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

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Abstract

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

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

JEL Classification: L10, D12, O12

"A study this year by the United Nations Economic Commission for Latin America and the Caribbean concluded that tens of millions of the region's inhabitants have risen into the middle class over the past two decades. That's prompted 'a notable expansion of the consumer market,' ...(thanks to) the prospects of los emergentes—the emerging ones—as marketers call the newly minted middle-class members."

Matt Moffett, *The Wall Street Journal*, November 15, 2011

"Across the developing world millions—perhaps billions—of people are currently forming tastes that will endure for the rest of their lives. Put one of Kraft's Oreos or Cadbury's Flakes in their hands and they may become loyal customers for decades to come."

The Economist, November 5, 2009

1 Introduction

The "emerging middle class" has become a major economic phenomenon in consumer markets around the globe. Since the mid 1990s, many developing countries, as far-flung and varied as Brazil, China, India, Indonesia and Turkey, are experiencing a socioeconomic transformation, whereby a substantial mass of low-income households emerge from below the poverty line and begin to consume goods and services that they previously could not afford.[1] Bolstering the demand for many consumer goods, these "new consumers" provide a potential engine of growth for the global economy. This motivates studying both the nature of this new demand, and its implications for competition in emerging consumer markets.

Our paper examines this demand expansion process via an important test case: the Brazilian market for carbonated soft drinks (or "soda"). We study the evolution of this market from December 1996 through March 2003, a six-year period over which two striking phenomena were evident: a substantial expansion in demand fueled by rising living standards, and the rapid growth of a competitive fringe of soda producers.

Brazil's large soda market trails only the United States and Mexico by volume. Following a successful economic stabilization plan in 1994, aggregate soda consumption almost doubled by 1997, and continued to grow at an annual rate of about 10% through 1999. This growth was driven, at least in part, by pronounced upward mobility among lower income households, who

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[1]The Economist (2011a) states that, using a broad income definition, "(t)he middle classes...trebled in number between 1990 and 2005 in developing Asia to 1.5 billion." Nomura Bank states that by 2014 Indonesia should boast almost 150m "newly affluent Indonesians (who) are certainly spending" (The Economist, 2011b). Ferreira et al (2012) calculate that "at least 43% of all Latin Americans changed social classes between the mid 1990s and the end of the 2000s." The emerging middle class is also referred to as the "lower-middle class," to emphasize its vulnerability to income shocks.

were no longer forced to pay an "inflation tax."[2] In 1999, the Financial Times reported that "the increased purchasing power that came with stable prices... allowed about 25m new consumers into the (soft-drink) market" (among a total population of 170m at the time). Other markets, ranging from fresh meat to refrigerators and television sets, saw similar expansions in demand.

One might have expected that established soda producers, namely the Coca-Cola Company (hereafter Coca-Cola) and Ambev, who in 1996 jointly accounted for almost 90% of Brazilian soda expenditure, were best positioned to tap into this new demand for soda.[3] Instead, between 1996 and 1999, the combined volume share of hundreds of regionally focused discount brands— which we label "generics"—doubled from 20% to 40%.[4] In contrast to the dominant duopoly's heavy investments in advertising, generic producers focused their marketing efforts on securing shelf space via low prices. With the stiff competition slowing down company growth, "Coca-Cola blamed difficulties in developing countries such as Brazil when it shocked Wall Street in December (1998) by announcing a rare drop in quarterly sales" (Financial Times 1999).

Having kept prices broadly constant during the preceding years of the fringe's expansion, in 1999 Coca-Cola abruptly cut prices across its brands by over 20%, a move that was soon matched by Ambev. Following this price cut, the growth in the market share of the generic fringe was halted. As we discuss below, however, the fringe was able to hold its ground, continuing to command a substantial market share even after the premium brands' large price cut.

The goal of this paper is to examine the mechanisms by which an emerging middle class can provide fertile ground for the growth of a generic fringe.[5] We focus on two possible complementary mechanisms that may have played a role in the Brazilian soda market. First, compared to the established middle class, emerging middle-class consumers may have been price sensitive, and thus likely to favor cheap generics over expensive brands. To stay with the Financial Times' analysis, "(t)he new (soda) customers...had different priorities...(t)hey were less concerned about expensive TV ads and more interested in value." A price-sensitive, expanding consumer segment may help explain both the growth of generics and the premium sellers' price cut.

Second, consumption habits could be playing an important role in the market for soda. If this is the case, the emergence of a new middle class should be interpreted as the arrival into the market of millions of new customers who have not yet formed persistent consumption patterns. This

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[2]A substantial mass of households with no access to inflation-indexed bank accounts were the main beneficiaries of the taming of chronically high inflation: "...Jose Benevenuto, a 53-year-old Rio de Janeiro bus driver...still recalls the years in the early 1990s when Brazil's four-digit inflation forced him to rush to the supermarket as soon as he was paid so he could spend his money before it lost all value" (Wall Street Journal 2011). By 1995, inflation was (sustainably) down to single-digit annual levels.

[3]Ambev distributed the Pepsi brand, and is now part of the AB Inbev group.

[4]This pertains to the dominant market segment of family-size bottles sold through the "self-service outlets" distribution channel (supermarkets with checkouts) in urban areas.

[5]Several emerging markets appear to feature a substantial presence of generic producers, underscoring the research question. The China-based appliance manufacturer Galanz cites the National Bureau of Statistics in claiming that there were "nearly 300 brands in (the) Chinese market" in 2008 (Galanz 2008). The Economist (2012) counts 100 "domestic carmakers" in China. Abbott India's brands Digene, Eptoin and Cremaffin face competition from 211, 327 and 242 "regional" generics, respectively, as shared by the company during a corporate presentation in late 2011.

may have aided generic firms in tapping into this emerging consumer segment. This mechanism may have also provided a strong incentive for Coca-Cola to cut prices with the goal of defending its future market position.[6]

We empirically investigate the price sensitivity of the rising lower-middle class, as well as the potential role played by habit formation in the Brazilian soda market. We develop a structural demand model that segments consumers according to both their (exogenous) socioeconomic standing and their (endogenous) previous consumption choices. We propose and implement an estimation strategy that utilizes mostly aggregate data. Identification is achieved via the rich variation afforded by the emerging market setup: the changing socioeconomic composition of households over time, as well as the stark variation in prices charged by premium brands. In general, we expect such aggregate data to be more readily available in emerging markets than consumer-level data.

Our framework presents a random-coefficient logit model in which unobserved household heterogeneity is captured by two features: the household's socioeconomic standing, and its habit state. Consumers belong in one of three discrete demographic groups: "poor," "established affluent," or "newly affluent." Established affluent households are those who were already affluent before the process of upward mobility began, whereas newly affluent households represent the new middle class, whose members do not typically enjoy the economic security of their established counterparts, at least over the horizon we consider (Ferreira et al 2012). Our model allows poor households to move up to newly affluent status, and newly affluents to move down to poor status. Such downward mobility is apparent toward the later part of our sample period, when the Brazilian economy was hit by a recession. In addition to such upward and downward mobility, our model also accounts for urbanization, another important demographic shift.

The second key component of our model is habit formation, of a special kind. In particular, we allow for three habit states: a habit to consume premium soda brands (a "premium habit"), a habit to consume generics (a "generic" or "frugal" habit), or not developing a habit to consume soda. Habits develop according to the choice made by the household in the immediately preceding period. We label this a *Brand Type Persistence* (BTP) mechanism, as it captures persistence in demand for a brand type, namely, premium (branded) or generic. In our model, developing a premium habit in period $t-1$ (by consuming, say, Coke) increases the utility from consuming any premium brand (say, Coke, Fanta or Pepsi) in period t. Similarly, recent consumption of some generic brand raises the utility from current consumption of any generic brand.

This parsimonious modeling approach allows us to capture the key dichotomy between premium and generic soda products in a rapidly evolving market, where consumers establish shopping patterns that may endure into the future. Except in a robustness check reported below,

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[6]The role of habit formation in food and beverage has been emphasized in the literature. See Atkin (2012) and Bronnenberg, Dubé and Gentzkow (2012) for recent contributions.

we do not model persistence in the demand for particular brands (i.e., "brand loyalty" effects). Our motivation, instead, is to use a simple mechanism to better understand the dynamics of consuming premium and generic brands, an important aspect of several emerging markets.[7]

Findings. We find that newly affluent households are more price sensitive than established affluent households yet less price sensitive than the poor. For example, conditional on recent consumption of premium soda, raising the price of Coke by 1% lowers the demand for the brand among established affluent, newly affluent and poor households by 1.4%, 3.3% and 5.7%, respectively. This finding is consistent with the view above, expressed in the Financial Times, and the intermediate price sensitivity of the rising lower-middle class indeed favored the competitive fringe: our estimates indicate that newly affluents were 1.4 times more likely to choose a generic brand over a premium brand, whereas for established affluents this ratio is only 0.5.

Our results provide strong empirical evidence for habit formation, and we estimate that this persistence in preferences carries a significant monetary value. For example, a "frugal habit" increases a newly affluent consumer's willingness to pay for a liter of generic soda by R\$ 1.08 (in Brazilian Real, or US\$ 0.54) relative to displaying no habit. The finding suggests that persistence in preferences plays a prominent role in explaining the growth of generic brands. It also explains the sense of urgency with which premium brands cut prices in mid 1999: had they failed to cut prices, an increasing fraction of new consumers would have "gone generic." The substantial premium price cut helped ensure that many consumers developed a premium habit instead.

We demonstrate this point in a counterfactual analysis. Our estimated model implies that, had premium brands failed to cut prices in mid 1999, their market shares would have suffered substantial declines through 2003, resulting in diminished variable profits. Our model, therefore, provides strong justification for the strategic price cut. The analysis further indicates that the premium price cut was particularly effective with consumers who were yet to form soda-consuming habits, and only partially effective with consumers who had already developed a generic habit. Finally, and importantly, an estimated model variant that shuts down the habit mechanism provides much weaker support for the premium price cut. Persistent preferences, therefore, may be an important ingredient in a model that studies strategic considerations of firms competing in emerging markets.

Estimation, identification, and literature. In our utility framework, a household's type is determined by both its current socioeconomic standing and its current habit state. These are features of unobserved heterogeneity: our main data source does not allow us to observe individual households, nor does it track households as they transition between socioeconomic

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[7]Executives of a global "fast-moving consumer goods" firm meeting one of us recently in Delhi stated that "as a company in the *A business* we don't naturally understand the *B business*, where the *value* proposition is at the heart of it, putting us at a certain disadvantage when selling to the *Bottom of the Pyramid* in the Indian market." (To be clear, all words—including the terms in italics—are the executives' own, though in slightly rearranged order without modifying context.)

and habit states. Rather, we observe market shares and prices of soda brands, as well as the population fractions that belong in each socioeconomic group over time. We also observe a single cross-section of consumer-level data, which we use to compute an initial condition for the dynamic process according to which the distribution of habit states and socioeconomic standings evolves. We show how to estimate such a model by matching observed aggregate brand shares to the model's predicted shares.

The empirical literature in economics and marketing has introduced habits or persistence into models of consumer choice.[8] These studies have typically relied on micro-level panel data, in settings that naturally exhibit rather stable demographics. Our paper, in contrast, relies mostly on aggregate data, in line with a recent literature that examines the separate identification of state dependence and consumer heterogeneity with such data (e.g., Horsky, Pavlidis and Song 2012, Anderson, Hansen and Misra 2012). We argue intuitively that our model is identified using the variation offered by the emerging market setup: the large, exogenous shift in the socioeconomic distribution of households, as well as the sharp drop in premium prices midway through the sample period. Such variation is typically not available in studies of mature markets.

To provide an example, during the recession that set in toward the end of our sample period, households fell back from newly affluent status to the ranks of the poor, yet soda consumption did not fall (nor did prices), providing evidence for persistence in demand. We also perform a Monte Carlo analysis that supports our identification strategy. Note, however, that our goal is not to propose a general method for estimating demand in emerging markets. Rather, we demonstrate that identification of persistence in demand is possible in the particular market we analyze. We then use the empirical analysis to shed light on a phenomenon which is potentially important in many other emerging consumer markets.

Our study relates to other lines of research. Competition between branded products and lower cost generics, particularly in pharmaceuticals, is examined by Chaudhuri, Goldberg and Jia (2006) in India, and Hurwitz and Caves (1988) and Scott Morton (2000) in the US. Another literature examines the relationship between the demographic composition of demand and prices, or inflation moderation, including Frankel and Gould (2001), Bils and Klenow (2004), Nevo and Hatzitaskos (2006), Lach (2007), and Calzolari, Ichino and Manaresi (2012). A very recent literature seeks to better understand the characteristics of demand by emerging-market consumers (e.g., Sancheti and Sudhir 2009).

The rest of the paper is organized as follows: Section 2 describes the data, while Section 3 develops our household choice model. Section 4 explains our estimation algorithm and provides arguments for identification. Section 5 reports our results, and Section 6 concludes.

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[8]Such work includes Eichenbaum, Hansen and Singleton (1988), Erdem (1996), Keane (1997), Shum (2004) and Dubé, Hitsch, Rossi and Vitorino (2008).

2 Market and data

This study brings together data from three main sources. The following subsections describe these data sources, as well as the manner with which they reflect the two striking phenomena discussed above: the emergence of a new middle class and the growth of the generic fringe.

2.1 Market-level data

We observe a panel of market-level data from Nielsen, consisting of total quantities and prices for soft-drink brands. There are $g = 1, ..., 7$ regions and $t = 1, ..., 57$ time periods, ranging from the December 1996-January 1997 bimonth to the March 2003 month (Nielsen raised the frequency of its bimonthly point-of-sale audits to a monthly basis in 2000). We therefore observe $7 \times 57 = 399$ region-period markets.

The seven geographic markets are urban and, as in Salvo (2009), we consider soft drinks sold through the "self-service" channel (supermarkets with checkouts) in the 2-liter family-size bottle. Our focus on this market segment is justified on several counts. First, the focus on urban areas is natural since more than 80% of Brazil's population was urbanized by 1996 and, importantly, our framework allows for rural-to-urban migration. Second, urban households in Brazil perform most of their grocery shopping in supermarkets with checkouts, rather than in behind-the-counter "traditional" retail stores. Finally, sales of family-size bottles dominate those of "single-serve" (300ml) bottles or cans (mostly sold in bars and restaurants). Moreover, the competitive fringe, whose success we wish to explain, was mostly present in the family-size bottle segment.

