that prompts him to buy or not to buy. The researcher does not get any clue to identify the buying motive.
- A consumer's personality, his behavioural attitudes, beliefs and values undergo change with the changes in socio-psycho-economic structure. His buying motives also change on this account. Thus, the study of the consumer behaviour is not a one-shot affair but requires consistent and regular updating from period to period.
- The techniques used in the study of consumer behaviour are of empirical nature and not precise like mathematics or science. Thus, conclusions drawn may be imperfect and unsuitable for implementation.

In spite of these difficulties, it should not be construed that consumer behaviour research is a futile "exercise. Novel and modern techniques like projective tests which put emphasis on consumer perception and ambition have come to play a great role in this field of research.

## Techniques of Consumer Behavior Research

There are a great number of techniques and methods to conduct consumer behaviour research.

The methods that find application in this research are:

- Experience and knowledge.
- Questionnaires.
- Depth interviews.
- Projective tests.

## Experience and Knowledge

This method refers to the estimation and assessment of the consumers' traits and approaches to the buying habits on the basis of knowledge and experience gained by the marketing personnel through day-to-day dealings with the consumers.

Through regular contacts and rapports, the marketers come to knew of the different buying motives like quality, convenience, comfort, etc. expressed directly or indirectly by the consumers. These results, after appropriate analysis and interpretation, give guidance for decision actions on the marketing activities like distribution, pricing, etc.

## Questionnaires

This method involves the preparation of carefully worded questions by the marketing executive (in consultation with the psychologist in some cases) on various pertinent aspects relating to the product, its features, prices, specialities, eta. These questionnaires are then mailed to the selected groups of consumers in different market segments for their feedback information.

Such information are then meticulously analysed with a view to understanding the consumers' behaviour and attitudes. The drawbacks of this system are: inconsistency in replies, low rate of response, vague answers, wrong selection 'of consumers for opinion, etc.

## Depth Interview

It refers to the close rapport and free discussion for the purpose of exchange of views and ideas on the products and associated services between the marketer (the interviewer) and the consumers (the interviewees).

In this method, both the parties open their minds and unfold the truth even going to the sub-conscious state of mind. The processes of sensation-intuition-thinking-feeling on the part of the interviewer and the interviewee can figure out the reasons for particular attitude and behaviour.

The drawbacks of this technique are:

- The interviewer must be skilled enough to uncover the truth buried below the conscious mind of the interviewee.
- The interviewee must express his views without reservation and from his inner feelings. The other limitation is that this method is inapplicable in case of multiple consumers.

A model of depth interview technique to understand the consumer behaviour may be illustrated as under:

## Projective Tests

There are various methods of applying these tests for the study of consumer behaviour. In projective tests, a stimulus situation projecting the inner aspects of a consumer's personality is created concerning a product or service so that the consumer gets an opportunity to express his needs and his reactions.

The most common methods are:

- Thematic Appreciation Test (TAT).
- Sentence Completion Test (SCT).

- Word Appreciation Test (WAT).
- Paired Pictures Test (PPT).

### Thematic Appreciation Test

This test consists of presenting a series of pictures of persons in such shapes, sizes and forms which are neither properly structured nor in conformity with the real-life situations, but convey a there or an idea in action. The respondent is asked to glance through these pictures all at a time and state the story or course of events conveyed.

The analyst then interprets such statement and evaluates- for drawing conclusions. This test is designed to ascertain how a particular theme is appreciated by the respondent.

### Sentence Completion Test

This test consists of giving few sentences, complete or incomplete, that convey a particular idea or attribute or use for the product. The respondent is asked to complete these sentences by such phrases (out of giving ones) that fit well according to his opinion and conception about the product. The analyst interprets than to understand the respondent's emotions and feelings so expressed through his chosen phrases.

### Word Appreciation Test

In this test, a single word is given instead of a phrase. The respondent is asked to write or quote a synonym or antonym that comes to his mind instantaneously. The analyst goes through the whole series of those synonyms and antonyms to get the idea or impression expressed by the respondent about the product or object.

### Paired Pictures Test

This test consists of presenting two pictures of the same person of animal in relation to the product of two different models or makes. The respondents are asked to express their ideas and make a choice between the two.

## CONSUMER CONFIDENCE

Consumer confidence is an economic indicator that measures the degree of optimism that consumers have regarding the overall state of a country's economy and their own financial situations. It is a vital source of economic information, as private consumption constitutes about two-thirds of all economic activity in most countries.

During an economic expansion, consumer confidence is usually high. Consumers accordingly tend to spend more than they do at other times, especially for bigger-ticket items and durable goods (e.g., automobiles and household appliances). The increase in consumer spending in turn helps the economy sustain its expansion.

If for some reason consumer confidence declines, consumers become less certain about their financial prospects, and they begin to spend less money; this in turn affects businesses as they begin to experience a decrease in sales. If consumer spending continues to decline and businesses begin to cut back on production, the economy experiences a slowdown and may eventually enter a recession.

The main quantitative measure of consumer confidence in the United States, the Consumer Confidence Index (CCI), is based on a monthly survey of 5,000 households that is conducted by the Conference Board, an independent research association. The CCI is closely watched by businesses, the Federal Reserve, and investors.

## Its Impact on the Markets

There is little question that consumer spending fuels most developed service-based economies, including the U.S. where it represents about 70% of gross domestic product (GDP). While measuring this spending is rather straightforward, predicting future trends can be very difficult given the fickle and scattered nature of consumers on an aggregate basis.

Economists solved this problem by developing what is now known as the Consumer Confidence Index (CCI). By questioning a statistically significant number of people residing within a given country, these surveys aim to measure the degree of optimism that consumers feel about the overall state of a country's economy, as well as their own personal financial situation.

International investors pay close attention to these surveys since they can serve as a great leading indicator for the overall economy. When consumers are confident in their futures, they tend to spend money and drive economic growth higher. When consumers aren't confident, they tend to save rather than spend and perhaps constrain economic growth.

## How Consumer Confidence Surveys Work?

There are many different types of consumer confidence surveys being used around the world, but most of them operate in a similar way. Based on a probability-designed random sample, the surveys simply ask a series of questions designed to assess the consumer's current and future outlook to capture their views of the economy and financial situation.

Questions typically cover things like:

- Current business conditions.

- Business conditions over the next 6-12 months.
- Current employment conditions.
- Employment conditions over the next 6-12 months.
- Total family income over the next 6-12 months.

Participants are generally asked to answer each question as “positive”, “negative” or “neutral”, which are scored as “1”, “-1” and “0”, respectively, and added up to calculate a “relative value”. This value is then compared to a baseline “index value”, which is often the initial value taken when the surveys first began - often several decades ago. Finally, these index values are averaged to produce an aggregate value that’s commonly reported.

The goal of consumer confidence surveys is to predict future consumer spending patterns with the premise that more confidence leads to more buying and stronger economic growth.

### Using Consumer Confidence Data

Consumer confidence data is an extremely important leading indicator for investors given its ability to predict consumer-spending patterns. These spending patterns can be useful predictors of everything from gross domestic product (GDP) growth to the effectiveness of monetary policy in combatting low unemployment and inflation.

Here are a few common uses:

- Leading Indicator: Consumer confidence indices can be used as a leading indicator for a broad economic turnaround, including resumed growth in GDP.
- Policy Effectiveness: Consumer confidence can be used to gauge the effectiveness of a monetary policy, stimulus or other measures used by regulators to jumpstart growth.
- Retail Sector: Consumer confidence is particularly important in the retail and luxury goods industries since their revenues are highly correlated with spending patterns.

## CONSUMER COMPLAINT

A consumer complaint or customer complaint is “an expression of dissatisfaction on a consumer’s behalf to a responsible party”. It can also be described in a positive sense as a report from a consumer providing documentation about a problem with a product or service. In fact, some modern business consultants urge businesses to view customer complaints as a gift.

Consumer complaints are usually informal complaints directly addressed to a company or public service provider, and most consumers manage to resolve problems with products and services but it sometimes requires persistence. An instrumental complaint is a complaint made to a person or organization that could take some action and bring about a specific remedy. An expressive complaint is a complaint made for the purpose of expressing feelings, without any realistic chance of anything being done. Most online complaints are expressive complaints.

### Complaining to Agencies

If the grievance is not addressed in a way that satisfies the consumer, the consumer sometimes registers the complaint with a third party such as the Better Business Bureau, a local or regional government (if it has a "consumer protection" office) and Federal Trade Commission. These and similar organizations in other countries accept for consumer complaints and assist people with customer service issues, as do government representatives like attorneys general. Consumers however rarely file complaints in the more formal legal sense, which consists of a formal legal process.

In some countries (for example Australia, the United Kingdom, and many countries of the European Community), the making of consumer complaints, particularly regarding the sale of financial services, is governed by statute (law). The statutory authority may require companies to reply to complaints within set time limits, publish written procedures for handling customer dissatisfaction, and provide information about arbitration schemes.

### Complaining Online

Internet forums and the advent of social media have provided consumers with a new way to submit complaints. Consumer news and advocacy websites often accept and publish complaints. Publishing complaints on highly visible websites increases the likelihood that the general public will become aware of the consumer's complaint. If, for example, a person with many "followers" or "friends" publishes a complaint on social media, it may go "viral". Internet forums in general and on complaint websites have made it possible for individual consumers to hold large corporations accountable in a public forum.

## BUYER'S REMORSE

Buyer's remorse is the sense of regret after having made a purchase. It is frequently associated with the purchase of an expensive item such as a vehicle or real estate.

Buyer's remorse is thought to stem from cognitive dissonance, specifically post-decision dissonance, that arises when a person must make a difficult decision, such as a heavily invested purchase between two similarly appealing alternatives. Factors that affect buyer's remorse may include: resources invested, the involvement of the purchaser, whether the purchase is compatible with the purchaser's goals, feelings encountered post-purchase that include regret.

## Causes of Buyer's Remorse

The remorse may be caused by various factors, such as: the person purchased a product now rather than waiting, the item was purchased in an ethically unsound way, the property was purchased on borrowed money, the purchased object was something that would not be acceptable to others.

In the phase before purchasing, a prospective buyer often feels positive emotions associated with a purchase (desire, a sense of heightened possibilities, and an anticipation of the enjoyment that will accompany using the product, for example); afterwards, having made the purchase, they are more fully able to experience the negative aspects: all the opportunity costs of the purchase, and a reduction in purchasing power.

Also, before the purchase, the buyer has a full array of options, including not purchasing; afterwards, their options have been reduced to:

- Continuing with the purchase, surrendering all alternatives.
- Renouncing the purchase.

Buyer's remorse can also be caused or increased by worrying that other people may later question the purchase or claim to know better alternatives.

The remorse associated with some extreme shopping activity may be, again, a sign of some deeper disquiet. However, normal "buyer's remorse" should not be confused with the complex emotional dynamics of "shopaholic" behavior, just as a binge on a special occasion should not be confused with a serious eating disorder such as bulimia.

## Cognitive Dissonance

The phenomenon of buyer's remorse has been generally associated with the psychological theory of cognitive dissonance, a state of psychological discomfort when at least two elements of cognition are in opposition, and which motivates the person to appease it by changing how they think about the situation. Buyer's remorse is an example of post-decision dissonance, where a person is stressed by a made decision and seeks to decrease their discomfort. The buyer may change their behavior, their feelings, their knowledge about the world (what they thought the purchased item would be like), or even their knowledge of themselves. The more resources such as money, time, and cognitive resources that are invested into making a purchase, the more likely the buyer will experience buyer's remorse or psychological discomfort.

Psychologists have focused on three main elements that are related to cognitive dissonance and buyer's remorse. They are: effort, responsibility, and commitment. Effort is the resources invested in a purchase (material, intellectual, psychological, and others) and effort is directly related to the importance of the purchase. Purchases that require high amounts of effort but do not bear high rewards are likely to lead to buyer's remorse. Responsibility refers to the fact that the purchase is done out of free will. Buyers that have no choice on the purchase will be less likely to feel dissonance because it was not of their own volition. Commitment refers to the continuing of an action. The purchase of an automobile has high commitment because the car must usually be driven for a long duration. Purchases with higher commitment will lead to more buyer's remorse. Low rewards matched with these three conditions will most likely result in buyer's remorse via cognitive dissonance. The buyer feels anxiety and psychological discomfort because their behavior (the purchase of the item) does not match their attitude (their expectation of the purchased item).

There may be a duality of attitudes that explain how a person may be satisfied with their purchase but have the intention to never repeat the purchase. For example, a husband who takes his wife to the most expensive restaurant in town for their anniversary only to find that the food and service does not meet his expectations might still be satisfied with his decision to go to the restaurant but have the intention to never return. In this extension of cognitive dissonance, the duality of satisfaction and intention are separate phenomena within buyer's remorse.

## Involvement

In social psychology, "involvement" describes the effort, investment, and commitment in purchases. Involvement is often coupled with cognitive dissonance to explain buyer's remorse. In most cases, buyer's remorse resulting from a purchase that demands high involvement and results in cognitive dissonance is, all else (most notably nominal purchase price) being equal, harder to overcome than is buyer's remorse resulting from a purchase that demands low involvement and results in cognitive dissonance. This phenomenon is a result of the brain's instinctive (and rational) treatment of the transaction costs involved in acquiring a product as part of the purchase price of that product: The more involvement that a purchase requires or the purchaser puts in, the more dissonance or psychological discomfort the buyer will experience if dissatisfied with the purchase, just as if the purchaser had spent more "on paper" (i.e., paid a higher nominal price) for the product.

Studies investigating the link between cognitive dissonance and impulse buying have shown that impulse buyers experience less cognitive dissonance when they are disappointed with their purchase. The main explanation for this is that impulse buyers go into the purchase already without high expectations. Another possible explanation, at least among more sophisticated buyers, is that persons who are dissatisfied with a purchase that they made on impulse may blame that dissatisfaction at least in part on their own failure to thoroughly consider whether the product will satisfy their prior expectations even if it performs as advertised, thus blaming any discrepancy at least in part on themselves (via their own impulsivity) rather than on the purchased product (via any sort of difference between its promised and its actual attributes and/or performance).

## Paradox of Choice

The paradox of choice is a theory by American psychologist Barry Schwartz claiming that, after a certain threshold is reached, an increase in the number of choices will cause a significant amount of psychological distress. This distress, according to Professor Schwartz, can manifest itself in many ways. One way is through buyer's remorse. The theory states that buyer's remorse is created through increasing opportunity costs associated with increased choices. Opportunity costs associated with alternative choices compound and create strong feelings of dissonance and remorse.

The number of choices in a typical grocery store aisle.

As the number of choices increase, it is easier to imagine a different choice that may have been better than the one selected. The constant comparison to one's expectations induces regret, which reduces the satisfaction of any decision, even if it fills the individual's needs. When there are many alternatives to consider, it is easy to imagine the attractive features of rejected choices and there is a decrease in overall satisfaction.

Consider the number of choices in a simple supermarket. There are likely to be many different options for a single type of product. With so many to choose from, the customer might expect that one of the available options must be perfect for their needs and will have no drawbacks. This leads to expectations rarely being met, a significant psychological issue. In the example of a supermarket, buying the wrong product may not be a significant mistake. For more involved decisions, the consequences of a wrong decision are significant.

## Reducing

Choice-supportive bias leads to an increased liking of one's choices, including purchases.

This seems to contradict the concept of buyer's remorse. However, this choice enhancement can collapse when presented with even minor indication that the wrong choice was made. While initial positivity towards a decision is greater for more difficult decisions, this positivity also has greater vulnerability to evidence of an incorrect choice. This effect is larger when the purchaser is more involved in the decision. However, buyer's remorse can be reduced by post-purchase confirmation, though post-purchase communication may aggravate a buyer's discomfort if the purchase did not meet the buyer's predominant goals. Indeed, if the purchase meets an individual's goals there will be less post-purchase dissonance which means there will be less remorse and greater decision satisfaction.

### Marketing Implications

Buyer's remorse is a powerful experience for consumers. For years, marketers have been attempting to reduce buyer's remorse through many different methods. One specific technique employed by marketers is the inclusion of a coupon towards a future purchase at the point of sale. This has many benefits for both the consumer and retailer. First, the consumer is more likely to return to the store with the coupon, which will result in a higher percentage of repeat customers. Each successive time a purchase is made and is deemed satisfactory, buyer's remorse is less likely to be experienced. Customers can justify their purchases with product performance.

Another technique used is the money back guarantee, a guarantee from the retailer that the product will meet the customer's needs or the customer is entitled to a full refund. This technique is highly successful at lessening buyer's remorse because it immediately makes the decision a changeable one. The unchangeability of an "all-sales-final" purchase can lead to a larger amount of psychological discomfort at the point of the decision. This makes the stakes higher, and poor choices will cause significant buyer's remorse.

In addition, legislation exists in various parts of the world enforcing the right to a cooling-off period, during which contracts may be cancelled and goods returned for any reason, for a full refund.

## CUSTOMER SWITCHING

In marketing and microeconomics, customer switching or consumer switching describes "customers/consumers abandoning a product or service in favor of a competitor". Assuming constant price, product or service quality, counteracting this behaviour in order to achieve maximal customer retention is the business of marketing, public relations and advertising. Brand switching—as opposed to brand loyalty is the outcome of customer switching behaviour.

## Reasons

Variability in quality or market price fluctuations—especially a rise in prices—may lead customers to consult price comparison services where alternative suppliers may be offered. Declining customer satisfaction may be due to poor service quality but also—to a lesser degree—be a symptom of boredom with the brand of choice. Brand loyalty can be very strong, however, and the longer a commitment to a brand lasts, the stronger the ties will usually be.

According to 2013 Nielsen study on customer loyalty, brand switching can happen for 5 main reasons, but mainly based on price considerations. The overall global averages are:

- Better Price (41%).
- Better Quality (26%).
- Better Service Agreement (15%).
- Better Selection (10%).
- Better Features (8%).

Because of the dominant role of pricing, market tactics like penetration pricing have evolved to offer a convincing incentive for switching. Along with these are the factors like service inconvenience, poor location, ethical issues like hard selling or unsafe products and also change in customers' income levels. Another approach is the advertisement of vaporware that seemingly will offer newer or better features than established products without actually possessing any innovation.

## Affected Sectors

Switching is a significant business factor affecting revenues for companies providing continuously delivered services, as is the case for the energy market as opposed to sectors providing products that stimulate non- or sparsely recurring purchase because of the durability of the product or a general orientation towards casual customers. Energy customer switching is a significant risk or success factor for energy suppliers.

## Serial Switching

The term serial switcher was first coined by Charles Turner and David Alexander in their Customer relationship management course and then their CRM Pocketbook. It describes a person who continually moves his/her patronage from one company to another and highlights the ignorance of many organisations, including credit card companies, who strive for customer acquisition regardless of retention rates.

By offering a range of financial incentives, such as free balance transfers or interest free periods, a company may hope to attract new customers. This is superficially attractive to companies if it meets acquisition and competitive switching targets. In practice, however, a serial switcher will not contribute any profit if he/she does not stay long enough to provide a return on investments. The lesson is that lack of integration and analysis across the business allows bad decisions to be made.

## CUSTOMER EXPERIENCE

In commerce, customer experience (CX) is the product of an interaction between an organization and a customer over the duration of their relationship. This interaction is made up of three parts: the customer journey, the brand touchpoints the customer interacts with, and the environments the customer experiences (including digital environment) during their experience. A good customer experience means that the individual's experience during all points of contact matches the individual's expectations. Gartner asserts the importance of managing the customer's experience.

Customer experience implies customer involvement at different levels – such as rational, emotional, sensorial, physical, and spiritual. Customers respond diversely to direct and indirect contact with a company. Direct contact usually occurs when the purchase or use is initiated by the customer. Indirect contact often involves advertising, news reports, unplanned encounters with sales representatives, word-of-mouth recommendations or criticisms.

Customer experience encompasses every aspect of a company's offering—the quality of customer care, but also advertising, packaging, product and service features, ease of use, and reliability. Creating direct relationships in the place where customers buy, use and receive services by a business intended for customers such as instore or face to face contact with the customer which could be seen through interacting with the customer through the retail staff. We then have indirect relationships which can take the form of unexpected interactions through a company's product representative, certain services or brands and positive recommendations – or it could even take the form of "criticism, advertising, news, reports" and many more along that line.

Customer experience is created by the contribution of not only the customers' values but also by the contribution of the company providing the experience.

All of the events experienced by customers before and after a purchase are part of the customer experience. What a customer experiences is personal and may involve sensory, emotional, rational and physical aspects to create a memorable experiencer. In the retail industry, both company and customers play a big role in creating a customer experience.

Forbes describes the customer experience as the "cumulative impact of multiple touch-points" over the course of a customer's interaction with an organization. Some companies are known to segment the customer experience into interactions through the web and social media, while others define human interaction such as over-the-phone customer service or face-to-face retail service as the customer experience.

According to a research, the six disciplines for great customer experience are strategy, customer understanding, design, measurement, governance and culture. A company's ability to deliver an experience that sets it apart in the eyes of its customers will increase the amount of consumer spending with the company and inspire loyalty to its brand. According to Jessica Sebor, "loyalty is now driven primarily by a company's interaction with its customers and how well it delivers on their wants and needs."

Wharton's Professor of Marketing Barbara E. Kahn has established an evolutional approach to customer experience as the third of four stages of any company in terms of its customer centricity maturity. These progressive phases are:

- Product orientation: Companies just manufacture goods and offer them the best way possible.
- Market orientation: Some consideration on customer needs and segmentation arises, developing different marketing mix bundles for each one.
- Customer experience: Adding to the other two factors some recognition of the importance of providing an emotionally positive experience to customers.
- Authenticity: This is the top maturity stage of companies. Products and service emerge from real soul of brand and connect naturally and on long term sustainable basis with clients and other stakeholders.

In today's competitive climate, more than just low prices and innovative products are required to survive in retail business. Customer experience involves every point of contact you have with a customer and the interactions with the products or service of the business. Customer experience has emerged as a vital strategy for all retail businesses that are facing competition. According to studies customer experience can be defined as a whole event that a customer comes into contact with when interacting with a certain business. This experience often affects the emotions of the customer. The whole experience occurs when the interaction takes place through the stimulation of goods and services consumed.

The type experience seen through a marketing perspective is put forward by Pine and Gilmore which they state that an experience can be unique which may mean different individuals will not have the same level experience that may not be memorable to the person therefore it won't be remembered over a period of time. Certain types of experiences may involve different aspects of the individual person such as emotional, physical, intellectual or even spiritual.

Customer experience is the stimulation a company creates for the senses of the consumers, this means that the companies and that particular brand can control the stimuli that they have given to the consumers senses which the companies can then control the consumers reaction resulting from the stimulation process, giving more acquisition of the customer experience as expected by company.

Kotler say that customer experience is about, “Adding value for customers buying products and services through customer participation and connection, by managing all aspects of the encounter”. The encounter includes touchpoints. Businesses can create and modify touchpoints so that they are suited to their consumers which changes/enhances the customers’ experience. Creating an experience for the customer can lead to greater brand loyalty and brand recognition in the form of logos, colour, smell, touch, taste, etc.

## Development

There are many elements in the shopping experience associated with a customer’s experience. Customer service, a brand’s ethical ideals and the shopping environment are examples of factors that effect a customer’s experience. Understanding and effectively developing a positive customer experience has become a staple within businesses and brands to combat growing competition. Many consumers are well informed, they are able to easily compare two similar products or services together. Therefore, consumers are looking for experiences that can fulfil their intentions. A brand that can provide this gains a competitive advantage over their competition. A study by Ali found that developing a positive behavioural culture created a greater competitive advantage in the long term. He looked at the customer experience at resort hotels and discovered that providing the best hotel service was not sufficient. To optimise a customer’s experience, management must also consider peace of mind and relaxation, recognition and escapism, involvement, and hedonics. The overall customer experience must be considered. The development of a positive customer experience is important as it increases the chances of a customer to make continued purchases and develops brand loyalty. Brand loyalty can turn customers into advocates, resulting in a long term relationship between both parties. This promotes word-of-mouth and turns the customer into a touchpoint for the brand. Potential customers can develop opinions through another’s experiences. Males and females both respond differently to brands and therefore, will experience the same brand differently. Males respond effectively to relational, behavioural and cognitive experiences whereas females respond greater to behavioural, cognitive and effective experiences in relation to branded apps. If female consumers are the target market, an app advert focused on the emotion of the product will provide an effective customer experience.

Today, retail stores tend to exist in shopping areas such as malls or shopping districts. Very few operate in areas alone. Customer experience is not limited to the purchase alone. It includes all activities that may influence a customer’s experience with a brand. Therefore, a shopping centre’s reputation that a store is located in will effect a brands customer experience. This is an example of the shopping environment effecting a customer's experience. A study by Hart, Stachow and Cadogan found that a consumer's opinion of a town centre can affect the opinion of the retail stores operating within both negatively and positively. They shared an example of a town centre's management team developing synergy between the surrounding location and the retail stores. A location bound with historical richness could provide an opportunity for the town centre and local businesses to connect at deeper level with their customers. They suggested that town centre management and retail outlets should work cooperatively to develop an effective customer experience. This will result in all stores benefiting from customer retention and loyalty.

Another effective way to develop a positive customer experience is by actively engaging a customer with an activity. Human and physical components of an experience are very important. Customers are able to recall active, hands-on experiences much more effectively and accurately than passive activities. Participants within a study were able to recount previous luxury driving experiences due to its high involvement. However, this can also have a negative effect on the customer's experience. Just as active, hands-on experiences can greatly develop value creation, it can also greatly facilitate value destruction. This is related to a customer's satisfaction of their experience. By understanding what causes satisfaction or dissatisfaction of a customer's experience, management can appropriately implement changes within their approach. A study on the customer experience in budget hotels revealed interesting results. Customer satisfaction was largely influenced by tangible and sensory dimensions. This included cleanliness, shower comfortability and room temperature, just to name a few. As budget hotels are cheap, customers expected the basic elements to be satisfactory and the luxury elements to be non-existent. If these dimensions did not reach an appropriate standard, satisfaction would decline, resulting in a negative experience.

## Management

Customer experience management (CEM or CXM) is the process that companies use to oversee and track all interactions with a customer during their relationship. This involves the strategy of building around the needs of individual customers. According to Jeananne Rae, companies are realizing that "building great consumer experiences is a complex enterprise, involving strategy, integration of technology, orchestrating business models, brand management and CEO commitment."

According to Bernd Schmitt, "the term 'Customer Experience Management' represents the discipline, methodology and/or process used to comprehensively manage a customer's cross-channel exposure, interaction and transaction with a company, product, brand or service." Harvard Business Review blogger Adam Richardson says that a company must define and understand all dimensions of the customer experience in order to have long-term success.

Although 80% of businesses state that they offer a "great customer experience," according to author James Allen, this contrasts with the 8% of customers expressing satisfaction with their experience. Allen asserts that for companies to meet the demands of providing an exceptional customer experience, they must be able to execute the "Three Ds":

- Designing the correct incentive for the correctly identified consumer, offered in an enticing environment.
- Delivery: A company's ability to focus the entire team across various functions to deliver the proposed experience.
- Development ultimately determines a company's success, with an emphasis on developing consistency in execution.

CEM has been recognized as the future of the customer service and sales industry. Companies are using this approach to anticipate customer needs and adopt the mindset of the customer.

CEM depicts a business strategy designed to manage the customer experience and gives benefits to both retailers and customers. CEM can be monitored through surveys, targeted studies, observational studies, or "voice of customer" research. It captures the instant response of the customer to its encounters with the brand or company. Customer surveys, customer contact data, internal operations process and quality data, and employee input are all sources of "voice of customer" data that can be used to quantify the cost of inaction on customer experience issues.

The aim of CEM is to optimize the customer experience through gaining the loyalty of the current customers in a multi-channel environment and ensure they are completely satisfied. Its also to create advocates of their current customers with potential customers as a word of mouth form of marketing. However, common efforts at improving CEM can have the opposite effect.

Utilizing surroundings includes using visuals, displays and interactivity to connect with customers and create an experience. CEM can be related to customer journey mapping, a concept pioneered by Ron Zemke and Chip Bell. Customer journey mapping is a design tool used to track customers' movements through different touchpoints with the business in question. It maps out the first encounters people may have with the brand and shows the different route people can take through the different channels or marketing (e.g. online, television, magazine, newspaper). Integrated marketing communications (IMC) is also being used to manage the customer experience; IMC is about sending a consistent message amongst all platforms; these platforms include: Advertising, personal selling, public relations, direct marketing, and sales promotion.

CEM holds great importance in terms of research and showing that academia is not as applicable and usable as the practice behind it. Typically, to make the best use of CEM and ensure its accuracy, the customer journey must be viewed from the actual perspective of customers, not the business or organization. It needs to be noted that there isn't a specific set of rules or steps to follow as companies (in their various industries) will have different strategies. Therefore, development into the conceptual and theoretical aspects are needed, based from customers' perspective on the brand experience. This can be seen through different scholarly research. The reasoning behind the interest in CEM increasing so significantly is because businesses are looking for competitive differentiation. Businesses want to be more profitable and see this as a means to do so. Hence why businesses want to offer a better experience to their customers and want to manage this process efficiently. In order to gain success as a business customers need to be understood. In order to fully utilise the models used in practice, academic research that is conducted can assist the practical aspect. This along with recognising past customer experiences can help manage future experiences.

A good indicator of customer satisfaction is the Net Promoter Score (NPS). This indicates out of a score of ten if a customer would recommend a business to other people. With scores of nine and ten these people are called protractors and will recommend other to the given product but on the other end of the spectrum are detractors, those who give the score zero to six. Subtracting the detractors from the protractors gives the calculation of advocacy. Those businesses with higher scores are likely to be more successful and give a better customer experience.

Not all aspects of CEM can be controlled by the business (e.g. other people and the influence they have). Besides, there is not much substantial information to support CEM claims in terms of academic research.

## Managing the Communication

The classical linear communication model includes having one sender or source sending out a message that goes through the media (television, magazines) then to the receiver. The classical linear model is a form of mass marketing which targets a large number of people where only a few may be customers; this is a form non-personal communication. The adjusted model shows the source sending a message either to the media or directly to an opinion leader/s and/or opinion former (Model, actress, credible source, trusted figure in society, YouTuber/reviewer), which send a decoded message to the receiver. The adjusted model is a form of interpersonal communication where feedback is almost instantaneous with receiving the message. The adjusted model means that there are many more platforms of marketing with the use of social media, which connects people with more touchpoints. Marketers use digital experience to enhance the customer experience. Enhancing digital experiences influences changes to the CEM, the customer journey map and IMC. The adjusted model allows marketers to communicate a message designed specifically for the 'followers' of the particular opinion leader or opinion former, sending a personalised message and creating a digital experience.

## Persuasion Techniques

Persuasion techniques are used when trying to send a message in order for an experience to take place. Marcom Projects came up with five mind shapers to show how humans view things. The five mind shapers of persuasion include:

- Frames: Only showing what they want you to see (a paid ad post).
- Setting and context: The surrounding objects of items for sale.
- Filters: Previous beliefs that shape thoughts after an interaction.
- Social influence: How behaviours of others impact us.
- Belief (placebo effect): The expectation.

Mind shapers can be seen through the use of the adjusted communication model, it allows the source/sender to create a perception for the receiver. Mind shapers can take two routes for persuasion:

- Central route, this route requires a thought process to occur, the content of the message is important. People think thoroughly about their reaction/reply. This can be seen in the purchase of homes, Internet providers, insurance companies.
- Peripheral route, does not require very much thought, the brain makes the connection. Marketers use recognisable cues like logos, colours and sounds. This type of marketing is used when the decision is about something simple like choosing a drink, food.