Also following Salvo (2009), we aggregate flavors and brands into $j = 1, ..., 9$ brand-groups. These groups include eight "premium brands" (or "A brands"): five brands of the Coca-Cola Company (Coke, Fanta, the guaraná-flavored Kuat, Diet Coke, and "Other Coca-Cola"), and three brands marketed by Ambev (Guaraná Antarctica, Pepsi, and "Other Ambev"). The ninth brand category is an aggregate of discount brands (or "B brands") that form the generic fringe.[9]

Table 1 describes the volume shares (of the soda category) for each of the nine brands across the seven Nielsen regions, in the first and last periods in our sample (all statistics pertain to family-size bottles sold in supermarkets with checkouts). Averaged arithmetically across regions, Coca-Cola's brands accounted for a 50% volume share in the first period, with Coke being dominant, whereas Ambev enjoyed a 31% share, with Guaraná Antarctica and Pepsi as its flagship brands. The table reports the stark growth in the generic share, from 19% at the start of the sample to 40% at the end. The table reflects some region-specific tendencies to consume particular brands. Our empirical framework controls for such region-brand effects.

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[9]The data provide limited information on the breakdown of this group into individual discount brands, as they are so numerous. Since Coca-Cola and Ambev are the prime users of these data, this aggregate structure is indicative of their perception of the fringe as a collection of small firms that do not offer substantial differentiation.

Defining market size. We denote the observed quantity and price associated with brand j sold in the region-period market gt by q_{jgt} and p_{jgt}, respectively. As is common in discrete-choice applications, we need to define the size of market gt, that is, the maximum amount of soft drinks that can potentially be consumed in this market. We define this quantity, denoted $\mathcal{M}_{gt}$, as six liters per week over the duration of period t multiplied by the number of urban households residing in market gt (which we obtain from a fourth data source). One may interpret the six liters per week as three weekly family meals in which a 2-liter family-size bottle of soda might be brought to the table (rather than water, juice, etc). We then compute brand j's share as $s_{jgt} = q_{jgt}/\mathcal{M}_{gt}$. The share of the outside option (that is, the option not to consume soft drinks) is given by $s_{0gt} = 1 - \sum_j s_{jgt}$.[10]

The growth of the competitive fringe and Coca-Cola's response. In contrast to the established Coca-Cola/Ambev duopoly, with their heavily advertised brands and nationwide distribution, fringe players ran small-scale operations, in most cases individually covering a fraction of a state, and selling at substantially lower prices. Having hovered around a 15% volume share of the soda category at least since 1980 (Salvo 2009), the fringe began growing strongly in the mid 1990s, as evidenced in Table 1. A shift from the returnable proprietary glass bottle (returned to the bottler for reuse, requiring a certain level of sophistication and scale) to the inexpensive non-returnable 2-liter PET bottle may have lowered barriers to entry (Ambev 2003). No census of fringe operators exists, but industry sources suggest that following three years of net entry, the number of firms selling generic soda may have reached 500 by 1999.[11]

Figure 1 reports that both premium and generic brands enjoyed substantial volume growth during the sample period (for illustrative purposes only, the figure aggregates quantities sold over all seven regions, and aggregates all eight premium brands together). Importantly, the generic fringe grew much faster than the premium brands over the first 30 months of the sample, that is, until Coca-Cola's abrupt mid-1999 price cut. The figure also reveals strong seasonality effects, for which we control in the empirical application. Our application also controls for the brands' retail presence, which we also obtain from Nielsen. As we report in the appendix (Figure A1, right panel), the proportion of stores that stocked at least one generic brand exceeded 80% already in the first period of our sample. Indeed, the fringe had existed for decades, and was present on retailers' shelves long before its impressive growth took off in the mid 1990s.

The left panel of Figure 2 illustrates the evolution of (mean share-weighted) prices for premium brands and for generics in R\$ per liter.[12] Premium brands initially held prices broadly flat, at R\$ 1.15. In mid 1999, Coca-Cola cut its prices by more than 20%, a move that was soon matched

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[10]The appendix reports robustness checks which reassure us that our results are not overly sensitive to the market size definition.

[11]The Financial Times (1999) speaks of over 900 companies in the industry, while Ambev's (2003) financial reports refer to 700 "low-price brands."

[12]Throughout the paper, R\$ prices are reported at constant Brazil CPI March 2003 terms (divide by 2 for rough US\$ values).

by Ambev. The figure clearly indicates the sudden nature of this price cut, which we will exploit for identification purposes.

For their part, prices in the fringe declined gradually but relentlessly, from R\$ 0.90 in late 1996 to R\$ 0.60 in late 2000.[13] Falling generic prices are consistent with substantial entry and capacity expansion in the fringe, as competitive firms passed efficiency gains through to consumers. Fringe prices did not respond to the premium price cut in the sense that they did not deviate from their trend, consistent with competitive behavior.

As the right panel of Figure 2 shows, after 30 months of generics gaining share at the expense of the premium brands, the premium price cut had a clear and immediate impact. It essentially put an end to the staggering generic growth, and led to stable volume shares for premium and generic brands through the end of the sample.

2.2   Data on aggregate social mobility

To track the undercurrent of social mobility in the Brazilian economy, we rely on the proprietary LatinPanel survey from IBOPE, a leading provider of data on consumer demographics.[14] The survey, widely used by marketing practitioners, profiles urban households in Brazil's different regions based on their expenditure on durable goods and services (e.g., ownership of a refrigerator, numbers of TVs and bathrooms in a residence, current employment of house maids, education attainment). Adopting an industrywide points scale (ABEP 2003), each household is assigned to a "socioeconomic group." The data we accessed provides the proportion of urban households who belong in each of three groups, **AB**, **C** or **DE**, respectively with "high," "intermediate" or "low" levels of affluence, in each of seven geographic regions over the period 1994-2006.[15]

The IBOPE data indicate that the demographic composition of urban households: (i) was stable between 1994 and 1996; (ii) displayed strong upward mobility from **DE** to **ABC** (i.e., {AB,C}) status between 1996 and 2000; and (iii) experienced a partial reversal of this upward mobility thereafter, consistent with a recessionary period. In aggregate, the proportion of **DE** households fell from 50% in 1996 to 33% in 2000, then rose to 44% by 2003 (conversely, the **AB** proportion rose from 19% in 1996 to 33% in 2000, then fell to 23% by 2003).

These demographic patterns are consistent with media and market research reports. The 1996-1999 upward mobility was fueled by successful economic reforms in the early 1990s, including trade liberalization and, most notably, the taming of very high inflation by the 1994 *Real* stabilization plan. These reforms were followed by strong consumption growth across the Brazilian

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[13]Since prices are in constant R\$, what this means in practice is that nominal prices in the fringe fell 17% compared with the overall price level in the economy (the CPI) growing by 25% over the 45 months to September 2000, i.e., $.6/.9 \simeq (1 - .17)/(1 + .25)$.

[14]The company's name is so established among Brazilian households that, as cited in Wikipedia, it is synonymous with research (e.g., see the *Aurélio* Portuguese language dictionary). Coca-Cola kindly shared the data with us for the purpose of this study.

[15]The points scale stays clear of income, there being reasons why income-based measures might less accurately reflect changes in the standard of living (Carvalho Filho and Chamon 2012, Economist 2007). To provide perspective, mean annual incomes in 2000 for **C** and **DE** urban households were respectively US\$ 6,100 and US\$ 2,600 (ABEP 2003, using nominal 2000 R\$/US\$).

economy, particularly among lower-income households. Figure 3 reports per capita consumption between the mid 1980s and mid 2000s in two different sectors—beverages (soft drinks) and housing (cement); a similar temporal pattern leading up to 2000 is present.[16]

The Boston Consulting Group (2002), reporting on its own household survey, spoke of the emergence of a middle class with "very strong consumer potential," whereas Fátima Merlin, chief economist for the Brazilian Association of Supermarkets (ABRAS), referencing the same IBOPE data that we use, stated that "following the *Real* Plan, thanks to price stability and real growth in workers' earnings, consumer markets experienced entry by households previously outside such markets, *with upward migration from the 'E' and 'D' segments of the population* to the 'C' segment, *as the IBOPE data indicate*" (SuperHiper 2003; emphasis added). As for the downward mobility reported by IBOPE over 2001-2003, economic episodes that may have dampened investor and consumer sentiment include the 1997-98 Asian crisis, the 1999 Brazilian currency crisis, and the 2000-01 Argentine crisis.[17]

To analyze the impact of the changing socioeconomic composition, we define three socioeconomic groups: "Established Affluent" (EA), "Newly Affluent" (NA) and "Poor" (P). Using the IBOPE proportions together with urban household counts, we track the number of households who belong in each of these groups, in each region and over time.[18] Our "Established Affluent" group consists of urban households who were already in **ABC** status in 1996, i.e., before the process of upward mobility took off. The number of households in this group, in each of the seven regions, is thus fixed across time at the initial number of **ABC** households in that region. We define the size of the "Poor" group in each region-period market gt by the number of urban households that IBOPE assigns in that market to **DE**.

Finally, we define the size of the "Newly Affluent" group in market gt as the difference between the contemporaneous number of **ABC** households and region g's initial (i.e., 1996) number of **ABC** households. In other words, the number of time-t newly affluents is computed by subtracting the region's (fixed) number of established affluents from the number of time-t households in **ABC** status. Notice that we observe the urban household population in each region to gradually grow over time. We interpret the demographic process affecting the overall count as (net) rural-to-urban migration, assuming that migrants join the "Poor" group among city dwellers.

To illustrate our computations by way of an example from the data, in the South region there were: (i) in $t = 1$ (Dec-96/Jan-97), 3149 (thousand urban) **ABC** households and 2116 **DE** households, and (ii) in $t = 2$ (Feb/Mar-97), 3238 **ABC** households and 2045 **DE** households. Between these periods, $3238 - 3149 = 89$ poor households moved up to newly affluent status, and

[16]See Carvalho Filho and Chamon (2012) and Salvo (2009, 2010) for further discussion of the consumption effects of reforms in the 1990s. See also Neri (1995).

[17]A similar temporal pattern of prosperity can be detected in earnings data from IBGE's monthly survey of earnings and employment, conducted in 6 large cities, though the turning points in the series tend to occur sooner than 2000.

[18]See the appendix for details as well as consistency checks between different data sources.

the number of migrants was $3238 + 2045 - (3149 + 2116) = 18$. Thus the numbers of established affluents, newly affluents and poor in this region, respectively, are (3149,0,2116) in period 1 and (3149,89,2045) in period 2.

Applying these definitions to the data, the number of newly affluent households is strictly positive for all regions and all time periods $t > 1$, and is equal to zero, by definition, for $t = 1$, the initial period of our Nielsen soda market data. The zero number of newly affluents in period 1 is justified by the fact that, in the IBOPE data, the process of upward mobility takes off just before our Nielsen sample begins in late 1996. This assumption is also consistent with press and trade articles from the time. For example, our measure of the number of newly affluent households in 1999, summed across the seven Nielsen regions, translates into 20m consumers, a notch below the Financial Times' (June 1999) count of "(Brazil's) 25m new consumers" (noting that our study does not cover rural areas or the northern states).

Figure 4 plots the evolution of the socioeconomic composition by region, i.e., the population fractions of established affluent, newly affluent and poor households. The figure clearly demonstrates the emergence of a new middle class. The increase, toward the end of the sample period, in the fraction of the poor at the expense of the fraction of newly affluents reflects the joint effects of the recession and the urbanization process. There are large regional disparities, with region 1 (states in the Northeast) being the least affluent and region 4 (São Paulo Metro) being the most affluent (65% and 36% of urban households in these regions are initially poor, respectively).

2.3   Data on household-level brand choices

Our third main data source allows us to relate household characteristics to soda consumption choices at the beginning of our period of study. We use an urban household expenditure survey—hereafter HEX 95/96—that was conducted between October 1995 and September 1996 by IBGE (a federal agency equivalent to the US Census Bureau and Bureau of Labor Statistics combined). This survey reports the type of soda brand purchased, as well as the amount spent, for consumption inside the home. Households in the survey are not classified according to the ABCDE system, but we use the detailed information available (e.g., ownership of a refrigerator, numbers of TVs and bathrooms in the residence, current employment of house maids, education attainment) to assign, like IBOPE does, each household to an affluence group from A to E.

Table 2 reports the relationship between inside-the-home consumption of soft drinks and socioeconomic status. For example, 34.5% of São Paulo Metro's (region 4) **ABC** households in 1996 purchased soda for home consumption whereas only 19.8% of **DE** households did so. Table 2 also shows, for each of the different regions, the share of **ABC** households who consume a premium (generic) brand, and similar figures for **DE** households. These reflect the co-variation between a household's socioeconomic standing and its choice between premium and generic brands. The

ratio of generic-to-premium consumption tended to be higher for **DE** soda-consuming house-holds compared to **ABC** soda-consuming households (e.g., in region 4, the ratio is 2.6 : 17.3 for **DE** versus 1.4 : 33.1 for **ABC**). As we note in the appendix, our modeling of soda-consuming households at each point in time as either premium or generic shoppers, but not "hybrids," is largely consistent with the HEX data.

As we explain below, the fact that the HEX survey was conducted shortly before the beginning of our Nielsen market data allows us to use this information as an "initial condition" for the evolving relationship between socioeconomic standing and consumption choices.

Additional data. Our analysis additionally draws on (see the appendix for sources): (i) the population of urban households by region over time; (ii) proprietary data on advertising intensity at the brand-market level, (iii) proprietary temperature data, and (iv) input prices for sugar, electricity and fuel.