Marketers can use human thought processes and target these to create greater experiences, they can do so by either maker the process more simple and creating interactive steps to help the process.

## Customer Relationship Management

According to Das, customer relationship management (CRM) is the "establishment, development, maintenance and optimization of long-term mutually valuable relationships between consumers and organizations". The official definition of CRM by the Customer Relationship Management Research Center is "a strategy used to learn more about the customers need and behaviours in order to develop stronger relationships with them". The purpose of this strategy is to change the approach to customers and improving the experience for the consumer by making the supplier more aware of their buying habits and frequencies.

The D4 Company Analysis is an audit tool that considers the four aspects of strategy, people, technology and processes in the design of a CRM strategy. The analysis includes four main steps.

- "Define the existing customer relationship management processes within the company.
- Determine the perceptions of how the company manages their customer relationships, both internally and externally.
- Design the ideal customer relationship management solutions relative to the company or industry.
- Deliver a strategy for the implementation of the recommendations based on the findings".

## Digital Customer Journey

In the classical marketing model, marketing is deemed to a funnel: at the beginning of the process (in the "awareness" stage) there are many branches competing for the attention of the customer, and this number is reduced through the different purchasing stages. Marketing is an action of "pushing" the brand through few touch points (for example through TV ads).

Since the rise of the World Wide Web and smartphone applications, there are many more touch points from new content serving platforms (Facebook, Instagram, Twitter, YouTube etc.), individual online presences (such as websites, forums, blogs, etc.) and dedicated smartphone applications.

As a result, this process has become a type of "journey":

- The number of brands does not decrease during the process of evaluating and purchasing a product.
- Brands not taken into account in the "awareness" stage may be added during the evaluation or even purchase stage.
- Following the post-purchase stage, there is a return to the first step in the process, thus feeding the brand awareness.

In relation to customers and the channels which are associated with sales, these are multichannel in nature. Due to the growth and importance of social media and digital advancement, these aspects need to be understood by businesses to be successful in this era of customer journeys. With tools such as Facebook and Twitter having such prominence, there is a constant stream of data that needs to be analysed to understand this journey. Business flexibility and responsiveness is vital in the ever-changing digital customer environment, as customers are constantly connected to businesses and their products. Customers are now instant product experts due to various digital outlets and form their own opinions on how and where to consume products and services. Businesses use customer values and create a plan to gain a competitive advantage. Businesses use the knowledge of customers to guide the customer journey to their products and services.

Due to the shift in customer experience, in 2014 Wolny and Charoensuksai highlight three behaviours that show how decisions can be made in this digital journey. The Zero Moment of truth is the first interaction a customer has in connection with a service or product. This moment affects the consumer's choice to explore a product further or not at all. These moments can occur on any digital device. Showrooming highlights how a consumer will view a product in a physical store but then decide to exit the store empty handed and buy online instead. This consumer decision may be due to the ability to compare multiple prices online. On the opposing end of the spectrum is webrooming. Consumers will research about a product online in regards to quality and price but then decide to purchase in store. These three channels need to be understood by businesses because customers expect businesses to be readily available to cater to their specific customer needs and purchasing behaviours.

## Customer Journey Mapping

The customer journey mapping approach for service design was first introduced by OxfordSM in 1998, in support of Eurostar to establish and implement their corporate mission and brand proposition. OxfordSM went on to use the approach widely, including with the UK Government, through which the guidance on the technique was publicly published. It has subsequently become one of the most widely used tools for service design and have been utilized as a tool for visualizing intangible services. A customer journey map shows the story of the customer's experience. It not only identifies key interactions that the customer has with the organization, but it also brings user's feelings, motivations and questions for each of the touchpoints. Finally, a customer journey map has the objective of teaching organizations more about their customers. To map a customer journey is important to consider the company's customers (buyer persona), the customer journey's time frame, channels (telephone, email, in-app messages, social media, forums, recommendations), first actions (problem acknowledgement) and last actions (recommendations or subscription renewal, f.i.). Customer Journey Maps are good storytelling conduits – they communicate to the brand the journey, along with the emotional quotient, that customer experiences at every stage of the buyer journey.

Customer journey maps take into account people's mental models (how things should behave), the flow of interactions and possible touch points. They may combine user profiles, scenarios, and user flows; and reflect the thought patterns, processes, considerations, paths, and experiences that people go through in their daily lives.

## Benefits of Customer Journey Mapping

Mapping the customer journey helps organisations understand how prospects and customers use the various channels and touchpoints, how the organisation's is perceived and how the organisation would like its customers and prospects' experiences to be. By understanding the latter, it is possible to design an optimal experience that meets the expectations of major customer groups, achieves competitive advantage and supports attainment of desired customer experience objectives.

## Retail Environment

Retail environment factors include social features, design, and ambience. This can result in enhanced pleasure while shopping, thus positive customer experience and more likely chances of the customer revisiting the store in the future. The same retail environment may produce varied outcomes and emotions, depending on what the consumer is looking for. For example, a crowded retail environment may be exciting for a consumer seeking entertainment, but create an impression of inattentive customer service and frustration to a consumer who may need help looking for a specific product to meet an immediate need.

Environmental stimuli such as lighting and music, can influence a consumer's decision to stay longer in the store, therefore increasing the chances of purchasing. For example, a retail store may have dim lights and soothing music which may lead a consumer to experience the store as relaxing and calming.

Today's consumers are consistently connected through the development of technological innovation in the retail environment. This has led to the increased use of digital-led experiences in their purchase journey both in-store and online that inspire and influence the sales process. For example, Rebecca Minkoff has installed smart mirrors in their fitting rooms that allows the customers to browse for products that may complement what they are trying on. These mirrors also hold an extra feature, a self-checkout system where the customer places the item on an RFID-powered table, this the sends the products to an iPad that is then used to checkout.

External and internal variables in a retail environment can also affect a consumer's decision to visit the store. External variables include window displays such as posters and signage, or product exposure that can be seen by the consumer from outside of the store. Internal variables include flooring, decoration and design. These attributes of a retail environment can either encourage or discourage a consumer from approaching the store.

## Sales Experience

Sales experience is a subset of the customer experience. Whereas customer experience encompasses the sum of all interactions between an organization and a customer over the entire relationship, sales experience is focused exclusively on the interactions that take place during the sales process and up to the point that a customer decides to buy.

Customer experience tends to be owned by the Marketing function within an organization and therefore has little control or focus on what happens before a customer decides to buy.

Sales experience is concerned with the buyer journey up to and including the point that the buyer makes a purchase decision. Sales is a very important touch-point for overall customer experience as this is where the most human interaction takes place.

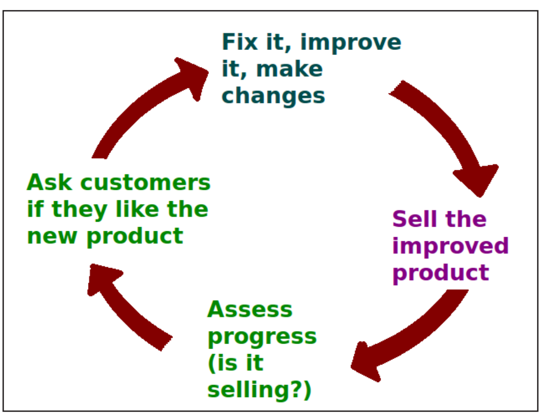
# CUSTOMER SATISFACTION

Customer satisfaction (often abbreviated as CSAT) is a term frequently used in marketing. It is a measure of how products and services supplied by a company meet or surpass customer expectation. Customer satisfaction is defined as "the number of customers, or percentage of total customers, whose reported experience with a firm, its products, or its services (ratings) exceeds specified satisfaction goals."

The Marketing Accountability Standards Board (MASB) endorses the definitions, purposes, and constructs of classes of measures that appear in Marketing Metrics as part of its ongoing Common Language in Marketing Project. In a survey of nearly 200 senior marketing managers, 71 percent responded that they found a customer satisfaction metric very useful in managing and monitoring their businesses.

It is seen as a key performance indicator within business and is often part of a Balanced Scorecard. In a competitive marketplace where businesses compete for customers, customer satisfaction is seen as a key differentiator and increasingly has become a key element of business strategy.

## Purpose




A business ideally is continually seeking feedback to improve customer satisfaction.

"Customer satisfaction provides a leading indicator of consumer purchase intentions and loyalty." Customer satisfaction data are among the most frequently collected indicators of market perceptions. Their principal use is twofold:

- Within organizations, the collection, analysis and dissemination of these data send a message about the importance of tending to customers and ensuring that they have a positive experience with the company's goods and services.
- Although sales or market share can indicate how well a firm is performing currently, satisfaction is perhaps the best indicator of how likely it is that the firm's customers will make further purchases in the future. Much research has focused on the relationship between customer satisfaction and retention. Studies indicate that the ramifications of satisfaction are most strongly realized at the extremes.

On a five-point scale, "individuals who rate their satisfaction level as '5' are likely to become return customers and might even evangelize for the firm. (A second important metric related to satisfaction is willingness to recommend. This metric is defined as "The percentage of surveyed customers who indicate that they would recommend a brand to friends." When a customer is satisfied with a product, he or she might recommend it to friends, relatives and colleagues. This can be a powerful marketing advantage.) "Individuals who rate their satisfaction level as '1,' by contrast, are unlikely to return. Further, they can hurt the firm by making negative comments about it to prospective customers. Willingness to recommend is a key metric relating to customer satisfaction."

## Theoretical Ground

In literature antecedents of satisfaction are studied from different aspects. The considerations extend from psychological to physical and from normative to positive aspects. However, in most of the cases the consideration is focused on two basic constructs as customers expectations prior to purchase or use of a product and his relative perception of the performance of that product after using it.

A customer's expectations about a product tell us how he or she anticipates how that product will perform. As it is suggested in the literature, consumers may have various "types" of expectations when forming opinions about a product's anticipated performance. For example, four types of expectations are identified by Miller: ideal, expected, minimum tolerable, and desirable. While, Day indicated among expectations, the ones that are about the costs, the product nature, the efforts in obtaining benefits and lastly expectations of social values. Perceived product performance is considered as an important construct due to its ability to allow making comparisons with the expectations.

It is considered that customers judge products on a limited set of norms and attributes. Olshavsky and Miller and Olson and Dover designed their researches as to manipulate actual product performance, and their aim was to find out how perceived performance ratings were influenced by expectations. These studies took out the discussions about explaining the differences between expectations and perceived performance."

In some research studies, scholars have been able to establish that customer satisfaction has a strong emotional, i.e., affective, component. Still others show that the cognitive and affective components of customer satisfaction reciprocally influence each other over time to determine overall satisfaction.

Especially for durable goods that are consumed over time, there is value to taking a dynamic perspective on customer satisfaction. Within a dynamic perspective, customer satisfaction can evolve over time as customers repeatedly use a product or interact with a service. The satisfaction experienced with each interaction (transactional satisfaction) can influence the overall, cumulative satisfaction. Scholars showed that it is not just overall customer satisfaction, but also customer loyalty that evolves over time.

## Disconfirmation Model

"The Disconfirmation Model is based on the comparison of customers' expectations and their perceived performance ratings. Specifically, an individual's expectations are confirmed when a product performs as expected. It is negatively confirmed when a product performs more poorly than expected. The disconfirmation is positive when a product performs over the expectations. There are four constructs to describe the traditional disconfirmation paradigm mentioned as expectations, performance, disconfirmation and satisfaction." "Satisfaction is considered as an outcome of purchase and use, resulting from the buyers' comparison of expected rewards and incurred costs of the purchase in relation to the anticipated consequences. In operation, satisfaction is somehow similar to attitude as it can be evaluated as the sum of satisfactions with some features of a product." "In the literature, cognitive and affective models of satisfaction are also developed and considered as alternatives. Churchill and Suprenant in 1982, evaluated various studies in the literature and formed an overview of disconfirmation process".

## Construction

Organizations need to retain existing customers while targeting non-customers. Measuring customer satisfaction provides an indication of how successful the organization is at providing products and/or services to the marketplace:

"Customer satisfaction is measured at the individual level, but it is almost always reported at an aggregate level. It can be, and often is, measured along various dimensions. A hotel, for example, might ask customers to rate their experience with its front desk and check-in service, with the room, with the amenities in the room, with the restaurants and so on. Additionally, in a holistic sense, the hotel might ask about over-all satisfaction with your stay ".

As research on consumption experiences grows, evidence suggests that consumers purchase goods and services for a combination of two types of benefits: hedonic and utilitarian. Hedonic benefits are associated with the sensory and experiential attributes of the product. Utilitarian benefits of a product are associated with the more instrumental and functional attributes of the product.

Customer satisfaction is an ambiguous and abstract concept and the actual manifestation of the state of satisfaction will vary from person to person and product/service to product/service. The state of satisfaction depends on a number of both psychological and physical variables which correlate with satisfaction behaviors such as return and recommend rate. The level of satisfaction can also vary depending on other options the customer may have and other products against which the customer can compare the organization's products.

Work done by Parasuraman, Zeithaml and Berry between 1985 and 1988 provides the basis for the measurement of customer satisfaction with a service by using the gap between the customer's expectation of performance and their perceived experience of performance. This provides the measurer with a satisfaction "gap" which is objective and quantitative in nature. Work done by Cronin and Taylor propose the "confirmation/disconfirmation" theory of combining the "gap" described by Parasuraman, Zeithaml and Berry as two different measures (perception and expectation of performance) into a single measurement of performance according to expectation.

The usual measures of customer satisfaction involve a survey using a Likert scale. The customer is asked to evaluate each statement in terms of their perceptions and expectations of performance of the organization being measured.

Good quality measures need to have high satisfaction loadings, good reliability, and low error variances. In an empirical study comparing commonly used satisfaction measures it was found that two multi-item semantic differential scales performed best across both hedonic and utilitarian service consumption contexts. A study found that a six-item 7-point semantic differential scale, which is a six-item 7-point bipolar scale, consistently performed best across both hedonic and utilitarian services.

It loaded most highly on satisfaction, had the highest item reliability, and had by far the lowest error variance across both studies. In the study, the six items asked respondents' evaluation of their most recent experience with ATM services and ice cream restaurant, along seven points within these six items: "pleased me to displeased me", "contented with to disgusted with", "very satisfied with to very dissatisfied with", "did a good job for me to did a poor job for me", "wise choice to poor choice" and "happy with to unhappy with". A semantic differential (4 items) scale which is a four-item 7-point bipolar scale, was the second best performing measure, which was again consistent across both contexts. In the study, respondents were asked to evaluate their experience with both products, along seven points within these four items: “satisfied to dissatisfied”, “favorable to unfavorable”, “pleasant to unpleasant” and “I like it very much to I didn’t like it at all”. The third best scale was single-item percentage measure, a one-item 7-point bipolar scale. Again, the respondents were asked to evaluate their experience on both ATM services and ice cream restaurants, along seven points within “delighted to terrible”.

Finally, all measures captured both affective and cognitive aspects of satisfaction, independent of their scale anchors. Affective measures capture a consumer’s attitude (liking/disliking) towards a product, which can result from any product information or experience. On the other hand, cognitive element is defined as an appraisal or conclusion on how the product’s performance compared against expectations (or exceeded or fell short of expectations), was useful (or not useful), fit the situation (or did not fit), exceeded the requirements of the situation (or did not exceed).

Recent research shows that in most commercial applications, such as firms conducting customer surveys, a single-item overall satisfaction scale performs just as well as a multi-item scale. Especially in larger scale studies where a researcher needs to gather data from a large number of customers, a single-item scale may be preferred because it can reduce total survey error.

## Methodologies

American Customer Satisfaction Index (ACSI) is a scientific standard of customer satisfaction. Academic research has shown that the national ACSI score is a strong predictor of Gross Domestic Product (GDP) growth, and an even stronger predictor of Personal Consumption Expenditure (PCE) growth. On the microeconomic level, academic studies have shown that ACSI data is related to a firm’s financial performance in terms of return on investment (ROI), sales, long-term firm value (Tobin’s q), cash flow, cash flow volatility, human capital performance, portfolio returns, debt financing, risk, and consumer spending. Increasing ACSI scores have been shown to predict loyalty, word-of-mouth recommendations, and purchase behavior. The ACSI measures customer satisfaction annually for more than 200 companies in 43 industries and 10 economic sectors. In addition to quarterly reports, the ACSI methodology can be applied to private sector companies and government agencies in order to improve loyalty and purchase intent.

The Kano model is a theory of product development and customer satisfaction developed in the 1980s by Professor Noriaki Kano that classifies customer preferences into five categories: Attractive, One-Dimensional, Must-Be, Indifferent, Reverse. The Kano model offers some insight into the product attributes which are perceived to be important to customers.

SERVQUAL or RATER is a service-quality framework that has been incorporated into customer-satisfaction surveys (e.g., the revised Norwegian Customer Satisfaction Barometer) to indicate the gap between customer expectations and experience.

J.D. Power and Associates provides another measure of customer satisfaction, known for its top-box approach and automotive industry rankings. J.D. Power and Associates' marketing research consists primarily of consumer surveys and is publicly known for the value of its product awards.

Other research and consulting firms have customer satisfaction solutions as well. These include A.T. Kearney's Customer Satisfaction Audit process, which incorporates the Stages of Excellence framework and which helps define a company's status against eight critically identified dimensions.

For B2B customer satisfaction surveys, where there is a small customer base, a high response rate to the survey is desirable. The American Customer Satisfaction Index found that response rates for paper-based surveys were around 10% and the response rates for e-surveys (web, wap and e-mail) were averaging between 5% and 15% - which can only provide a straw poll of the customers' opinions.

In the European Union member states, many methods for measuring impact and satisfaction of e-government services are in use, which the eGovMoNet project sought to compare and harmonize.

These customer satisfaction methodologies have not been independently audited by the Marketing Accountability Standards Board (MASB) according to MMAP (Marketing Metric Audit Protocol).

Recently there has been a growing interest in predicting customer satisfaction using big data and machine learning methods (with behavioral and demographic features as predictors) to take targeted preventive actions aimed at avoiding churn, complaints and dissatisfaction.

## IMPULSE BUYING

An impulse purchase or impulse buying is an unplanned decision to buy a product or service, made just before a purchase. One who tends to make such purchases is referred to as an impulse purchaser or impulse buyer. Research findings suggest that emotions and feelings play a decisive role in purchasing, triggered by seeing the product or upon exposure to a well crafted promotional message.

Marketers and retailers tend to exploit these impulsive shopping which are tied to the basic want for instant gratification. For example, a shopper in a supermarket might not specifically be shopping for confectionery. However, candy, gum, mints and chocolate are prominently displayed at the checkout aisles to trigger impulse buyers - and/or their children - to buy what they might not have otherwise considered. Alternatively, impulse buying can occur when a potential consumer spots something related to a product that stirs a particular passion in them, such as seeing a certain country's flag on the cover of a certain DVD. Sale items are displayed in much the same fashion.

The Apple Macintosh 128K computer's graphical user interface was so innovative in 1984, and so compelling to consumers, that one dealer described it as "the first $2,500 impulse item". Impulse buying can also extend to more expensive items such as automobiles, couches, and home appliances. Automobiles in particular are as much an emotional purchase as a rational one. This in turn leads auto dealers all over the world to market their products in a rapid-fire, almost carnival-like manner designed to appeal to emotion over reason.

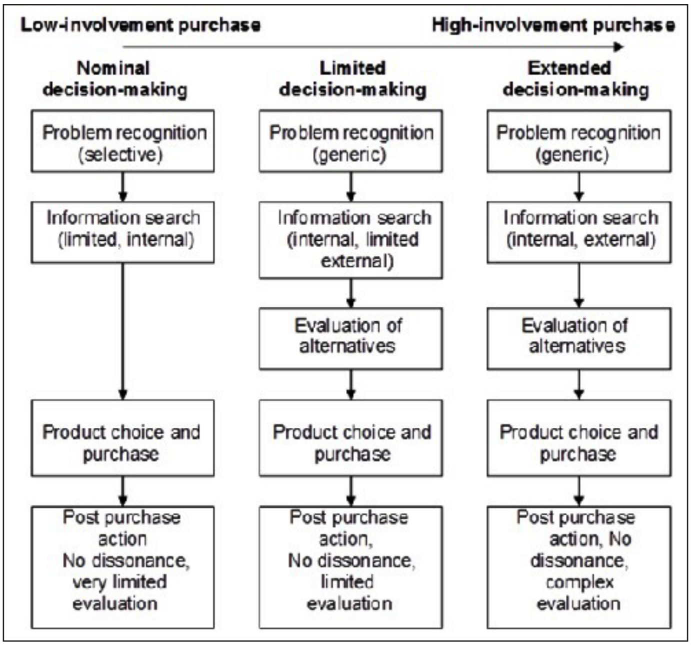
Impulse buying disrupts the normal decision making models in consumers' brains. The logical sequence of the consumers' actions is replaced with an irrational moment of self gratification. Impulse items appeal to the emotional side of consumers. Some items bought on impulse are not considered functional or necessary in the consumers' lives. Preventing impulse buying involves techniques such as setting budgets before shopping and taking time out before the Purchase is made.

A study published in the June 2008 suggests that consumers are more susceptible to making impulsive purchases for one brand over another if they are distracted while shopping. In the study, Central Michigan University Psychology professor Bryan Gibson surveyed college students by measuring their preference for a variety of soft drinks, including Coke and Pepsi. Results of Gibson's study found that implicit attitudes, or those that people may not be conscious of and able to verbally express, predicted product choice only when participants were presented with a cognitive task, suggesting that implicit product attitudes may play a greater role in product choice when the consumer is distracted or making an impulse purchase.

Researchers at the University of British Columbia and the Cheung Kong Graduate School of Business found that impulse spending is a behavior associated with disorganized environments. The study concluded that being surrounded by chaos impairs a person's ability to perform other tasks requiring 'brain' power, which results in a threat to a person's sense of personal control.

# CONSUMER BUYING BEHAVIOR

Consumer buying behavior is the study of an individual or a household that purchases products for personal consumption. The process of buying behavior is shown in the figure.




## Stages of Purchasing Process

A consumer undergoes the following stages before making a purchase decision:

Stage 1 – Needs/Requirements:

It is the first stage of the buying process where the consumer recognizes a problem or a requirement that needs to be fulfilled. The requirements can be generated either by internal stimuli or external stimuli. In this stage, the marketer should study and understand the consumers to find out what kinds of needs arise, what brought them about, and how they led the consumer towards a particular product.

Stage 2 – Information Search:

In this stage, the consumer seeks more information. The consumer may have keen attention or may go into active information search. The consumer can obtain information from any of the several sources. This include personal sources (family, friends, neighbors, and acquaintances), industrial sources (advertising, sales people, dealers, packaging), public sources (mass media, consumer-rating and organization), and experiential sources (handling, examining, using the product). The relative influence of these information sources varies with the product and the buyer.

Stage 3 – Evaluation of Alternatives:

In this stage, the consumer uses information to evaluate alternative brands from different alternatives. How consumers go about evaluating purchase alternatives depends on the individual consumer and the specific buying situation. In some cases, consumers use logical thinking, whereas in other cases, consumers do little or no evaluating; instead they buy on aspiration and rely on intuition. Sometimes consumers make buying decisions on their own; sometimes they depend on friends, relatives, consumer guides, or sales persons.

Stage 4 – Purchase Decision:

In this stage, the consumer actually buys the product. Generally, a consumer will buy the most favorite brand, but there can be two factors, i.e., purchase intentions and purchase decision. The first factor is the attitude of others and the second is unforeseen situational factors. The consumer may form a purchase intention based on factors such as usual income, usual price, and usual product benefits.

Stage 5 – Post-Purchase Behavior:

In this stage, the consumers take further steps after purchase based on their satisfaction and dissatisfaction. The satisfaction and dissatisfaction depend on the relationship between consumer's expectations and the product's performance. If a product is short of expectations, the consumer is disappointed. On the other hand, if it meets their expectations, the consumer is satisfied. And if it exceeds their expectations, the consumer is delighted.

The larger the gap between the consumers' expectations and the product's performance, the greater will be the consumer's dissatisfaction. This suggests that the seller should make product claims that faithfully represent the product's performance so that the buyers are satisfied.

Consumer satisfaction is important because the company's sales come from two basic groups, i.e., new customers and retained customers. It usually costs more to attract new customers than to retain existing customers and the best way to retain them is to get them satisfied with the product.

## CUSTOMER PRIORITY

Customer priority involves the emotional drive of the customer to buy your product or service. An entrepreneur may create a product that fulfills an important need or want for the customer; however, the customer's willingness to buy that product or service at a given time is measured by priority. For example, when the next generation of the IPhone is coming out, customers line up outside of stores and wait for days. This shows that there is a high degree of priority for this customer segment. On the other hand, the greater the number of options that exist for fulfilling the need or want, generally the lower the level of priority. When you see a commercial for a new type of dishwashing detergent, you typically don't rush directly to the store to purchase it. This shows that you have a low priority.

### Factors for Determining Customer Priority

The most important aspect of priority concerns the level of effort that it will take to convince the customer to purchase your product. Further, that will influence the amount of the product or service that the customer will purchase. There are several factors that you can use to determine the level of priority for a given product:

- The severity of the need or want that your customer has for the product (often referred to as the customer's level of "pain" or "hurt".
  - How important is it that the customer fulfill the need or want. Are there any physical, financial, social or other repercussions for failing to fulfill it.
- How urgent is it that the customer fulfills that need or want?
  - This has to do with the issue of timing. If the need or want needs to be fulfilled in a short period of time, there is a higher degree for customer purchase at first introduction.
- What are the costs of the product to the customer or client?
  - The price, inconvenience, social costs, etc., should be at a level that it will increase the customer's priority, rather than dissuade a purchase. Think of product sales. The customer priority goes up because there is a perception that the good or service will not be available at that price for long.
- Are there other goods that or providers who meet or fulfill the customer's need or want?
  - Generally, the greater the number of options (substitute goods or services or providers of a type of good or service), the lower the level of priority. Customers feel that they have other options and do not need to settle on a product or service at a given point in time. This increases the need for sales and marketing effort to acquire the customer or client.

## VALUES AND E-CONSUMER BEHAVIOR

E-Consumer behavior models prior attitudes to predict e-loyalty in front values or another internal factors of customers.

Values are concepts or beliefs about a final desirable state. Values cross-specific situations guiding the selection and evaluation of events and behaviors ordering them through a hierarchical structure. In the operational definition of "values" we can distinguish three dimensions:

- An ethical dimension strategic or of preferential election: in this case the value is like a conviction or a stable belief in the time that a determinate way of behavior, or an existential purpose is personal or socially preferable to his opposite way of behavior or to his contrary existential purpose. The values can be understood like strategic learnings and relatively stable in the time that allow us act orienting us to achieve ours outputs.

- An economic dimension or cost: this dimension does reference near at hand of the significance or to the importance of a thing. When we are making decisions, values are reference guides that allow us regarding people, objects or ideas. In that sense they can be considered as internal decision criteria.
- A psychological dimension: understood as in which it defines it as: "a moral quality that moves to tackle big companies and to face without big fear dangers."

Beside these dimensions of this definition, it is possible to explain the fragmentation and subjectivity of a concept and sense and different uses across situations. Regarding cultural meanings, ethical, human, and morals, values are considered like general and categorical concepts that influence in individual behavior with regard to what results are desirable and not desirable in relation to surroundings and determinate people to consider besides beliefs prescribed on what is well or what is bad.

Researches puts of self-evident that values are the most important factor that conform the bases of a culture and affect to the training of attitudes, being considered, therefore, like a product of a culture and the base on which form individual values that drive people by the way to taking socially desirable decisions. Therefore, values are formed between people that live in a determinate generation and go transmitting them to other generations through a socialization process, being able to be considered like a concept umbrella that includes elements such as values, beliefs, and norms shared by a collectively useful for distinguishing a determinate group of people from another. Regarding meanings referred specifically to consumers, values would be consider like internal guides that head to the individuals in relation to purchase behavior like consumers.

## Values and Consumer Behavior

Studies of values in consumer behavior try to establish the relations between concrete attributes of products, abstract attributes and consequences, and consumer values. A second group of the studies about the values and behavior of consumer are those investigations that consider the values like an antecedent variable. These investigations try to explain how values influence thoughts and motivations, purchase behavior, or product elections, preferences, attitudes, or needs. Finally, the third kind of studies has been using values to segment markets or to develop advertising strategies.

## Personal Values and Consumer Behavior

During the last decade, the study of personal values has been an object of a large attention by part of researchers. They have been multiple the disciplines as well as the approaches that have stood out the importance of the values. From sociology, going through psychology and economy, personal values in a direct or indirect way had been present in numerous studies. According to there are two approaches to the study of values. The first approach treats to establish relations between the values and the consumer behavior. Like this, different authors have tried to relate values of the subject with consumption of products, motivations of purchase, retail election, choice of a certain kind of food, culture, or with consumer behavior in general.

The second approach studies values' influence on the behavior of consumption. The effect of the system of values in the process of decision of the consumer also has been very established in researches.

Personal values are principles that guide behaviors and that are strongly tied with motivations of individuals. The personal values and the perception of value would constitute the main managerial strength of the intention of purchase for products of luxury-especially in the Occident and in the east emergent markets. In accordance with, the strength of the personal value would root in the perception of utility in relation with the image and the symbolism in association or dissociation with cultural referents and demographic partner. In relation to the consumption and the personal values, there are two orientations that have been collected through the researches: the utilitarian orientation and the hedonic orientation.

The utilitarian orientation in consumption has been described like a tendency to emphasize the perception of functional value or his future provision. Traditionally, functional value has been considered the primary conductive strength in elections of consumers and the more easily adopted by consumers with traditional lifestyles. In this sense, consumers with utilitarian values tend to have simple lifestyles, considering the consumption like necessary for the survival but without any purpose of entertainment. Consistently, they tend to be more conscious of the value and have more positive perceptions of this value in relation to the price that they have to pay.

The hedonic term recognizes different behaviors in consumers basing them in mental criteria. Mental criteria include entertainment and appearances of excitement with the experience about the product and/or service. Entertainment reflects sensory dimensions (sight, hearing, taste, and touch) of a perceived experience. Sometimes these experiences cannot be reedited in back experiences. For example, customer experience generates directly emotional excitation, evoking emotions like pleasure, envy, fury, or anger. We can observe it when somebody goes to the restaurant and does value neither the price nor the quality of the foods, being for him or her more important, the decoration of the restaurant or the musical thread.

Study of the hedonic values initiates to finals of the 1970s from the investigation about consumer motivations and their relationship with products symbolism. Even so, it is not until years later that some studies recognize in the products the existence of symbolic values, going further to traditional utilitarian values. From here the acts of consumption are based not in what the consumers think that is real but in what they wish that it was. The election of a product or a mark bases frequently in the congruence of the lifestyle and the values of consumption, as well as the symbolic perception or the meaning of the product or of the mark. Like this, the consumers with strong hedonic values choose his products or the marks basing more in his symbolic or expressive values that in his functional values.

## Perceived Values and Consumer Behavior

Perceived values are an imperative strategy for organizations giving to customers an upper input about organizations and adopting an important paper in all activities of marketing of business success. In the actuality comes accepting the idea that successful companies do not deliver products in return of a gain but rather value in return of utility. The value perceived is defined like the result of the comparison by part of the consumer of the profits perceived and the sacrifices made. According to this definition, we are faced with a concept of subjective nature characterized by a certain ambiguity. This fact prevents a uniform interpretation according to the term. Certain confusion in the term "perceived values" creates difficulties to compare distinct empirical studies and inconsistency in the procedures of measurement of the value perceived. In this way there is consensus regarding the multidimensional of the concept of value accepting the existence of several factors that should explain and measure the value perceived.