3 The model

We develop a model of household demand for soft drinks which accounts for socioeconomic variation and state-dependence in brand choice. Our model accommodates the fundamental features of the data. Importantly, we do not observe the choices of socially mobile individuals over time. Such micro-level data are, in general, not likely to be available in an emerging market experiencing a period of rapid evolution. We argue below (and demonstrate in the appendix via a Monte Carlo analysis) that the large and exogenous shift in the socioeconomic household composition, as well as the sharp price cut by premium sellers, allow us to identify consumer demand, including its persistence component.

3.1 Household types and the utility framework

In each period t, a household belongs in one of three socioeconomic groups (EA, NA, P) (again, established affluent, newly affluent or poor) and, consistent with the data, we model region-specific mobility across these groups over time.

We denote the eight premium brands (or A brands) as elements of the set $\mathcal{A}$, and the ninth brand category as the only element of the set of generics (or B brands) $\mathcal{B}$. A household's current preferences over substitute soft-drink brands depend on its current socioeconomic standing as well as on the household's previous-period consumption. In particular, we allow for three habit states, differentiating households who, in the preceding period, consumed: (i) a premium brand $j \in \mathcal{A}$, (ii) a generic brand $j \in \mathcal{B}$, or (iii) did not consume any soda, i.e., chose $j \in \mathcal{O}$, with $\mathcal{O}$ denoting the outside option set. Crossing together the three socioeconomic groups and the three habit states, we obtain nine discrete household types, indexed by r:

$$r \in \mathcal{R} := \left\{ EA^{\mathcal{A}}, EA^{\mathcal{B}}, EA^{\mathcal{O}}, NA^{\mathcal{A}}, NA^{\mathcal{B}}, NA^{\mathcal{O}}, P^{\mathcal{A}}, P^{\mathcal{B}}, P^{\mathcal{O}} \right\} \tag{1}$$

Thus, for example, a time-t newly-affluent household who consumed a generic brand in period $t-1$ is of type $r = NA^{\mathcal{B}}$, whereas an established affluent household who consumed a premium brand in the preceding period is of type $r = EA^{\mathcal{A}}$. Fixing a region-period market gt, let $F_{r,gt}$ denote the fraction of that market's household population that belongs to type r. We collect these fractions for the nine types in a 9-dimensional vector denoted $\mathcal{F}_{gt}$, to which we refer as market gt's *type-distribution vector*.

The indirect utility of household i of type r in market gt from consuming brand j is given by:

$$u_{i \in r, j, gt} = \delta_{jgt} + \alpha_r \cdot p_{jgt} + \lambda \cdot h_{jr} + \epsilon_{ijgt} \tag{2}$$

We now explain each component of this function. The term δ_{jgt} denotes a market-specific, household-invariant base utility from brand j:

$$\delta_{jgt} = x'_{jgt}\beta + \alpha \cdot p_{jgt} + \xi_{jgt},$$

where x_{jgt} contains brand-region fixed effects, seasonal effects, market temperature, brand-level advertising and in-store presence, and region-specific time trends. These trends allow for region-specific temporal evolution in the utility from the outside option, such as differential rates of expansion in markets for soft-drink alternatives (e.g., juices). The brand's price is p_{jgt}, and ξ_{jgt} denotes a (brand-market specific) utility shock observed by firms and consumers, but unobserved to the econometrician, and (α, β) are coefficients to be estimated.

The second and third terms in (2) introduce household-type heterogeneity. The parameter α_r shifts the base price sensitivity α in accordance with the household type r:

$$\alpha_r := \begin{cases} \alpha_{EA} \text{ if } r \in \left\{ EA^{\mathcal{A}}, EA^{\mathcal{B}}, EA^{\mathcal{O}} \right\} \\ \alpha_{NA} \text{ if } r \in \left\{ NA^{\mathcal{A}}, NA^{\mathcal{B}}, NA^{\mathcal{O}} \right\} \\ 0 \text{ otherwise} \end{cases}$$

Whereas α is the price sensitivity of poor households, the sums $(\alpha + \alpha_{EA})$ and $(\alpha + \alpha_{NA})$ are the price sensitivities of the established affluent and the newly affluent, respectively. Note that we allow price sensitivity to vary with a household's socioeconomic standing, but not with its "habit." Below we provide intuition for role played by this restriction in identification.

The variable h_{jr} in (2) captures the persistence, or habit, feature, and is given by:

$$h_{jr} := \begin{cases} 1 \text{ if } r \in \{EA^{\mathcal{A}}, NA^{\mathcal{A}}, P^{\mathcal{A}}\} \text{ and } j \in \mathcal{A} \\ 1 \text{ if } r \in \{EA^{\mathcal{B}}, NA^{\mathcal{B}}, P^{\mathcal{B}}\} \text{ and } j \in \mathcal{B} \\ 0 \text{ otherwise} \end{cases} \tag{3}$$

This specification implies that consuming *any premium brand* in the previous period shifts one's utility from consuming *any premium brand* in the current period by a magnitude of λ. Such a household is characterized by a "premium" habit in the current period. Similarly, consuming *any generic brand* in the previous period shifts one's utility from consuming *any generic brand* in the current period by λ, a situation we refer to as a "frugal" or "generic" habit.

Our modeling of state dependence is parsimonious: habit is formed toward a class of brands—premium or generic—rather than toward an individual brand. This choice is driven by our motivation: to capture a potentially important mechanism in an emerging-market setting characterized by rapid growth in discount brands with minimal advertising. The appendix reports a robustness check in which we modified our specification to consider brand-loyalty effects, producing similar qualitative findings.[19]

The last term in the utility function, ϵ_{ijgt}, represents household and product-specific shocks that follow the Type I Extreme Value distribution and are i.i.d. across households, brands and markets. We complete the specification by defining the utility from the outside option, $u_{i \in r, j=0, gt} = \epsilon_{i,0,gt}$. We denote the model parameters to be estimated by $\theta = \{\beta, \alpha, \alpha_{EA}, \alpha_{NA}, \lambda\}$, further classifying these into "linear" and "non-linear" parameters, $\theta_1 = \{\beta, \alpha\}$ and $\theta_2 = \{\alpha_{EA}, \alpha_{NA}, \lambda\}$, consistent with familiar terminology from the literature. We refer to this baseline specification as the *Brand Type Persistence* (BTP) model, and it is on this specification that we base our empirical work.

Two additional aspects of the demand model are worth noting. First, letting only the preceding period's choices determine the habit state, as opposed to allowing it to form over a longer choice history, is consistent with the literature. Note also that the time interval in our application is longer than the interval between two consecutive shopping trips that is often modeled in studies that have access to household-level data (e.g., via store scanners). In that sense, relying on monthly or bimonthly periods is less restrictive. Second, again consistent with the literature, we do not allow consumers to be forward-looking: they maximize current-period utility and do not internalize the effect of current choices on future utility. We view this approach as appropriate, especially given the nature of the product (non-durable, relatively inexpensive).[20] Nonetheless,

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[19]Also reported in the appendix is a specification that allows premium and frugal habits to shift household utility by different magnitudes rather than by the uniform effect of λ. While that analysis suggests that the effect could be stronger for the premium habit, another specification showed that the effects were similar. In the interest of parsimony, we maintain a uniform habit effect in our baseline specification.

[20]An alternative could be to follow the dynamic estimation literature and model consumers as maximizing an infinite-horizon utility

the persistence feature in utility does produce persistence patterns in the demand for brand types, and our goal is to better understand how this feature interacts with social mobility, and what this implies for competition between premium and generic brands.

The share of type-r households consuming brand j in market gt is given by:

$$s_{j,r,gt}(\theta) = \frac{exp(\delta_{jgt} + \alpha_r \cdot p_{jgt} + \lambda \cdot h_{jr})}{1 + \sum_{\ell=1}^{J} exp(\delta_{\ell gt} + \alpha_r \cdot p_{\ell gt} + \lambda \cdot h_{\ell r})}, \tag{4}$$

where $J = 9$ is the number of brands sold in each market. The notation $s_{j,r,gt}(\theta)$ reflects the fact that these shares are model predictions that depend on parameter values. The predicted aggregate share for brand j is the weighted sum of brand j's share across each of the nine household types, where the weights are the fractions of the population of each type:

$$s_{jgt}(\theta) = \sum_{r \in \mathcal{R}} F_{r,gt} \cdot s_{j,r,gt}(\theta) \tag{5}$$

Our framework, therefore, incorporates a random-coefficient logit model where the unobserved consumer heterogeneity is introduced by the nine consumer types described above. We now complete the description of this model by describing the dynamic process that shifts the distribution of households across these types over time.

3.2   Dynamic type evolution

Over time, social mobility (and, to a lesser extent, rural-to-urban migration) in a particular urban region g changes the number of households in each socioeconomic group. In addition, in each period t, households make consumption choices, contingent on type and on model parameters, that affect the habit state with which they enter period $t + 1$. These processes determine how the type-distribution vector $\mathcal{F}_{gt}$ evolves over time.

We begin by computing $\mathcal{F}_{g1}$, i.e., the type-distribution vector for period $t = 1$ in region g. These values are computed directly from the HEX survey. Recall that this survey was conducted right before our Nielsen data begins, and that it links a household's socioeconomic class to its consumption choice: premium soda, generic soda, or "no soda." Further recalling Section 2, for each region in period $t = 1$ we set the number of newly affluent households to zero. By construction, therefore, the $t = 1$ fractions of the population belonging in each of the three newly affluent types (that is, newly affluent households with premium, generic and no-soda habits) are zero. Population fractions at $t = 1$ for the three established-affluent types are set in proportion to the HEX shares for **ABC** households across premium brands, generics, and

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function, making predictions about the future path of prices. Our view is that the product's nature makes this extension unnecessary.

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no soda. Population fractions at $t = 1$ for the three poor types are set analogously using HEX shares for **DE** households.

Given a particular value for the model's parameters θ, these fractions are updated forward for periods $t = 2, ..., 57$. Fixing region g and period t, we explain how to obtain $\mathcal{F}_{g(t+1)}$ given $\mathcal{F}_{gt}$ and a value for θ. Repeating this updating process for $t = 1, ..., 56$, starting from a known $\mathcal{F}_{g1}$, yields the full trajectory of the distribution of household types over the sample period. Each guess of θ yields a prediction, via (4), of the shares (and masses) of type-r households who consume premium and generic soda in period t.

The social mobility and rural-urban migration that we observe in the aggregate data requires that we make assumptions on how these demographic shifts interact with previous consumption. For instance, whenever aggregate upward mobility is detected in a given region between periods t and $(t+1)$, it follows that some of period $(t+1)$'s newly affluent households were poor in period t. Determining these households' $(t + 1)$ habit requires, therefore, an assumption regarding their soda choices in period t, when they were still "Poor." Aggregate downward mobility and urbanization similarly require assumptions. We specify two such assumptions that we deem to be reasonable. While these assumptions may seem strong, the appendix reports several checks that reassure us that our findings are strongly robust to changes in these assumptions.

Assumption 1 (Socioeconomic Mobility)**.** *Among those households moving up (down) from Poor to Newly Affluent (Newly Affluent to Poor) status, the previous-period shares of premium versus generic brands equal the previous-period shares of premium versus generic brands among all Poor (Newly Affluent) households.*

Assumption 1 implies that social mobility between periods t and $(t + 1)$ is independent of consumption choices at time t. For example, a household who "moved up" from being poor at t to newly affluent at $(t+1)$ is as likely to have consumed each type of soda at time t as any member in the wider population of poor households at time t. We similarly incorporate an assumption regarding rural-urban mobility (again, the appendix demonstrates robustness to both Assumption 1 and Assumption 2):

Assumption 2 (Migration)**.** *Households moving to urban areas join the Poor socioeconomic group and have a no-soda habit. Households moving out of urban areas leave the Poor group, and have premium, generic and no-soda habits in proportion to the shares of those habits among the Poor that remain.*

4   Identification and estimation

4.1   The estimation procedure

Since the type-specific shares $s_{j,r,gt}(\theta)$ from (4) are not observed in our data, estimation is based on matching the aggregate shares $s_{jgt}(\theta)$ predicted from (5) with shares s_{jgt} computed from the Nielsen data. This follows the spirit of the literature that estimates random-coefficient demand models with discrete-type unobserved heterogeneity (e.g., Berry, Carnall and Spiller 1996, Kalouptsidi 2010). In this literature, types are often abstract groupings of "similar" consumers, and the population fractions of these types are treated as parameters to be estimated. For example, Nair (2007) models video-game consumers as either "high valuation" or "low valuation" types, and estimates their relative population fractions.

In contrast, our approach places a specific structure on the unobserved heterogeneity, tying it down to both the household's current socioeconomic standing and its current habit state. Population fractions for these unobserved types are, therefore, computed by combining data on aggregate social mobility and model predictions of household choices. Because time-t choices determine time-$(t+1)$ habit states, we incorporate a dynamic updating routine into each evaluation of the GMM objective function. We briefly describe the logic of the estimation algorithm and leave further details to the appendix.

The following steps allow us to construct a GMM objective function and evaluate it at some generic value of the model's parameters θ. As explained, the first-period type-distribution vector, $\mathcal{F}_{g1}$, is computed from our single cross-section of micro-level data. Conditional on $\mathcal{F}_{g1}$ and the parameters θ, equation (5) yields predicted aggregate brand shares in period $t = 1$. Using the contraction mapping from Berry, Levinsohn and Pakes (1995), we invert the market share equation that equates predicted aggregate shares to shares that are observed in the data, and solve for the unique vector of brand-specific base utilities δ that satisfies this equation (to be clear, since we do not observe type-specific shares, we cannot "match" them). We use these base utilities in equation (4) to predict type-specific brand choices, from which we obtain the type-specific fractions of households who, in period $t = 1$, consume premium brands, generic brands, or no soda. Following Section 3.2, these predicted choices (which generate second-period habit states) are then combined with the aggregate socioeconomic mobility observed between periods $t = 1$ and $t = 2$ to obtain the second-period type-distribution vector, $\mathcal{F}_{g2}$.