Perceived value is therefore a subjective construct in several senses: it varies between customers, between cultures, and in different temporary situations. This last assessment conceives the perceived value like a dynamic factor that consumer experiences before the purchase, in the moment of the purchase, in the moment of his use, and after his use. For each one of these moments, the assessment made is different. Of this form, in the moment of the purchase, the attributes of the product and the price are determinants, whereas during the use and after the same, the consequences and results obtained are the most valued elements by the customer. Therefore, to understand the process by which determinate values can generate the loyalty in the consumers, it will be necessary to define more clearly their perceived value.

## Perceived Values, Preferences and Intentions of Purchase

The existing researche signals a perceived value like an indicator of the intention of purchase relating it besides with the attitude, the preferences, the purchase behavior, and the loyalty. That is to say, the buyer wishes the function or the service that the product is susceptible to loan and not the product in himself the same. The training of preferences conceives perceived value like a development of affective states that correspond with the results of evaluation and ordination of alternatives about the available purchase made only in function of his qualities and without any consideration of costs and sacrifices associated. We speak as of a process of evaluation that takes place in absence of restrictions of cost and budgetary, as if of free and free products treated. However, against profits that can contribute the product, all consumers have to bear a cost. The cost is not only economic, it also includes the time of research and the risks associated to the on-line purchase for the e-consumer. Hence the cost is one of the measures with which the consumer evaluates the sum of the profits and the satisfaction associated that expects to obtain from the purchase and the consumption of the product. From this point of view, the price is not but what the consumer offers or is had to offer in return of the quality that is received or trusts to receive. The consumer estimates the expectations and the degree of profit or the advantages that expects to receive in shape of reward when purchasing a product/service from the efforts and sacrifices that necessarily will have to make when he is choosing a product/service. Perceived value affects the purchase intention of clients. This is a result between the perceived quality of the product and the corresponding sacrifice associated with obtaining it. It coincides with what usually knows like the relation of quality/price between what is expected to be received–quality and what in return is necessary to give–price. From all of the above, we can conclude that the purchase intention is the result of an evaluation process in terms of costs and benefits. From here, unlike what occurs with the preferences, the intentions of purchase reveal like predictors reasonable in the final behavior of consumer.

## Perceived Values and Attitudes in Behavior of Purchase and Loyalty

The concept of attitude refers to the learnt predisposition to answer in a consistent form to an object favorable or not favorable. According to the theory of reasoned action, the attitude of the consumer influences on the behavior of the purchase of the same. According to this theory, behavior is determined by intentions and influenced by attitudes and subjective norms. The relation between attitude and behavior intentions has been widely examined and supported empirically. Since the attitudes are learnt, these seem affected by the information and the experiences. The value perceived can influence the attitude of the customer. At the same time, perceived value is important because of the influences in the confidence of consumer.

The existing research about how values influence behavior to go shopping and the preferences is not very common. There are not too many empirical studies that demonstrate the relationship between the values and the intention of purchases or the buying behavior.

## Values and E-consumer Behavior

### Values Online

Investigations around values online have prospered at the same time that purchase online has been common. New ways of investigation have opened from the instant that the retailers did not comprise the reasons about why customers used this channel, how it is used, and the requests that were necessary for his use. Keeney creates a series of objective and specific categories like influence factors in the intention of purchase in the Internet. Besides, it gave a definition of value associated to the trade in the Internet like "the value of the network in terms of profits and costs of both in relation to a product and his processes of research, request, and reception of the same." In accordance with, the value online present in the activities that offers the Internet should be generated into the following process: research, evaluation, solution of the problem, and transaction. From here that for the companies that operate through the Internet, the value was one of the key elements since it offers a competitive advantage to the companies that develop his organizational activities orienting them and focusing to his customers, across perceived value a key to generate to consumer satisfaction and loyalty. In e-commerce, perceived values affect the intention to adopt the channel of purchase as well as the attitude to use it and in the intention of repurchase online.

Pahnila and Warsta had proposed a model of consumer behavior online where hedonic and utilitarian values were antecedents of purchase behavior prioritizing values in front of the attitudes and focusing their efforts in analyzing purchase behavior online. Besides the exploration of the paper of perceived values and consumer behavior in relation of e-commerce, they propose a structural model in which they hypothesize that utilitarian and hedonic values have a direct impact on the affections of e-consumers and acting like an indirect way on the behaviors of purchase in the virtual surroundings. On the other hand, they analyze the importance of the habit in e-consumers behavior relating it to his time with e-commerce. The results obtained by these authors confirm the incidence in an indirect way of hedonic and utilitarian values in affections and indirectly on the behavior in relation to the e-commerce.

In a virtual purchase, proposes two dimensions of value: like an achieve component (profits that buyer obtains of the offer to the seller) and like a concede component (monetary costs and not monetary costs in which it incurs in the acquisition of the offer). In this sense, the importance of perceived value in the electronic business comes from, between other causes, the ease that offers to the consumer to compare the characteristics of products and/or services online in relation to his prices. When the perceived value is low, the customers will bend for changing to companies and will weaken his loyalty. In other words, the customers satisfied will not be faithful to a virtual establishment if they feel that they are not obtaining the greater value perceived. Approach of is predominantly economic. The economic approach is the first identified approach in brand management, and several authors pointed out that the elements of the economic approach serve as a prerequisite for most planning and execution of brand management still today. Nevertheless, this approximation does not consider neither the influence that can have the individual characteristics in the perceptive process that the consumer carries out when he interacts with the virtual surroundings from their personal values. The impulsive purchase results to be a product of wishes, longings, and motivations in the unconscious level of the consumer being and conditioned by the relation of surroundings and his individual characteristics.

## Predict Models of Consumer Behavior and Values Online

Multiple predict models about values online show the incidence of utilitarian and hedonic values in a positive affection about e-shop and on e-loyalty and the experience of purchase in e-shops or their relationship with fashion marks. Hedonic and utilitarian values have been studied as market segmentation criteria, as a background of consumer satisfaction and as influencing factors in the purchase intention in the online store. Also it has verified their empirical relation with certain dimensions of the online store, with the catalogue of products, with the intention of being sponsoring, with the adoption of devices of virtual purchase, with the antecedents of the attitude and the wish of purchase to the on-line retail trade, with the use of Internet as a shopping channel, and with preferences of customer about shopping online. Likewise, it has linked to the hedonic personal values and utilitarian personal values with factors like flow online with intention about the use of electronic devices with the gender and the perception of utility and with the perception of profits to buy in virtual shops.

Based on the theoretical foundation some of postulates present in the cognitive theories of social psychology (theories of the attribution, theory of the cognitive dissonance and theory of the expectation-value), it is possible to assume that the e-loyalty to a determinate online shop depends of the degree of adjust/unfit between personal values of consumer and organizational values perceived in the on-line shop where the consumer develops his behaviors of purchase. In this way e-loyalty can be affected in a positive or negative way in function of the degree of conflict or the existence of congruence between organizational values perceived by the consumer in the e-shop and his own personal values in each experience of purchase online. A higher degree of congruence between personal values and organizational values perceived by the consumer in e-shop can be considered by e-buyers like as a positive result to repeat their e-purchases in a certain online store. This positive result increased the probability that in the future the consumer buys another time in the same e-shop. In this regard, congruence and/or conflict between organizational values perceived and personal values could be produced during any one of the three phases that constitute purchase process (research of information, purchase, and post-purchase process) and always from the relations of interaction generated between subject and the organization in the e-shop. The apparition of relations of conflict between personal values and organizational values perceived, understanding in this case the conflict like the degree of incongruence generated in the interactive way between personal values and the perceived values across the mark in the e-shop, would affect in a negative way to the intention of purchase as to the purchase, without offering possibilities to develop any type of loyalty to a determinate business B2C by two components: like a future preferential election of the e-shop and like a repetition of purchase.

Morales, in his predicted model of e-loyalty, found a clear differentiation between categories of utilitarian and hedonic values and a strong Pearson correlation index between utilitarian personal values and utilitarian organizational values and a weak Pearson correlation index between personal hedonic values and organizational hedonic values. Results confirm, in accordance with the existent researches, the coexistence of two types of personal values (utilitarian and hedonic) when the consumers develop their behaviors of on-line purchase. The results obtained confirm the relationship between personal values and organizational values and the relationship between personal values and some dimensions of store online like virtual design, product assortment, after-sales service and virtual store information.

# IMPLICATIONS OF CONSUMER BEHAVIOR IN MARKETING

Though similar, consumers are unique in themselves; they have needs and wants which are varied and diverse from one another; and they have different consumption patterns and consumption behavior. The marketer helps satisfy these needs and wants through product and service offerings. For a firm to survive, compete and grow, it is essential that the marketer identifies these needs and wants, and provides product offerings more effectively and efficiently than other competitors. A comprehensive yet meticulous knowledge of consumers and their consumption behavior is essential for a firm to succeed. Herein, lies the essence of Consumer Behavior, an interdisciplinary subject, that emerged as a separate field of study in the 1960s.

Consumer behavior may be defined as "the interplay of forces that takes place during a consumption process, within a consumers' self and his environment:

- This interaction takes place between three elements viz. knowledge, affect and behaviour.
- It continues through pre-purchase activity to the post purchase experience.
- It includes the stages of evaluating, acquiring, using and disposing of goods and services.

The "consumer" includes both personal consumers and business/industrial/organizational consumers. Consumer behavior explains the reasons and logic that underlie purchasing decisions and consumption patterns; it explains the processes through which buyers make decisions. The study includes within its purview, the interplay between cognition, affect and behavior that goes on within a consumer during the consumption process: selecting, using and disposing off goods and services.

## Characteristics of Consumer Behavior

- The subject deals with issues related to cognition, affect and behavior in consumption behaviors, against the backdrop of individual and environmental determinants. The individual determinants pertain to an individual's internal self and include psychological components like personal motivation and involvement, perception, learning and memory, attitudes, self-concept and personality, and, decision making. The environmental determinants pertain to external influences surrounding an individual and include sociological, anthropological and economic components like the family, social groups, reference groups, social class, culture, sub-culture, cross-culture, and national and regional influences.

- The subject can be studied at micro or macro levels depending upon whether it is analyzed at the individual level or at the group level.
- The subject is interdisciplinary. It has borrowed heavily from psychology (the study of the individual: individual determinants in buying behavior), sociology (the study of groups: group dynamics in buying behavior), social psychology (the study of how an individual operates in group/groups and its effects on buying behavior), anthropology (the influence of society on the individual: cultural and cross-cultural issues in buying behavior), and economics (income and purchasing power).
- Consumer behavior is dynamic and interacting in nature. The three components of cognition, affect and behavior of individuals alone or in groups keeps on changing; so does the environment. There is a continuous interplay or interaction between the three components themselves and with the environment. This impacts consumption pattern and behavior and it keeps on evolving and it is highly dynamic.
- Consumer behavior involves the process of exchange between the buyer and the seller, mutually beneficial for both.

## Phases of Consumer Decision Process

## Problem Recognition

Information Search The ecological attributes of a product plays important role in choosing the product. The consumer here will pass from the two situation "Firstly Sustainability Needs" it's required by a consumer likes or not and secondly "the environment" lower in importance but influence on the consumer change the customer behavior and it takes time to diffuse in the marketing. For this type of degree on innovation, firms usually introduce a different manufacturing process, product or service that attains environmental sustainability the consumer decision process model starts with the problem recognition what are the needs and satisfaction process.

## Purchasing Process

This phase focuses on the two aspects:

- Purchase patterns, it include where to buy (Location) quantity to buy, and when to buy (timing).
- Outcome, the final outcome of the action.

## Avoiding Dissonance

Fuller describes when the purchase is less than satisfactory for whatever reasons, it creates a state of tension called post purchase dissonance. Post purchase dissonance is basically an after purchase cognitive behavior. Kreidler, and Joseph explained that people react in two different ways toward environment, "Approach and Avoidance behavior". In approach behavior people shows positive behaviors to stay, keep searching for the product, power to spend money and look into particular environment. On the other side Avoidance includes negative behavior is attached, exhibiting to leave from a particular situation.

## Research Tools and Techniques

In case of primary data, the major tools and techniques are surveys (questionnaires and interviews), focus groups, observation, behavioral measures and experiments. These methods would use questionnaires, which may be structured or unstructured.

## Survey Research

Surveys are the most popular of all techniques for data collection as far as the field of marketing is concerned. They are conducted over a sample to learn about customers' awareness, liking and preferences for an offering or a brand. They may also be undertaken to measure customer satisfaction. The findings from such surveys are then generalized to the entire population (in our case, the market). Hence, the sample should be chosen with care; it should be adequate, appropriate and representative. The sample may be chosen randomly or purposively. The major instrument used for surveys is through administration of the questionnaire; interview technique may also be used. The questions framed may be structured and formatted or may even be unstructured. They may be open-ended, closed ended, dichotomous, multiple choice, rating scales, ranking scales etc. Questionnaires may be administered personally or by postal mail, electronic mail or even on telephone. Surveys are used in quantitative research.

Example: Conducting a survey to test customer awareness and reaction about a new advertisement campaign.

## Focus Group Research

As the name suggest, this kind of research is conducted over a group of people through a moderator. The moderator focuses on the group of people, numbering 6-10, who are carefully selected purposively based on demographic, psychographic and/or behavioral considerations. The group members are asked questions about a product and the 4 Ps and they are even involved in discussions related to the research problem/issue. Through discussions, the moderator is able to gain insight into the group members' emotions and feelings, attitudes, underlying motivations and interests etc. These sessions are recorded for further analysis. The technique is used commonly during pre-testing of product in the market before it is launched; provides insight into product acceptance in the market. Focus group research is used in qualitative research.

Example: Why do customers prefer a higher priced branded electronic good as compared to a lower priced local one?

## Observational Research

As the name suggests, this research technique is based on observing people, and drawing conclusions. The technique helps gain an insight and an in-depth understanding as to how peoplebehave in the marketplace by carefully watching them buying and use products and services. These customers could be current customers or potential customers; they are observed in the marketplace while they are involved in the buying activity. The consumption pattern is observed. The technique could also be applied to test customer verbal and non-verbal reactions to product offerings (features and benefits, quality, aesthetics etc), price (increase/decrease, discounts and allowances exchange, warranties and guarantees), distribution (stores, layout, ambience, attitude of staff etc) an, promotion (advertising, sales promotion etc). The observations may be overtly or cohertly; in the case of overt observations, the participant is aware of the objectives of the study and knows that he is being observed; in the case of cohert observations, the person is unaware that he is being observed and that his actions are being recorded by the researcher personally or through hidden cameras and recorders (mechanical and electronic devices: videos, closed circuit TVs; technological devices: credit cards, shopping cards, online shopping and automated phone systems).

## Behavioral Measures

The customer reactions in terms of their behavior are interpreted through customer databases and the store scanning data. Customers' actual responses in terms of "purchase" are recorded and analyzed; the assumption is that there is a difference between customer's intention to buy and actual purchase. So actual behavior is recorded and analyzed. This is regarded as more reliable than questionnaire surveys and is used in both quantitative and qualitative research. Experimental Research: This type of research technique is the most time consuming, but most scientifically valid and reliable approach towards conducting research studies and solving problems. It studies the cause-and-effect relationships between independent (cause) and dependent (effect) variables; the researcher alters/manipulates one or more variables, and controls and measures any change in other variables. In controlled settings, where the sample is treated as a test group, the variables under study are altered/manipulated and the reactions of the sample are recorded; thereafter these findings are generalized. This i used in quantitative research. The technique is commonly used in test marketing for pre-testing of the product before launch.

## Consumer Communication

Communication is defined as the flow of information from a sender to a receiver with the latter having a proper understanding of it. Marketing communication or consumer communication may be defined as the flow of information about a product/service offering from a marketer to the consumer.

This could assume two forms:

- Personal: Interpersonal communication between the marketer and the salesperson or dealer.
- Impersonal: By using channel or a media (print, audio-visual etc).

Initial Customer Communications Management concepts were focused upon the utilisation of company transactional documents. These documents such as bank-statement, statement of account, invoices and other customer transactional documents were viewed as ideal media to promote company products to customers.

But Customer Communications Management is not just about making offers to customers. It also provides companies with the opportunity to improve the clarity of their communications. Rather than producing line driven data in which it is difficult for a customer to extrapolate trends and a deepening of understanding in respect of his or her relationship with the supplying company, Customer Communications Management provides the opportunity for a company to deliver visual analysis through clear graphics and highlighted content.

Consumer communication should be used effectively to drive maximum benefits to the company. You must be thinking how. Few ways which will help you market effectively even in a downturn:

- When economy is changing, it is all the more important to get the customer feedback. It is not a good idea to fill their inboxes and mobiles with promotional messages. More so, you can use online surveys to understand how they are thinking and what they want. You can then make changes in your strategies, processes and so on to deliver the product that your consumers are aiming for.

- It is just not important to feed information to your consumers. Having a dialogue with them from time to time is also important. You can use the email marketing newsletters to invite them for such conversations. Apart from understanding their concerns, showing your consumers that you care is also very important. This will have far-reaching consequence and will benefit your company's image.
- Try and co-host an event with another local business. This will highlight your product's image in a positive manner. This is a kind of customer relationship building activity where you interact face-to-face with the consumer and show him your expertise.
- Consumers are becoming more and more environmentally aware these days. Anything against the environment would put you in a bad light. So focus that your product or service is following all the environment friendly standards. You can also show your concern by teaming up with local charity and involving your consumers in the event too.

## Consumer Attitude

An individual with a positive attitude towards a product/service offering is more likely to make a purchase; this makes the study of consumer attitudes highly important for a marketer. An attitude may be defined as a feeling of favorableness or unfavorableness that an individual has towards an object (be it a person, thing or situation). It is a learned predisposition to exhibit and act based on evaluation resulting in a feeling of like or dislike towards and object. In terms of consumer behavior, consumer attitudes may be defined as an inner feeling of favorableness or unfavor ableness towards a product or service offering and the 4Ps. As Schiffman has defined, "Attitudes are an expression of inner feelings that reflect whether a person is favorably or unfavorably predisposed to some "object" (e.g., a brand, a service, or a retail establishment)," and "Attitude formation, in turn, is the process by which individuals form feelings or opinions toward other people, products, ideas, activities, and other objects in their environment".

## Nature of Attitudes

Consumer attitude can be better explained by understanding the nature and characteristics of attitude. Attitudes are composed of three components, viz, knowledge or cognitive component, a feeling and affect component and a behavioral and conative component. In terms of consumer learning, the attitude would express a consumer's feeling of like or dislike about a product or service offering and the marketing mix. The knowledge component is reflected in the learned knowledge that a consumer obtains from his interaction with others as well as his own experiences. The feeling component is reflected in his evaluation, and the resultant feeling of favorableness and unfavorableness. The behavioral component is reflected in the predisposition to act (purchase) based on the evaluation. Based on this explanation, the nature of attitudes can be elaborated as follows:

- Attitudes are directed towards an object (product/service offering, price, store, dealer, promotion, advertisement etc.) about which a consumer has feelings and beliefs.

- Attitudes have a direction; they could be positive or negative. A consumer could possess feelings of like/dislike, favorableness and unfavorableness towards a product or service as well as the mix. They vary in degrees and intensity, and can fall anywhere along a continuum from very favorable to very unfavorable.

- Attitudes are consistent in nature, particularly with respect to the third component, i.e. behavior. Consumers are consistent with respect to their behavior. However, they are not entirely permanent and may change if the cognitive or the component is changed. This implies that if the consumer witnesses new experience or is exposed to new information about product/service offering and the mix (cognition), and) feelings are changed from dislike to like (affect), attitudes towards the offering and the mix can undergo change. In other words, while attitudes are stable and do not change frequently, they can be changed if something is done to change them.

- Attitudes are a learned predisposition. Attitudes are learned; they are formed as a result of i) self experiences with the product/service offering and the mix; ii) interaction with other people, be it family, friends, peers and colleagues; iii) information obtained from the marketer through promotion particularly advertisements as well as dealers and salespeople. Attitude formation as a process is impacted by needs and motivation, perception as well as learning.

- Attitudes cannot be observed directly. While attitudes are comprised of three components, behavior is just one of them. It is only this component that can be seen; the cognitive and affect components cannot be seen. Thus it is said that attitudes cannot be seen; they can only be inferred from the manner in which an individual behaves. Thus, we can infer that a person who buys Colgate Total toothpaste and disregards Pepsodent has a positive attitude towards Colgate.

- While attitudes can be inferred from our behavior, it is not synonymous to behavior. It has two other components, and reflects a learned predisposition to act favorable or unfavorably towards a product and service offering and the mix.

- Attitudes are situation specific; they occur within a situation. Sometimes depending upon the situation, a consumer may exhibit a behavior that may be inconsistent with his/her attitude. He may prefer to buy Pepsodent over Colgate because the former is on a sales promotion and gets him a free toothbrush.

## Attitudes and Implications for Marketers

Consumer attitude has implications for a marketer. An individual with a positive attitude towards a product/service offering is more likely to make a purchase; this makes the study of consumer attitudes highly important for a marketer. Marketer should understand the dynamics of attitude formation and change.

- Consumer attitudes are reflective of consistent favorable or unfavorable feelings that a consumer or a prospect forms as a result of an evaluation about an object; the object being, a product/service offering, brand, price, store and dealer, salesperson, advertisement, promotion etc. They are directed towards an object (product/service offering, price, store, dealer, promotion, advertisement etc.) about which a consumer has feelings and beliefs.
- They cannot be observed; they can only be inferred from what people say or what they do and how they behave.
- Consumer attitudes are formed on the basis of experiences as well as information received from personal (WOM, family, friends, peers etc.) as well as impersonal (marketer's sources) sources of information that are retained in one's memory. Marketer should be careful while providing relevant information.
- Attitude formation as a process is impacted by needs and motivation, perception as well as learning. They are formed as a result of learning that occurs because of:
    - Self experiences with the product/service offering and the mix.
    - Interaction with other people, be it family, friends, peers and colleagues.
    - Information obtained from the marketer through promotion particularly advertisements as well as dealers and salespeople.
- Consumers form positive attitudes towards product/service offerings because:
    - They provide a utility.
    - Help defend their ego, self-image and self-concept.
    - Expresses a person's values and lifestyle, personality and self image.
    - Reaffirm their knowledge base, to finally help them simplify purchase decision making.
- A consumer may exhibit a behavior that may be inconsistent with their attitude. For example, a consumer may have a neutral feeling or may be indifferent with a brand, but he would go in for a purchase as he gets a good bargain (a concession or a discount etc). Attitudes are situation specific.

- Marketers should understand the formation of attitudes, as well as their change, so as to be able to predict acts of behavior, and influence them.
- While attitudes are stable and do not change frequently, they can be changed if something is done to change them. Marketers should understand the dynamics of attitude formation and change, and make attempts to transform neutral or unfavorable attitudes into favorable ones.
- Consumer's attitudes towards a product/service offering or a brand, is a function of the presence or absence of certain attributes, and the corresponding evaluation. Consumers would tend to have favorable attitudes toward such offerings and/or brands that they have sufficient amount of attributes that are deemed important and evaluated as positive.
- A consumer may have positive feelings towards an attitude object, but he may have a negative attitude regarding his intention for buying such a product/service offering. Thus, a positive attitude towards the offering may not necessarily end upas an act of purchase.
- The behavior of a consumer is based on his intention to act, which is moderated by the attitude towards behavior and other subjective norms. Intention precedes actual behavior; beliefs and attitudes as well as subjective norms precede intention.
- Consumer's attempts at purchase and consumption, get impeded by personal and environmental impediments, thus preventing the action (act of purchase) from occurring.
- Consumers form judgments and feelings as a result of exposure to an advertisement. Not only does a consumer form attitudes towards the advertisement, he or she also forms an opinion towards the brand. Thus marketers need to be careful while formulating ads especially for innovative products and services and for new brands.
- Attitudes can be measured by observation, qualitative studies (focus group, depth interviews, psychological tests) and quantitative techniques (or rating scales).

## STEREOTYPES IN CONSUMER BEHAVIOR

Consumer stereotyping is a process of creation of generalizations about consumption objects of members from a particular social category.

This definition is based on the well-established idea that people connect ownership of certain products with membership in a certain social group. The key determinant to know more about consumption is a self-identity, the symbolic meaning of goods and the role played by brands.

Stereotypes say about a fixed form or convention and also about something missing in individuality or originality. Human brain proceed the informations and then stores them in the memory, but there is a huge amount of informations it collects, that it is inavoidably to sort and then categorize them. Stereotypes are when people are using couple of characteristics and impressions, that they can identify and perceive a group of individual components to put into a certain main category, to understand more easily their social environment. Stereotypes provide their holders with scripts, specifying how to interact with members of specific social groups (e.g., what products to choose or avoid and how certain actions may be interpreted). Knowledge about consumer stereotypes helps people with exploiting past experiences and social learning to conclude the specific characteristics and behaviors of individual group members.

Consumers often engage in shared consumption in order to become acquainted with and learn more about each other. Consumers very often are using stereotypes to help in forming their choices. The types of impressions consumers wish to create and the products they choose will be shaped by interpersonal goals, characteristics of the consumption partner, and the ability to effectively convey desired impressions.

Stereotypes allow people to infer the preferences of others in a wide variety of consumption domains. Consumer research in the social identity domain has shown that it is often the case that specific products are closely tied to certain social groups.

For example, Star Wars is considered masculine while Bridget Jones is considered feminine.

Because stereotypes are such rich knowledge structures, simply knowing someone's group membership provides a guide for inferring his or her consumption preferences across a wide range of domains. For example, by knowing that one's consumption partner is male, an individual may assume that he enjoys Star Wars, beer, car magazines, and sporting events. Armed with this knowledge, a consumer can convey a considerate and friendly image by tailoring his or her product choices to serve the preferences of the consumption partner.

The main goal of cross-national comparisons of purchase and consumer behaviour is to show similarities and differences between countries because results of researches in many cases just confirm already existing stereotypes. This is very useful for marketing departments in many companies, which are usually more interested in findings similar features to define marketing strategy for each country.

Also, consumers use stereotypes as a resource to help inform their choices, because stereotypes are socially shared and provide information about social groups based on easily identified qualities (e.g. race, gender), they may prove useful in inferring the preferences and anticipating the behavior of one's consumption partner.

## Classification of Images of the Consumer Behavior

The development of this category applies to both research and business areas (e.g. consumer protection), but also the importance of performing specific roles of consumer society (identification of individuals with the people that play similar roles) for the transformation of the social structure (e.g. New forms social life, such as IKEA-family).

Consumers are depicted in a number of ways. Aldridge made a classification of images of consumers, which refers to the social construction of consumers in Western discourse about their consumption behaviours. The classification includes four different images of consumers: the rational actor, communicator, victim and dupe:

- Rational actor (man choosing).
- The sender of a message.
- Victim (cheated when making choices).
- Naive (believer that achieves their goals, targets meanwhile, pursues the objectives of others).

Another proposal for the classification of consumer identity presented by R. Sassatelli:

- Unlimited ruler (sovereign).
- Entrepreneur.
- Snob.
- A follower (imitator).
- A slave.
- Collector.
- Flâneur.
- The rebel.

## Impact of Media in Creating Stereotypes

The media often uses and misrepresents stereotypes; however, they are significantly accepted by people among society. The most common way of showing stereotypes is through TV commercials or TV shows. If we consider TV commercials, we can easily understand that in the biggest part of commercials which are advertising domestic products main actors are women. Women are used in this type of commercials because they are considered the ones who make main decisions in purchasing domestic products. On the other hand, in commercials advertising beers or car, main actors are men. Following these examples, it can be understood that a stereotype can be made just through use of gender roles in commercials. There is also a possibility of creating stereotypes through TV shows. TV shows such as the Simpsons are packed with stereotypes within its broadcast of half an hour. The Simpsons contains a large number of audience that watch the show daily as it is broadcast during prime time. Characters such as Apu are highly discriminated and stereotyped. On this show Apu is characterized as an Indian immigrant, who prays to Ganesh, and holds a highly noticeable and dissimilar accent. This is a stereotype which is observed by young children and is perceived as humorous; they apply this knowledge towards those they meet in real-life. Viewers of this show believe this information to be completely accurate for they hold little or no knowledge about that particular group. Though the stereotypes shown on TV are usually misrepresented, they are quite well accepted by the audience as the truth. Media grabs the interests of their audience through comedy, drama, and action which causes the viewers to disregard the immorality behind the content.

## Impression Management, Stereotypes and Joint Consumption

Consumers often engage in shared consumption in order to become acquainted with and learn more about each other. For example, new friends may go see a movie together to socialize or a salesperson may take a new client to dinner to learn about the client's needs. Whether the purpose is to make new friends or bring in new business, consumers often engage in joint consumption to forge new relationships with others. In these types of situations, the impressions people convey early in the relationship are important. Though new information is gained as interactions continue, additional information that contradicts the initial impression tends to be overlooked. Given the importance of creating a pleasant consumption experience in the early stages of a relationship, the products consumers choose for joint consumption are quite important and have the potential to make or break a budding relationship.

When consumers are just beginning to get to know each other, they have very little information regarding their consumption partner's preferences and expectations for the interaction. Consumers use stereotypes as a resource to help inform their choices because stereotypes are socially shared and provide information about social groups based on easily identified qualities (e.g., race, gender), they may prove useful in inferring the preferences and anticipating the behavior of one's consumption partner.

When consumers wish to create a relationship with their consumption partners but have little information about them, they will rely on stereotypes to anticipate their consumption partner's responses. Furthermore, the types of impressions consumers wish to create and the products they choose will be shaped by interpersonal goals, characteristics of the consumption partner, and the ability to effectively convey desired impressions.

# ONLINE SHOPPER BEHAVIOR

The internet has played a significant role in our daily life in that people can talk through the internet to one who is actually on the other side of the Earth, can send email around the clock, can search information, can play game with others, and even can buy things online. Meanwhile, Internet shopping has been widely accepted as a way of purchasing products and services It has become a more popular means in the Internet world. It also provides consumer more information and choices to compare product and price, more choice, convenience, easier to find anything online. Online shopping has been shown to provide more satisfaction to modern consumers seeking convenience and speed. On the other hand, some consumers still feel uncomfortable to buy online. Lack of trust, for instance, seems to be the major reason that impedes consumers to buy online. Also, consumers may have a need to exam and feel the products and to meet friends and get some more comments about the products before purchasing. Such factors may have negative influence on consumer decision to shop online.

## Offline and Online Consumer Decision-making Process

The process of making decision are very similar whether the consumer is offline or online. But one some major differences are shopping environment and marketing communication. According to traditional consumer decision model, Consumer purchase decision typically starts with need awareness, then information search, alternative evaluations, deciding to purchase and finally, post-purchasing behavior.

In terms of online communication, when customers see banner ads or online promotion, these advertisements may attract customers' attention and stimulate their interesting particular products. Before they decide to purchase, they will need additional information to help them out. If they do not have enough information, they will search through online channels, e.g., online catalogs, websites, or search engines. When customers have enough information, they will need to compare those choices of products or services. In the search stage, they might look for the product reviews or customer comments. They will find out which brand or company offers them the best fit to their expectation. During this stage, well-organized web site structure and the attractive design are important things to persuade consumers to be interested in buying product and service. Moreover, the information sources' nature may influence buyer behavior. The most useful characteristic of internet is that it supports the pre-purchase stage as it helps customers compare different options. During the purchasing stage, product assortment, sale services and information quality seem to be the most important point to help consumers decide what product they should select, or what seller they should buy from. Post-purchase behavior will become more important after their online purchase. Consumers sometimes have a problem or concern about the product, or they might want to change or return the product that they have bought. Thus, return and exchange services become more important at this stage.

All five stages are affected by external factors of risks and trusts. The search process is a significant component of customer's online shopping behavior. The source risk comes in the stage of information search and evaluation because the information in the web sites might contain some mistakes. Some websites require customers to register before searching their website. As such, in addition to product risk, consumers also face the risk of information security. Because of the nature of online purchasing, customers take the risk as they are not able to examine the product before purchasing. They also take the risk in the payment process because they may need to provide personal information including their credit card number. Security problem does not stop at the purchase stage but continues to the post-purchase stage because their personal information might be misused.

A framework that compares online consumer decision with offline decision making was developed by Laudon and Traver, who suggest that a general consumer behavior framework requires some modification to take into account new factors.

When consumers want to buy product, they will look at the brand and the characteristics of product or service. Some products can be purchased and shipped easily online such as, software, books. On the other hand, some products are hard to decide through online channel. Web site features, firm capabilities, marketing communication stimuli, and consumer skills are also important, in terms of the proposed framework. When consumers want to buy product, they will look at the brand and the characteristics of product or service. Some products can be purchased and shipped easily online such as, software, books. On the other hand, some products are hard to decide through online channel. Web Site feature is one of the important things that can influence consumers to buy product online. For example, online retailers can use high technology to improve their websites in order to influence consumer perceptions of the web environment. If the web site is too slow, not navigability, or not safe enough, will have negatively impact consumer willingness to try or buy products from the website. Consumer experience with online shopping or consumer skills, which refer to the knowledge that consumers have about product, and how online shopping works also influences online shopping behaviors. Clickstream behavior is another aspect that becomes more important in the online world. It refers to the behavior that consumers search for information through web sites many sites in the same time, then to a single site, then to a single page, and finally to a decision to purchase. All these factors lead to specific attitudes and behaviors about online purchasing and a sense that they can control their purchasing environment thru the online world.

## Influences of Online Shopping Decision

## Motivations that Lead Consumer to Buy Online

There are many reasons why people shop online. For examples, consumers can buy anything at any time without going to the store; they can find the same product at a lower price by comparing different websites at the same time; they sometime want to avoid pressure when having a face-to-face interaction with salespeople; they can avoid in store traffic jam, etc. These factors can be summarized into four categories—convenience, information, available products and services, and cost and time efficiency.

Convenience: Empirical research shows that convenient of the internet is one of the impacts on consumers' willingness to buy online. Online shopping is available for customers around the clock comparing to traditional store as it is open 24 hours a day, 7 days a week. Research shows that 58 percent chose to shop online because they could shop after-hours, when the traditional stores are closed and 61 percent of the respondents selected to shop online because they want to avoid crowds and wailing lines, especially in holiday shopping. Consumers not only look for products, but also for online services. Some companies have online customer services available 24 hours. Therefore, even after business hours, customers can ask questions; get necessary support or assistance, which has provided convenience to consumers.

Some customers use online channels just to escape from face-to-face interaction with salesperson because they pressure or uncomfortable when dealing with salespeople and do not want to be manipulated and controlled in the marketplace. This is especially true for those customers who may have had negative experience with the salesperson, or they just want to be free and make decision by themselves without salespersons' presence.

Information: The internet has made the data accessing easier. Given customers rarely have a chance to touch and feel product and service online before they make decision, online sellers normally provide more product information that customers can use when making a purchase. Customers put the weight on the information that meets their information needs. In addition to get information from its website, consumers can also benefit from products' reviews by other customers. They can read those reviews before they make a decision.

Available products and services: E-commerce has made a transaction easier than it was and online stores offer consumers benefits by providing more variety of products and services that they can choose from. Consumers can find all kinds of products which might be available only online from all over the world. Most companies have their own websites to offer products or services online, no matter whether they already have their front store or not. Many traditional retailers sells certain products only available online to reduce their retailing costs or to offer customers with more choices of sizes, colors, or features. Boccia Titanium, for instance, has stores in many states but not in Connecticut. The company offers website to reach and to fulfill the need of Connecticut customers to order online. Similarly, Yves Rocher, a French company, does not have the front store in the U.S. It offers the website so that U.S. customers can just add products they want into the online shopping cart and the product will be shipped to their house.

Moreover, online shopping sometimes offer good payment plans and options for customers. Customers can decide their payment date and amount in their own preference and convenience.

Cost and time efficiency: Because online shopping customers are often offered a better deal, they can get the same product as they buy at store at a lower price. Since online stores offer customers with variety of products and services. It gives customers more chances to compare price from different websites and find the products with lower prices than buying from local retailing stores. Some websites, Ebay for example, offer customers auction or best offer option, so they can make a good deal for their product. It also makes shopping a real game of chance and treasure hunt and makes shopping a fun and entertainment. Again, since online shopping can be anywhere and anytime, it make consumers' life easier because they do not have to stuck in the traffic, look for parking spot, wait in checkout lines or be in crowd in store. As such, customers often find shop from the website that is offering convenience can reduce their psychological costs.

## Factors that Impede Consumers from Online Shopping

Major reason that impede consumers from online shopping include unsecured payment, slow shipping, unwanted product, spam or virus, bothersome emails and technology problem. Business should be aware of such major problems which lead to dissatisfaction in online shopping.

Security: Since the payment modes in online shopping are most likely made with credit card, so customers sometime pay attention to seller's information in order to protect themselves. Customers tend to buy product and service from the seller who they trust, or brand that they are familiar with. Online trust is one of the most critical issues that affect the success or failure of online retailers. Security seems to be a big concern that prevents customers from shopping online. Because they worried that the online store will cheat them or misuse their personal information, especially their credit card. For instance, report indicated that 70 percent of US web users are seriously worried about their personal information, transaction security, and misuse of private consumer data.

Intangibility of online product: Some products are less likely to be purchased online because of the intangible nature of the online products. For example, customers are less likely to buy clothes through online channel because they have no chance to try or examine actual product. Customers viewing a product on computer screen can show a different effect than actually seeing it in the store. In sum, customers cannot see, hear, feel, touch, smell, or try the product that they want when using online channel. In many cases, customers prefer to examine the product first and then decide whether or not they want to buy. Some people think the product information provided in website is not enough to make a decision. Online shoppers will be disappointed if the product information does not meet their expectation.

Social contact: While some customers likely to be free from salesperson pressure, many online shopping would feel difficult to make a choice and thus get frustrated if there is no experienced salesperson's professional assistance. Moreover, some customers are highly socially connected and rely on other peoples' opinions when making purchase decision tend. There are also consumers who sometimes shop at traditional store because they want to fulfill their entertainment and social needs which are limited by online stores.

Dissatisfaction with online shopping: customers' past online shopping experience often affect their future purchase decision. In online shopping, for example, they may get unwanted product or low quality products, product does match what is described or expected. The product may be fragile, wrong, or not working. Some online sellers may not agree to refund those products even though it is not what the customer wanted. Delivery is another thing that affects online purchasing decision. Slow or late shipping, for instance, makes customer walk away from online shopping.

## Implications

### Managerial Implications

Online shopping is an important business model in e-commerce. If the online sellers want to persuade and retain online buyer, they need to know what the issues online buyers use to decide their online purchase. To better understand online customer shopping behavior, seller can improve or create the effective marketing program for their customer. There are couple ways that company or seller can do or should do to persuade those who do not shop online to become more interested, and, finally, to be a potential customer.

After looking at major motivations that lead customers to shop online, online sellers should keep those issues in mind and try to satisfy customer whenever possible. Also, understanding what make some customers hesitate to shop online, sellers should find ways to reduce those negative aspects in order to gain more customers by building trustable and securer website, attractive and useful website, offering online service, and offering additional option.

Trustable and Securer website: Consumer willingness to buy and patronize online store are affected by consumer's trust in giving personal information and security for payment through credit card transactions. They also concern about transaction security and data safety when purchase online. Getting approved certificate from an organization such as eTrust is one of the ways to make a website more trustable. By doing so, a website will be more secure and it will increase customer confidence and lead to sale increase. For example, Scribendi, English language editing and proofreading services, bought SSL Certificate from VeriSign—the most trusted mark on the internet; by then site visitors who saw the green address bar made the sale leapt by 27%. When the companies have this certificate, the address bar of their website will change to green color and the Web address will begin with https://; so customers know that the website is secure and trustable.

Another way seller can do to reduce customers' risk concern when purchasing online is to carry brand name product in the website or even have its own brand name such as Amazon. Holding and selling brand name product can improve the trust of the website. Brand name is one of the most important issues which affect customer's buying decision.

It is imperative for online companies to ensure customer that they will never use customers' information to other purposes by clarifying customer privacy policy. This will at least ease consumer concern about their identify security. Online stores may use integrated mechanism in order to build the trust in safeguarding consumer's personal information and avoidance of misuse of credit card mode of payments.

User Friendly Website: Customers can be influenced by the image of the web site when they decide what website or buyer they should buy from. Not only should companies create their secured website, but also should create it to be more attractive and more useful. Online stores can change a shopper into a buyer if the stores provide variety and useful information of product, good customer service, and easy-to-access website. Their websites should have enough information but should not be too overwhelming. Putting unstructured or useless information in the website can reduce internet usefulness and ease of use. Also, companies and sellers should double-check any single words in their website to reduce mistakes and customers' misunderstanding. Information quality and visual design is important effect on repurchasing. The willingness to purchase online will be low if the online store lacks of ease in searching and comparing shopping, and product updates. Online store should make their website to be easy for consumers to search product and service. Making web designs and portals novel and sophisticated and web atmospherics friendly is a key to attract visitors. Moreover, if online stores want to convert visitor into buyer, they should improve their website by offering customer a comfortable, logical, interesting and hassle-free process and easy language by creating fast website with functional design as smooth as possible. Online payment process is another issue that should be taken care of because it affects the willingness to pay. Online stores should make their payment process to be as easy and secure as possible. To sum, if online stores want to increase the customer, they should take care of their website design to be more user-friendly.

Online Service: Customer service is as important as quality of website. According to Hermes, 72 percent of online consumers revealed that customer service is a major factor in online shopping satisfaction. If the customer service is not available or reachable, customers will perceive that companies are trying to hide something or not intending to solve their problems. Online stores should provide the added-value of service to customers and have customer feedback channel in their website. There should be interactivity customer service in the website, so that customers can contact with the seller anywhere and anytime. Software downloading, e-form inquiry, order status tracking, customer comment, and feedback are some of example that online sellers can use to fulfill their online service.

Additional option: Because customers are not able to touch or try products before they buy, online store should offer them some additional options. For instance, a money-back guarantee is one of the means to reduce customers' concern. Sellers might consider to offer money-back guarantee policy including shipping expenses refund to reduce purchasing risk In addition, to avoid shipping delay and product lost, online store may cooperate with other companies with expertise in logistic to improve their distribution channels.

Offering customers more flexible prices and promotions or offering a one-stop shopping service are some more examples that online stores can use to make their business succeed. Online sellers may offer customers to use their bank account number, or stored-value card to complete their purchase. It is also suggested that online stores may offer customer an e-wallet which transfers balance from customer's online bank account to the store payment system. This may help sellers to gain more sales from those who want to buy online products or services but do not have credit card or do not want to use their credit card online.

## E-COMMERCE: IT'S IMPACT ON CONSUMER BEHAVIOR

The internet is being developed rapidly since last two decades, and with relevant digital economy that is driven by information technology also being developed worldwide. After a long term development of internet, which rapidly increased web users and highly speed internet connection, and some new technology also have been developed and used for web developing, those lead to firms can promote and enhance images of product and services through web site. Therefore, detailed product information and improved service attracts more and more people changed their consumer behavior from the traditional mode to more rely on the internet shopping. On the other hand, more companies have realized that the consumer behavior transformation is unavoidable trend, and thus change their marketing strategy. As the recent researches have indicated that, the internet shopping particularly in business to consumer (B2C) has risen and online shopping become more popular too many people. There are many reasons for such a rapid developing of internet shopping, which mainly due to the benefits that internet provides. First of all, the internet offers different kind of convenience to consumers. Obviously, consumers do not need go out looking for product information as the internet can help them to search from online sites, and it also helps evaluate between each sites to get the cheapest price for purchase. Furthermore, the internet can enhance consumer use product more efficiently and effectively than other channels to satisfy their needs. Through the different search engines, consumers save time to access to the consumption related information, and which information with mixture of images, sound, and very detailed text description to help consumer learning and choosing the most suitable product.

However, internet shopping has potential risks for the customers, such as payment safety, and after service. Due to the internet technology developed, internet payment recently becomes prevalent way for purchasing goods from the internet. Internet payment increase consumptive efficiency, at the same time, as its virtual property reduced internet security.

## Difference between Online/Offline Stores

Even the internet shopping has been rapidly developed, especially in consumer goods industry, but there still have a big difference between traditional and online consumer shopping. Referred to sales in the Indian consumer goods industry, the online sales occupied at a very low percentage rate. That could be caused by many reasons, but the most importance is the advantages exist in both traditional shops and online market; both of them have specific characteristics. For example, the traditional seller can provide convenience in parking and shopping, it allows customers come to read and check the quality of goods before they purchase, and the after service is more directly to customers. However, the traditional store has limited number of goods, and the selling cost is higher than online store. By comparison, we can find out the limitations of traditional store are more likely as the advantages of online store, in contrast, the weakness of online store is also seems as the advantages of traditional store. It is clear from the overview of internet and internet shopping development that e-commerce is being used in many corporations due to the dramatic development of technology and competitive advantages of web selling. Moreover, the expansions of the usage by individuals also become main contributors to the development of internet shopping. Relatively few studies have investigated in the internet shopping and impact on consumer behavior. The previous studies are more focus on the marker's point of view, such as how to establish a more efficient marketing channel online rather than the traditional offline channel. Therefore, this research will combines with previous studies from literature reviews, and focus on the impact of the internet shopping on consumer behaviors to find out a comprehensive analytical framework which showing the essential ingredient of marketing and business to satisfying the consumer's needs, and a deeply understanding of online consumer behavior as a reference for any ecommerce company to make marketing strategies.

## Impact of Internet on Consumer Behavior

The influences on consumer behavior are often made between external and internal factors. External factors are come from the environmental conditions, and internal factors are usually from the consumer's mind. There are many factors could influence consumer's behaviors. According to Warner, the external influences could divide into five sectors: Demographics, socio-economics, technology and public policy; culture; sub-culture; reference groups; and marketing. The internal influences are variety of psychological processes, which include attitudes, learning, perception, motivation, self image, and semiotics. In addition to these, Sheth also suggested that the consumers have two types of motives while shopping, which are functional and non-functional. The functional motives are mostly about the time, shopping place and consumer's needs, which could be like one-stop shopping to save time, the environmental of shopping place such as free parking place, lower cost of products and available to choose from widely range of products. The non-functional motives are more related with culture or social values, such as the brand name of the store.

The traditional shopping is simply about the customer to purchase their needs. This behavior will be influenced by the seller's advertising and promotion which attracts customers goes there and purchase goods, afterwards a part of new products will be taken home and be used.

## Internet Shopping

Internet shopping and traditional shopping are sharing many similarities, at the same time, it still exists some differences between them, such as the Internet shopping could provide convenience and interactive services, and the traditional shopping could give customers more comfortable shopping environment and good quality of products. Both aspect of shopping malls are trying to improving their services by learn commutatively from each other, such as traditional shopping malls provide more parking spaces, more counters, and closer to residential area in order to improve services in convenience; Internet shopping malls adopt virtual reality and 3D techniques to improve the presentation of products.

## Convenience

Internet provides a big convenience for shopper as the main reason for the shopping online has been agreed by most of researcher and customers. Due to the feature of Internet, it allows customer to shopping online anytime and anywhere, which means customer can browse and shopping online 24-hours a day, 7 days a week from home or office, which attracts some time-starved shoppers come to Internet for save time to searching products in physical store. Additionally, Internet offers some good ways to save money and time. For example, shoppers do not need go out to the physical store and thus there is no transportation cost. Compare with the traditional shopping, there is no waiting line for shoppers on the Internet, and some shoppers reported that they feel pressure from the sales people sometimes, but Internet offers them more enjoyable while shopping online.

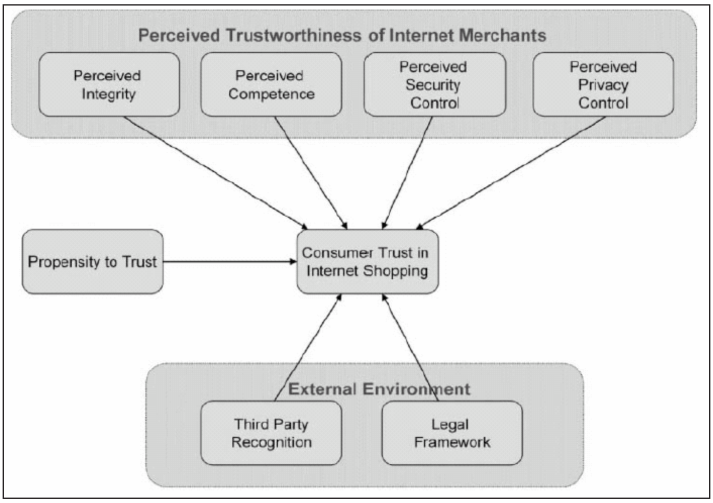
## Technology

The convenience based on Internet is mainly according to the technology development, and which plays a key role during the development of Internet shopping. In the last decade, organizations have realized that the new technology could impact on Internet shopping deeply, and thus there are many important technologies like virtual reality and 3D techniques have adopted to gain big competitive advantages. Information technology has used in the form of the Internet improved better quality of product information, which help shopper's decision making. Through the wide range of surveys about the Internet use, the growth of Internet and the rate of growth of Internet usage have been rapid increased in the last decade. According to the BMRB International and GVU's WWW 9th User Surveys, the number of Internet users in Great Britain has increased to 22.7 million among 48.4% of the adult population, and about 53% of Internet users have reported that shopping is a primary use of the Web. Moreover, a statistical report on the Internet Development in China from CNNIC (China Internet Network Information Centre) have released in July 2006. From this report, in the aspect of Internet shopping, there are 30 million users often shopping online, and near 1/4 Internet users have online shopping experience. Both surveys shows that more and more Internet users prefer online payment while they shopping, thus the security of online payment certainly will become a significant factor to influence the Internet shopping.

## Consumer Trust in Internet Shopping

Mayer, Davis, and Schoorman defined trust as, "the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party". This definition is widely recognized and the most frequently cited.

People purchase products and services are the most based on their level of trust in this product or services, and sellers either in the physical store or online shops. Online trust is the basic and essential element for building a relationship with customers. A present research shows that online trust is lower level than the face-to-face interactions in the physical store, and the result from Cheung and Lee shows that trustworthiness of Internet merchant (perceived integrity, perceived competence, and perceived security control) and external environment (third-party recognition and legal framework) have considerable impact on consumer trust in Internet shopping. The trustworthiness of E-commerce web site is very relying on the how much privacy security can be provided. For example, a highly technical competence can be a factor to influence the trustworthiness. The web merchant can provide third-party verification to E-commerce web site, and while this privacy and security strategies are used, customers will think their E-commerce transactions through Internet are secure and thus the site is more reliable to them. Beside this point, if the Ecommerce web site can provide the information about their customer services, location of the office, contact telephone number, and a help button on the web site, customers could also increase their trustiness as they can feel that the online retailers is truly exist.




An Integrative model of consumer trust in internet shopping.

# SEARCH AND EVALUATION IN CONSUMER BEHAVIOR

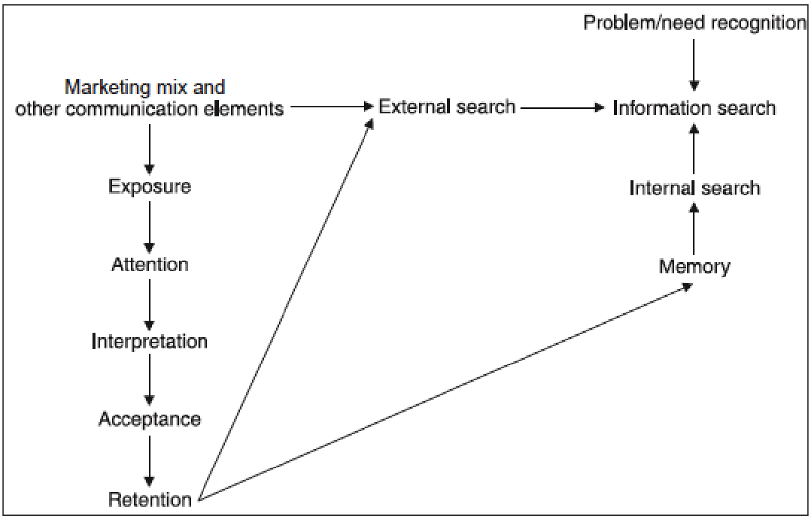
Information search starts the moment a need is recognized. It is a deliberate attempt to gain appropriate knowledge about products. Knowledge of brands and their important characteristics, and knowledge of stores from where to purchase the goods is gained. Optimum amount of information is required for making a proper choice. Consumers gather information, they then understand (perceive) by selecting, organizing and interpreting it:

- Acquisition process type of involvement.
- On going search Enduring involvement (computer).
- Purchase specific search Situational involvement.
- Passive acquisition Low involvement.

### Questions Faced by Marketer

- What are the types of information search, and what are their determinants?
- What is the appropriate information load that can be handled by customers?

- How can marketers help facilitate the information search?
- Which source of information is used by the customer?




Information search for high involvement consumer durables.

## Types of Information Search

- Internal search: It is sufficient in case of loyalty decisions and impulsive purchases. Internal search is also done for routine response behavior and limited problem solving.
- External Search: It is a mediated, planned and rational pursuit of information for high involvement purchase decision, i.e., extensive problem solving.
- Passive Search: Low involvement use repetitive advertising use TV Emphasize Price Promotion and in-store marketing stimuli.
- Active Information Search: Marketer must vary message content frequently. Use Print Media. Emphasize advertising and emphasize marketing before customer enters store.
- Hedonic Search: In this, sensory stimuli dominate. There is on-going information search. Personal sources are more important symbols and imagery is most effective.
- Utilitarian Search: Product attributes are more important for purchase. There is specific information search. Non-personal sources are more important. Product information is more effective.

## Information Overload

Jacob Jacoby and Associates developed this concept, which cautions marketers against the popular assumption "If some information is good, then more information must be better".

Too much information confuses the consumer, and with more information, often poor decisions are made. Increasing package information adversely affects the ability to choose best brands.

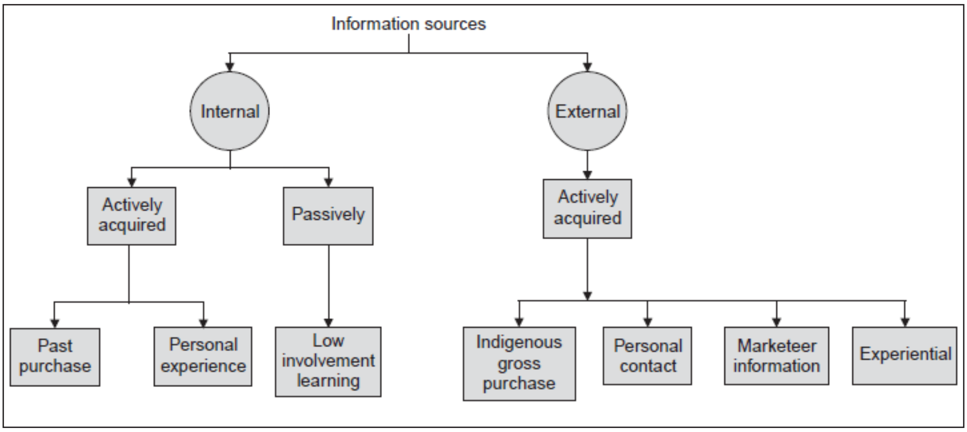
## Sources of Information

- Controlled by marketers:
    - Advertising: Provides about 35 per cent to 50 per cent information sought. It is the most important sources of information.
    - In-store promotion: E.g., display prices, danglers, brochures, technical reports, summaries.
    - Information on distribution support: Yellow pages.
    - Package information: Colour, design, ingredients and mode of using.
    - Sales personnel: Consumer durables, furniture, electronic, clothing indigenous products.
    - Samples and demonstrations (most important): Create a favourable impact for marketers.
- Outside marketer's control: Personal friends, independent consumer reports, new articles shopping columns. Some sources are face to face, others are non-personal in nature (advertisement and publicity, etc.). There are many situations which lead to high or low information search.

## Factors Leading to high Information Search

- If one feels that there will be more benefit by undertaking a search is high.
- If there is greater involvement in the product, i.e., a camera bought by a professional photographer or, a racket chosen by a professional tennis player.
- If one likes shopping and enjoys it search is high.
- If more time is available high search.
- If one is mobile and can go from place to place, i.e., his movement is not restricted high information search.

- If one can process the information easily about the product one wants to buy. It leads to high information search.
- If many attributes are to be evaluated and one is interested in many attributes and their mix high information search.
- If there is a little product knowledge and experience it leads to high risk. Therefore, more information search is required.
- If there is more product differentiation high price is charged.




Information sources.

## Factors Leading to low Information Search

- If the cost of the information search is high it leads to low information search.
- If one relies on his past experience of purchases low information search.
- If one is satisfied with existing brands he is using he will go for low information search.
- If there is social pressure of friends and relatives to buy a particular product low information search.
- If one has low confidence in dealing with information or, cannot process much information low information search. For external information search, certain measures are taken:
    - Number of stores visited.
    - Number of alternatives considered.
    - Number of personal sources used.
    - Overall or combination measures.

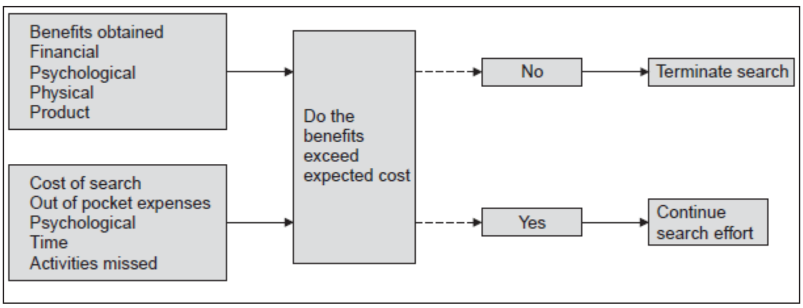
Consumers can be classified as:

- Non-searchers.
- Limited information searchers.
- Extended information searchers.

## Cost vs. Benefit Analysis

Benefits can be:

- Tangible, i.e., lower price preferred style, more quantity and better quality.
- Intangible reduced risk, greater confidence even providing enjoyment. It has been observed that 50 per cent of the appliance buyers do little or no external search as they do not perceive enough benefits from it.




Cost and benefit doubt.

## Cost

No search is also done because of the cost incurred. It can be both monetary and non-monetary, i.e., money used in transportation, lost time, lost wages, lost opportunities.

Non-monetary may include psychological and physical cost, frustration cost, conflict between searches and other activities fatigue, etc.

When a consumer undertakes a search, he comes across various brands and has to choose from them. Some brands are considered out of the total set of brands available. We thus have:

- Total set: All the brands available in the market.
- Awareness set: Brands potential buyer is aware of.
- Inept set: Not suitable/rejected.
- Considerations set (Evoked set): Brand to be considered.

- Choice set: In contention with final choice.
- Choice: Ultimate choice.

Table: Set that lead to choice.

| Total Set | Awareness Set | Inept Set | Consideration Set | Choice Set | Choice |
|---|---|---|---|---|---|
| Godrej | Godrej | Voltas | LG | LG | LG |
| Samsung | LG | Samsung | Videocon | Videocon | |
| LG | Videocon | Godrej | Kelvinator | | |
| Kelvinator | Kelvinator | BPL | | | |
| Videocon | BPL | | | | |
| Allwyn | | | | | |
| BPL | | | | | |
| Voltas | | | | | |

Table: Marketing strategy based on information search process.

| Brand position | R.R.B | Limited D.M. | Extended D.M. |
|---|---|---|---|
| Brand in set (consider-ation) | Maintenance Strategy | Capture Strategy | Preference |
| Brand not in evoked set (consideration) | Disrupt Strategy | Intercept Strategy | Acceptance Strategy |

To design market strategies, the nature of search is to be considered, i.e., R.R. B., L.P.S., E.P.S. and the nature of the evoked set (This influences the direction of search). This gives rise to six strategies.

## Maintenance Structure

If the brand is purchased habitually, the strategy is to maintain that behaviour. Attention is to be paid to product quality, avoiding out of stock situation, reinforcement, advertising. Also defend against the competitor's move which might be disruptive to the brand. Maintain product development; give rebates, P.O.P. displays, etc.

## Disruptive Structure

If the brand is not in the evoked set and the decision is habitual, we must disrupt the existing decision-making process. It is a difficult task. A major product improvement must be made. Attention attracting advertising should be done. Free samples, coupons, rebates and tie-insalescan disrupt habitual decision-making.

### Capture Structure, Limited Decision-making and Evoked Brand

Limited decision-making involves few brands which are evaluated on price or availability. Information search is mostly done at P.O.P. and through available media prior to purchase. Strategy is to catch as much of the market share as possible/practical. In limited search, the marketer tries to supply information of his brand by cooperative advertising. He must also maintain product quality and adequate distribution.

### Intercept Structure, Limited Decision-making and not Evoked Set (Consideration Set)

Marketer has to intercept the consumer during a search on brands in evoked set. Emphasis will be on local media with cooperative advertisement, P.O. P. displays, shelf space, and package design. Consumer's attention is to be drawn as the brand is not in the evoked set. Coupons can also be effective. Low involvement learning, product improvement and free samples can also be used.

### Preference Structure, Extended Decision-making and Evoked Set

Extended decision-making involves several brands, several attributes and many information sources. We have to have a campaign that will result in the target market preferring our brand.

We should be strong in the attributes preferred by the target markets. Extensive advertising campaigns must be undertaken to impart information to groups. Groups be encouraged to test the brand. Extra motivation be given to salesmen. Pamphlets be provided.

### Acceptance Structure

It is used in extended decision-making and for the brands that are not in the evoked set.

Similar to preference structure brand is not in evoked set, therefore, the customer is not seeking information about the product. Motivate customer to learn about the brand and visit showrooms. Besides preferred strategies, effort should be made to bring the brand in the evoked set by extended advertisement and imparting information.

### Marketing Implications of Research Behavior are broad Ranging

It makes marketers aware of how customers search for information. They can help the customer and facilitate the search process to match with their marketing stimuli. Marketers influence search process by advertising product and packaging and pricing policies.

## Marketers' Influence on Information Search

Through areas of advertising, product and packaging policies and pricing:

- Advertising: Complex due to selective reception and perception. With time, audience erosion occurs, constant review is important. Audience may not be attentive to the advertisement.
- Review is the key word: To present an attractive packaging, one should vary the packaging and design of the product.
- Product and packaging: Use words like 'new', 'improved', 'better', or 'power' packed. Change in package design and co lour, periodically helps to push information through. It stimulates the consumer and, pushes the information through the threshold level. These adjectives help the consumer to break the threshold level faster, so that the purchases are expedited.
- Pricing: Review pricing permutations and combinations to convey desired price quality perception. Most people are sensitive to price variations. This strategy is commonly used.