Repeating this process for periods $t = 2, ..., 56$ (and solving for the base utilities in the last sample period $t = 57$), and then repeating for each region g, we obtain the base utilities for every brand in every region-period market. From $\xi = \delta - x'\beta - \alpha p$, we compute the demand unobservable $\xi_{jgt}(\theta)$ for each brand j in each region-period market gt. We follow the demand estimation literature and make the identifying assumption that these demand unobservables

are mean-independent of a set of instrumental variables Z. This assumption gives rise to a GMM objective function that attempts to set the co-variance between the instruments and the computed demand unobservables as close to zero as possible.[21]

Choice of instruments. We adopt three classes of demand instruments used by Salvo (2009).[22] The correlation of these instruments with prices helps alleviate biases associated with price endogeneity.[23] The first class of instruments are the prices of inputs, namely sugar, electricity and fuel. Specifically, we interact these three input prices with two brand type dummies (premium or generic), forming six instruments.

The second class of demand instruments borrows from Hausman, Leonard and Zona (1994). We instrument for a brand's price in a given region with the contemporaneous mean price for this brand in the other six regions, forming one instrument. The identifying assumption is that prices across different regions are correlated through a common cost structure or through common shifts in the way firms strategically interact (for instance, the mid-1999 premium price cut). This approach can be challenged if common demand unobservables are present (see Bresnahan 1997a, 1997b). However, such issues are of a lesser concern in our setting, for the following two reasons: first, we control for region-specific, brand-level advertising intensity and in-store presence, often absent from demand studies. Second, there is considerable regional variation in demand, explaining the very local nature of Brazilian soft-drink distribution and promotion.[24]

Finally, a third set of instruments is afforded by the premium brands' mid-1999 price cut. We argue that this sharp price cut was exogenous to the brand-region-time specific demand unobservables ξ_{jgt}: this large and sudden price drop was a response to the demographic shifts and expansion of the fringe that we observe in 1996-1999, rather than a response to some sudden unobserved mid-1999 demand shock (noting that we also control for advertising intensity, in-store presence, weather shocks and region-specific drifts). In practice, we generate a post-July 1999 dummy variable and interact it with brand-region fixed effects, forming $9 \times 7 = 63$ instruments that allow the effects to vary by brand within each region.

4.2 Identification

In this section, we provide intuitive identification arguments, suggesting that the parameters of the choice model specified in Section 3.1 can be recovered using our richly varying aggregate data on market shares, prices and social mobility for the different regions over time. A formal proof of

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[21]Note that inversions of the market share equation cannot be performed independently for different markets over time. One must perform this inversion for period t, obtain the fractions of the population of each type for period $(t + 1)$, and then perform the inversion for period $(t + 1)$. This dynamic process must be performed at every candidate value of θ.

[22]Salvo (2009) estimates an AIDS demand model, a different approach compared to the discrete-choice model we offer in this paper. Just the same, instrumenting for price endogeneity is similarly relevant to both frameworks.

[23]In the Monte Carlo exercise in the appendix, we model price endogeneity and adopt the same three instrument classes during estimation.

[24]It is worth noting that the penetration of national retailers in Brazil is still limited relative to the United States.

identification is beyond the scope of this paper. In the appendix, we illustrate this argument by way of Monte Carlo studies that show how the socioeconomic transitions and price variation, of the magnitude that we observe in the aggregate data, help identify our specified habit mechanism as well as the heterogeneous price sensitivities.

Socioeconomic transitions. Recall that we observe both the growth of a new middle class from 1996/97 on and its partial reversion during the recession that started around 2000/01. Importantly, these demographic shifts occurred at differential rates across regions. While our inclusion of brand-region fixed effects controls for *fixed* differences in preferences across regions— stemming, for instance, from cultural or historical reasons—the intra-region temporal shifts in the socioeconomic distribution of households provides a key source of variation.

To illustrate this point, consider two regions that vary substantially in terms of their dynamic evolution: region 1 (the Northeast) and region 4 (São Paulo Metro). The following tables depict some socioeconomic and product market data for these regions at several points in time:

% Urban households	Dec/Jan 1997		Dec/Jan 2000		Dec/Jan 2003	
	Poor	New. Affl.	Poor	New. Affl.	Poor	New. Affl.
Region 1 (Northeast)	65%	—	44%	24%	57%	15%
Region 4 (São Paulo Metro)	36%	—	23%	16%	23%	19%

Shares: No Soda & Generics	Dec/Jan 1997		Dec/Jan 2000		Dec/Jan 2003	
	s_0	s_{gen}	s_0	s_{gen}	s_0	s_{gen}
Region 1 (Northeast)	87%	0.3%	82%	5.0%	80%	8.4%
Region 4 (São Paulo Metro)	61%	6.6%	62%	12.6%	59%	11.9%

Sources: Nielsen, IBOPE, IBGE (PNAD). Market shares s_0 and s_{gen} are for the outside option and for generics, respectively.

At the start of our sample, region 1 is substantially poorer than region 4 (65% of region 1's urban households are poor vis-à-vis 36% for region 4) and, at the same time, exhibits lower soda penetration relative to its wealthier counterpart (87% of region 1's households do not consume soda against 61% for region 4). Notice that this cross-sectional variation can in principle be explained not only by the poor being more price sensitive than the established affluent, but also by region 1 potentially exhibiting a lower preference for soda relative to region 4. Such fixed differences, however, are controlled for with brand-region fixed effects in the utility specification.

From 1997 to 2000, region 1 boasted stronger upward mobility relative to region 4: by 2000, 24% of region 1's households were newly affluent compared with 16% of region 4's households. Over these same years, region 1's soda penetration $(1 - s_0)$ grew substantially, from 13% to 18%, while soda penetration in region 4 was about flat. Generic brands in region 1 enjoyed a huge gain in share (s_{gen}) from 0.3% to 5.0%, while in region 4, the share of generics "only" doubled.

This joint temporal variation in social mobility and soda consumption choices helps pin down the price sensitivity parameters $(\alpha_{EA}, \alpha_{NA}, \alpha)$. Recall that our model allows price sensitivity to vary by socioeconomic standing. Intra-regional social mobility of households between poor and newly affluent status thus changes the aggregate price sensitivity in the region. Co-variation of these shifters of price sensitivity with aggregate market shares, controlling for prices, helps identify the heterogeneous price sensitivities. As expected, Monte Carlo experiments in which we restricted social mobility increased the variance of our estimates.

The data tables above also report the differential effects of the recessionary period in the two regions. Region 1 saw the proportion of newly affluent households shrink considerably, from 24% in 2000 to 15% by 2003, yet the penetration of soda consumption continued rising, even if at a lower rate, from 18% to 20%. Importantly, the recession was not accompanied by declining soda prices (see Figure 2). This pattern is suggestive of persistence in preferences. Intuitively, such data variation helps to pin down the parameter λ and illustrates how persistence manifests itself directly in the data. To emphasize this point, Figure 3 contrasts the stability of soda consumption in the recessionary period with the substantial decline in the sales of cement during the same period, after years of growth for soda and cement alike. The differential pattern is suggestive of stronger persistence in preferences over food and beverage, such as soft drinks, compared to other product categories, noting that cement can be considered a consumer good in Brazil.

It is also intuitive that controlling for persistence in preferences may actually help recover the heterogeneous price sensitivities. To see this, imagine a model that did not allow for persistence. Such a model would then interpret the data variation in the recessionary period as evidence that the poor are "not that price sensitive," since all one would see through the lens of the model is an increasingly poor population consuming stable amounts of soda. It might then be more difficult to elicit greater price sensitivity among the less affluent households. This is consistent with an estimated variant of the model that shuts down the habit mechanism, reported below.

Price variation. Another important source of data variation is afforded by price shifts that can be viewed as exogenous to unobservable demand shocks. We argued in Section 4.1 that the premium brands' decision to abruptly cut prices in mid 1999 was largely exogenous to the demand unobservables ξ_{jgt}. Similarly, the gradual decline in fringe prices observed between 1996 to 2000 (recall Figure 2) was likely driven by supply-side effects, with the close substitutability among generic brands suggesting that their price should, to a large extent, stay close to the marginal cost of production and distribution. Expanded capacity and scale, learning effects and exit of inefficient producers may all have contributed to declining fringe costs and prices.

Through most of the period of declining fringe prices, generics were able to grow substantially at the expense of the premium brands and the outside good. To stay with the examples shown in the table of shares above, between 1997 and 2000: (i) in region 1, the generic share grew by

5 points, with the premium share (i.e., $1 - s_{gen} - s_0$) holding up quite well; and (ii) in region 4, the generic share grew by 6 points, and at the expense of the premium share. Intuitively, the co-movement in prices and shares is picked up by the parameters that govern price sensitivity and habit formation, thus contributing to their identification.

The table also suggests that the generic share in regions 1 and 4 held up quite well following the premium price cut in mid 1999 (see Figure 2 for all regions combined). This provides further evidence of persistence in preferences and, specifically, it helps identify our Brand Type Persistence (BTP) mechanism: a habit of "going generic," developed by part of the population prior to the mid-1999 premium price cut, made it very difficult for premium brands to win such households over, even via a drastic price cut. The price cut did, however, help protect premium brands from *further* market share losses, in part by attracting households who, at the time, had a "no soda" habit. We return to this discussion in the results section. To sum, wide variation in the socioeconomic composition of households and the sharp price cut help us identify both heterogeneous price sensitivities and our habit mechanism.

5   Results

5.1   Estimates from the demand model

Table 3 reports estimates for our demand model. The price sensitivity of poor households has the expected negative sign and is precisely estimated at -5.7. The parameters α_{EA} and α_{NA} are positively signed, with $\hat{\alpha}_{EA} > \hat{\alpha}_{NA}$. Recalling that $(\alpha + \alpha_{EA})$ and $(\alpha + \alpha_{NA})$ capture the price sensitivities of the two affluent groups, this implies that the established affluent are the least price sensitive group, the poor are the most sensitive group, and the newly affluents display an intermediate level of sensitivity. Namely, $\hat{\alpha} + \hat{\alpha}_{EA} = -2.1$ (with a standard error of 0.2) for the established affluent, and $\hat{\alpha} + \hat{\alpha}_{NA} = -3.9$ (with a standard error of 0.6) for the newly affluent. This ranking is consistent with the Financial Times article referenced in the introduction.

In terms of statistical significance, the newly affluent are marginally less price sensitive than the poor (the p-value of a test of equality is 0.10) but significantly more price sensitive than the established affluent (the p-value of a test of equality is 0.00).[25] We discuss the economic significance of these estimated parameters below when we examine demand elasticities and conduct a counterfactual experiment.[26]

We find strong evidence for the second mechanism we study in this paper—habit formation. The coefficient λ is estimated to be positive and it is very precisely estimated. As we note

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[25]This follows from the estimates reported in Table 3, namely $\hat{\alpha}_{NA} = 1.8$, s.e. 1.4 and $\hat{\alpha}_{EA} - \hat{\alpha}_{NA} = 1.8$, s.e. 0.5.

[26]The appendix reports robustness checks. Across the bulk of specifications we tried, the exact point estimate for α_{NA} is less robust when compared to other parameter estimates, but the finding that it does not exceed α_{EA} (i.e., newly affluents are no *less* price sensitive than established affluents) holds rather consistently.

in the appendix, this finding is robust across different specifications.[27] In terms of economic significance, our utility framework provides a measure of the increased willingness to pay for generic (premium) soda that results from previous consumption of generic (premium) soda. In particular, the implied increase for a newly affluent household is $-\lambda/(\alpha + \alpha_{NA}) = 1.1$ R\$/liter.[28] Further, the implied increase in willingness to pay for a generic over a premium brand when the household has a generic habit *rather than a premium habit* is twice this amount.

Such measures suggest a substantial monetary value for habit formation, and a crucial role played by this mechanism in emerging market dynamics. Once a newly affluent (or other) household develops a generic habit, "convincing" it to switch to a premium product becomes substantially more difficult. In the wake of an emerging middle class and declining fringe prices, our estimated model helps explain the sense of urgency with which premium brands acted in mid 1999, as we argue in the counterfactual analysis below.

Table 3 further reports the effects of several shifters of δ_{jgt}, the base utility of consuming brand j in region-period market gt. Our specification includes the effects of brands' media advertising and in-store presence.[29] In either case, we interact the brand-region-period varying "visibility" variable with regional dummy variables, allowing effects to differ across regions. For instance, in the case of advertising, this might reflect cross-sectional variation in households' exposure to media, and the fact that these measures pertain only to the main cities within each region (so they are not comparable across regions). We generally obtain positive effects for media advertising and for in-store presence.

Coefficients on (similarly region-specific) time trends tend to be negative. Such negative effects are consistent with continued improvement in the value of the outside option, which includes beverages other than soda such as juices and (tap or bottled) water, concomitant with the overall trend of economic growth.[30] Finally, note that our specification controls for $9 \times 7 = 63$ brand-region fixed effects, capturing the tendencies of particular regions to consume different brands (e.g., historically, tastes for Pepsi are known to be relatively strong in the South, region 6—see Table 1). We also control for bi-monthly seasonality effects interacted with brand type, to allow these effects to differ across premium and generic brands. Over and above seasonality,

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[27]One possible interpretation for persistence in market shares could be serial correlation in the demand shocks ξ. Our inclusion of brand-region fixed effects and region-specific trends alleviates this concern. Just the same, calculating the simple correlation between current-period and previous-period estimated values for ξ for each brand-region combination yields correlations that are mostly negative (52 out of 63) and mostly small in absolute value. Of the six correlations that exceed 0.2 (with a maximum correlation of 0.5), five are in region 1, and they do not pertain to the leading brands Coke, Guaraná Antarctica and Fanta.

[28]Corresponding amounts for established affluent and poor households are 2.0 and 0.7 R\$/liter, respectively.

[29]The appendix further discusses these covariates and reports robustness tests in which they are dropped from the specification. To gain a sense of variation in premium brands' advertising, intensity for the Coke brand in São Paulo Metro was measured at 2199 Gross Rating Points in December 2000, rising to 3587 GRP in December 2001, whereas Pepsi's GRP were 351 and 598 in these respective periods. Media advertising in the fringe is measured at zero GRP throughout.