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# Consumer Budget and Demand

CHAPTER 4

The real purchasing power with which a consumer can purchase quantities of two goods, given their prices is called consumer budget. Demand refers to the consumer's will to buy goods and services. This chapter closely examines the subject of consumer budget and demand to provide an extensive understanding of the subject.

## CONSUMER BUDGET

Consumer Budget is the balance of income and expenditures of a family, which characterizes the established or calculated living standard of various groups of workers' families. It shows family income according to sources of revenue and expenditures according to their purpose. A consumer budget is the real purchasing power with which he can purchase quantities of two goods, given their prices.

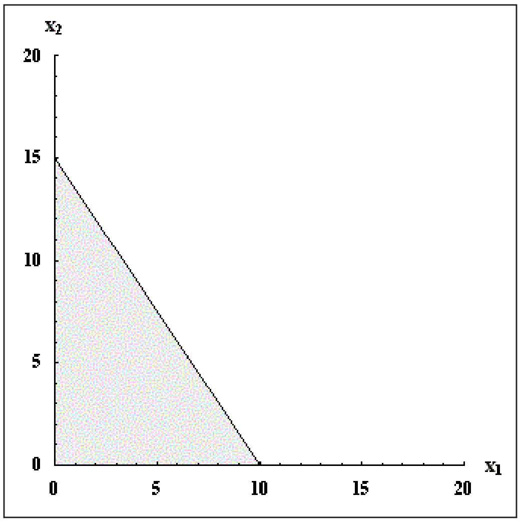
One objective of the models of choice is to evaluate how choices change as the set of alternative choices change. Demand relates observed choices to the price level for a commodity. Price changes are one form of change to the set of available alternative choices. So the first problem that we need to address is how to represent the set of alternative choices that are available to a consumer.

### Consumption Space

One of the most common problems in consumer choice is the choice of a consumption level for each of a number of commodities, each with a fixed price, when income is fixed. It is not too difficult to formulate and analyze this type of problem even when the number of commodities is large, but the problem is greatly simplified and the ideas can be described graphically when there are only two commodities, so we begin the description of the consumer choice model for that case. If the consumption levels for commodities 1 and 2 are $x_1 \geq 0$ and $x_2 \geq 0$ then the consumption point is written $x = (x_1, x_2)$, which is the quantity $x_1$ of commodity 1 consumed, and the consumption $x_2$ of commodity 2. The set of all possible consumption levels is written $X = \{(x_1, x_2) : x_1 \geq 0, x_2 \geq 0\}$.

### Choice Set or Budget Set

Limited income and positive prices for each of the two commodities produces a finite set of alternative choices, which is often called a choice or budget set. Suppose that income is M = 120 and the prices of commodities 1 and 2 are $p_1 = 12$, and $p_2 = 8$. Use this to determine the total amount $x_1$ of commodity 1 that you can purchase. Do the same if you spend all your income on commodity 2. An example of a set of alternative choices is shown in figure. Compare the answers to the intersections of the budget set with the $X_1$ axis and with the $X_2$ axis.




Budget set with prices $p_1 = 12$, $p_2 = 8$, and income M = 120.

## BUDGET SET

There are two factors that affect a consumer's choice of quantities to purchase between two goods: prices and money income. Price times quantity for each good gives us the expenditure incurred on purchasing a good. In our analysis, there are two goods. So, the expenditure on both goods must be less than or equal to the money income of the consumer. This is the budget constraint faced by a consumer. It is depicted as:

$$P_1.X_1 + P_2.X_2 <= M$$

All those bundles that satisfy this criterion are set to form a part of what is called the budget set. The consumer can choose to consume out of any of these bundles.

### Budget Line

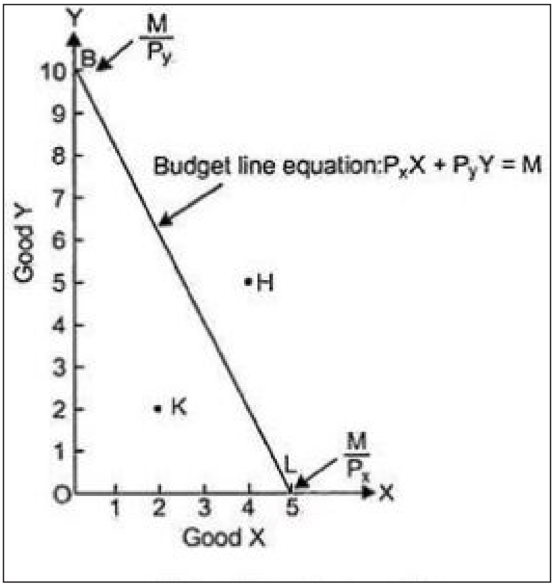
In consumer budget, the graphical representation of all such bundles which cost the consumer exactly his money income is called the budget line. The equation of the budget line is, therefore:

$$P_1.X_1 + P_2.X_2 = M$$

We measure the quantity of good 1 on the horizontal axis and that of good 2 on the vertical axis. We can depict the budget line by calculating the horizontal and vertical intercept. The intercepts are the maximum of each good the consumer can afford to buy.

So, horizontal intercept = $M/P_1$ (the consumer buys only good 1, $X_2 = 0$).

And, vertical intercept = $M/P_2$ (the consumer buys only good 2, $X_1 = 0$).




Budget line.

The figure assumes good 1 to be 'X' and good 2 to be 'Y'. A bundle such as 'K' forms a part of the budget set and costs less than the total money income. A bundle such as 'H' on the other hand lies outside the budget line and is hence not affordable.

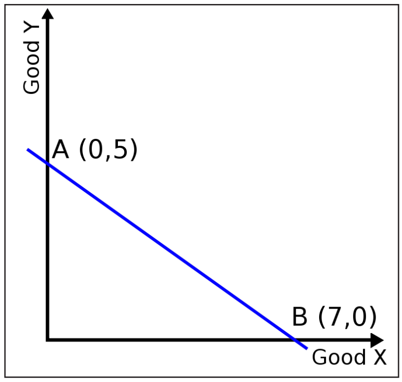
## Slope of the Budget Line

Why does the budget line slope downward? We must understand that the quantities of goods 1 and 2 are limited and the consumer has a fixed money income. So, to have more of good 1, he has to 'give up' some amount of good 2. This negative relation between consumption quantities of two goods causes the budget line to slope downwards.

The slope of the budget line is the amount of good 2 given up to have one more unit of good 1. The price of one unit of good 1 is $P_1$. To have one more unit of good 1, therefore, consumption of good 2 must be reduced by $P_1$ amount. Now, with the $P_2$ amount, one unit of good 2 could have been bought. So, with the $P_1$ amount, of good 2 could have been bought.

Thus, the consumer must give up units of good 2 to obtain one extra unit of good 1, i.e. the slope of the budget line.

# BUDGET CONSTRAINT

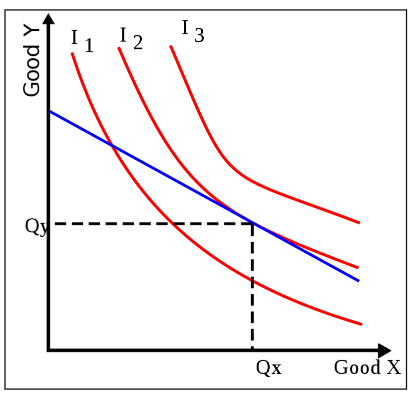



Budget constraint, where $A = \dfrac{m}{P_x}$ and $B = \dfrac{m}{P_x}$.

In economics, a budget constraint represents all the combinations of goods and services that a consumer may purchase given current prices within his or her given income. Consumer theory uses the concepts of a budget constraint and a preference map to analyze consumer choices. Both concepts have a ready graphical representation in the two-good case.

## Uses

## Individual Choice




An individual should consume at (Qx, Qy).

Consumer behaviour is a maximization problem. It means making the most of our limited resources to maximize our utility. As consumers are insatiable, and utility functions grow with quantity, the only thing that limits our consumption is our own budget.

In general, the budget set (all bundle choices that are on or below the budget line) represents all possible bundles of goods an individual can afford given their income and the prices of goods. When behaving rationally, an individual consumer should choose to consume goods at the point where the most preferred available indifference curve on his preference map is tangent to his budget constraint. The tangent point (the xy coordinate) represents the amount of goods x and y the consumer should purchase to fully utilize their budget to obtain maximum utility. It is important to note that the optimal consumption bundle will not always be an interior solution. If the solution to the optimality condition leads to a bundle that is not feasible, the consumer's optimal bundle will be a corner solution which suggests the goods or inputs are perfect substitutes. A line connecting all points of tangency between the indifference curve and the budget constraint is called the expansion path.

All two dimensional budget constraints are generalized into the equation:

$$P_x x + P_y y = m$$

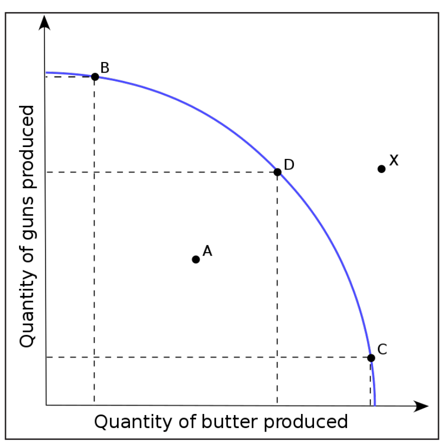
Where:

- $m =$ money income allocated to consumption (after saving and borrowing).
- $P_x =$ the price of a specific good.
- $P_y =$ the price of all other goods.
- $x =$ amount purchased of a specific good.
- $y =$ amount purchased of all other goods.

The equation can be rearranged to represent the shape of the curve on a graph: $y = (m / P_y) - (P_x / P_y)x$, where $(m / P_y)$ is the y-intercept and $(-P_x / P_y)$ is the slope, representing a downward sloping budget line.

The factors that can shift the budget line are a change in income (m), a change in the price of a specific good ( $P_x$ ), or a change in the price of all other goods ( $P_y$ ).

## International Economics




Point X is unobtainable given the current "budget" constraints on production.

A production-possibility frontier is a constraint in some ways analogous to a budget constraint, showing limitations on a country's production of multiple goods based on the limitation of available factors of production. Under autarky this is also the limitation of consumption by individuals in the country. However, the benefits of international trade are generally demonstrated through allowance of a shift in the consumption-possibility frontiers of each trade partner which allows access to a more appealing indifference curve. In the "toolbox" Hecksher-Ohlin and Krugman models of international trade, the budget constraint of the economy (its CPF) is determined by the terms-of-trade (TOT) as a downward-sloped line with slope equal to those TOTs of the economy. (The TOTs are given by the price ratio Px/Py, where x is the exportable commodity and y is the importable).

## Many Goods

While low-level demonstrations of budget constraints are often limited to less than two good situations which provide easy graphical representation, it is possible to demonstrate the relationship between multiple goods through a budget constraint.

In such a case, assuming there are $n$ goods, called $x_i$ for $i = 1,\ldots,n,$ , that the price of good $x_i$ is denoted by $p_i$ , and if $W$ is the total amount that may be spent, then the budget constraint is:

$$\sum_{i=1}^{n} p_i x_i \leq W.$$

Further, if the consumer spends his income entirely, the budget constraint binds:

$$\sum_{i=1}^{n} p_i x_i = W.$$

In this case, the consumer cannot obtain an additional unit of good $x_i$ without giving up some other good. For example, he could purchase an additional unit of good $x_i$ by giving up $p_i / p_j$ units of good $x_j$.

# DEMAND

In economics, demand is the quantity of a good that consumers are willing and able to purchase at various prices during a given period of time. The relationship between price and quantity demanded is also known as the demand curve. Preferences which underlie demand, are influenced by cost, benefit, odds and other variables.

## Factors Influencing Demand

Innumerable factors and circumstances affect a buyer's willingness or ability to buy a good. Some of the common factors are:

Good's own price: The basic demand relationship is between potential prices of a good and the quantities that would be purchased at those prices. Generally the relationship is negative meaning that an increase in price will induce a decrease in the quantity demanded. This negative relationship is embodied in the downward slope of the consumer demand curve. The assumption of a negative relationship is reasonable and intuitive. For example, if the price of a gallon of milk rose from \$5 to a price of \$15, this is a big price increase. This significant price increase causes the consumer to demand less of that product at the price of \$15 because not only is it more expensive, but the new price is very unreasonable for a gallon of milk.

Price of related goods: The principal related goods are complements and substitutes. A complement is a good that is used with the primary good. Examples include hotdogs and mustard, beer and pretzels, automobiles and gasoline. (Perfect complements behave as a single good.) If the price of the complement goes up the quantity demanded of the other good goes down.

Mathematically, the variable representing the price of the complementary good would have a negative coefficient in the demand function. For example, $Q_d = a - P - P_g$ where Q is the quantity of automobiles demanded, P is the price of automobiles and $P_g$ is the price of gasoline. The other main category of related goods is substitutes. Substitutes are goods that can be used in place of the primary good. The mathematical relationship between the price of the substitute and the demand for the good in question is positive. If the price of the substitute goes down the demand for the good in question goes down.

Personal Disposable Income: In most cases, the more disposable income (income after tax and receipt of benefits) a person has, the more likely that person is to buy.

Tastes or preferences: The greater the desire to own a good the more likely one is to buy the good. There is a basic distinction between desire and demand. Desire is a measure of the willingness to buy a good based on its intrinsic qualities. Demand is the willingness and ability to put one's desires into effect. It is assumed that tastes and preferences are relatively constant.

Consumer expectations about future prices, income and availability: If a consumer believes that the price of the good will be higher in the future, he/she is more likely to purchase the good now. If the consumer expects that his/her income will be higher in the future, the consumer may buy the good now. Availability (supply side) as well as predicted or expected availability also affects both price and demand.

Population: If the population grows this means that demand will also increase.

Nature of the good: If the good is a basic commodity, it will lead to a higher demand.

This list is not exhaustive. All facts and circumstances that a buyer finds relevant to his willingness or ability to buy goods can affect demand. For example, a person caught in an unexpected storm is more likely to buy an umbrella than if the weather were bright and sunny.

## Demand Function and Equation and Curve

The demand equation is the mathematical expression of the relationship between the quantity of a good demanded and those factors that affect the willingness and ability of a consumer to buy the good. For example, $Q_d = f(P; P_{rg}, Y)$ is a demand equation where $Q_d$ is the quantity of a good demanded, P is the price of the good, $P_{rg}$ is the price of a related good, and Y is income; the function on the right side of the equation is called the demand function. The semi-colon in the list of arguments in the demand function means that the variables to the right are being held constant as one plots the demand curve in (quantity, price) space. A simple example of a demand equation is $Q_d = 325 - P - 30P_{rg} + 1.4Y$. Here 325 is the repository of all relevant non-specified factors that affect demand for the product. P is the price of the good. The coefficient is negative in accordance with the law of demand. The related good may be either a complement or a substitute. If it is a complement, the coefficient of its price would be negative as in this example. If it is a substitute, the coefficient of its price would be positive. Income, Y, has a positive coefficient indicating that the good is a normal good. If the coefficient was negative the good in question would be an inferior good meaning that the demand for the good would fall as the consumer's income increased. Specifying values for the non price determinants, $P_{rg} = 4.00$ and $Y = 50$, results in the demand equation $Q = 325 - P - 30(4) + 1.4(50)$ or $Q = 275 - P$. If income were to increase to 55 the new demand equation would be $Q = 282 - P$. Graphically this change in a non price determinant of demand would be reflected in an outward shift of the demand function caused by a change in the x intercept.

## Demand Curve

In economics the demand curve is the graphical representation of the relationship between the price and the quantity that consumers are willing to purchase. The curve shows how the price of a commodity or service changes as the quantity demanded increases. Every point on the curve is an amount of consumer demand and the corresponding market price.

## Price Elasticity of Demand (PED)

PED is a measure of the sensitivity of the quantity variable, Q, to changes in the price variable, P. Elasticity answers the question of the percent by which the quantity demanded will change relative to (divided by) a given percentage change in the price. For infinitesimal changes the formula for calculating PED is the absolute value of $(\partial Q/\partial P)\times(P/Q)$.

## Elasticity along Linear Demand Curve

The slope of a linear demand curve is constant. The elasticity of demand changes continuously as one moves down the demand curve because the ratio of price to quantity continuously falls. At the point the demand curve intersects the y-axis PED is infinitely elastic, because the variable *Q* appearing in the denominator of the elasticity formula is zero there. At the point the demand curve intersects the x-axis PED is zero, because the variable *P* appearing in the numerator of the elasticity formula is zero there. At one point on the demand curve PED is unitary elastic: PED equals one. Above the point of unitary elasticity is the elastic range of the demand curve (meaning that the elasticity is greater than one). The inelastic range, in which the elasticity is less than one. The decline in elasticity as one moves down the curve is due to the falling P/Q ratio.

## Constant Price Elasticity Demand

Constant elasticity of demand occurs when $Q = aP^c$ where *a* and *c* are parameters, and the constant price elasticity is $c \leq 0$.

## Perfectly Inelastic Demand

Perfectly inelastic demand is represented by a vertical demand curve. Under perfect price inelasticity of demand, the price has no effect on the quantity demanded. The demand for the good remains the same regardless of how low or high the price. Goods with (nearly) perfectly inelastic demand are typically goods with no substitutes. For instance, insulin is nearly perfectly inelastic. Diabetics need insulin to survive so a change in price would not effect the quantity demanded.

## Market Structure and the Demand Curve

In perfectly competitive markets the demand curve, the average revenue curve, and the marginal revenue curve all coincide and are horizontal at the market-given price. The demand curve is perfectly elastic and coincides with the average and marginal revenue curves. Economic actors are price-takers. Perfectly competitive firms have zero market power; that is, they have no ability to affect the terms and conditions of exchange. A perfectly competitive firm's decisions are limited to whether to produce and if so, how much. In less than perfectly competitive markets the demand curve is negatively sloped and there is a separate marginal revenue curve. A firm in a less than perfectly competitive market is a price-setter. The firm can decide how much to produce or what price to charge. In deciding one variable the firm is necessarily determining the other variable

## Inverse Demand Function

In its standard form a linear demand equation is Q = a - bP. That is, quantity demanded is a function of price. The inverse demand equation, or price equation, treats price as a function g of quantity demanded: P = f(Q). To compute the inverse demand equation, simply solve for P from the demand equation. For example, if the demand equation is Q = 240 - 2P then the inverse demand equation would be P = 120 - .5Q, the right side of which is the inverse demand function.

The inverse demand function is useful in deriving the total and marginal revenue functions. Total revenue equals price, P, times quantity, Q, or TR = P×Q. Multiply the inverse demand function by Q to derive the total revenue function: TR = (120 - .5Q) × Q = 120Q - 0.5Q². The marginal revenue function is the first derivative of the total revenue function; here MR = 120 - Q. The MR function has the same y-intercept as the inverse demand function in this linear example; the x-intercept of the MR function is one-half the value of that of the demand function, and the slope of the MR function is twice that of the inverse demand function. This relationship holds true for all linear demand equations. The importance of being able to quickly calculate MR is that the profit-maximizing condition for firms regardless of market structure is to produce where marginal revenue equals marginal cost (MC). To derive MC the first derivative of the total cost function is taken. For example, assume cost, C, equals 420 + 60Q + Q². Then MC = 60 + 2Q. Equating MR to MC and solving for Q gives Q = 20. So 20 is the profit maximizing quantity: to find the profit-maximizing price simply plug the value of Q into the inverse demand equation and solve for P.

## Residual Demand Curve

The demand curve facing a particular firm is called the residual demand curve. The residual demand curve is the market demand that is not met by other firms in the industry at a given price. The residual demand curve is the market demand curve D(p), minus the supply of other organizations, So(p): Dr(p) = D(p) - So(p).

## Demand Function and Total Revenue

If the demand curve is linear, then it has the form: p = a - b*q, where p is the price of the good and q is the quantity demanded. The intercept of the curve and the vertical axis is represented by a, meaning the price when no quantity demanded. And b is the slope of the demand function. If the demand function has the form like that, then the Total Revenue should equal quantity demanded times the price of the good, which can be represented by: TR= q*p = q(a-bq).

## Is the Demand Curve for PC Firm Really Flat?

Practically every introductory microeconomics text describes the demand curve facing a perfectly competitive firm as being flat or horizontal. A horizontal demand curve is perfectly elastic. If there are n identical firms in the market then the elasticity of demand PED facing any one firm is:

$$PED_{mi} = nPED_{m} - (n - 1)\ PES$$

where $PED_m$ is the market elasticity of demand, PES is the elasticity of supply of each of the other firms, and (n -1) is the number of other firms. This formula suggests two things. The demand curve is not perfectly elastic and if there are a large number of firms in the industry the elasticity of demand for any individual firm will be extremely high and the demand curve facing the firm will be nearly flat.

For example, assume that there are 80 firms in the industry and that the demand elasticity for industry is -1.0 and the price elasticity of supply is 3. Then:

$$PED_{mi} = (80 \times (-1)) - (79 \times 3) = -80 - 237 = -317$$

That is the firm PED is 317 times as elastic as the market PED. If a firm raised its price "by one tenth of one percent demand would drop by nearly one third." if the firm raised its price by three tenths of one percent the quantity demanded would drop by nearly 100%. Three tenths of one percent marks the effective range of pricing power the firm has because any attempt to raise prices by a higher percentage will effectively reduce quantity demanded to zero.

## Demand Management in Economics

Demand management in economics is the art or science of controlling economic or aggregate demand to avoid a recession. Such management is inspired by Keynesian macroeconomics, and Keynesian economics is sometimes referred to as demand-side economics.

## Different Types of Goods Demand

Negative demand: If the market response to a product is negative, it shows that people are not aware of the features of the service and the benefits offered. Under such circumstances, the marketing unit of a service firm has to understand the psyche of the potential buyers and find out the prime reason for the rejection of the service. For example: if passengers refuse a bus conductor's call to board the bus. The service firm has to come up with an appropriate strategy to remove the misunderstandings of the potential buyers. A strategy needs to be designed to transform the negative demand into a positive demand.

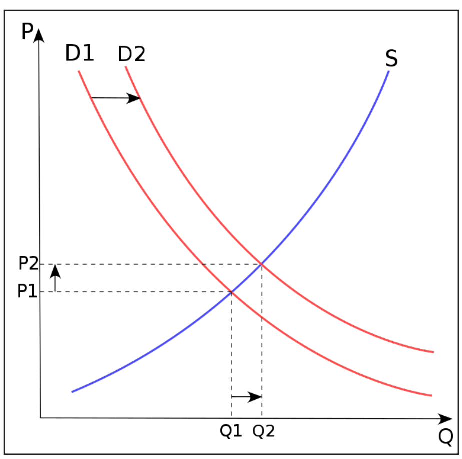
No demand: If people are unaware, have insufficient information about a service or due to the consumer's indifference this type of a demand situation could occur. The marketing unit of the firm should focus on promotional campaigns and communicating reasons for potential customers to use the firm's services. Service differentiation is one of the popular strategies used to compete in a no demand situation in the market.

Latent demand: At any given time it is impossible to have a set of services that offer total satisfaction to all the needs and wants of society. In the market there exists a gap between desirables and the available. There is always a search on for better and newer offers to fill the gap between desirability and availability. Latent demand is a phenomenon of any economy at any given time, it should be looked upon as a business opportunity by service firms and they should orient themselves to identify and exploit such opportunities at the right time. For example, a passenger traveling in an ordinary bus dreams of traveling in a luxury bus. Therefore, latent demand is nothing but the gap between desirability and availability.

Seasonal demand: Some services do not have an all year round demand, they might be required only at a certain period of time. Seasons all over the world are very diverse. Seasonal demands create many problems to service organizations, such as idling the capacity, fixed cost and excess expenditure on marketing and promotions. Strategies used by firms to overcome this hurdle are like - to nurture the service consumption habit of customers so as to make the demand unseasonal, or other than that firms recognize markets elsewhere in the world during the off-season period. Hence, this presents and opportunity to target different markets with the appropriate season in different parts of the world. For example, the need for Christmas cards comes around once a year. Or the, seasonal fruits in a country.

Demand patterns need to be studied in different segments of the market. Service organizations need to constantly study changing demands related to their service offerings over various time periods. They have to develop a system to chart these demand fluctuations, which helps them in predicting the demand cycles. Demands do fluctuate randomly, therefore, they should be followed on a daily, weekly or a monthly basis.

# DEMAND CURVE




An example of a demand curve shifting. *D*1 and *D*2 are alternative positions of the demand curve, *S* is the supply curve, and *P* and *Q* are price and quantity respectively. The shift from D1 to D2 means an increase in demand with consequences for the other variables.

A demand curve is a graph depicting the relationship between the price of a certain commodity (the $y$-axis) and the quantity of that commodity that is demanded at that price (the $x$-axis). Demand curves may be used to model the price-quantity relationship for an individual consumer (an individual demand curve), or more commonly for all consumers in a particular market (a market demand curve). It is generally assumed that demand curves are downward-sloping, as shown in the adjacent image. This is because of the law of demand: for most goods, the quantity demanded will decrease in response to an increase in price, and will increase in response to a decrease in price.

Demand curves are used to estimate behaviors in competitive markets, and are often combined with supply curves to estimate the equilibrium price (the price at which sellers together are willing to sell the same amount as buyers together are willing to buy, also known as market clearing price) and the equilibrium quantity (the amount of that good or service that will be produced and bought without surplus/excess supply or shortage/excess demand) of that market. In a monopolistic market, the demand curve facing the monopolist is simply the market demand curve.

Demand curves are usually considered as theoretical structures that are expected to exist in the real world, but real world measurements of actual demand curves are difficult and rare.

## Shape of the Demand Curve

Demand curves are often graphed as straight lines, where $a$ and $b$ are parameters:

$$Q = a + bP \text{ where } b < 0.$$

The constant $a$ embodies the effects of all factors other than price that affect demand. If income were to change, for example, the effect of the change would be represented by a change in the value of "a" and be reflected graphically as a shift of the demand curve. The constant $b$ is the slope of the demand curve and shows how the price of the good affects the quantity demanded.

The graph of the demand curve uses the inverse demand function in which price is expressed as a function of quantity. The standard form of the demand equation can be converted to the inverse equation by solving for P:

$$P = \frac{Q}{b} - \frac{a}{b}.$$

## Shift of a Demand Curve

The shift of a demand curve takes place when there is a change in any non-price determinant of demand, resulting in a new demand curve. Non-price determinants of demand are those things that will cause demand to change even if prices remain the same—in other words, the things whose changes might cause a consumer to buy more or less of a good even if the good's own price remained unchanged.

Some of the more important factors are the prices of related goods (both substitutes and complements), income, population, and expectations. However, demand is the willingness and ability of a consumer to purchase a good *under the prevailing circumstances*; so, any circumstance that affects the consumer's willingness or ability to buy the good or service in question can be a non-price determinant of demand. As an example, weather could be a factor in the demand for beer at a baseball game.

When income increases, the demand curve for normal goods shifts outward as more will be demanded at all prices, while the demand curve for inferior goods shifts inward due to the increased attainability of superior substitutes. With respect to related goods, when the price of a good (e.g. a hamburger) rises, the demand curve for substitute goods (e.g. chicken) shifts out, while the demand curve for complementary goods (e.g. ketchup) shifts in (i.e. there is more demand for substitute goods as they become more attractive in terms of value for money, while demand for complementary goods contracts in response to the contraction of quantity demanded of the underlying good).

## Factors Affecting Individual Demand

- Changes in the prices of related goods (substitutes and complements).
- Changes in disposable income, the magnitude of the shift also being related to the income elasticity of demand.
- Changes in tastes and preferences. Tastes and preferences are assumed to be fixed in the short-run. This assumption of fixed preferences is a necessary condition for aggregation of individual demand curves to derive market demand.
- Changes in expectations.

## Factors affecting Market Demand

In addition to the factors which can affect individual demand there are three factors that can cause the market demand curve to shift:

- A change in the number of consumers.
- A change in the distribution of tastes among consumers.
- A change in the distribution of income among consumers with different tastes.

Some circumstances which can cause the demand curve to shift in include:

- Decrease in price of a substitute.
- Increase in price of a complement.

- Decrease in income if good is normal good.
- Increase in income if good is inferior good.

### Movement along a Demand Curve

There is movement *along* a demand curve when a change in price causes the quantity demanded to change. It is important to distinguish between movement along a demand curve, and a shift in a demand curve. Movements along a demand curve happen only when the price of the good changes. When a non-price determinant of demand changes, the curve shifts. These “other variables” are part of the demand function. They are “merely lumped into intercept term of a simple linear demand function.” Thus a change in a non-price determinant of demand is reflected in a change in the x-intercept causing the curve to shift along the x axis.

### Price Elasticity of Demand (PED)

PED is a measure of the sensitivity of the quantity variable, Q, to changes in the price variable, P. Elasticity answers the question of how much the quantity will change in percentage terms for a 1% change in the price, and is thus important in determining how revenue will change. PED is negative because of the inverse relationship between the price of a good and the quantity of the good demanded, a consequence of the law of demand.

The elasticity of demand indicates how sensitive the demand for a good is to a price change. If the absolute value of PED is between zero and 1, demand is said to be inelastic; if the absolute value of PED equals 1, the demand is unitary elastic; and if the absolute value of Price elasticity of demand is greater than 1, demand is elastic. A low coefficient implies that changes in price have little influence on demand. A high elasticity indicates that consumers will respond to a price rise by buying a lot less of the good and that consumers will respond to a price cut by buying a lot more.

## ELASTICITY AND EXPENDITURE

The notion that price-induced changes in total expenditure (price times quantity) depend on the relative price elasticity of demand. If demand is relatively elastic, then changes in price cause total expenditure to change in the opposite direction. If demand is relatively inelastic, then changes in price cause total expenditure to change in the same direction. If demand is unit elastic, then changes in price do not cause any change in total expenditure.

The total expenditure that buyers make when purchasing a good depends on the price elasticity of demand. The price elasticity of demand is the relative change in quantity demanded due to a change in price. Total expenditure is price times quantity.

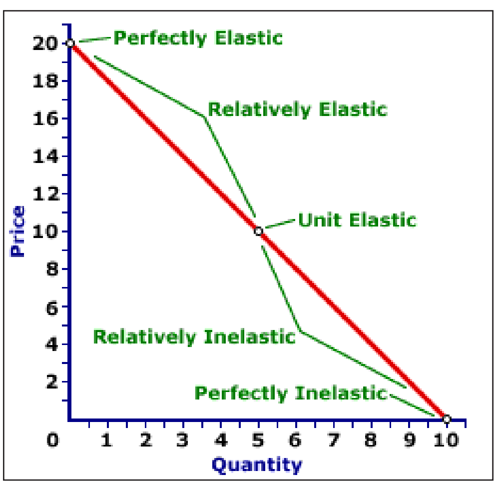
Because price and quantity change in opposite directions along a demand curve, changes in total expenditure depend on the relative changes in price and quantity. If price changes relatively less than quantity (elastic demand), then total expenditure changes in the opposite direction of price. If price changes relatively more than quantity (inelastic demand), then total expenditure changes in the same direction of price.

## Five Elasticity Alternatives

First, consider the relation between the five elasticity alternatives and a straight-line demand curve, such as the one for Digital Distance telephone services presented in this exhibit. The price ranges from 0 to 20 cents per minute and the quantity ranges from 0 to 10 million minutes per month.

- The point of intersection between the demand curve and the vertical price axis is perfectly elastic (E=∞).
- The segment between the midpoint and the price-axis intercept is relatively elastic (1 < E < ∞).
- The exact middle, or midpoint, of the demand curve is unit elastic (E=1).
- The segment between the midpoint and the quantity-axis intercept is relatively inelastic (0 < E < 1).
- The intersection point between the demand curve and the horizontal quantity axis is perfectly inelastic (E=0).