[30]Forbes (2004) reports that the "the juice category grew twenty times over the past decade, albeit from a low base." IBGE's annual household surveys (PNAD) also indicate a sustained increase in access to tap water and piped sewerage in urban Brazil. Note that we rescale variables to vary between 0 and 1, so the trend coefficients reflect variation from the start to the end of the sample: these effects are economically small.

market gt's mean temperature is estimated to have a significantly positive effect on demand.[31]

To further explore the economic implications of our demand estimates, Table 4 reports estimated own-price elasticities. The table lists both aggregate elasticities for the leading brands, and elasticities by household type for Coke and for generics, reporting means over all region-period markets gt.[32] A 1% increase in Coke's price lowers its market share by 1.7%, compared with somewhat larger (in magnitude) elasticities of -2.0 to -2.1 for the other premium brands, Guaraná Antarctica, Fanta and Pepsi. The own-price elasticity for generics is -0.7. While this value may seem low, note that this is the elasticity of demand for the aggregation of generic brands. The demand for each individual generic brand should be much more elastic, given the limited differentiation and fierce price competition within the fringe.

Examining the nine type-specific elasticities, and fixing the habit state, we see that demand becomes more elastic the lower is the socioeconomic standing. For instance, considering households with a premium habit, Coke elasticities are (-1.4,-3.3,-5.7) for the established affluent, newly affluent, and poor groups, respectively. Fixing the socioeconomic standing, the habit state has a strong impact on demand elasticities. Considering, for example, the newly affluent group, demand for Coke is least elastic for households with a premium habit -3.3. Households with either generic or "no-soda" habits exhibit higher elasticities of roughly -4.2.

The evolution of these type-specific own-price elasticities is shown in Figure 5 (for region 4). The left panel considers the Coke brand. Demand by all types becomes less elastic halfway through the sample, when premium brands cut prices. The least elastic demand for Coke is by the established affluent with a premium habit; the most elastic demand is by the three poor types, particularly those who did not consume premium soda previously. Coke elasticities among newly affluent types lie between the elasticities displayed by the established affluent and the poor. The picture underscores the important role we infer for habit formation: members of the emerging middle class who have developed a premium habit display price sensitivities for Coke that are "half way" between newly affluents who have not developed such a habit and the more sensitive among the rich. The right panel depicts own-price elasticities for generics. The demand for generics is less elastic among newly affluent types who have already "gone generic" than among established affluent types who have not yet been "grabbed," once again demonstrating the important role played by persistent preferences.

Table 5 continues to describe the economic implications of our estimated demand model.

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[31]To illustrate within-season variation in temperature, winter temperatures in the South region averaged 15.1^oC in July 2001 against 12.1^oC in July 2000.

[32]The household type-r specific own-price ($j = k$) and cross-price ($j \neq k$) elasticities of demand for brand j are computed from $\eta_{jk,r,gt} = \left(\partial s_{j,r,gt}/\partial p_{kgt}\right)\left(p_{kgt}/s_{j,r,gt}\right)$ where, for brevity, we omit the argument θ, and,

$$\frac{\partial s_{j,r,gt}}{\partial p_{kgt}} = \begin{cases} (\alpha + \alpha_r)\, s_{j,r,gt}\,(1 - s_{j,r,gt}) & \text{if } j = k \\ -(\alpha + \alpha_r)\, s_{j,r,gt} s_{k,r,gt} & \text{if } j \neq k \end{cases}$$

Panel A reports predictions for the share of households purchasing soda, by type of household and brand. Overall soda penetration is 69%, 22% and 5% for the established affluent, the newly affluent and the poor, respectively (these are means computed across all regions over the last 12 months of the sample). Compared to the established affluent, newly affluent households are *more* likely to favor generic over premium brands: generic-to-premium consumption ratios are 0.5, 1.4 and 2.7 for the established affluent, newly affluent and poor groups, respectively. Panel B provides transition matrices that further underscore the persistence in preferences: a newly affluent household who established a premium (generic) habit in the previous period consumes premium (generic) soda in the current period with a probability of 0.66 (0.73). For the established affluent, these probabilities are even higher (0.90 and 0.87, respectively).

A "no habit" model variant. Table 6 presents results from a variant of our demand model which shuts down the habit formation mechanism by constraining λ to equal zero. Estimates from this model imply that the newly affluent are more price sensitive than the poor. This stands in contrast to the findings of our baseline model, whose predictions we view as more realistic. The demand surge observed beginning in 1996 across many consumer goods markets, soft drinks being one of them, suggests that Brazil's emerging middle class was *less*, not more, price sensitive than the poor. The estimated no-habit model suggests that the emergence of a new middle class changed the aggregate price sensitivity in the "wrong" direction, missing the phenomenon which is at the heart of our study: an expansion in demand stemming from a socioeconomic transformation.

The downward bias in the poor's price sensitivity in the model variant is consistent with the intuition provided in Section 4.2 above: during the recession in the later part of the sample, households moved down from newly affluent to poor status, yet soda consumption remained stable. By not allowing a habit mechanism, the restricted model appears to interpret this as evidence that the poor are not very price sensitive. This further demonstrates the importance of accounting for persistence in preferences.

5.2   Counterfactual analysis of the premium price cut

A striking feature of the data is the premium brands' sharp price cut, led by Coca-Cola, almost halfway through the sample period. As the solid lines in the left panel of Figure 6 indicate (for region 5, with similar variation for other regions), per-liter premium brand prices stayed broadly flat at about R\$ 1.15 until mid 1999, then dropped abruptly to R\$ 0.90 and stayed at this lower level. Fringe prices, in contrast, experienced a prolonged, gradual decline from R\$ 0.80 to R\$ 0.55 between late 1996 and mid 2000. The picture reveals that fringe prices did not deviate from their downward trend in response to the premium price cut, consistent with fringe prices closely tracking their producers' marginal costs.

We employ the estimated model to simulate the evolution of market shares had premium sellers *not* cut prices in mid 1999. This counterfactual price path is marked by the dashed line in the left panel of Figure 6. In this analysis, we keep fringe prices equal to the ones observed in the data. This assumption is justified by the fringe's competitive nature and, as discussed, the absence of an apparent pricing response to the premium price cut.

The right panel of Figure 6 reports the estimated impact on aggregate premium and generic market shares. Observed shares are marked by solid lines, whereas counterfactual shares are marked by dashed lines (shares in this figure are out of the total market size, which includes the outside option, so that the premium and generic shares do not sum to one). A clear picture emerges: had premium producers failed to cut prices, they would have suffered a deep loss of market share, hitting a rock bottom in the winter of 2000. At that point, the premium share would have been 12%, compared to a share of over 20% in the observed sample.

In the counterfactual scenario, generic brands grow relentlessly at the expense of their premium competitors. The figure reports that the generic market share would have surpassed the premium share early in 2000. By 2003, generics in region 5 would have enjoyed a market share advantage over premium brands of 9% (25% against 16%).

This analysis provides support for Coca-Cola's price cut, in that it seems to have prevented a substantial drop in market share. A key insight from the analysis is that the premium price cut was especially effective in terms of attracting customers who otherwise would have chosen the outside, "no soda" option. It was only partially effective in converting consumers of generic brands into premium consumption. This can be inferred by comparing the actual versus counterfactual shift in the premium shares over time to the smaller corresponding shift in generic shares. For example, actual inside shares over 2001-02 averaged 46% (28% premium plus 18% generic) to be compared with counterfactual inside shares of 40% (17% premium plus 23% generic). This is suggestive of substantial market segmentation, consistent with state dependence that limits the scope for "business stealing" across the types of brand offerings and the high monetary value of habit formation. Still, in the absence of premium brands cutting prices, the fringe's penetration would have been almost 30% larger (i.e., $(23 - 18)/18$).

Impact on variable profit. While our analysis indicates that Coca-Cola's price cut succeeded in avoiding a deep market share loss, we note that this was achieved at a cost: a deep price cut of over 20%. In other words, premium sellers sacrificed a non-negligible portion of their margins to protect their market shares.[33] To assess the impact of the price cut on earnings, we perform a back-of-the-envelope calculation of variable profit both in the observed sample, and under the counterfactual no-price-cut scenario.

Using information gleaned from Ambev's local SEC filings, and from conversations with in-

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[33]Protecting market shares, even at a high cost, may be rational insofar as current market share is an "asset," predictive of future profit. See Bronnenberg, Dhar and Dubé (2009) on the persistence of brand market shares.

dustry insiders, among other sources, we estimate that the premium brands' combined variable profits (excluding fixed costs) during the first three years after the price drop amounted to R\$ 861 million, to be compared to counterfactual profits of R\$ 807 million, had the price cut not occurred.[34] That is, a 6% loss in variable profit, considering only the medium run, was avoided by the premium price cut. The evidence supports the notion that the price cut was beneficial in terms of its impact on both market shares and profits.

A comparison with the "no habit" model variant. To further explore the role played by the habit mechanism, we perform the same counterfactual analysis but using estimates from the no-habit model variant presented above. The results are displayed in Figure 7. Comparing Figure 7 to Figure 6, we learn that, relative to the baseline model, the no-habit model predicts a substantially smaller erosion of market share for premium brands had they failed to cut prices. Further, using the same back-of-the-envelope calculations discussed above, the no-habit model implies that the price cut actually *decreased* premium brands' variable profit, from R\$ 1,013 million (with no price cut) to R\$ 861 million (with price cut) over the same three years. This stands in stark contrast to the predictions of the baseline model.

Discussion. The counterfactual analysis lends strong justification to Coca-Cola's strategic price cut. Importantly, this conclusion is delivered by the baseline model but *not* by the no-habit variant, a finding that we interpret to be indicative of the role played by state dependence in this emerging market. Our estimates suggest that habit carries a large monetary value. Once a newly affluent household "goes generic," it is significantly less likely to switch into premium soda consumption, and vice versa. The arrival into the market of millions of new customers, who have yet to form persistent consumption patterns, provides an opportunity for generic producers to challenge the position of established brands.

Our analysis suggests that the main effect of the premium sellers' price cut was not to convert households with the generic habit into consumption of their products. Rather, the price cut's main effect was to tap into the large pool of households with the no-soda habit. By inducing a substantial portion of these households to develop a habit of consuming premium soda, Coca-Cola and Ambev were able to shield themselves against further losses. The analysis suggests that it is this mechanism that stabilized market shares after mid 1999, despite the decline in fringe prices continuing for another year (recall Figure 2). The ability to draw such conclusions stems from implementing a rich utility framework that allows for both heterogeneity in price sensitivity and for persistent preferences. A standard no-habit variant appears ill-suited to a rapidly changing market as ours.

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[34]See the appendix for details on how this calculation was performed.

6 Concluding remarks

This paper examines two salient features of the Brazilian soft-drink market: the emergence of a new middle class, and the rapid growth of a generic fringe. Using mainly aggregate data that exhibit very rich variation, we estimate a household choice model that highlights two aspects which we view as highly important in such markets: the heterogeneous price sensitivities of different socioeconomic groups, and habit formation in household preferences.

The Brand Type Persistence mechanism that we specify captures a world in which premium brands are prompted to cut prices in the wake of an emerging middle class. If they fail to do this, a substantial mass of the "new customers" might be captivated by the generic habit. It may then prove much more difficult to convince these consumers to pay substantially more for a highly advertised premium brand.

While our application focuses on the Brazilian soft-drink market, we view the issues tackled in this work as highly pertinent to many consumer goods markets in the developing world, where a tension between advertised branded offerings and discounted generics exists or is developing. Understanding the features of demand and the nature of competition in such markets should be of great interest for policymakers and firms alike.

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A   Appendix

A.1   Data

Figure A1 reports variation over the sample period in: (i) the intensity of premium brands' media advertising (left panel, summed across brands, meaned across regions); and (ii) retail distribution for the main premium brand, Coke, and for generic brands (right panel, meaned across regions). The sources are McCann-Erickson and Nielsen, respectively. The fluctuation in premium soda advertising is considerably larger than that of premium soda quantities sold and does not share as seasonal a pattern (Figure 1). The proportion of self-service outlets that were stocking at least one generic brand on the day of Nielsen's audit already stands at a fairly high 83% in the first period and grows to 98% by mid 1999, whereas the Coke brand is stocked by close to 100% of stores all along. Our baseline specification controls for such brand-level variation in "visibility" both in the media and at the store.

The temperatures we include as additional demand shifters are region-specific monthly averages, sourced from the National Institute of Meteorology. Input prices that we include among demand instruments are the Fundação Getúlio Vargas's wholesale price for refined sugar (the 'IPA-OG açúcar') and price index for transportation fuel (the 'IPA-OG combustíveis e lubrificantes'), besides regional high-voltage electricity prices ('classe industrial') obtained from the National Agency for Electrical Energy. We inflation-adjust all nominal prices—for soda and for inputs—using a consumer price index (the 'IPC-br') published by the Fundação Getúlio Vargas. For perspective, the CPI has averaged +7.8% per year over the sample period.

The remaining part of this subsection explains how we combine IBOPE's LatinPanel survey with IBGE's annual household survey (the PNAD, 'Pesquisa Nacional por Amostra de

Domicílios') to produce household counts by socioeconomic standing. We also detail how we obtain the first period's type-distribution vector, $\mathcal{F}_{g1}$, from IBGE's 1995/96 urban household expenditure survey (the 'Pesquisa de Orçamentos Familiares').

Data on aggregate social mobility. From IBOPE's LatinPanel we observe, for every region-year pair, what proportion of urban households belong to each of two socioeconomic groups, **ABC** or **DE**. IBOPE's regions map directly into Nielsen's seven regions, with the exception of region 1 (northeastern states less Maranhão and Piauí) for which IBOPE's coverage includes all northeastern and northern states. Since Maranhão, Piauí and the North comprise the country's least urbanized and least populated area, we simply take IBOPE's urban distributions for the Northeast/North as representative of urban households in Nielsen's region 1. IBOPE's survey through 2002 was representative of all municipalities with populations of at least 20,000, and their coverage was expanded in 2003 to represent municipalities with populations exceeding 10,000.

We obtain household counts from IBGE's annual household surveys (PNAD). These cover households, both urban and rural, in all 27 states of the country. For perspective, 115,654 households were sampled in 1999. We use the weights provided to expand the representative sample to the universe of households. We consider only households residing in urban areas and in states within each Nielsen region. For example, for region 1, we sum the number of urban households across all states in the Northeast less Maranhão and Piauí.