As the price declines from a high of 20 cents per minute at the top left of the demand curve to a low of 0 cents per minute at the bottom right, the price elasticity of demand changes from infinite (E=∞) to zero (E=0).



## Calculating Total Expenditure

Consider now a few total expenditure calculations. Total expenditure is calculated as price times quantity.

- For example, if the price is 18 cents per minute and the corresponding quantity demanded is 1 million minutes, then total expenditure on Digital Distance telephone services is $180,000 (= $0.18 x 1,000,000).

- Alternatively, if the price is 10 cents per minute and the corresponding quantity demanded is 5 million minutes, then total expenditure is $500,000 (= $0.10 x 5,000,000).

- Or, if the price is 2 cents per minute and the corresponding quantity demanded is 9 million minutes, then total expenditure on Digital Distance telephone services is also $180,000 (= $0.02 x 9,000,000).

Note that as the price declines from 18 cents to 10 cents, total expenditure increases from $180,000 to $500,000. However, as the price declines further from 10 cents to 2 cents, total expenditure decreases from $500,000 to $180,000. This pattern of increasing then decreasing total expenditure is related to the changing price elasticity of demand on the demand curve.

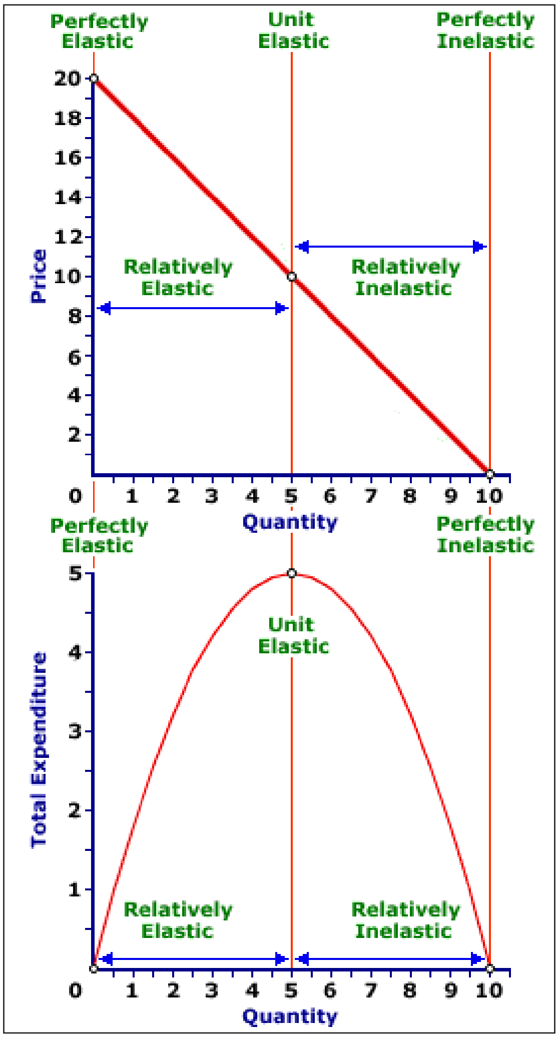
## Total Expenditure and Demand

The relation between demand elasticity and total expenditure can be illustrated with the exhibit at the right. The top panel on this graph is the straight-line demand curve for digital distance telephone services with the five elasticity alternatives. The top segment of this demand curve is relatively elastic, the bottom portion is relative inelastic, and the midpoint is unit elastic.

The bottom panel can be used to present the total expenditure curve derived from the demand curve. Total expenditure is found by multiplying the quantity by the corresponding price found on the demand curve. A quantity of 2 million minutes is associated with a price of 18 cents, giving a total expenditure of $180,000. A quantity of 5 million minutes is associated with a price of 10 cents and the total expenditure is $500,000. A quantity of 9 million minutes is associated with a price of 2 cents, also giving a total expenditure of $180,000. Other points on the total expenditure curve are identified in a like manner.

The result is an inverted-U shaped total expenditure curve. When quantity is zero, total expenditure is also zero, as the curve starts from the origin. As the quantity increases from 0 to 5 million minutes, total expenditure also rises. The curve peaks at 5 million minutes with a total expenditure of $500,000. The curve then declines until it reaches zero once again at a quantity of 10 million minutes.

The shape of this curve is connected to the price elasticity of demand along the demand curve. Along the relatively elastic range of the demand curve, for prices between 20 and 10 cents per minute, lower prices induce greater total expenditure. Along the relatively inelastic range of the demand curve, for prices between 10 and 0 cents per minute, lower prices induce lower total expenditure. And the peak of the total expenditure curve, when total expenditure is neither rising nor falling, the demand curve is unit elastic.




# ECONOMIC FACTORS FOR DEMAND OF CONSUMER GOODS

The consumer goods sector includes a wide range of retail products purchased by consumers, from staples such as food and clothing to luxury items such as jewelry and electronics. While overall demand for food is not likely to fluctuate wildly – although the specific foods consumers purchase can vary significantly under different economic conditions – the level of consumer spending on more optional purchases, such as automobiles and electronics, varies greatly depending on a number of economic factors. The economic factors that most affect the demand for consumer goods are employment, wages, prices/inflation, interest rates, and consumer confidence.

## How Employment and Wages affect Consumer Goods Demand?

One of the main factors influencing the demand for consumer goods is the level of employment. The more people there are receiving a steady income and expecting to continue receiving one, the more people there are to make discretionary spending purchases. Therefore, the monthly unemployment rate report is one economic leading indicator that gives clues to demand for consumer goods.

The level of wages also affects consumer spending. If wages are steadily rising, consumers generally have more discretionary income to spend. If wages are stagnant or falling, demand for optional consumer goods is likely to fall. Median income is one of the best indicators of the condition of wages for American workers.

## Prices and Interest Rates

Prices, affected by the rate of inflation, naturally impact consumer spending on goods significantly. This is one reason the producer price index (PPI) and the consumer price index (CPI) are considered leading economic indicators. Higher inflation rates erode purchasing power, making it less likely that consumers have excess income to spend after covering basic expenses such as food and housing. Higher price tags on consumer goods also deter spending.

Interest rates can also impact the level of spending on consumer goods substantially. Many higher-end consumer goods, such as automobiles or jewelry, are often purchased by consumers on credit. Higher interest rates make such purchases substantially more expensive and therefore deter these expenditures. Higher interest rates generally mean tighter credit as well, making it more difficult for consumers to obtain the necessary financing for major purchases such as new cars. Consumers often postpone purchasing luxury items until more favorable credit terms are available.

## Consumer Confidence

Consumer confidence is another important factor affecting the demand for consumer goods. Regardless of their current financial situation, consumers are more likely to purchase greater amounts of consumer goods when they feel confident about both the overall condition of the economy and about their personal financial future. High levels of consumer confidence can especially affect consumers' inclination to make major purchases and to use credit to make purchases.

Overall, demand for consumer goods increases when the economy producing the goods is growing. An economy showing good overall growth and continuing prospects for steady growth is usually accompanied by corresponding growth in the demand for goods and services.

## Effect of the Invisible Hand

Consumers participate in, help guide and are ultimately some of the benefactors of the invisible hand of the market. Through competition for scarce resources, consumers indirectly inform producers about what goods and services to provide and in what quantity they should be provided. As a result of their collective demands, preferences, and spending, consumers tend to receive cheaper, better and more goods and services over time, with all else being equal.

## Invisible Hand of the Market

In economics, the term "invisible hand" is used to describe the mechanisms that lead to spontaneous social benefits in a free market economy. These processes are "spontaneous" in the sense that they take place without dictate from a central authority, such as the government. The term was taken from a line in Adam Smith's famous book, An Inquiry into the Nature and Causes of the Wealth of Nations.

Professor Karen Vaughn described the impact of the invisible hand this way: "The invisible hand was Smith's metaphor for describing the mutually beneficial aspect of trade in an exchange economy that emerged as the unplanned consequences of the prosecution of individual plans."

Milton Friedman, an American economist, and professor at the University of Chicago during the second half of the 20th century provided perhaps the best known description of the role of the invisible hand. Friedman noted that it was "cooperation without coercion" and individual people, guided by their own self-interest, are guided to promote the general welfare of society at large, which was not part of their intention.

Much of the spontaneous order and many of the benefits of the market arise from different producers and consumers wanting to engage in mutually beneficial trades. Since all voluntary economic exchanges require each party to believe it benefits in some way, even psychologically, and because every consumer and producer has competitors to contend with, the overall standard of living is raised through the pursuit of separate interests.

## Consumers and the Invisible Hand

There are two primary mechanisms by which consumers affect and are affected by the invisible hand. The first mechanism is initiated through competitive bidding for various goods and services. Through decisions about what to buy and what not to buy, and at what prices those exchanges are acceptable, consumers express value to producers. Producers then compete with one another to organize resources and capital in such a way to provide those goods and services to consumers for a profit. The scarce resources in the economy are continuously rearranged and redeployed to maximize efficiency.

The second major effect arrives through the risk-taking, discovery, and innovations that occur as competitors consistently seek ways to maximize their productive capital. Increases in productivity are naturally deflationary, meaning consumers can purchase relatively more goods for relatively fewer monetary units. This has the effect of raising the standard of living, affording consumers more wealth even when their incomes remain the same.

## ANALYSIS OF CUSTOMER DEMAND TO CAPTURE CUSTOMER

Customer demand discrimination is a well-established methodology for the analysis of customer relationship management systems. The customer demand knowledge is descriptive information about customer consume preference and consume behavior that to identify customer demand. However, in the actual marketing, not only the preference cannot be defined by customers exactly, but also the preference is erratic. Especially in the telecommunication industry, the customers' demands are more variable and ambiguous because of various services and depressed switching cost, etc. Furthermore, there are some factors that potentially impact the customer perceptive value, which are customer education background, market circumstance, customer emotion, etc.

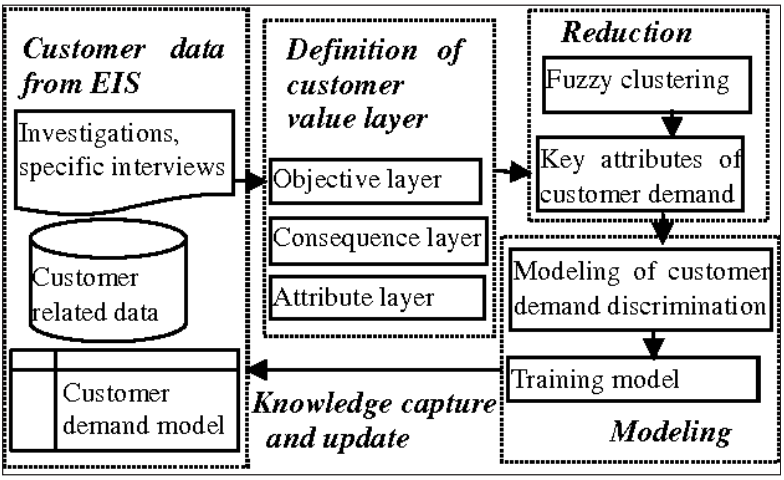
The complexity of customer demand discrimination is indicated in two aspects: firstly, a customer may belong to multiplex sorts that are simply classified by demand attributes. Secondly, there are uncertain relationships between the customer demand attributes and consume decision-making. So the customer demand discrimination is a subject of customer classification under uncertain condition.

Previous studies mainly focus on these subjects: firstly, predicting customer preferences and repeat-purchase patterns by consume data analysis; secondly, analyzing the antecedents and consequences of consume behavior and customer loyalty; thirdly, classifying customers by using clustering analysis. The shortage of this method is subjective with low intelligence level and large manual work.

Woodruff, Burns and Goodstein proposed the CVD (Customer Value Determination) and built the correlative relationships among the customer demand attribute layer, the consequence layer and the objective layer. However they did not present technical tools to implement the CVD knowledge capture.

## Framework for Customer Demand Discrimination

The supporting framework for the process of mobile costumer demand analysis is presented in figure.




Framework for customer demand discrimination.

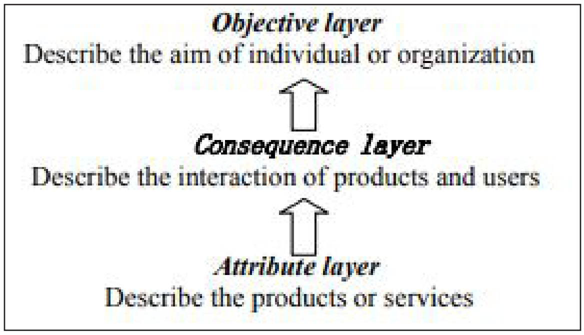
- Definition of customer value: According to Woodruff's CVD theory, which suggested that customer demand hierarchy contains the objective layer, the consequence layer and the attribute layer, the mobile customer value hierarchy is defined.
- Reduction: This step is to find the significant attributes of customer value layers, which is a group of attribute layer variables that influence the customer demand objectives. That is solved by the fuzzy cluster analysis.
- Modeling: A customer demand discrimination model is built. Well formed model could judge the classification of customer demand objective layer perfectly from their choices on demand attribute layer. This is achieved by adopting the neural network method.

## Mobile Customer Demand Analysis

## Contour Model of Mobile Customer Value Hierarchy

Woodruff advanced the CVD indicating that how customer consider product with hierarchy structure. The customer value hierarchy is presented in figure.

From the bottom of customer value hierarchy, customers firstly consider the attributes and availabilities of products. At the second layer, customers begin to make expectation according to these attributes. At the top layer, customers form expectation about the realization of their aim.




Customer value hierarchy.

The mobile customer value hierarchy consists of the customer demand objective layer, the consequence layer and the attribute layer:

- The objective layer: The objective layer means the ultimate motivations of customers engaging in mobile telecommunication services. Customers may have multiple motivations in the objective layer.
- Consequence layer: The Consequence layer means the customer experience of mobile services.
- Attribute layer: The Attribute layer means the usage of mobile services.

The factors of objective layer and attribute layer are defined as the variable a(i=1, 2...29)$_{\text{o.}}$

Table: Mobile customer value hierarchy.

| Objectives | Consequences | Attributes | |
|---|---|---|---|
| Communicative Object (a26) | Convenient communication, | Short massage service | a1 |
| | | Call waiting call | a2 |
| | | Diversion | a3 |
| | | Little secretary | a4 |
| | | Voice mail box | a5 |
| Business Object(a27) | High quality, knight service, high standing | U-net | a6 |
| | | Routine service | a7 |
| | | Ticket booking | a8 |
| | | Uni-colour E | a9 |
| | | E- bank Stock exchange | a10 |
| | | | a11 |
| | | Mobile purchase | a12 |

| | | | |
|---|---|---|---|
| Recreational Object(a28) | Fashion, pleasure, selfhood, fun | Color ring back tone mobile ring<br>Mobile picture<br>E-game<br>Chat<br>Mobile movie | a13<br>a14<br>a15<br>a16<br>a17<br>a18 |
| Informational Object(a29) | knowledge, in time, information | News service<br>Weather info<br>Travel info<br>Finance info<br>Physical news Entertainment info<br>U-map | a19<br>a20<br>a21<br>a22<br>a23<br>a24<br>a25 |

## Significant Attributes Analysis of Customer Value Hierarchy

The significant attributes of customer value hierarchy mean the key attribute variables of the attribute layer which distinctly correlate with the objective layer.

Because of the large numbers of mobile telecommunication products/services and the relatively small percentage of the mobile services/products engagement, the original data of customer value hierarchy is high dimensional sparse feature data. Therefore, this step is mainly to decrease the data dimension in customer demand analysis.

## Principles of Significant Attributes Analysis

According to the rough set theory, data of the customer value objective layer and attribute layer can be defined as S= (U, A, V, f). Here: U= $\{u_1, u_2, \cdots, u_n\}$: the set of customers where n is the total number of customer. A= $\{a_1, a_2, \cdots, a_m\}$: the set of variables of the objective layer and the attribute layer. $A = C \cup D$, where C is the characteristics set of the attribute layer, and D is the characteristics set of the objective layer. V is the set of the customer attribute parameters. The value of $f(u_j, a_i)$ indicates the value of $u_j$ about $a_i$

The significant attributes analysis is solved by fuzzy cluster. The process of the analysis is:

Step1: Partition customer set A into D and C. Consider the numerical character of attribute ai in attributes set C, and represent attribute $a_i$ as $a_{ij}$ j=1,2,...,k). Here k is the number of incoordinate value of attribute $a_i$.

Step2: Calculate the fuzzy similarity matrix R. The equation below is the Cosine distance measure as the method of similarity measurement of the study objects.

$$r_{ij} = \sum_{k=1}^{m}\left(a_{ik}a_{jk}\right)^2 / \sqrt{\left(\sum_{k=1}^{m} a_{ik}^2\right)\left(\sum_{k=1}^{m} a_{jk}^2\right)}$$

Step3: Calculate the fuzzy transitive closure t(R) of the fuzzy correlation matrix R. Use the cluster method to analyze t(R) with intercept λ and find out the significant attributes set.

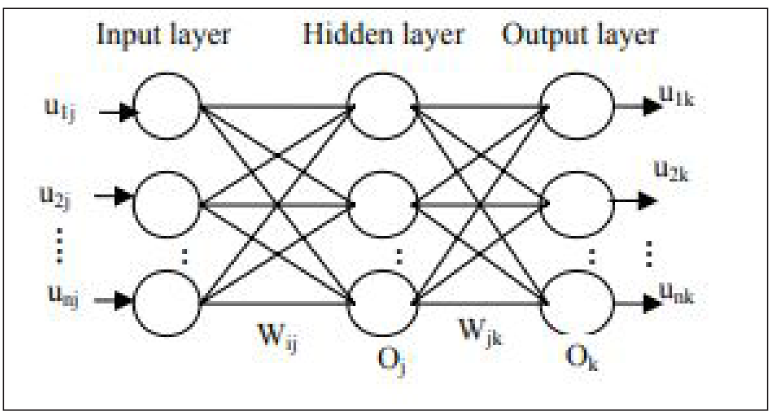
## Mobile Customer Demand Discrimination Modeling

The customer demand hierarchy is applied into customer demand analysis modeling for concluding customer demand object by analyze customer demand attribute. This is achieved by adopting BP-neural network method.

## Principle of Modeling of Mobile Customer Demand Discrimination

Customer demand discrimination model is built while making the customer demand objective layer $U = [u_{1k}, u_{2k}, \ldots u_{nk},](k \in D)$ as the output of the model and making significant attributes of the attribute layer $U = [u_{1j}, u_{2j}, \ldots u_{nj},](j \in C_c)$ as the input of the model.

The structure of neural network is shown in figure. wij is the weight from input layer to hidden layer; wjk is the weight from hidden layer to output layer. The crunodes number of the hidden layer is set between 3 and 20.




Model of BP-neutral network for customer demand discrimination.

## Customer Demand Knowledge Capture

Well-formed model could judge the classification of customer demand objectives dynamically from their demand attributes. 3 customers are randomly selected from samples and the comparison between the analytical conclusions and the actual demands is presented in table. For getting obvious conclusion, we assume 3 as the dividing line.

Table: Comparison between analytical conclusions and actual demands.

| Customer | | a26 | a27 | a28 | a29 | Customer demand object |
|---|---|---|---|---|---|---|
| 1 | Actual demand | 5.0 | 2.0 | 2.0 | 3.0 | Communication object.<br>Information object. |
| | Analytical conclusion | 4.9 | 3.1 | 2.6 | 3.8 | 8 Communication object.<br>Business object.<br>Information object. |
| 2 | Actual demand | 5.0 | 3.0 | 2.0 | 4.0 | Communication object.<br>Business object.<br>Information object. |
| | Analytical conclusion | 4.9 | 3. | 2.9 | 3.8 | Communication object.<br>Business object.<br>Information object. |
| 3 | Actual demand | 5.0 | 3.0 | 3.0 | 5.0 | Communication object.<br>Business object.<br>Recreation object.<br>Information object. |
| | Analytical conclusion | 4.9 | 2.6 | 3.1 | 3.9 | Communication object.<br>Recreation object.<br>Information object. |

It can be indicated that the model can discriminate the customer demand with high accurate percentage. The sort order of customer demand objects that discriminated by the model are accordant to customer‘s actual object's sort order, even though the conclusion is not absolutely correct. That is because the conclusion is influenced by the dividing line of customer demand. Furthermore, the model can indicate a mensurable conclusion based on customer motivation that has the advantage of stability and reliability.

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# Consumerism

5 CHAPTER

The acquisition of goods and services that are encouraged through social and economic order is known as consumerism. A few of its aspects are critical consumerism, ethical consumerism, consumer protection, consumer privacy, etc. All the aspects related to consumerism have been carefully analyzed in this chapter.

Consumerism is the idea that increasing consumption of goods and services purchased in the market is always a desirable goal and that a person's wellbeing and happiness depends fundamentally on obtaining consumer goods and material possessions. In an economic sense, it is related to the predominantly Keynesian idea that consumer spending is the key driver of the economy and that encouraging consumers to spend is a major policy goal. From this point of view, consumerism is a positive phenomenon that fuels economic growth.

In common use, consumerism refers to a tendency of people living in a capitalist economy to engage in a lifestyle of excessive materialism that revolves around reflexive, wasteful, or conspicuous overconsumption. In this sense, consumerism is widely understood to contribute to the destruction of traditional values and ways of life, exploitation of consumers by big business, environmental degradation, and negative psychological effects. Early uses of the term in the mid-20th century were intended to have a positive connotation, which would emphasize the benefits that capitalism had to offer consumers in improving standards of living and an economic policy that would prioritize the interests of consumers, but these meanings have fallen out of general use.

As consumers spend, economists presume that consumers benefit from the utility of the consumer goods that they purchase, but businesses also benefit from increased sales, revenue, and profit. For example, if car sales are increasing, auto manufacturers will see a boost in profits. Additionally, the companies that make the steel, tires, and upholstery for cars also see increased sales. In other words, spending by the consumer can benefit the economy and the business sector in particular. Because of this, businesses and some economists have come to view increasing consumption as a critical goal in building and maintaining a strong economy, irrespective of the benefit to the consumer or society as a whole.

In Keynesian macroeconomics, boosting consumer spending through fiscal and monetary policy is a primary target for economic policy makers. Consumer spending makes up the lion's share of aggregate demand and Gross Domestic Product, so boosting consumer spending is seen as the most effective way to steer the economy toward growth. Saving can even be seen as harmful to the economy because it comes at the expense of immediate consumption spending.

Consumerism also helps shape some business practices. Planned obsolescence of consumer goods can displace competition among producers to make more durable products. Marketing and advertising can become focused on creating consumer demand for new products rather than informing consumers.

Beyond these effects, consumerism involves on the impact that increasing consumption in itself, and the view of the consumer as target of economic policy and a cash cow for the business sector, has on the consumer and the society within which the economy operates. Economist Thorstein Veblen developed the concept of conspicuous consumption, where consumers purchase, own, and use products not for their direct use value but as a way of signaling social and economic status. As standards of living rose subsequent to the Industrial Revolution, conspicuous consumption grew. High rates of conspicuous consumption can end up being a wasteful zero-sum or even negative-sum activity as real resources are used up to produce goods that are not valued for their use. This can be analogous to the phenomenon of rent seeking, including associated deadweight loss, but with social status as the objective rather than political influence.

## Advantages of Consumerism

Advocates of consumerism point to how consumer spending can drive an economy forward and lead to an increased production of goods and services. As a result of increased consumption spending, a rise in GDP growth or Gross Domestic Product can occur. In the U.S., signs of healthy consumer demand can be found in consumer confidence indicators, retail sales, and personal consumption expenditures. Business owners, workers in industry, and owners of raw resources can profit from sales of consumer goods either directly or by downstream buyers.

## Disadvantages of Consumerism

Consumerism can be criticized on economic grounds. In the form of conspicuous consumption, consumerism can impose enormous real costs on an economy. Consuming real resources in zero- or negative-sum competition for social status can offset the gains from commerce in a modern industrial economy and lead to destructive creation in markets for consumer and other goods. Consumerism can also create incentives for consumers to take on unsustainable levels of debt, which can contribute to financial crises and recessions.

Consumerism is also often criticized on cultural grounds. Some see that consumerism can lead to a materialistic society that neglects other values. Traditional modes of production and ways of life can be replaced by a focus on consuming ever more costly goods in larger quantities. Consumerism is often associated with globalization in promoting the production and consumption of globally traded goods and brands, which can be incompatible with local cultures and patterns of economic activity.

Environmental problems are frequently associated with consumerism to the extent that consumer goods industries and the direct effects of consumption produce environmental externalities. These can include pollution by producing industries, resource depletion due to widespread conspicuous consumption, and problems with waste disposal from excess consumer goods and packaging.

Lastly, consumerism is often criticized on psychological grounds. It is blamed for increasing status anxiety, where people experience stress for increasing competition for social status in the constant drive to “keep up with the Joneses” by increasing their consumption. Psychological research has shown that people who organize their lives around consumerist goals, such as product acquisition, report poorer moods, greater unhappiness in relationships, and other psychological problems. Psychological experiments shown that people exposed to consumerist values based on wealth, status, and material possessions display greater anxiety and depression. Others show that encouraging people to identify as consumers leads to lower trust, lower sense of personal responsibility, and less willingness to cooperate with others.

## Advantages of Consumerism

### Consumerism Stimulates Economic Growth

When goods or services are demanded in a society, then businesses must work harder to produce those items. It creates a never-ending cycle of buying and selling which allows the economy to grow. Increased production levels lead to more jobs. Additional employment leads to better wages in local communities. Higher wages lead to more spending. As the cycle continues to grow, the standard of living continually rises. That process creates more home, food, and job security for the average family.

### It also Boosts Creativity and Innovation

Businesses must continue to offer new goods or services to encourage ongoing sales. The only way to provide opportunities like this is to invest in research and development products. Consumers are always looking for the next product which solves their pain points better, cheaper, or both. That desire for something better places a lot of pressure on companies to continue producing better items. Then the cycle of economic growth continues.

### Cost Reductions are Encouraged because of Consumerism

When a society focuses on consumerism, the goal is to create the best value promise possible for the consumer. To define value, companies must recognize the pain points of their targeted demographics. Then they must be innovative with their production techniques to keep manufacturing costs as low as possible. This combination keeps prices down, which then allows a consumer to purchase items without being overly indebted to the process.

## It Weeds out the Poor Performers Naturally

Companies are forced to stay innovative when managing consumerism. There is no other way to be competitive. Anyone can enter the market with relatively few barriers to entry. The consumers will then have the final say as to who gets to stay and who leaves, based on their purchasing preferences. Although that causes some companies to go out of business, which means fewer jobs the best and the brightest almost always stick around.

## Consumerism Encourages Freelancing, Entrepreneurialism and Self-employment

People are encouraged to take risks in a society which encourages consumerism. You'll find more freelancers working on their own, securing contracts to work from home, in this type of society compared to others. Entrepreneurs who run "lean and mean" organizations have an opportunity to strike it big. Self-employment becomes an option because individuals provide high-quality services at prices much lower than the average competitor.

It is in these areas where real economic growth occurs:

- 99.9% of all businesses in the United States are classified as a small business.
- There are 8 million minority-owned small businesses currently operating in the U.S. right now.
- 58.9 million people in the United States are currently employed because of the structure of consumerism.
- Over 20 million people are employed by agencies with 20 employees or fewer.

## It Creates Safer Goods for Consumers

When consumerism is the element driving society, then purchasers become familiar with their rights and responsibilities. They seek protection from faulty products or inadequate goods by holding companies to higher standards. If those standards are not met, then the purchaser follows a process to be made whole – often through the court system.

These standards may even include how the business treats their customers. If two companies sell a similar item at the same price, it is the customer service which will sway the value proposition.

### Consumers are given more Choices in this Society

You can find more choices today than ever before in several product categories. New beverage flavors from Coca-Cola and Pepsi are introduced more often than ever before. You can find new potato chip flavors, mooncake flavors, and much more. Consumers even have the option to choose which celebrities they prefer to support by purchasing items that they choose to endorse. That is how consumerism improves the economy. You get what you want if you're willing to pay for it.

### Disadvantages of Consumerism

### Economy takes Precedence over the Environment

When a society focuses on consumerism, the environment is usually the first element to see degradation occur. When consumers focus an increased demand for goods or services, the natural resources in the area come under pressure. Raw materials, water, and food products may experience scarcity. Because the best price possible is also encouraged, shortcuts happen too, such as using harmful chemicals to encourage a better price point. By the time all is said and done, consumerism does harm than good from the perspective of the environment.

### It Changes the Moral Fabric of Society

Consumerism focuses on the personal ability to secure the best-possible goods or services when required. There are no ethics involved in this transaction. If you could achieve the lowest price when solving the most pain points, then you're the best. No consideration is given on how you got there.

Families experience this shift in the moral fabric too. They feel a "need" to purchase goods or services that are not required, as if shopping were an addiction. These purchases occur to facilitate equality in a society where everyone has access to the same products or services as everyone else.

### Consumerism Encourages Debt

People take out short-term loans to meet the needs of consumerism more often than they do under different spending structures. Credit card purchases are frequent, especially during special events, holidays, or new product launches. For Black Friday 2018, consumers in the United States spent over $717 billion on items for the holidays, a 4.3% increase from the year before. Over $1,000 per person was spent for the first time. Compare that to 2005, when $496 billion was spent with an average of $734 per person.

The United States is often viewed as the world's leader in consumerism. You'll find the average American has 3 or 4 credit cards in their possession and are carrying a rotating debt of more than $16,000. When the net worth of a household is less than $5,000, their average credit card debt is just under $4,000.

## It Leads to Health Problems

When people encounter debt that will not go away, higher stress levels are sure to follow. Constant exposure to stress leads to ongoing health problems, ranging from insomnia to depression and other mental health issues. The only way to be successful when your focus is on consumerism is to work harder, earn more, borrow more, and spend more time doing these things. You have less time for relationships, hobbies, or time to yourself.

## Consumerism does not Provide Fulfillment

Research consistently shows that people do not receive long-lasting fulfillment when their primary focus is on the materialism which occurs through consumerism. By the time someone starts earning $200,000 per year, the benefits of earning a higher salary disappear. People who make the most money tend to score the highest on a scale of negative emotions, reaching more than 50% by the time $360,000 is reached.

## It can be used as a Political Tool

During the 1950s, Americans were lauded for their approach to consumerism. Some messages were so strong that people were told they weren't patriotic if they chose to save money instead of spending it. During that decade, the U.S. economy grew by 37%. Families had 30% more spending power in 1959 compared to 1950 figures. Unemployment during the decade dropped to 4.5% at one point.

Despite all those advantages, 1 in 4 people still lived in poverty despite all the spending. It was one of the highest rates of poverty ever seen in the country outside of the Great Depression and wartime efforts, yet because of all the spending and the politics involved, it is often remembered as the best decade in U.S. history.

## Consumerism Conflicts with Various Spiritual Beliefs

Jesus told the rich young ruler that all he had to do to enter heaven was to give away all that he had. Islamic law prohibits earning interest or paying it. Buddhism looks at hard work and steady efforts as a path toward prosperity and progress. Judaism believes in completing God's creation while being smart stewards of money. Societies which are overly religious tend to avoid consumerism. Families who follow spiritual practices are often cast aside when living in consumerist lands. It is difficult to love money and God at the same time, and consumerism teaches that money should come first.

### Poor are always Left behind by Consumerism

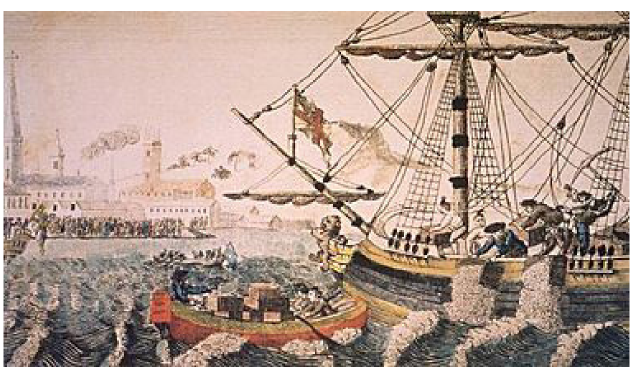
If you don't have the money to pursue a choice, then you're left with no choice. You purchase what you can afford to meet your needs. There is a negative stigma in consumerist societies involving people who ask for help. Even if you've been cast aside through no fault of your own, when you don't purchase, then you're not participating. You are cut-off from the very fabric of society until you can provide yourself once again. That creates a cycle which is difficult to break. You can't participate because you're not employed or poor, but you can't get a job because you're not engaged with society.

## CRITICAL CONSUMERISM

Critical consumption is the conscious choice of buying or not buying a specific product according to ethical and political beliefs. The critical consumer recognizes the importance of considering some characteristics of the product and its realization, such as environmental sustainability and respect of workers' rights. Indeed, critical consumers take full responsibility for the environmental, social and political effects of their choices. The critical consumer can sympathize with certain social movement goals and contributes towards them through modifying their consumption behavior.

Work on critical consumption has differed in the terms used to refer to boycotting and buycotting actions. The more prominent include ethical consumption and political consumerism, while sustainable consumption, more linked with policy, has also increased in usage.

Often consumer and citizen are considered as different because consumers only show self-interest, whereas citizens denote expanded self-interest. The general idea is that, consumers 'buy what they want—or what they have been persuaded to want—within the limits of what they can get. Citizenship, on the other hand, carries duties or responsibilities along with various rights. Since consumers are seen also as citizens they have to behave in a community-oriented, moral and political way, rather than as a self-interested one.



The Boston Tea Party was an important example of boycotting against England.

The chase for a fair consumption has deep roots in consumption history, starting for example with the American Revolution. Sympathizers of the American cause, in those years, refused to buy English goods, to support colons rebellion. This act of conscious choice can be seen as the beginning of both critical and political consumption. Traces of these two concepts can be found at the turn of the nineteenth century, in the United States, where the National Consumer League promoted the so-called “Whitelists”, in which all the companies that treated fairly their employees were listed.

At the end of the century, also the first forms of political activism in consumption took place in the United States and Europe, like the “Dont Buy Jewish” boycotts. Several organizations were born in those times and in the following centuries, asking the consumers to join the mobilizations as active subjects.

A variety of discourses about the “duty” and the “responsibilities” of social actors arose after the 1999 World Trade Organization protests in Seattle. People were explicitly asked to think that to shop is to vote.

## Boycotting and “Buycotting”

Boycotting and “buycotting” (Anti-boycott), as a particularly self-conscious form of consumption, are expressions of an individual’s political, ethical or environmental stance. Both boycotting and “buycotting” are discrete acts of critical consumption and they are mutually contingent. In fact, if the use-value or utility of a product is important, then it is difficult to view them as separate actions.


Buy Nothing Day demonstration.

Boycotting refers to abstaining from buying, avoiding specific products or brands to punish companies for undesirable policies or business practices. “Buycotting” is a term coined by Friedman; it refers to “positive buying” that aims to foster corporations that represent values – fair trade, environmentalism, sustainable development – that consumers choose to support.

When one boycotts a product or service, it does not mean that he abstains from consuming at all, but that he may select an alternative product or service. Equally, a choice to "buycott" could be understood as including a rejection or boycott of the non-ethical alternative. This interdependence is useful to explain the traditional pairing of boycotting and "buycotting" in much analysis of consumer politics.

One of the rising types of boycotting is the ad hoc one, which underlines the importance of consumers as political subjects. These initiatives show that critical consumption is really impacting in special occasions, gaining much more visibility than everyday boycotts. An example of this type of events is the Buy Nothing Day (BND).

### Sustainability

The notion of sustainability has both a temporal dimension demonstrated by the trade-off between present and future generations, and a justice dimension which considers the different distribution of harm and benefit. Under the term sustainability, notions of sustainable resource consumption by recycling, environmental protection, animal welfare, social justice, and climate responsibilities are gathered.

Although the "good" purposes of critical consumerism there are some critics and pitfalls connected to this practice of consumption:

- Fair trade protocols invite to respect all the communities and their cultures, workers' rights and so on. At the same time, however, it appears as a hegemonic tool to impose a western culture of which the right standards must be.
- It requires a huge production of green and ethical products, but it is difficult to realize in the small-scale local production.
- People live in an asymmetrical world in terms of information. They take decisions just with the use of few elements.
- "A 'paradox of sustainability' arises because more substantive approaches to sustainability may be too complex to effectively motivate appropriate social responses. Moreover, all human food consumption has some kind of impact—hence there will always be some kind of prioritization".

## ETHICAL CONSUMERISM

Ethical consumerism is a type of consumer activism based on the concept of dollar voting. It is practiced through the buying of ethically-made products that support small scale manufacturers and local artisans while protecting animals and the environment, and boycott' products that exploit children as workers, are tested on animals, or damage the environment.

The term "ethical consumer", now used generically, was first popularised by the UK magazine *Ethical Consumer*, first published in 1989. *Ethical Consumer* magazine's key innovation was to produce 'ratings tables', inspired by the criteria-based approach of the then emerging ethical investment movement. *Ethical Consumer*'s ratings tables awarded companies negative marks across a range of ethical and environmental categories such as 'animal rights', 'human rights' and 'pollution and toxics', empowering consumers to make ethically informed consumption choices and providing campaigners with reliable information on corporate behaviour. Such criteria-based ethical and environmental ratings have subsequently become commonplace both in providing consumer information and in business-to-business corporate social responsibility and sustainability ratings such as those provided by Innovest, Calvert Foundation, Domini, IRRC, TIAA–CREF and KLD Analytics. Today, Bloomberg and Reuters provide "environmental, social and governance" ratings direct to the financial data screens of hundreds of thousands of stock market traders. The not-for-profit Ethical Consumer Research Association continues to publish *Ethical Consumer* and its associated website, which provides free access to ethical ratings tables.

Although single-source ethical consumerism guides such as Ethical Consumer, Shop Ethical, and The Good Shopping Guide have proven to be popular, they suffer from the drawback of incomplete coverage. User-generated ethical reviews are more likely, long-term, to provide democratic, in-depth coverage of a wider range of products and businesses. The Green Stars Project promotes the idea of including ethical ratings (on a scale of 1-5 green stars) alongside conventional ratings on retail sites such as Amazon or review sites such as Yelp.

The term political consumerism first used in a study titled "The Gender Gap Reversed: Political Consumerism as a Women-Friendly Form of Civic and Political Engagement" from authors Dietlind Stolle and Michele Micheletti is identical to idea of ethical consumerism; however in this study, the authors found that political consumerism is a form of social participation that often goes overlooked at the time of writing and needs to be accounted for in future studies of social participation.

## Consumer Groups

In the late 19th and early 20th centuries, people began to have formal consumer movement to ensure that people will get value for their money for the things they purchased in industrialised countries. This kind of movements focused on the unfair labor practices of the companies, labelling requirements of food, cosmetics, drugs and etc. Examples to the consumer movements were Consumer League which was established in New York, USA in 1891, National Consumers League created in USA in 1898, Consumers Council which was established during World War I in Great Britain. During that time workers were not well-paid, they did not have secure employment with benefit of social protection, working conditions was decent and in this Irish trade union movement focused the ILO policy of campaigning for decent work wherever there is an opportunity for job improvement or job creation.

## Global Morality

An electric wire reel reused as a center table in a Rio de Janeiro decoration fair. When consumers choose and reuse environmentally friendly material like this, they are practicing ethical consumerism.

In *Unequal Freedoms: The Global Market As An Ethical System*, John McMurtry argues that no purchasing decision exists that does not itself imply some moral choice, and that there is no purchasing that is not ultimately moral in nature. This mirrors older arguments, especially by the Anabaptists, e.g. Mennonites, Amish, that one must accept all personal moral and spiritual liability of all harms done at any distance in space or time to anyone by one's own choices. It is often suggested that Judeo-Christian scriptures further direct followers towards practising good stewardship of the Earth, under an obligation to a God who is believed to have created the planet for us to share with other creatures. A similar argument presented from a secular humanist point of view is that it is simply better for human beings to acknowledge that the planet supports life only because of a delicate balance of many different factors.

## Spending as Morality

Some trust criteria, e.g. creditworthiness or implied warranty, are considered to be part of any purchasing or sourcing decision. However, these terms refer to broader systems of guidance that would, ideally, cause any purchasing decision to disqualify offered products or services based on non-price criteria that affect the moral rather than the functional liabilities of the entire production process. Paul Hawken, a proponent of natural capitalism, refers to "comprehensive outcomes" of production services as opposed to the "culminative outcomes" of using the product of such services. Often, moral criteria are part of a much broader shift away from commodity markets towards a deeper service economy where all activities, from growing to harvesting to processing to delivery, are considered part of the value chain and for which consumers are "responsible".

Andrew Wilson, Director of the UK's Ashridge Centre for Business and Society, argues that "Shopping is more important than voting", and that the disposition of money is the most basic role we play in any system of economics. Some theorists believe that it is the clearest way that we express our actual moral choices, i.e., if we say we care about something but continue to buy from parties that have a high probability of risk of harm or destruction of that thing, we don't really care about it, we are practising a form of simple hypocrisy.

# CONSPICUOUS CONSUMPTION

Conspicuous consumption is the spending of money on and the acquiring of luxury goods and services to publicly display economic power— the income or of the accumulated wealth of the buyer. To the conspicuous consumer, such a public display of discretionary economic power is a means of either attaining or maintaining a given social status.

The development of Thorstein Veblen's sociology of conspicuous consumption produced the term invidious consumption, the ostentatious consumption of goods that is meant to provoke the envy of other people; and the term conspicuous compassion, the deliberate use of charitable donations of money in order to enhance the social prestige of the donor, with a display of superior socio-economic status.

## Consumerism Theory

As proposed by Thorstein Veblen in the 19th century, conspicuous consumption (spending money to buy goods and services for their own sake) explains the psychological mechanics of a consumer society, and the increase in the number and the types of the goods and services that people consider necessary to and for their lives in a developed economy.

Supporting interpretations and explanations of contemporary conspicuous consumption are presented in Consumer Culture, by C. Lury, Consumer Culture and Modernity, by D. Slater, Symbolic Exchange and Death, by Jean Baudrillard, and Spent: Sex, Evolution, and the Secrets of Consumerism, by Geoffrey Miller. Moreover, Hiding in the Light, by D. Hebdige, proposed that conspicuous consumption is a form of displaying a personal identity, and a consequent function of advertising, as proposed in Ads, Fads, and Consumer Culture, by A. A. Berger.

Each variant interpretation and complementary explanation is derived from Thorstein Veblen's original sociologic proposition in The Theory of the Leisure Class: that conspicuous consumption is a psychological end in itself, from which the practitioner (man, woman, family) derived the honour of superior social status.

## Distinctions of Type

- The term conspicuous consumption denotes the act of buying many things, especially expensive things that are not necessary to one's life, done in a way that makes people notice the buyer's having bought the merchandise. In the article "Veblen, Bourdieu, and Conspicuous Consumption", A. Trigg defined conspicuous consumption as the behaviours whereby a man or a woman can display great wealth, by means of idleness—expending much time in the practice of leisure activities, and spending much money to consume luxury goods and services.

- Self-worth: In the book Income, Saving and the Theory of Consumer Behavior, J. S. Duesenberry proposed that a person's conspicuous consumption psychologically depends not only upon the actual level of spending, but also depends upon the degree of his or her spending, as compared with and to the spending of other people. That the conspicuous consumer is motivated by the importance, to him or to her, of the opinion of the social and economic reference groups for whom are performed the patterns of conspicuous consumption.

- Aggressive ostentation: In the television report "Aggressive Ostentation", Dick Meyer said that conspicuous consumption is a form of anger towards society, an "aggressive ostentation" that is an antisocial behaviour, which arose from the social alienation suffered by men, women, and families who feel they have become anonymous in and to their societies, which feeling of alienation is aggravated by the decay of the communitarian ethic essential to a person feeling him or herself part of the whole society.

- Shelter and transport: In the U.S., the trend towards building houses that were larger-than-needed, by a nuclear family, began in the 1950s. Decades later, in the year 2000, that practice of conspicuous consumption resulted in people buying houses that were double the average size needed to comfortably house a nuclear family. The negative consequences of either buying or building an oversized house was either the loss of or the reduction of the family's domestic recreational space—the back yard and the front yard; the spending of old-age retirement funds to pay for a too-big house; and over-long commuting time, from house to job, and vice versa, because the required plot of land was unavailable near a city.

  Oversized houses facilitated other forms of conspicuous consumption, such as an oversized garage for the family's oversized motor vehicles or buying more clothing to fill larger clothes closets. Conspicuous consumption becomes a self-generating cycle of spending money for the sake of social prestige. Analogous to the consumer trend for oversized houses is the trend towards buying oversized light-trucks, specifically the off-road sport-utility vehicle type (cf. station wagon and estate car), as a form of psychologically comforting conspicuous consumption, because such big motor-vehicles usually are bought by people who reside in a city, an urban nuclear family.

- Prestige: Status consumption is based upon conspicuous consumption; yet, the literature of contemporary marketing does not establish definitive meanings for the terms status consumption and conspicuous consumption. Moreover, sociologists often incorrectly used the terms "status consumption" and "conspicuous consumption" as interchangeable and equivalent terms. In a later study, O'Cass and Frost determined that, as sociologic constructs, the terms "status consumption" and "conspicuous consumption" denote different sociologic behaviours. About the ambiguities of denotation and connotation of the term "conspicuous consumption", R. Mason reported that the classical, general theories of consumer decision-processes do not readily accommodate the construct of "conspicuous consumption", because the nature of said socio-economic behaviours varies according to the social class and the economic group studied.
- Motivations: Whilst marketing and sales researchers recognise the importance of the buyer's social and psychological environment—the definition of the term status-directed consumption remains ambiguous, because, to develop a comprehensive general theory requires that social scientists accept two fundamental assumptions, which usually do not concord. First, though the "rational" (economic) and the "irrational" (psychologic) elements of consumer decision-making often influence a person's decision to buy particular goods and services, marketing and sales researchers usually consider the rational element dominant in a person's decision to buy the particular goods and services. Second, the consumer perceives the utility of the product (the goods, the services) as a prime consideration in evaluating its usefulness, i.e. the reason to buy the product. These assumptions, required for the development of a general theory of brand selection and brand purchase, are problematic, because the resultant theories tend either to misunderstand or to ignore the "irrational" element in the behaviour of the buyer-as-consumer; and because conspicuous consumption is a behaviour predominantly "psychological" in motivation and expression, Therefore, a comprehensive, general theory of conspicuous consumption would require a separate construct for the psychological (irrational) elements of the socio-economic phenomenon that is conspicuous consumption.

High levels of conspicuous consumption may be seen as socially undesirable on two grounds; firstly, as it is often associated with high relative income, high levels of conspicuous consumption may be an indicator of high levels of income inequality, which may be found intrinsically or instrumentally objectionable; secondly conspicuous consumption differs from other forms of consumption in that the main reason for the purchase of positional goods is not due to the additional direct utility provided by the goods alleged high quality, but rather the social prestige associated with the consumption of that good. One downside of this search for status is that individual purchases of positional goods may at a social level be self-defeating due to external effects. In this case, the externality is status anxiety, the loss of social status suffered by people whose stock of high-status goods (positional goods) is diminished, in relation to the stocks of other conspicuous consumers, as they increase their consumption of high-status goods and services; effectively, status-seeking is a zero-sum game—by definition, the rise of one person in the social hierarchy can occur only at the expense of other people. Therefore, the conspicuous consumption of luxury goods and services (positional goods) is an economic loss—like competitive military spending (an arms race), wherein each country must match the military expenditures of other countries in the arms race, or suffer a loss of relative military power. In the case of conspicuous consumption, taxes upon luxury goods diminish societal expenditures on high-status goods, by rendering them more expensive than non-positional goods. In this sense, luxury taxes can be seen as a market failure correcting Pigovian tax—with an apparent negative deadweight loss, these taxes are a more efficient mechanism for increasing revenue than 'distorting' labour or capital taxes.

In the 19th century, the philosopher John Stuart Mill recommended taxing the practice of conspicuous consumption.

A luxury tax applied to goods and services for conspicuous consumption is a type of progressive sales tax that at least partially corrects the negative externality associated with the conspicuous consumption of positional goods. In *Utility from Accumulation*, Louis Kaplow said that assets exercise an objective social-utility function, i.e. the rich man and the rich woman hoard material assets, because the hoard, itself, functions as status goods that establish his and her socio-economic position within society. When utility is derived directly from accumulation of assets, this lowers the dead weight loss associated with inheritance taxes and raises the optimal rate of inheritance taxation.

In place of luxury taxes, the economist Robert H. Frank proposed the application of a progressive consumption tax; as a remedy for the social and psychological malaise that is conspicuous consumption, the personal income tax should be replaced with a progressive tax upon the yearly sum of discretionary income spent on the conspicuous consumption of goods and services. Another option is the redistribution of wealth, either by means of an incomes policy – for example the conscious efforts to promote wage compression under variants of social corporatism such as the Rehn–Meidner model and/or by some mix of progressive taxation and transfer policies, and provision of public goods. When individuals are concerned with their relative income or consumption in comparison to their peers, the optimal degree of public good provision and of progression of the tax system is raised. Because the activity of conspicuous consumption, itself, is a form of superior good, diminishing the income inequality of the income distribution by way of an egalitarian policy reduces the conspicuous consumption of positional goods and services. In *Wealth and Welfare*, the economist A. C. Pigou said that the redistribution of wealth might lead to great gains in social welfare:

> "Now the part played by comparative, as distinguished from absolute, income is likely to be small for incomes that only suffice to provide the necessaries and primary comforts of life, but to be large with large incomes. In other words, a larger proportion of the satisfaction yielded by the incomes of rich people comes from their relative, rather than from their absolute, amount. This part of it will not be destroyed if the incomes of all rich people are diminished together. The loss of economic welfare suffered by the rich when command over resources is transferred from them to the poor will, therefore, be substantially smaller relatively to the gain of economic welfare to the poor than a consideration of the law of diminishing utility taken by itself suggests."

The economic case for the taxation of positional, luxury goods has a long history; in the mid-19th century, in *Principles of Political Economy with some of their Applications to Social Philosophy*, John Stuart Mill said:

> "I disclaim all asceticism, and by no means wish to see discouraged, either by law or opinion, any indulgence which is sought from a genuine inclination for, any enjoyment of, the thing itself; but a great portion of the expenses of the higher and middle classes in most countries is not incurred for the sake of the pleasure afforded by the things on which the money is spent, but from regard to opinion, and an idea that certain expenses are expected from them, as an appendage of station; and I cannot but think that expenditure of this sort is a most desirable subject of taxation. If taxation discourages it, some good is done,

and if not, no harm; for in so far as taxes are levied on things which are desired and possessed from motives of this description, nobody is the worse for them. When a thing is bought not for its use but for its costliness, cheapness is no recommendation."

# CONSUMER PROTECTION

Consumer protection is the practice of safeguarding buyers of goods and services, and the public, against unfair practices in the marketplace. Consumer protection measures are often established by law. Such laws are intended to prevent businesses from engaging in fraud or specified unfair practices in order to gain an advantage over competitors or to mislead consumers. They may also provide additional protection for the general public which may be impacted by a product or its production even when they are not the direct purchaser or consumer of that product. For example, government regulations may require businesses to disclose detailed information about their products—particularly in areas where public health or safety is an issue, such as with food or automobiles.

Consumer protection is linked to the idea of consumer rights and to the formation of consumer organizations, which help consumers make better choices in the marketplace and pursue complaints against businesses. Entities that promote consumer protection include government organizations (such as the Federal Trade Commission), self-regulating business organizations (such as the Better Business Bureaus), and non-governmental organizations that advocate for consumer protection laws and help to ensure their enforcement (such as consumer protection agencies and watchdog groups).

A consumer is defined as someone who acquires goods or services for direct use or ownership rather than for resale or use in production and manufacturing. Consumer interests can also serve consumers, consistent with economic efficiency, but this topic is treated in competition law. Consumer protection can also be asserted via non-government organizations and individuals as consumer activism.

## Consumer Law

Consumer protection law or consumer law is considered as an area of law that regulates private law relationships between individual consumers and the businesses that sell those goods and services. Consumer protection covers a wide range of topics, including but not necessarily limited to product liability, privacy rights, unfair business practices, fraud, misrepresentation, and other consumer/business interactions. It is a way of preventing frauds and scams from service and sales contracts, eligible fraud, bill collector regulation, pricing, utility turnoffs, consolidation, personal loans that may lead to bankruptcy.

# CONSUMER PRIVACY

Consumer privacy, also known as customer privacy, involves the handling and protection of the sensitive personal information provided by customers in the course of everyday transactions. The internet has evolved into a medium of commerce, making consumer data privacy a growing concern.

## Consumer Privacy Issues

Personal information, when misused or inadequately protected, can result in identity theft, financial fraud and other problems that collectively cost people, businesses and governments millions of dollars per year.

Common consumer privacy features offered by corporations and government agencies include:

- "Do not call" lists.
- Verification of transactions by email or telephone.
- Nonrepudiation technologies for email.
- Passwords and other authorization measures.
- Encryption and decryption of electronically transmitted data.
- Opt-out provisions in user agreements for bank accounts, utilities, credit cards and similar services.
- Digital signatures.
- Biometric identification technology.

The emergence of internet commerce and big data in the early 2000s cast consumer data privacy issues in a new light. While the World Wide Web Consortium's (W3C's) Platform for Privacy Preferences Project (P3P) arose to provide an automated method for internet users to divulge personal information to websites, widespread gathering of web activity data was largely unregulated.

The ways in which data is used and collected now are more expansive than ever before. Data has taken on a new value for corporations and, as a result, almost any interaction with a large corporation, no matter how passive, results in the collection of consumer data. This is partially because more data leads to improved online tracking, behavioral profiling and data-driven targeted marketing.

The surplus of valuable data, combined with minimal regulation, increases the chance that sensitive information will be misused or mishandled.

## Laws that Protect Consumer Privacy

Consumer privacy is derived from the idea of personal privacy, which, although not explicitly outlined in the U.S. Constitution, has been put forward as an essential right in a number of legal decisions. The Ninth Amendment is often used to justify a broad reading of the Bill of Rights to protect personal privacy in ways that aren't specifically outlined, but implied.

Despite this, there is currently no comprehensive legal standard for data privacy at the federal level in the United States. There have been attempts at creating one, but none have been successful.

For example, in 2017 the U.S. federal government reversed a federal effort to broaden data privacy protection by requiring internet service providers (ISPs) to obtain their customers' consent prior to using their personal data for advertising and marketing. Another comprehensive federal consumer privacy bill was proposed in late 2019 called the Consumer Online Privacy Rights Act (COPRA), but it has yet to pass and many speculate that its approval will be a struggle.

Currently, the U.S. relies on a combination of state and federal laws enforced by various independent government agencies such as the Federal Trade Commission (FTC). These can sometimes lead to incongruities and loopholes in U.S. privacy law since there is no central authority enforcing them.

By contrast, legislation has enforced high standards of data privacy protection in Europe. For example, the European Union passed the General Data Protection Regulation (GDPR) in 2018, which unified data privacy laws across the EU, and updated existing laws to better encompass modern data collection and exchange practices.

The law also had a significant effect on nations outside of Europe - including the U.S. - because multinational corporations that serve EU citizens were forced to rewrite their privacy policies to remain in compliance with the new regulation. Companies who didn't comply could incur huge financial penalties. The most notable example is Google, which was fined $57 million under the GDPR in 2019 for failing to adhere to transparency and consent rules in the set-up process for Android phones.

GDPR is touted by many as the first legislation of its kind and has influenced other nations - and states within the U.S. - to adopt similar regulations. The reason the GDPR is possible for the EU is largely because many European nations have central data privacy authorities to enforce it.

While the U.S. doesn't have a unified data privacy framework, it does have a collection of laws that address data security and consumer privacy in various sectors of industry. Some federal laws that are relevant to consumer privacy regulations and data privacy in the U.S. include:

- The Privacy Act of 1974: Which governed collection and use of information about individuals in federal agencies' systems. The Privacy Act prohibits the disclosure of an individual's records without their written consent, unless the information is shared under one of 12 statutory exceptions.

- The Health Insurance Portability and Accountability Act of 1996 (HIPAA): Which outlines how Protected Health Information (PHI) used in the healthcare industry should be protected.
- The Fair Credit Reporting Act (FCRA) of 1970: Which protects consumer information as it pertains to their credit report, which provides insight into an individual's financial status.
- The Children's Online Privacy Protection Act (COPPA) of 1998: Which ensures that children under the age of 13 do not share personal information online without the consent of their parents.
- The Financial Modernization Act of 1999: Which governs how companies that provide financial products and services collect and distribute client information, as well as prevents companies from accessing sensitive information under false pretences. When defining client confidentiality, this act makes distinctions between a customer and a consumer. A customer must always be notified of privacy practices, whereas a consumer must only be notified under certain conditions.
- Family Educational Rights and Privacy Act (FERPA) of 1974: Which protects the privacy of student education records and applies to all schools that receive funding from the U.S. Department of Education.

Many of these federal laws, while providing reasonable privacy protections, are considered by many to be lacking in scope and out-of-date. However, at the state level, several important data privacy laws have recently been passed, with more pending approval in 2020. Because these laws were passed recently, they more adequately protect consumers in a way that applies to current data exchange practices.

The most notable of these state laws is the California Consumer Privacy Act (CCPA), which was signed in 2018 and took effect on January 1st, 2020. The law introduces a set of rights that previously had not been outlined in any U.S. law. Under the CCPA, consumers have several privileges, which a business is obliged to honor upon verifiable consumer requests. The law entitles consumers to:

- Know what personal data about them is being collected.
- Know if their personal data is being sold and to whom.
- Say no to the sale of personal information.
- Access their collected personal data.

- Delete data being kept about them.
- Not be penalized or charged for exercising their rights under the CCPA.
- Children require parental consent for data collection, and consumers 13-16 years old are required to provide affirmative consent - opt-in - to collection of their personal data.

The law applies to corporations that either make $25 million per year or collect data on more than 50,000 people. Companies that do not comply face sizeable penalties and fines.

The law also only applies to residents of California currently. However, it is expected to set the precedent for other states to take similar action. Several companies have also promised to honor the rights granted under the CCPA for consumers in all 50 states, so as not to have an entirely different privacy policy for Californians. Participating businesses include:

- Starbucks.
- Netflix.
- UPS.
- Microsoft.

Some other states enacting or currently practicing similar laws are:

- Vermont: In 2018, the state approved a law that requires data brokers to disclose consumer data collected, and grants consumers the right to opt-out.
- Nevada: In 2019, the state enacted a law allowing consumers to say no to the sale of their data.
- Maine: The state has enacted legislation set to take effect in 2020 that would prohibit broadband internet service providers from using, disclosing, selling or allowing access to customer data without explicit consent.
- New York: The state is in the process of constructing a privacy bill known as the New York Privacy Act (NYPA), which is modeled after - and aims to surpass - the CCPA.

Critics of these laws worry that they may still fall short and create loopholes that could be exploited by data brokers. Also, increased compliance regulations force corporations to adapt in order to abide, which creates more work, potential bottlenecks and may even hinder the development of valuable technology and services. A multitude of unique state laws may also create conflicting compliance requirements and end up creating new problems for consumers and corporations alike. However, privacy advocates view this somewhat concurrent state-level effort as a step toward comprehensive federal legislation in the future.

## Agencies that Regulate Data Privacy

Some of the agencies that regulate data privacy in the U.S. are:

- The Federal Trade Commission (FTC), which requires companies to disclose their corporate privacy policies to customers. The FTC can take legal action against companies that violate customer privacy policies or companies that compromise their customers' sensitive personal information. It also provides resources for those who want to learn more about privacy policies and best practices, as well as information for victims of privacy-related crimes, such as identity theft. The FTC is currently the most involved agency in regulating and defending data privacy in the U.S.

- The Consumer Financial Protection Bureau (CFPB), which protects consumers in the financial sector. It has outlined principles that protect consumers when authorizing a third party to access their financial data and regulates the provision of financial services and products using these principles.

- The U.S. Department of Education, which administers FERPA, and aids schools and school districts using best practices for the handling of student information. Students, especially those paying for secondary education, are consumers of an educational service.

- The Securities and Exchange Commission (SEC), which enforces rules surrounding the disclosure of data breaches and general data protection.

## Why Consumer Privacy Protection is Necessary?

A series of high-profile data breaches in which corporations failed to protect consumer data from internet hacking have drawn attention to shortcomings in personal data protection. Several such events were followed by government fines and forced resignations of corporate officers. In 2017, the litany of customer data breaches included Uber, Yahoo and Equifax, each providing unauthorized access to hundreds of thousands, if not millions, of customer records.

Table: High-profile data breaches have drawn attention to shortcomings in data protection.

| Company/Type of Data Involved | Estimated Number of Accounts Affected |
|---|---|
| Yahoo mail accounts | 3 Billion |
| Equifax credit reports | 143 Million |

| | |
|---|---|
| Deep root analytics U.S vector records | 198 Million |
| Various enterprise solutions customer information | 1.5 Million |
| Anthem medical records | 79 Million |
| Home depot customer payment-card accounts | 56 Million |
| Target customer payment-card accounts | 41 Million |

Consumer privacy issues have arisen as prominent web companies like Google and Facebook moved to the top of business ranks using web browser data to gain revenue. Other companies, including data brokers, cable providers and cell phone manufacturers, have also sought to profit from related data products.

The privacy measures offered to users by these companies are also insufficient. A research study published in 2019 showed that there is a limit to how much protection a social media user can get by self-regulating their content using an app's privacy settings. Even when Twitter users set their account to protected mode - the most prominent privacy setting - researchers found that the supposedly protected information was still being disclosed continuously.

Concern for corporate use of consumer data led to the creation of the GDPR to curb data misuse. The regulation requires organizations doing business in the EU to appropriately secure personal data and allow individuals to access, correct and even erase their personal data. Such compliance requirements have led to renewed emphasis on data governance, as well as data protection techniques such as anonymization and masking.

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# Consumers and National Economy

CHAPTER 6

A national economy is a broad amalgamation where consumers represent a major factor. Consumer spending is an important factor as it coincides with overall consumer confidence in the nation's economy. This chapter discusses the subject of consumers and their role in national economy in detail.

## ROLES OF HOUSEHOLDS FOR BUILDING AN ECONOMY

Households are the main sector for the consumption of an economy.

The performances of the households are categorised into two ways:

- It supplies the factor services to the firms in the form of factors of production like land, labour, capital etc.
- It purchases all the final goods and services produced by the firms from the markets directly. Hence, they supply different factor services to the economy and on the other hand they create demand for the final goods and services from the market.

### Role of Households

The roles and importance of households for building an economy are immense. Some of the performances are briefly given below:

### Act as a Producer

There are several families around the world  who are the owners of several small production units. These households act as entrepreneurs or producers of different goods and services. They form the enterprises which are basically semi-corporate in nature.