We then multiply, for each Nielsen region and year, the IBOPE socioeconomic proportions of urban households by the IBGE urban household counts. To increase the frequency of the resulting panel from annual to monthly periods (or bimonthly periods, thus matching the frequency of Nielsen's point-of-sale audits), we linearly interpolate from September of one year to September of the following year, noting that September is the IBGE PNAD's annual "month of reference."

Data on household-level brand choices. IBGE's HEX 95/96 surveyed 16,013 households in 11 large metropolitan areas across the country. Carvalho Filho and Chamon (2012) discuss this survey in detail. Over a reference period of one week falling between October 1995 and September 2006, the soft drink expenditure in R\$ for consumption inside the home was recorded for each household, detailed by soda brand(s) purchased. We then classified the following brand descriptions and codes as "premium" brands: *Coca-Cola* (9301); *Pepsi* (9302); *Guaraná* (9303); *Fanta laranja, uva, limão* (9304); *Soda limonada* (9307); *Mirinda* (9308); *Sukita* (9315); *Pop laranja* (9316); and *Refrigerante água tônica* (9349). Examples of coded brand descriptions that we classified as "generic" brands are: *Refrigerante tubaína* (9318); *Refrigerante laranja exceto Fanta, Sukita, Pop, Crush* (9339); *Refrigerante cola exceto Coca-Cola e Pepsi-Cola* (9340); *Refrigerante cajú qualquer marca* (9346); and *Refrigerante Goianinha* (9355). Of the 16,013 households, 10,172 (or 64% of households) were recorded as making no soda purchases, 4,465 households (28%) purchased only brands that we can confidently identify as premium, 310 households (2%)

purchased only brands that we identify as generic, and 236 households (only 1%) simultaneously purchased brands that we identify as premium and brands that we identify as generic. This observation justifies our modeling of soda-consuming households at each point in time as either premium or generic shoppers, but not "hybrids."

We deemed four soda descriptions to be ambiguous with regard to brand type: *Refrigerante água natural* (9310); *Refrigerante gasosa* (9319); *Refrigerantes não especificado* (9335); and *Refrigerante dietético* (9360). We need to assign the soda expenditure of the remaining 830 soda-purchasing households (5% of the survey sample) to either premium brands or generic brands. These are households whose soda expenditure we cannot entirely identify by brand type, such as a household purchasing R$ 4 of Coke (9301) and R$ 2 "Soda not specified" (9335). To do this, we first designate as premium the "brand-unidentifiable" soda expenditure portion (R$ 2 in the example) for those households whose identifiable-premium expenditure share of soda exceeds 50% (Coke's 67% share in the example) *and* identifiable-generic expenditure share of soda is less than 10% (0% in the example). Similarly, we assign to generic the unidentifiable soda expenditure portion for those identified-generic-dominant households. Finally, the soda expenditure portion that for a remaining 614 households is still not assigned to a brand type— e.g., a yet-to-be-assigned R$ 4 purchase of "Soda not specified" (9335)—is allocated among premium and generic expenditure: (i) in proportion to the (identified or designated) premium versus generic expenditure shares within the household; or (ii) if none of the household's soda expenditure is identifiable (say the household in this second example purchased only "Soda not specified"), the allocation is done in proportion to the premium versus generic expenditure shares across households in the same socioeconomic group and metropolitan area.

We use balance sheet data to classify households according to socioeconomic standing, **ABC** or **DE**, as described in Section 2. We use the weights provided to expand the representative sample to a universe of 12.5 million households across the 11 metropolitan areas. To calculate household-level premium and generic quantities, we divide HEX 95/96 expenditures on premium and generic soda by Nielsen's region-specific share-weighted mean prices for premium and generic brands, respectively, in period $t = 1$ (Dec-96/Jan-97). We then aggregate premium (resp., generic) quantities across the universe of households in each socioeconomic segment and in the surveyed metropolitan areas for each Nielsen region g (e.g., the cities of Recife, Fortaleza and Salvador in the Northeast, $g = 1$).

The premium (resp., generic) soda shares among the initial masses of established affluent and poor households are calculated analogously to how we define $s_{jgt} = q_{jgt}/\mathcal{M}_{gt}$ in Section 2, i.e., taking market size (in our base specification) as six liters per household per week times the number of weeks in period $t = 1$. Combining these premium versus generic (versus no soda) shares by socioeconomic group with first-period household counts by socioeconomic group (as per above),

yields $F_{EA^{\mathcal{A}},g1}, F_{P^{\mathcal{A}},g1}$ and $F_{EA^{\mathcal{B}},g1}, F_{P^{\mathcal{B}},g1}$ (recall that $F_{NA^{\mathcal{A}},g1} = F_{NA^{\mathcal{B}},g1} = 0$). We consider only soda purchases that were recorded as being for the household's inside-the-home consumption (rather than recorded as "individual consumption") and at stores coded as *Supermercado* (1), *Hipermercado* (2), *Padaria* (3), *Lanchonete* (11), and *Mercado & Central de Abastecimento* (26), in view of the mapping to Nielsen's self-service channel (stores with checkouts).

Two points are noteworthy. First, the HEX survey suggests that urban household size does not vary significantly across socioeconomic group. Mean household sizes are 3.64 for **ABC** (with a standard deviation of 1.58) and 3.76 for **DE** (s.d. 1.99). Second, while the HEX shares that enter the initial conditions $\mathcal{F}_{g1}$ are calculated following the market share definition of Section 2, one should note that the shares reported in Table 2 are extensive margins of soda consumption, i.e., the proportions of households who purchase any soda quantity. As for intensive margins, the modal intensity of soda consumption, conditional on positive consumption, is 2 liters per household per week regardless of the socioeconomic group and the region. One can intuitively interpret this pervasive intensive margin as "one 2-liter family-size bottle of soda that is brought to the table every week."

We performed all manner of "consistency checks," where applicable, to ensure that the data were consistent across the different sources. For example, among households residing in the three metropolitan areas in the Northeast that were surveyed in the HEX, premium and generic market shares amount to 12.5% and 0.4%, respectively.[35] These HEX shares of 12.5% and 0.4% are similar to the Nielsen market shares of 12.3% across premium brands and 0.3% for generics in the Dec-96/Jan-97 bimonth (soda sold in family-size bottles through self-service outlets in the Northeast). By way of another example, the HEX 95/96 projects the universe of households for region 3 (the Rio de Janeiro metropolitan area) at 2.96 million (Table 2), to be compared to 2.64 million households projected for Dec-96 in the IBGE PNAD (noting that Nielsen's region 3, which we adopt for the IBGE household counts, excludes some peripheral villages around the city of Rio de Janeiro). Further, using the HEX 95/96's balance sheet data, we assigned **ABC** socioeconomic status to 55% of region 3's households (Table 2), whereas the IBOPE data suggest that at that time 57% of region 3's households were **ABC**.

A.2 Further estimation details

A.2.1 Dynamic type evolution

We provide examples, from the data, of the dynamic updating process. We consider two transitions, both for region 4 (the São Paulo metropolitan area). The first transition, from $t = 1$ to $t = 2$, features upward mobility and, unusually in the data (yet we need to allow for this),

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[35]These shares are as defined in Section 2. Shares grow to 26.6% and 0.7%, respectively, if we condition on **ABC** households (these are similar to the extensive margins reported in Table 2).

a slight flow of residents out of the region ("net urban-to-rural migration"). The second transition, from $t = 10$ to $t = 11$, features upward mobility and the rural-to-urban migration that is prevalent in the data. We illustrate these transitions at the estimated model parameters θ^*. We also comment on the robustness of our estimates to the baseline mobility Assumptions 1 and 2.

Region 4, $t = 1$ to $t = 2$. The initial type-distribution vector is

$$
\begin{aligned}
\mathcal{F}_{g=4,t=1} &= \left\{ F_{EA^{\mathcal{A}},4,1}, F_{EA^{\mathcal{B}},4,1}, F_{EA^{\mathcal{O}},4,1}, F_{NA^{\mathcal{A}},4,1}, F_{NA^{\mathcal{B}},4,1}, F_{NA^{\mathcal{O}},4,1}, F_{P^{\mathcal{A}},4,1}, F_{P^{\mathcal{B}},4,1}, F_{P^{\mathcal{O}},4,1} \right\} \\
&= \left\{ 0.255, 0.029, 0.361, 0, 0, 0, 0.048, 0.009, 0.299 \right\}
\end{aligned}
$$

As explained, the last element, for instance, is the product of (region 4's) poor household count in $t = 1$ (observed from combining IBOPE and IBGE) and the share of the outside option among region 4's **DE** households (calculated from the HEX 95/96), divided by the total household count (IBOPE/IBGE), i.e., $1346585 \times 0.84093/3789771 \simeq 0.299$. From $s_{j,r,g=4,t=1}(\theta^*)$ (see (4)), we obtain the mass of households for each of the nine types who choose to consume premium, generic, or no soda. For example, the share of premium soda among established affluent households who have a premium habit, $\sum_{j \in \mathcal{A}} s_{j,EA^{\mathcal{A}},g=4,t=1}(\theta^*) \simeq 94\%$. In contrast, the shares of premium soda among established affluents with generic habits and no-soda habit are 3% and 20%, respectively. Thus, since the established affluent population is constant over time (at 2443186), the number of established affluent households going into $t = 2$ with a premium soda habit is (in thousands, hereafter) $3790 \, (0.255 \times 0.94 + 0.029 \times 0.03 + 0.361 \times 0.20) \simeq 1192$.

As for mobility, according to IBOPE/IBGE, the socioeconomic distribution of households evolves from $(\textbf{ABC}, \textbf{DE}) = (2443, 1347)$ in $t = 1$ to $(2511, 1269)$ in $t = 2$. It follows that, in $t = 2$: (i) $2511 - 2443 = 68$ households are newly affluent; (ii) $(2443 + 1347) - (2511 + 1269) = 10$ households migrated out of the urban area (again, this rarely happens in the data); and (iii) 1269 households are poor. Following Assumption 1 (Socioeconomic Mobility), the 68 upwardly mobile households entering $t = 2$ are endowed with habits in proportion to the choices of poor households in $t = 1$ among premium, generic and no soda (where these proportions are calculated as illustrated for established affluents, for which a proportion $1192/2443 \simeq 49\%$ chose premium rather than generic or no soda). These counts (summing 68) are deducted from the $t = 1$ poor population (1347) that is transitioning to $t = 2$ in proportion to the poor's choices across brand types. Similarly, following Assumption 2 (Migration), the 10 households leaving the city are dropped from the counts of the poor (totaling $1347 - 68$) in proportion to the poor's choices across brand types.

Region 4, $t = 10$ to $t = 11$. We keep this example brief, highlighting mobility. The type-distribution vector following choices made in $t = 9$ and mobility into $t = 10$ is

$$
\mathcal{F}_{g=4,t=10} = \left\{ 0.250, 0.109, 0.279, 0.003, 0.007, 0.137, 0.000, 0.002, 0.214 \right\}
$$

Having updated from $t = 1$, the history of choices and mobility now determines the distribution of habits across each socioeconomic group. At $t = 10$, the generic-to-premium ratio is $0.109 : 0.250 = 0.4$ among the established affluent (see Table 5). From IBOPE/IBGE data, the mass of households by socioeconomic group (in thousands) in $t = 10$ is computed as: 2443 established affluent (this stays constant), 560 newly affluent and 826 poor (see Figure 4; $t = 10$ is the Jun-98/Jul-98 bimonth).

The evolution of (**ABC**,**DE**) from $(3003, 826)$ in $t = 10$ to $(3060, 784)$ in $t = 11$ implies that: (i) the newly affluent count grows by 57 (to 617); (ii) 16 migrants arrive at the city and join the ranks of the poor; and (iii) the poor count drops by $57 - 16 = 42$ (to 784). The 57 upwardly mobile households making choices with newly affluent status in $t = 11$ are endowed with habits in proportion to the $t = 10$ choices of the poor they left behind (Assumption 1). The 16 migrants who are new to the city have a no-soda habit (Assumption 2).

Robustness to Assumptions 1 and 2. Our results are very robust to alternative mobility assumptions, namely: (i) modifying Assumption 1 to endow households moving up from poor to newly affluent status with habits in proportion to the previous-period soda choices of the newly affluents they are joining, rather than the poor they are leaving behind[36] (and analogously with respect to households moving down from newly affluent to poor status, based on the previous-period choices of the poor); and (ii) modifying Assumption 2 to endow households moving to urban areas with habits in proportion to the previous-period soda choices of the city-dwelling poor they are joining. For example, under (ii), $(\alpha_{EA}, \alpha_{NA}, \alpha)$ and λ are estimated, respectively, at $(3.62, 1.87, -5.76)$ and 4.21 (with standard errors of $(1.42, 1.45, 1.47)$ and 0.26), very close to baseline estimates (Table 3). Estimates under model variant (i) are also very close to baseline.

A.2.2 The estimation algorithm

We explain the structure of the GMM objective function and detail how it is evaluated at generic parameter values. Given any generic value for the non-linear parameters θ_2, steps 1 to 5 of the algorithm below yield an $N \times 1$ vector $\delta(\theta_2)$, containing the base utilities for every brand in every region-period market ($N = 9 \cdot 7 \cdot 57$). As noted in Section 4.1, conditioning on the full parameter vector $\theta = (\theta_1, \theta_2)$, one obtains an $N \times 1$ vector of demand unobservables by subtracting the systematic portion of the base utility from δ_{jgt}, i.e., $\xi_{jgt} = \delta_{jgt} - x'_{jgt}\beta - \alpha p_{jgt}$. Stacking all these unobservables together, we can write:

$$\xi(\theta) = \delta(\theta_2) - X\theta_1$$

---

[36] The exception is the first transition, from $t = 1$ to $t = 2$, in which the newly affluent are a random sample of the poor as, by definition, there are no newly affluents in $t = 1$.

where the $N \times K_1$ matrix X contains the K_1 base-utility covariates (including price), and let K_2 denote the dimension of θ_2. Now let Z denote a $N \times L$ matrix of instruments containing all covariates in X but price, as well as excluded instruments, where $L > K_1 + K_2$. Writing $W = (Z'Z)^{-1}$, the GMM objective is defined by:

$$Q_N(\theta) = \xi(\theta)' ZWZ' \xi(\theta)$$

Computation time can be reduced substantially by noting (see BLP 1995, Nevo 2000) that, conditional on a guess for θ_2, there is a closed-form solution for the linear parameters θ_1 that minimizes the objective:

$$\theta_1^*(\theta_2) = \left(X'ZWZ'X \right)^{-1} X'ZWZ' \delta(\theta_2)$$

This allows us to maximize the objective by searching only over values for θ_2. At every guess $\tilde{\theta}_2$ for the non-linear parameters, the GMM objective is evaluated via the following steps:

1. For every region $g = 1, ..., 7$, and period $t = 1$, given $\mathcal{F}_{g1}$ and $\tilde{\theta}_2$, use the BLP contraction mapping to solve for the unique vector of base utilities that matches observed aggregate market shares with those predicted by the model.