### Act as a Consumer

The households are the final consumers of goods and services produced by the firms.

They create demand in the market and according to their tastes and preferences. The firms produced and supplied goods in the market, as per their demand. Therefore, households determine the production line of a country.

### Act as a Tax-payer

Households are the main sources of the government tax-revenue. They are the main tax-payer. A household pays income tax, wealth tax, estate duty, gift tax etc. as direct taxes to the state. Similarly, a household pays several indirect taxes to the government like sales tax, customs duty, VAT etc. also. All these tax revenues are collected for the welfare and development of the economy.

### Act as a Professional

All types of professional services like doctor, teacher, lawyer, engineer etc. come from households. Their activities are very much required for the country to enhance economic development. These professional services increase the living standard of the people.

### Act as a Saver

Income left after consumption is saving. Hence households earn money income after giving several services to the economy. The portion of their income left after the consumption, is saved in the banks or financial institutions. These savings are considered as one of the main sources of capital formation.

## CONSUMER CONFIDENCE

Consumer confidence is an economic indicator that measures the degree of optimism that consumers feel about the overall state of the economy and their personal financial situation. If the consumer has confidence in the immediate and near future economy and his/her personal finance, then the consumer will spend more than save.

When consumer confidence is high, consumers make more purchases. When confidence is low, consumers tend to save more and spend less. A month-to-month trend in consumer confidence reflects the outlook of consumers with respect to their ability to find and retain good jobs according to their perception of the current state of the economy and their personal financial situation.

Consumer confidence typically increases when the economy expands, and decreases when the economy contracts. In the United States, there is evidence that the measure is a lagging indicator of stock market performance.

## Usage

Investors, manufacturers, retailers, banks, public opinion researchers and government agencies use various assessments of consumer confidence in planning their actions. The ability to predict major changes in consumer confidence allows businesses to gauge the willingness of consumers to make new purchases. As a result, businesses can adjust their operations and the government can prepare for changing tax revenue. If confidence is dropping and consumers are expected to reduce their spending, most producers will tend to reduce their production volumes accordingly. For example, if manufacturers anticipate consumers will reduce retail purchases, especially for expensive and durable goods, they will cut down their inventories in advance and may delay investing in new projects and facilities. Similarly, if banks expect consumers to decrease their spending, they will prepare for the reduction in lending activities, such as mortgage applications and credit card use. Builders will plan for the decline in home construction volumes. The government will get ready for the reduction in future tax revenues. On the other hand, if consumer confidence is improving, people are expected to increase their purchases of goods and services. In anticipation of that change, manufacturers can boost production and inventories. Large employers can increase hiring rates. Builders can prepare for higher housing construction rates. Banks can plan for a rise in demand for credit products. Government can expect improved tax revenues based on the increase in consumer spending.

## Conference Board, Present Situation Index and the Business Cycles

Major drops in the Present Situation Index tend to precede a drop in the business cycle. The economy enters a recession after the Conference Board, Present Situation Index drops by 15 points from its prior year's value.

## United States

## University of Michigan Consumer Sentiment Index

The University of Michigan Consumer Sentiment Index (MCSI) is produced by the University of Michigan and distributed by Thomson Reuters. The MCSI is designed to gauge consumer attitudes toward the overall business climate, the state of personal finances, and consumer spending. The University of Michigan releases three related figures each month: the Index of Consumer Sentiment (ICS, or MCSI), the Index of Current Economic Conditions (ICC), and the Index of Consumer Expectations (ICE). The most recent data for ICS is published by Reuters here. The Index of Consumer Expectations is an official component of the U.S. Index of Leading Economic Indicators.

On June 12, 2013, the CNBC reported that Thomson Reuters allows fee-paying customers access to the Index before it is available to others.

## Methodology of the MCSI

The Index of Consumer Sentiment (ICS) is based on the monthly telephone survey of the US household data. The Index is aggregated from five questions on the following topics: i) personal financial situation now and a year ago, ii) personal financial situation one year from now, iii) overall financial condition of the business for the next twelve months, iv) overall financial condition of the business for the next five years, v) current attitude toward buying major household items. The ICS is calculated from computing the “relative scores” for each of the five index questions: the percent giving favorable replies minus the percent giving unfavorable replies, plus 100. Each relative score is then rounded to the nearest whole number. All five relative scores are then summed and the sum is divided by 6.7558 (the 1966 base period) and 2 is added to the result (a constant to correct for sample design changes from the 1950s). ICC is calculated by dividing the sum of the rounded “relative scores” of the questions one and five by 2.6424 and adding 2. ICE is calculated by dividing the sum of the rounded “relative scores” of the questions two, three, and four by 4.1134 and adding 2.

## Bloomberg Consumer Comfort Index

The Bloomberg Consumer Comfort Index represents a four-week rolling average based on 250 telephone interviews a week with adults nationwide, giving a sample size of 1,000 for each four-week period. The survey began in December 1985 by the polling firm Langer Research Associates and was originally known as “The ABC News Consumer Comfort Index” before Bloomberg licensed the rights in 2011. The Index is based on consumers’ ratings of the economy, the buying climate, and personal finances. Unlike the other indicators, it measures only current conditions with no questions about expectations.

## Methodology of the Consumer Comfort Index

The Index aggregates consumer responses to three questions on the following topics: i) national economy (“would you describe the state of the nation’s economy these days as excellent, good, not so good, or poor?”, ii) on personal finances (“would you describe the state of your own personal finances these days as excellent, good, not so good, or poor?”) and iii) buying climate (“considering the cost of things today and your own personal finances, would you say now is an excellent time, a good time, a not so good time, or a poor time to buy the things you want and need?”). The Index is derived by subtracting the negative response to each question from the positive response to that question. The three resulting numbers are then added and divided by three. The index can range from +100 (everyone positive on all three measures) to -100 (all negative on all three measures).

## Consumer Confidence Average Index

The Consumer Confidence Average Index (CCAI) is a monthly indicator that aggregates data from the above three major national polls on consumer confidence. It represents the rescaled average of the Conference Board Consumer Confidence Index, the University of Michigan Consumer Sentiment Index, and the Bloomberg Consumer Comfort Index.

## Methodology of the CCAI

The CCAI takes into account historical values of all three indexes starting from December 1985. The value 0 of the Consumer Confidence Average represents the lowest value of each index. The value 100 of the Consumer Confidence Average represents the highest value of each index.

## Gallup Economic Confidence Index

The Gallup Economic Confidence Index is a broad indicator of Americans' confidence in national economic conditions, based on the combined responses to two questions. One question asks Americans to evaluate current economic conditions; the other measures their perceptions of whether the economy is getting better or getting worse. Gallup has asked the component questions periodically since 1992, monthly since October 2000, and daily since January 2008. Gallup reports results of the Economic Confidence Index on Gallup.com on a daily, weekly, monthly, and quarterly basis.

## Methodology of the ECI

Gallup's Economic Confidence Index is a composite of the two questions that Gallup asks daily of a nationally representative sample of 500 adults, aged 18 and older, and reports weekly based on approximately 3,500 interviews. The first question asks Americans to rate economic conditions in the country today, and second question asks whether they think economic conditions in the country as a whole are getting better or getting worse. The two questions have equal weight in the index, which is reported without revisions or seasonal adjustments. They can also be analyzed separately, providing insight into changes in the overall index. The survey is conducted with respondents contacted on landlines and cellphones, and includes Spanish-language interviewing. Gallup calculates the Economic Confidence Index by adding the percentage of people rating current economic conditions (["excellent" + "good"] minus "poor") to the percentage saying the economy is ("getting better" minus "getting worse"), and then dividing that sum by two. The Gallup Economic Confidence Index has a possible maximum of +100 (reached if all Americans rate current economic conditions as excellent or good, and all Americans say the economy is getting better) and a possible minimum of -100 (reached if all rate the current economy as poor, and say the economy is getting worse).

## Canada

The Conference Board of Canada's Index of Consumer Confidence has been ongoing since 1980. It is constructed from responses to four attitudinal questions posed to a random sample of Canadian households. Those surveyed are asked to give their views about their households' current and expected financial positions and the short-term employment outlook. They are also asked to assess whether now is a good or a bad time to make a major purchase such as a house, car or other big-ticket items.

### India

The relevance of a consumer confidence index for a country like India is evident from the fact that Consumption Expenditure accounts for over 60% of India's GDP. The BluFin Consumer Confidence Index is the first monthly, statistically robust index of consumer sentiment in India. The CCI is designed to provide reliable insights into the direction of the Indian national and regional economies. Released once a month, the index is computed from the results of a monthly survey of 4,000 consumers in 18 cities across India.The Zyfin (formerly known as BluFin) Consumer Confidence Index was developed by a team of financial economists and statisticians led by Dr. Sam Thomas, Ph.D., Director of Research and Development at BluFin. Dr Thomas is also Professor of Banking and Finance at the Weatherhead School of Management, Case Western Reserve University, Cleveland, Ohio.

### Israel

The Israeli consumer confidence index is conducted by Israel's daily Globes and is published monthly by Globes's research unit.

### Spain

The Spanish CCI is made since 2004. The Instituto de Credito Oficial (ICO) based its calculation on the methodology of Michigan and the USA Conference Board. Since November 2011 is the Centro De Investigaciones Sociológicas (CIS) who is responsible for its publication.

The CCI is built up from a monthly survey of opinion with implementing standardized telephone questionnaire to a representative sample of the population resident in Spain of 1000 individuals over 16 years. The sampling procedure is multistage, with selection of primary sampling units (municipalities) in a random proportional to each of the Spanish provinces and the secondary units (households) from telephone numbers and the last units (individuals) as cross-gender quotas and age.

The CCI-CIS is published on 3th every month or the next working day in case of bank holidays or weekend.

### Worldwide

Prior to 2009, there had been no systematic attempt to track and measure consumer confidence around the world. In 2009 and 2012, Gallup collected global economic confidence data through its Gallup World Poll, and analyzed the data from 108 countries surveyed in both years. Gallup's Economic Confidence Index is based on the combined responses to two questions: the first asking individuals to rate economic conditions in their country today, and the second, whether they think economic conditions in the country as a whole are getting better or getting worse.

### Nielsen Global Consumer Confidence

The Nielsen Global Consumer Confidence Index measures the confidence, major concerns and spending habits of online consumers in 54 countries on the half-annual basis. The Index is developed based on consumers' confidence in the job market, status of their personal finances and readiness to spend. It is produced by the Nielsen Company (Nielsen Customized Research) from its Nielsen Global Online Consumer Survey. In April 2008 the survey answers included responses from 28,153 online users.

In the first quarter 2015, three of the best countries are India (130), Indonesia (123), and Philippines (115) among 60 countries surveyed, while three of the worst countries are Ukraine (41), South Korea (46), and Serbia (53).

### GfK Consumer Confidence Barometer

The GfK Consumer Confidence Barometer has now been running in the same format across Europe since the early 1970s. GfK have been conducting the Consumer Confidence Barometer in the UK since June 1995. The survey is carried out on a monthly basis on behalf of the European Commission, who sponsor the same research in all European Union member countries. The main aim of this research is to monitor the general public's confidence in the British economy. Each month the survey tracks changes in personal finance, general economic situation, inflation, unemployment, current purchasing climate, consumer spending and saving. Quarterly research tracks car purchasing, home purchasing and home improvements. Results from The GfK Consumer Confidence Barometer are available as either a 6-monthly or annual subscription, running from May – April. Subscriptions can also be taken out part way through subscription year Purchase of back-data is also possible. The GfK Consumer Confidence Barometer is published on the last working day of each month at 00:01am

## CONSUMER CONFIDENCE INDEX

Consumer confidence index (CCI) is an economic indicator published by The Conference Board to measure consumer confidence, which is defined as the degree of optimism on the state of the U.S. economy that consumers are expressing through their activities of savings and spending. Global consumer confidence is not measured.

Country-by-country analysis indicates huge variance around the globe. In an interconnected global economy, tracking international consumer confidence is a lead indicator of economic trends.

In the United States The Conference Board, an independent economic research organization, issues monthly measures of consumer confidence, based on 5,000 households. Such measurement is indicative of the consumption component level of the gross domestic product. The Federal Reserve looks at the CCI when determining interest rate changes, and it also affects stock-market prices.

The consumer confidence index started in 1967 and is benchmarked to 1985 = 100. This year was chosen because it was neither a peak nor a trough. The index is calculated each month on the basis of a household survey of consumers' opinions on current conditions and future expectations of the economy. Opinions on current conditions make up 40% of the index, with expectations of future conditions comprising the remaining 60%. In the glossary on its website, The Conference Board defines the Consumer Confidence Survey as "a monthly report detailing consumer attitudes and buying intentions, with data available by age, income and region".

Another well-established index that measures consumer confidence in the United States of America is the University of Michigan Consumer Sentiment Index, run by University of Michigan's Institute for Social Research.

## Calculation

In simple terms, increased consumer confidence indicates economic growth in which consumers are spending money, indicating higher consumption. Decreasing consumer confidence implies slowing economic growth, and so consumers are likely to decrease their spending. The idea is that the more confident people feel about the economy and their jobs and incomes, the more likely they are to make purchases. Declining consumer confidence is a sign of slowing economic growth and may indicate that the economy is headed into trouble.

Each month The Conference Board surveys 5,000 US households. The survey consists of five questions that ask the respondents' opinions about the following:

- Current business conditions.
- Business conditions for the next six months.
- Current employment conditions.
- Employment conditions for the next six months.
- Total family income for the next six months.

Survey participants are asked to answer each question as "positive", "negative" or "neutral." The preliminary results from the consumer confidence survey are released on the last Tuesday of each month at 10am EST.

Once the data have been gathered, a proportion known as the "relative value" is calculated for each question separately. Each question's positive responses are divided by the sum of its positive and negative responses. The relative value for each question is then compared against each relative value from 1985. This comparison of the relative values results in an "index value" for each question.

The index values for all five questions are then averaged together to form the consumer confidence index; the average of index values for questions one and three form the present situation index, and the average of index values for questions two, four and five form the expectations index. The data are calculated for the United States as a whole and for each of the country's nine census regions.

## Usage

Manufacturers, retailers, banks and the government monitor changes in the CCI in order to factor in the data in their decision-making processes. While index changes of less than 5% are often dismissed as inconsequential, moves of 5% or more often indicate a change in the direction of the economy.

A month-on-month decreasing trend suggests consumers have a negative outlook on their ability to secure and retain good jobs. Thus, manufacturers may expect consumers to avoid retail purchases, particularly large-ticket items that require financing. Manufacturers may pare down inventories to reduce overhead and/or delay investing in new projects and facilities. Likewise, banks can anticipate a decrease in lending activity, mortgage applications and credit card use. When faced with a down-trending index, the government has a variety of options, such as issuing a tax rebate or taking other fiscal or monetary action to stimulate the economy.

Conversely, a rising trend in consumer confidence indicates improvements in consumer buying patterns. Manufacturers can increase production and hiring. Banks can expect increased demand for credit. Builders can prepare for a rise in home construction and government can anticipate improved tax revenues based on the increase in consumer spending.

## Consumer-demand Surveys versus Consumer-confidence and Sentiment Surveys

Consumer-demand surveys are interview-based statistical surveys that measure the percentage of households that will buy a car, white goods, PCs, TVs, home furnishings, kitchenware or toys in, for example, the next three-month period. The surveys provide a percentage of those who will purchase more, less or the same amount of food and clothing in the next three months than in the corresponding period the year before. If you ask people about their purchasing behavior within the coming six or 12 months, there will be more of those who “hope to be able to buy”, than if consumers are asked about what they will purchase in the next three months. The shorter the time spans, the closer to actual behavior.

Consumer-confidence and -sentiment surveys measure how people are doing financially, how they look at the overall economy of the country or business conditions in the country, if they think that the government is doing a good or a poor job and if people think that it is a good or a bad time to buy a car or to buy or sell a house.

When the business cycle is fairly stable, consumer demand surveys and consumer confidence and sentiment indices will often correlate closely and indicate the same direction of the economy, but in times with a high degree of economic or political uncertainty or during a prolonged crisis, the two types of consumer surveys might differ significantly. In 2011 the confidence and sentiment surveys went up from March to April, while consumer demand surveys dropped significantly. In August 2011 the confidence and sentiment surveys dropped significantly and stayed low during September and October, while consumer demand surveys showed resilience, a development confirmed later by official statistics.

Thomson Reuters/University of Michigan and the Conference Board both publish a monthly consumer confidence and attitude survey. The Institute for Business Cycle Analysis publishes a monthly consumer demand survey known as US Consumer Demand Indices.

## CONSUMER SPENDING

Consumers can buy a large range of goods and services at shopping malls.

Consumer spending, consumption, or consumption expenditure is the acquisition of goods and services by individuals or families. It is the largest part of aggregate demand at the macroeconomic level. There are two components of consumer spending: induced consumption (which is affected by the level of income) and autonomous consumption (which is not).

## Macroeconomic Factors

### Taxes

Taxes are a tool in the adjustment of the economy. Tax policies designed by governments affect consumer groups, net consumer spending and consumer confidence. Economists expect tax manipulation to increase or decrease consumer spending, though the precise impact of specific manipulations are often the subject of controversy.

Underlying tax manipulation as a stimulant or suppression of consumer spending is an equation for Gross Domestic Product (GDP). The equation is GDP = C + I + G + NX, where C is private consumption, I is private investment, G is government and NX is the net of exports minus imports. Increases in government spending create demand and economic expansion. However, government spending increases translates to tax increases or deficit spending. This creates a potential negative impact on private consumption, investment, and/or the balance of trade.

### Consumer Sentiment

Consumer sentiment is the general attitude of toward the economy and the health of the fiscal markets, and they are a strong constituent of consumer spending. Sentiments have a powerful ability to cause fluctuations in the economy, because if the attitude of the consumer regarding the state of the economy is bad, then they will be reluctant to spend. Therefore, sentiments prove to be a powerful predictor of the economy, because when people have faith in the economy or in what they believe will soon occur, they will spend and invest in confidence. However sentiments do not always affect the spending habits of some people as much as they do for others. For example, some households set their spending strictly off of their income, so that their income closely equals, or nearly equals their consumption (including savings). Others rely on their sentiments to dictate how they spend their income and such.

### Government Economic Stimulus

In times of economic trouble or uncertainty, the government often tries to rectify the issue by distributing economic stimuli, often in the form of rebates or checks. However such techniques have failed in the past for several reasons. temporary financial reprieve rarely succeeds because people do not often like rapidly shifting their spending habits. Also, people are many times intelligent enough to realize that economic stimulus packages are due to economic downturns, and therefore they are even more reluctant to spend them. Instead they put them into savings, which can potentially also help spur the economy. By putting money into savings, banks profit and are able to decrease the interest rates, which then encourage others to save less and promote future spending.

### Fuel

When fuel supplies are disrupted, the demand for goods that are dependent on fuel, like motor vehicles and machinery, may decrease. Disruption in energy supplies creates uncertainty regarding availability and upcoming prices of these supplies. Often, consumers will not purchase energy-dependent products until they can be sure that fuel will be available to use the product.

Increases in the price of fuel do not lead to decreases in demand because it is inelastic. Rather, a greater portion of income is spent on fuel, and less is available to purchase other goods. This leads to an overall decrease in consumer spending.

## IMPORTANCE OF CONSUMER SPENDING

A national economy is a broad amalgamation of individual, business and government spending or investment. Governments typically pay close attention to economic factors to measure the strength of an economy. Consumers represent a major factor in economies. According to Henry Hazlitt, author of "Economics in One Lesson," U.S. consumers account for approximately 70 percent of the national economy. Spending is an important role of consumers. Free market economies rely on consumer demand to gauge the allocation and distribution of economic resources.

Consumer spending is an important economic factor because it usually coincides with the overall consumer confidence in a nation's economy. High consumer confidence indicators usually relate to higher levels of consumer spending in the economic market. Consumer confidence provides governments and businesses with an analysis on consumer perception. In the United States, The Conference Board measures consumer confidence by conducting a survey of 5,000 households. Consumers respond to a few questions from which The Conference Board calculates consumer confidence.

## Types of Consumer Spending

Several types of consumer spending are found in the economic market. Necessities, non-durable goods, durable goods and luxury items are types of consumer spending. Necessities represent the food, shelter and clothing individuals need to maintain a certain quality of life. Non-durable goods last less than three years; these include gasoline, paper products and office supplies. Cars and houses are examples of durable goods, which last more than three years. Luxury items include jewelry, high-priced cars and other items not necessary for living a standard lifestyle.

## Function of Consumer Spending

Significant changes to consumer spending in durable and luxury goods can be an important economic indicator. Consumer spending increases in these two categories usually represent individuals with higher income. Conversely, spending decreases may indicate lower individual income or consumer confidence. These spending categories can help businesses and governments determine if consumer spending is expanding or contracting based on the number of purchases.

## Benefits of Consumer Spending

Businesses use consumer spending data in their supply and demand economic calculations. Supply and demand helps businesses produce goods or services at the most favorable consumer price points. Businesses who can achieve the equilibrium price will sell the maximum amount of goods with the highest available profit margin. Consumer spending helps companies determine which products have the most value in the economic marketplace. Businesses can also use information to find unmet consumer needs and develop new products.

## Considerations of Consumer Spending

Consumer spending is the result of many factors, including monetary or fiscal policy, inflation, purchasing power and supply of goods. Businesses and governments should review economic indicators relating to these other items when gauging the overall health of the economy. While consumer spending plays an important role in the economy, these other factors can also provide information for businesses creating corporate or business strategies.

# CONSUMER SPENDING AND ITS IMPACT ON THE ECONOMY

Consumer spending is what households buy to fulfill everyday needs. This private consumption includes both goods and services. Every one of us is a consumer. The things we buy every day create the demand that keeps companies profitable and hiring new workers.

Almost two-thirds of consumer spending is on services, like real estate and health care. Other services include financial services, such as banking, investments, and insurance. Cable and internet services also count, and even services from non-profits.

The remaining one-third of our personal consumption expenditure is on goods. These include so-called durable goods, such as washing machines, automobiles, and furniture. More frequently, we buy non-durable goods, such as gasoline, groceries, and clothing.

## Five Determinants of Consumer Spending

There are five determinants of consumer spending. These are the things that affect how much you spend. Changes in any of these components will affect consumer spending.

The most important determinant is disposable income. That's the average income minus taxes. Without it, no one would have the funds to buy the things they need. That makes disposable income one of the most important determinants of demand. As income increases so does demand. If manufacturers ramp up to meet demand, they create jobs. Workers' wages rise, creating more spending. It's a virtuous cycle leading to ongoing economic expansion. If demand increases but manufacturers don't increase supply, then they will raise prices. That creates inflation.

The second component is income per capita. It tells you how much each person has to spend. Income measurements might rise just because the population increases. Income per person reveals whether each person's standard of living is also improving.

Income inequality is the third determinant of spending. Some people's income may rise at a faster pace than others. The economy benefits when most of the gain goes toward low-income families. They must spend a more significant share of each dollar on necessities until they reach a living wage. The economy doesn't benefit as much when increases go toward high-income earners. They are more likely to save or invest additions to income instead of spending.

The fourth factor is the level of household debt. That includes credit card debt, auto loans, and school loans. Current consumer debt statistics show that household debt has reached new record levels. Surprisingly, high health care costs are one of the biggest causes of overwhelming debt.

The fifth determinant is consumer expectations. If people are confident, they are more likely to spend now. The Consumer Confidence Index measures how confident people are about the future. It includes their expectations of inflation. If consumers expect inflation to be high, they will buy more now to avoid future price increases. That's why the Federal Reserve targets a 2% inflation rate.

## How it affects us?

Consumer spending is the single most important driving force of the U.S. economy. Keynesian economic theory says that the government should stimulate spending to end a recession. On the other hand, supply side economists believe the government should cut business taxes to create jobs. But companies won't boost production without demand no matter how low taxes are.

If you doubt this, think about what would happen if everyone stopped spending. Businesses would eventually go bankrupt and lay off workers. The government would then have no one to tax.

The economy would have to rely on exports, assuming other countries kept up their consumer spending. Borrowing would keep the government and factories open. These additional components of the gross domestic product aren't as critical as consumer spending.

But too much of a good thing can also be damaging. When consumer demand exceeds manufacturers' ability to provide the goods and services, prices increase. If this goes on, it creates inflation. If consumers expect ever-increasing prices, they will spend more now. That further increases demand, forcing businesses to raise prices. It becomes a self-fulfilling prophecy that 's hard to stop. That's why the primary mandate of the nation's central bank, the Federal Reserve, is to ward off inflation.

## How Consumer Spending is Measured

Consumer spending is measured in many different ways. The most comprehensive is the monthly Personal Consumption Expenditures report.

The Consumer Expenditure Survey is released in August each year by the Bureau of Labor Statistics. It is similar to the PCE but has a little more detail about types of households. That's because the BLS analyzes data from the U.S. Census. The BLS releases the most current report in September each year.

Retail sales is another component of consumer spending. You can check how healthy it is with the most recent retail sales statistics.

Consumer spending drives a significantly large part of U.S. GDP. This makes it one of the biggest determinants of economic health. Data on what consumers buy, don't buy, or wish to spend their money on can tell you a lot where the economy may be heading. Watching the trend on consumer spending can serve as an invaluable tool for managing your investments.

## CONSUMPTION FUNCTION

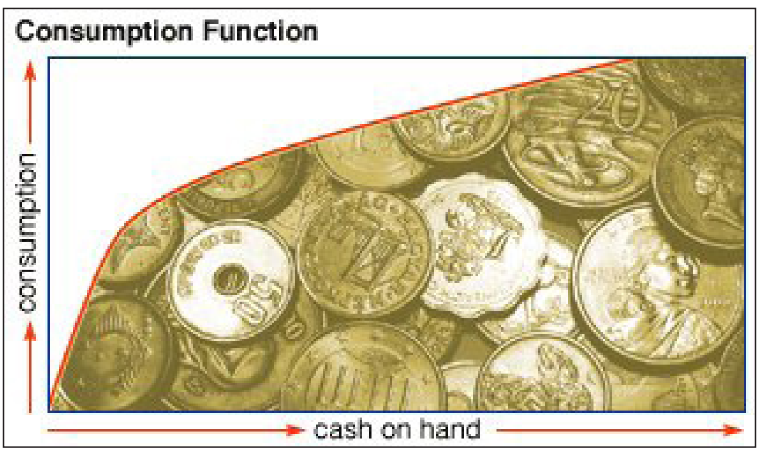
In economics, consumption function is the relationship between consumer spending and the various factors determining it. At the household or family level, these factors may include income, wealth, expectations about the level and riskiness of future income or wealth, interest rates, age, education, and family size. The consumption function is also influenced by the consumer's preferences (e.g., patience, or the willingness to delay gratification), by the consumer's attitude toward risk, and by whether the consumer wishes to leave a bequest. The characteristics of consumption functions are important for many questions in both macroeconomics and microeconomics.

In macroeconomic models the consumption function tracks total aggregate consumption expenditures; for simplicity it is assumed to depend on a basic subset of the factors economists believe are important at the household level. Analysis of consumption expenditure is important for understanding short-term (business cycle) fluctuations and for examining long-run issues such as the level of interest rates and the size of the capital stock (the amount of buildings, machinery, and other reproducible assets useful in producing goods and services). In principle, the consumption function provides answers to both short-run and long-run questions. In the long run, since income that is not consumed is saved, the responsiveness of households to any tax policy (such as those meant to spur aggregate saving and increase the capital stock) will depend on the structure of the consumption function and particularly what it says about how saving responds to interest rates. In the short run, the effectiveness of tax cuts or other income-boosting policies (such as those meant to stimulate a recessionary economy) will depend on what the consumption function says about how much the typical recipient spends or saves out of the extra income.

At the microeconomic level the structure of the consumption function is of interest in itself, but it also has a powerful influence on many other kinds of economic behaviour. For example, individuals with only a small stock of savings who are laid off from their jobs may be forced to take new jobs quickly, even if those jobs are a poor match for their skills. On the other hand, laid-off consumers with substantial savings may be able to wait until they can find a better job match. Whether a consumer is likely to have much savings when laid off will depend on the degree of patience reflected in the consumption function.

The standard version of the consumption function emerges from the "life-cycle" theory of consumption behaviour articulated by economist Franco Modigliani. The life-cycle theory assumes that household members choose their current expenditures optimally, taking account of their spending needs and future income over the remainder of their lifetimes. Modern versions of this model incorporate borrowing limits, income or employment uncertainty, and uncertainty about other important factors such as life expectancy.

Economist Milton Friedman advocated a simplified version of this model, known as the "permanent income hypothesis," which abstracts from retirement saving decisions. The figure shows the consumption function that emerges from a standard version of the permanent income hypothesis (assuming uncertain future income and a standard "utility function" that specifies consumers' attitudes toward the level and riskiness of their spending). The figure relates the consumer's current stock of spendable resources (also known as "cash on hand," or the sum of current income and spendable assets) to his or her level of spending. Perhaps the most important feature of the figure, for both microeconomic and macroeconomic analysis, is what it says about the marginal propensity to consume (MPC)—that is, how much extra spending will result from a given increase in cash on hand. When levels of cash on hand are low, the MPC is very high, indicating that poor households are likely to spend any windfall income rather quickly. However, when levels of cash on hand are high (that is, for wealthy households), the MPC becomes quite low, suggesting that a windfall will prompt only a small increase in current spending. Several strands of empirical research confirm the proposition that low-wealth households exhibit higher MPCs than high-wealth households.




According to the permanent income hypothesis, the marginal propensity to consume decreases as the amount of cash on hand increases.

This figure demonstrates that, when analyzing the short-run macroeconomic effects of a government's tax and spending policies, it is important to know whether the households affected will be concentrated in the area to the left of the figure, where the extra spending induced by a windfall is high, or to the right of the figure, where the MPC is low. These insights carry over to the more sophisticated life-cycle versions of the model that incorporate retirement planning and other considerations.

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# PERMISSIONS

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We would like to thank the editorial team for lending their expertise to make the book truly unique. They have played a crucial role in the development of this book. Without their invaluable contributions this book wouldn't have been possible. They have made vital efforts to compile up to date information on the varied aspects of this subject to make this book a valuable addition to the collection of many professionals and students.

This book was conceptualized with the vision of imparting up-to-date and integrated information in this field. To ensure the same, a matchless editorial board was set up. Every individual on the board went through rigorous rounds of assessment to prove their worth. After which they invested a large part of their time researching and compiling the most relevant data for our readers.

The editorial board has been involved in producing this book since its inception. They have spent rigorous hours researching and exploring the diverse topics which have resulted in the successful publishing of this book. They have passed on their knowledge of decades through this book. To expedite this challenging task, the publisher supported the team at every step. A small team of assistant editors was also appointed to further simplify the editing procedure and attain best results for the readers.

Apart from the editorial board, the designing team has also invested a significant amount of their time in understanding the subject and creating the most relevant covers. They scrutinized every image to scout for the most suitable representation of the subject and create an appropriate cover for the book.

The publishing team has been an ardent support to the editorial, designing and production team. Their endless efforts to recruit the best for this project, has resulted in the accomplishment of this book. They are a veteran in the field of academics and their pool of knowledge is as vast as their experience in printing. Their expertise and guidance has proved useful at every step. Their uncompromising quality standards have made this book an exceptional effort. Their encouragement from time to time has been an inspiration for everyone.

The publisher and the editorial board hope that this book will prove to be a valuable piece of knowledge for students, practitioners and scholars across the globe.

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