2. For every region $g = 1, ..., 7$ and household type $r = 1, ..., 9$, use equation (4), the base utilities recovered in step 1, and $\tilde{\theta}_2$, to predict the shares of type-r households who consume premium brands, generic brands or no soda in period $t = 1$.

3. For every region $g = 1, ..., 7$, use the shares obtained in step 2, data on aggregate social mobility and migration, and Assumptions 1 and 2, to obtain next period's type-distribution vector, $\mathcal{F}_{g2}$ (recall Section 3.2).

4. Repeat steps 1-3 for periods $t = 2, ..., 57$.

5. Stack the base utilities for all brands in all regions and periods in the $N \times 1$ vector $\delta\left(\tilde{\theta}_2\right)$, and evaluate the GMM objective at $\tilde{\theta}_2$, as explained above.

A.2.3 Robustness

Given space restrictions, we briefly describe some of the alternative specifications, on top of the alternative mobility assumptions discussed above, that we have estimated to confirm the validity and robustness of our baseline results. Estimates of these model variants are available upon request.

Market size. Our baseline model defines market potential as six liters per week, interpreted as 3 meals/week in which a 2-liter family-size bottle of soda might be brought to the table. Estimated price sensitivities and the habit parameter hardly vary as we vary the number of meals per week between 2.8, 2.7, ... , 3.7. Beyond this range, all the way from 2.0 to 4.0 meals/week, estimated $(\alpha_{EA}, \alpha_{NA}, \alpha)$ vary more, but our estimate for λ is very stable, between 4 and 5.

Habit formation. Specifications that we implemented, each addressing alternative mechanisms than the one we wish to highlight, include: (i) allowing habit to form for soda in general, *regardless* of the type of brand; thus, consuming either heavily advertised premium or discount generic soda in this period shifts the utility from consuming any soda next period by λ; (ii) allowing loyalties to form for the flagship premium brands Coke (including Diet Coke), Guaraná Antarctica, Fanta, or Pepsi; for example, consuming Pepsi in this period increases one's utility from consuming Pepsi in the next period—but not another brand—by λ; and (iii) allowing loyalty to form only for the Coke (including Diet Coke) brand. To illustrate, model (ii) has five habit states which, interacted with 3 socioeconomic groups, implies 15 household types (and we must modify the initial conditions from the HEX accordingly). Brand loyalty is estimated to be strong and significant under alternative models (ii) and (iii), leading to aggregate own-price elasticities that appear too low in magnitude, namely, -0.6 and -1.1 for Coke under (ii) and (iii), respectively (compared to -1.7 in Table 4). In general, estimated habit parameter(s) under these alternative models are large and significant, but do not provide as strong a justification for Coca-Cola's mid 1999 price cut.

Other specifications. A more general model allowed the premium habit and the frugal habit to vary in magnitude. Estimated habit parameters $\lambda^{\mathcal{A}}$ and $\lambda^{\mathcal{B}}$, for premium and frugal respectively, are 4.67 (s.e. 0.33) and 2.90 (s.e. 0.49), and price sensitivity is similar to baseline, namely $(\hat{\alpha}_{EA}, \hat{\alpha}_{NA}, \hat{\alpha}) = (3.71, 2.12, -5.94)$ with s.e. $(1.71, 1.61, 1.75)$.

Further, our estimates are robust to: (i) dropping media advertising ($\hat{\lambda} = 4.31$ with s.e. 0.25, $(\hat{\alpha}_{EA}, \hat{\alpha}_{NA}, \hat{\alpha}) = (4.74, 2.94, -6.97)$ with s.e. that almost double compared to Table 3); and (ii) dropping retail distribution ($\hat{\lambda} = 4.93$ with s.e. 0.35, $(\hat{\alpha}_{EA}, \hat{\alpha}_{NA}, \hat{\alpha}) = (3.07, 2.67, -5.33)$ with s.e. that are similar to Table 3).

We also tested robustness with regard to: (i) initial HEX 95/96 shares (namely, expanding the HEX outlet codes that map to Nielsen's stores with checkouts); and (ii) defining market share by the extensive margin once the region-specific intensive margin, as observed in the single cross-section of household-level data (HEX 95/96), is fixed over time.

A.2.4 Variable profit

Our back-of-the-envelope calculation of variable profit considers the three-year period between April 2000 and March 2003. We assume that the premium sellers' net sales price is 35% of the price Nielsen observes on the shelf, which is paid by the end consumer. (See Ambev 2003 and Salvo 2009 for a discussion of the very high taxes incurred along the formal vertical chain, as well as vertical relations. We also base our calculations on interviews with an executive at a premium seller.) Thus, the observed shelf price of R\$ 0.913 / liter (sales weighted across premium brands, averaged over the three years) corresponds to a net sales price for Coca-Cola/Ambev of R\$ 0.320 / liter, net of sales tax, retail margin, and distribution costs. Had the premium sellers not cut prices in mid 1999, we assume that this price would have been proportionately higher, at R\$ 0.385 / liter. Based on Ambev (2003), we take the "cost of goods sold" as R\$ 0.199 / liter. We note that the real prices of sugar, plastic, electricity, labor, and fuel were quite stable between 2000 and 2002 (in general, they began rising at the end of our sample period, in 2003). The variable profit margins for the Coca-Cola/Ambev "systems" are thus R\$ 0.120 / liter with the observed price cut and R\$ 0.186 / liter under the counterfactual of no price cut. Multiplying by the premium sellers' observed and counterfactual quantities sold over this three-year period (namely, 7.2 billion liters observed; 4.3 bi liters counterfactual under the Brand Type Persistence model; 5.4 bi liters counterfactual under the "no habit" model variant) yields the variable profits stated in the text (respectively, R\$ 861 million, R\$ 807 million, and R\$ 1,013 million).

A.2.5 Monte Carlo experiments

Data generating process. Demand for soda follows the state-dependent household-level choice model developed in Section 3, namely indirect utility (2) with habit feature (3). We take as true parameters the point estimates reported in Table 3—these are reproduced in column I of Table A1. We design each simulated dataset to have the same dimensions as our empirical dataset: 9 brands (8 of which are premium), 7 regions and 57 time periods. This enables us to take covariates x_{jgt}, the first-period distribution of types $\mathcal{F}_{g1}$, and the evolution of each region's household population by socioeconomic group as observed in the data (see definitions in Section 3). Assumptions 1 and 2 ("orthogonality") dictate how demographic shifts interact with previous-period consumption. Prices are simulated according to:

$$
p_{jgt} = \begin{cases} \Lambda_t^{prem} c_{jt}^{prem} + \rho\xi_{jgt} \text{ if } j \in \mathcal{A} \\ c_{jt}^{gen} \text{ if } j \in \mathcal{B} \end{cases}
$$

where c_{jt}^{prem} and c_{jt}^{gen} are marginal costs for premium and generic brands, respectively, that are flat in output and vary across brands and over time, but not across regions (one can relax this);

Λ_t^{prem} is a time-varying price markup over marginal cost for premium brands (this can also be made to vary across brands and regions); unobserved taste shocks ξ_{jgt} are i.i.d. across brands (including generics), regions and time; and $0 \leq \rho < 1$ is a pass-through ratio from utility shocks for premium brands to prices. Define marginal costs as the time-varying price of inputs W (e.g., sugar) times a cost efficiency (inverse productivity) parameter τ that varies by brand type (premium or generic) and over time, plus a brand-and-time varying disturbance term u:

$$
\begin{aligned}
c_{jt}^{prem} &= W_t \tau_t^{prem} + u_{jt} \\
c_{jt}^{gen} &= W_t \tau_t^{gen} + u_{jt}
\end{aligned}
$$

Specifically, the simulations reported in Table A1—except column V—consider price variation that is inspired by (is "comparable" to) what we observe in the real data: (i) premium brands' markup $\Lambda_t^{prem} \sim N(2, 0.02^2)$ until April-May 1999 and, following the 20% price cut, $\Lambda_t^{prem} \sim N(1.6, 0.02^2)$ thereafter; (ii) factor price $W_t \sim U(0.85, 1.15)$; (iii) premium brands' cost efficiency τ_t^{prem} equal to 0.55 throughout the sample period; (iv) generics' cost efficiency τ_t^{gen} equal to 0.9 in the first period, decreasing linearly to 0.6 in August 2000, and constant thereafter; and (v) brand cost disturbance $u_{jt} \sim N(0, 0.01^2)$.

By contrast, the simulation reported in column V, marked "less simulated data variation versus real": (i) drops the premium price cut, simulating the premium brands' markup according to $\Lambda_t^{prem} \sim N(2, 0.02^2)$ throughout; (ii) drops the fringe's price decline, setting the generics' cost efficiency τ_t^{gen} already at 0.6 from the first period; and (iii) freezes each region's household population by socioeconomic group (EA, NA, P) from the second period on.

Completing the description of the simulated datasets, we consider a pass-through ratio $\rho = 0.3$ and model utility shocks $\xi_{jgt} \sim N(0, \sigma^2)$ with varying orders of magnitude of variance, as reported in each column of Table A1. Notice that our experiments do not rely on the established firms pricing optimally, and that premium prices are endogenous since the established firms pass through a proportion of brand-market specific taste shocks to prices. Because taste shocks are i.i.d. and prices correlate across regions through a common cost (and markup) structure, prices in one region are a valid instrument for prices in another region.

Estimation. To estimate using simulated data, we follow the estimation procedure proposed in Section 4. This includes adopting the same three instrument classes, namely: (i) the price of inputs, (ii) the contemporaneous mean price for a brand in the other regions, and (iii) a dummy variable indicating periods after July 1999 interacted with brand-region fixed effects. Since we calculate household-type specific brand shares analytically, there is no sampling variation in the logit shock ϵ_{ijgt}. For every simulation $\omega = 1, ..., \Omega$, we complete the experimental—i.e.,

aggregate—dataset and make inference using the true (baseline) demand model (see columns II to V). As in Section 5, we also estimate a no-habit model variant (column VI).

Results. With $\sigma = 0.001$, the estimated baseline model recovers the true parameters to at least 2 decimal places (column II). Precision falls but is still quite high, particularly for $\hat{\lambda}$, when $\sigma = 0.1$ (column IV). Estimates using simulated data that exhibits less rich variation than what we observe empirically—namely, where we shut down the premium price cut, the generic price decline and the socioeconomic transitions—are substantially more noisy (column V compared to column IV). Estimates using the no-habit model variant (column VI compared to column IV) are noisier and, importantly, price sensitivity appears biased downward (for brevity, the bottom of the table reports household-type specific elasticities for Coke only).

B   Tables and Figures

Table 1: Brand Volume Shares of the Soda Category

Brand	Region 1		Region 2		Region 3		Region 4		Region 5		Region 6		Region 7	
	t=1	t=57	t=1	t=57	t=1	t=57	t=1	t=57	t=1	t=57	t=1	t=57	t=1	t=57
Coke	0.40	0.21	0.37	0.26	0.36	0.26	0.32	0.24	0.31	0.25	0.28	0.31	0.34	0.29
Fanta	0.08	0.06	0.05	0.08	0.05	0.09	0.08	0.09	0.06	0.08	0.06	0.08	0.03	0.05
Kuat	0.03	0.06	0.02	0.04	0.04	0.06	0.07	0.06	0.06	0.04	0.04	0.04	0.05	0.03
Diet Coke	0.02	0.03	0.02	0.03	0.03	0.05	0.02	0.04	0.03	0.03	0.03	0.04	0.02	0.03
Other Coca-Cola	0.02	0.03	0.02	0.02	0.02	0.02	0.05	0.06	0.04	0.05	0.05	0.04	0.05	0.02
Guarana Antartica	0.17	0.09	0.07	0.06	0.06	0.09	0.09	0.10	0.08	0.07	0.05	0.05	0.09	0.10
Other Ambev	0.19	0.02	0.11	0.01	0.15	0.01	0.16	0.02	0.12	0.01	0.17	0.01	0.06	0.02
Pepsi	0.06	0.03	0.08	0.03	0.19	0.07	0.05	0.05	0.06	0.04	0.11	0.09	0.09	0.05
Generics	0.03	0.47	0.26	0.47	0.12	0.36	0.17	0.34	0.25	0.41	0.21	0.33	0.27	0.41

Volume shares of the soda category, by brand in each region in the first and last time periods. Coke, Fanta, Kuat, Diet Coke, and "Other Coca-Cola" are premium brands marketed by the Coca-Cola Company. Guarana Antarctica, Pepsi, and "Other Ambev" are premium brands marketed by Ambev. Source: Nielsen.

Table 2: Soda Consumption by Socioeconomic Group (HEX)

Region of survey. cities	Socioeconomic group	Households ×1000 Universe	%	Soda purchasing	By brand type Premium	Generic	No soda
1 (Northeast)	ABC	696	36	28.0%	27.0%	0.9%	72.0%
	DE	1230	64	9.1%	8.3%	0.8%	90.9%
2 (MG, ES,	ABC	529	57	39.9%	37.9%	2.0%	60.1%
RJ interior)	DE	404	43	23.2%	22.1%	1.2%	76.8%
3 (RJ Metro)	ABC	1625	55	31.9%	31.6%	0.3%	68.1%
	DE	1331	45	18.3%	18.3%	0.0%	81.7%
4 (SP Metro)	ABC	2586	60	34.5%	33.1%	1.4%	65.5%
	DE	1689	40	19.8%	17.3%	2.6%	80.2%
6 (South)	ABC	955	63	43.2%	42.5%	0.7%	56.8%
	DE	559	37	20.4%	20.1%	0.3%	79.6%
7 (DF, GO	ABC	428	61	36.5%	34.4%	2.1%	63.5%
MS)	DE	270	39	23.6%	21.1%	2.5%	76.4%

The extensive margin of soda consumption inside the home by different socioeconomic groups in 1995/96. Socioeconomic groups are defined per the points scale used by IBOPE. Metropolitan areas surveyed were: (Region 1) Recife, Fortaleza and Salvador; (Region 2) Belo Horizonte; (Region 3) Rio de Janeiro Metro; (Region 4) Sao Paulo Metro; (Region 6) Curitiba and Porto Alegre; (Region 7) Brasilia and Goiania. No city was surveyed in Region 5 (state of Sao Paulo excluding Sao Paulo Metro). We do not consider the northern city of Belem as it is located outside the area covered by Nielsen. Source: IBGE HEX 1995/96.

Table 3: Demand Estimation Results

	coeff	(s.e.)		coeff	(s.e.)		coeff	(s.e.)
Price Sensitivity Parameters			Combinations					
α_{EA}	3.56	(1.39)	$\alpha + \alpha_{EA}$	-2.14	(0.17)			
α_{NA}	1.80	(1.42)	$\alpha + \alpha_{NA}$	-3.90	(0.61)			
α	-5.70	(1.43)	$\alpha_{EA} - \alpha_{NA}$	1.76	(0.52)			
Habit Parameter								
λ	4.20	(0.26)						
Other Effects								
Constant	-3.84	(0.37)						
Temperature	2.91	(0.32)						
Advertising GRPs:			In-store Presence:			Time Trends:		
Advertising×Region 1	0.44	(0.22)	Distribution×Region 1	3.10	(0.27)	Region 1	-0.37	(0.12)
Advertising×Region 2	0.25	(0.37)	Distribution×Region 2	3.70	(0.46)	Region 2	0.13	(0.19)
Advertising×Region 3	0.00	(0.27)	Distribution×Region 3	4.09	(0.96)	Region 3	-0.33	(0.12)
Advertising×Region 4	0.40	(0.37)	Distribution×Region 4	2.72	(0.45)	Region 4	-0.66	(0.09)
Advertising×Region 5	0.32	(0.32)	Distribution×Region 5	3.33	(0.48)	Region 5	0.02	(0.17)
Advertising×Region 6	0.66	(0.34)	Distribution×Region 6	1.24	(0.28)	Region 6	-0.05	(0.17)
Advertising×Region 7	0.49	(0.32)	Distribution×Region 7	1.11	(0.33)	Region 7	-0.07	(0.21)
Seasonality×Brand Type Effects		Yes						
Brand-Region Fixed Effects		Yes						

Standard errors in parentheses. Source: estimated baseline model.

Table 4: Estimated Demand Elasticities

Aggregate Own-Price Elasticities		Household-Type Specific Own-Price Elasticities			
Coke	-1.65	Coke, $EA^{\mathcal{A}}$	-1.42	Generic, $EA^{\mathcal{A}}$	-1.33
Guaraná Antarctica	-2.06	Coke, $EA^{\mathcal{B}}$	-2.29	Generic, $EA^{\mathcal{B}}$	-0.23
Fanta	-2.01	Coke, $EA^{\mathcal{O}}$	-2.18	Generic, $EA^{\mathcal{O}}$	-1.24
Pepsi	-2.01	Coke, $NA^{\mathcal{A}}$	-3.29	Generic, $NA^{\mathcal{A}}$	-2.42
Generic	-0.68	Coke, $NA^{\mathcal{B}}$	-4.20	Generic, $NA^{\mathcal{B}}$	-0.86
		Coke, $NA^{\mathcal{O}}$	-4.16	Generic, $NA^{\mathcal{O}}$	-2.37
		Coke, $P^{\mathcal{A}}$	-5.70	Generic, $P^{\mathcal{A}}$	-3.56
		Coke, $P^{\mathcal{B}}$	-6.14	Generic, $P^{\mathcal{B}}$	-2.14
		Coke, $P^{\mathcal{O}}$	-6.14	Generic, $P^{\mathcal{O}}$	-3.54

Reported elasticities are means across region-and-time markets, and only a few elasticities are shown due to space constraints.

Table 5: Predicted Consumption Patterns and Habit Transitions by Type

A: Predicted Soda Penetration and Consumption Patterns by Socioeconomic Group*

	Soda Penetration	Premium Share	Generic Share	Generic:Premium Ratio
Established Affluent	0.69	0.47	0.23	0.5
Newly Affluent	0.22	0.09	0.13	1.4
Poor	0.05	0.01	0.04	2.7

*Soda penetration, for the entire category and by type of brand, in each socioeconomic group, as predicted by
the estimated demand model. Reported numbers are means across all regions over the last 12 months of the sample.

B: Transitions by Household Type**

	Premium Habit	Generic Habit	No Habit
$EA^{\mathcal{A}}$	0.90	0.01	0.09
$EA^{\mathcal{B}}$	0.02	0.87	0.11
$EA^{\mathcal{O}}$	0.15	0.09	0.76
$NA^{\mathcal{A}}$	0.66	0.01	0.33
$NA^{\mathcal{B}}$	0.01	0.73	0.26
$NA^{\mathcal{O}}$	0.04	0.04	0.92
$P^{\mathcal{A}}$	0.31	0.01	0.68
$P^{\mathcal{B}}$	0.00	0.52	0.48
$P^{\mathcal{O}}$	0.01	0.02	0.97

** Reported transition rates are means across all regions in the last 12 months of the sample.

Table 6: Estimates from the "No Habit" Demand Model

	coeff	(s.e.)		coeff	(s.e.)
Price Sensitivity Parameters					
			Parameter Combinations:		
α_{EA}	0.47	(0.58)	$\alpha + \alpha_{EA}$	-1.51	(0.19)
α_{NA}	-0.85	(0.35)	$\alpha + \alpha_{NA}$	-2.83	(0.65)
α	-1.98	(0.42)	$\alpha_{EA} - \alpha_{NA}$	1.32	(0.77)
Other Effects					
Constant	-2.72	(0.24)			
Temperature	1.64	(0.11)			
Advertising×Region		Yes			
In-store Presence×Region		Yes			
Time Trend×Region		Yes			
Seasonality×Brand Type Effects		Yes			
Brand-Region Fixed Effects		Yes			

Table A1: Monte Carlo Experiments

	I	**II**		**III**		**IV**		**V**		**VI**	
Model		Baseline		Baseline		Baseline		Baseline		No-habit	
Simulated vs. actual		"Comparable"		"Comparable"		"Comparable"		"Less"		"Comparable"	
σ		0.001		0.01		0.1		0.1		0.1	
	True	Median	(S.D.)	Median	(S.D.)	Median	(S.D.)	Median	(S.D.)	Median	(S.D.)
Price Sensitivity											
α_{EA}	**3.56**	3.56	(0.00)	3.57	(0.04)	3.55	(0.38)	3.20	(0.71)	3.50	(1.13)
α_{NA}	**1.80**	1.80	(0.00)	1.80	(0.04)	1.80	(0.37)	0.67	(23.80)	2.94	(1.03)
α	**-5.70**	-5.70	(0.00)	-5.71	(0.04)	-5.66	(0.42)	-5.24	(0.65)	-4.96	(1.19)
Combinations:											
$\alpha + \alpha_{EA}$	**-2.14**	-2.14	(0.00)	-2.14	(0.01)	-2.09	(0.06)	-2.04	(0.14)	-1.45	(0.07)
$\alpha + \alpha_{NA}$	**-3.90**	-3.90	(0.00)	-3.90	(0.01)	-3.85	(0.14)	-4.34	(23.82)	-2.01	(0.21)
$\alpha_{EA} - \alpha_{NA}$	**1.76**	1.76	(0.00)	1.76	(0.01)	1.76	(0.10)	2.27	(23.83)	0.56	(0.16)
Habit											
λ	**4.20**	4.20	(0.00)	4.20	(0.01)	4.16	(0.09)	4.18	(0.15)	–	–
Household-Type Specific Own-Price Elasticities for Coke											
$EA^{\mathcal{A}}$		-1.08	(0.02)	-1.08	(0.02)	-1.06	(0.03)	-1.25	(0.11)	-1.22	(0.06)
$EA^{\mathcal{B}}$		-1.99	(0.02)	-1.99	(0.03)	-1.94	(0.06)	-2.24	(0.15)	-1.22	(0.06)
$EA^{\mathcal{O}}$		-1.87	(0.03)	-1.87	(0.03)	-1.83	(0.05)	-2.14	(0.16)	-1.22	(0.06)
$NA^{\mathcal{A}}$		-2.46	(0.05)	-2.47	(0.05)	-2.44	(0.13)	-3.85	(26.60)	-1.74	(0.19)
$NA^{\mathcal{B}}$		-3.64	(0.05)	-3.64	(0.05)	-3.60	(0.13)	-4.76	(26.18)	-1.74	(0.19)
$NA^{\mathcal{O}}$		-3.60	(0.05)	-3.60	(0.05)	-3.56	(0.13)	-4.75	(26.20)	-1.74	(0.19)
$P^{\mathcal{A}}$		-4.58	(0.09)	-4.58	(0.11)	-4.58	(0.52)	-5.15	(0.83)	-4.52	(1.14)
$P^{\mathcal{B}}$		-5.34	(0.07)	-5.35	(0.08)	-5.32	(0.40)	-5.71	(0.71)	-4.52	(1.14)
$P^{\mathcal{O}}$		-5.33	(0.07)	-5.34	(0.08)	-5.31	(0.41)	-5.71	(0.72)	-4.52	(1.14)

Medians and standard deviations (in parentheses) of estimated parameters are taken over 50 simulations (reported standard deviations in column VI exclude one iteration, $\omega = 24$, for which estimates were clear outliers). Reported elasticities are means across region-and-time markets.
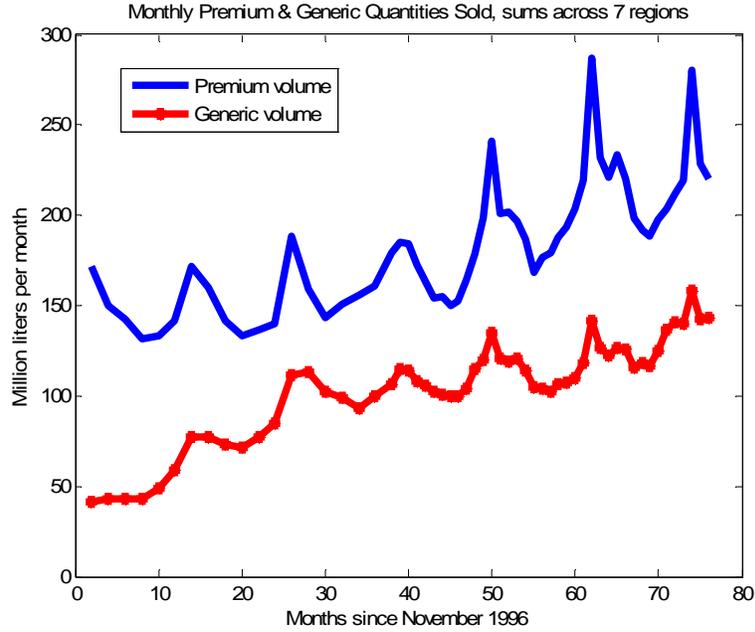
Figure 1: The evolution of quantities (in million liters/month) by type of brand (Premium versus Generic), for soda sold in family-size bottles through the self-service channel across the seven Nielsen regions, in the period Dec-96 to Mar-03. Source: Nielsen.
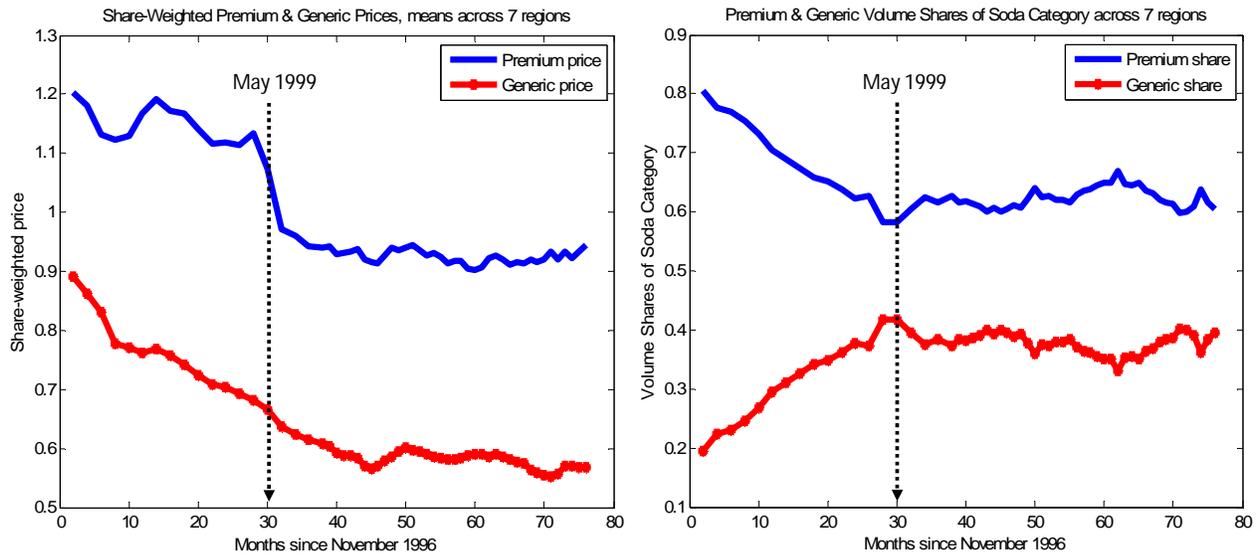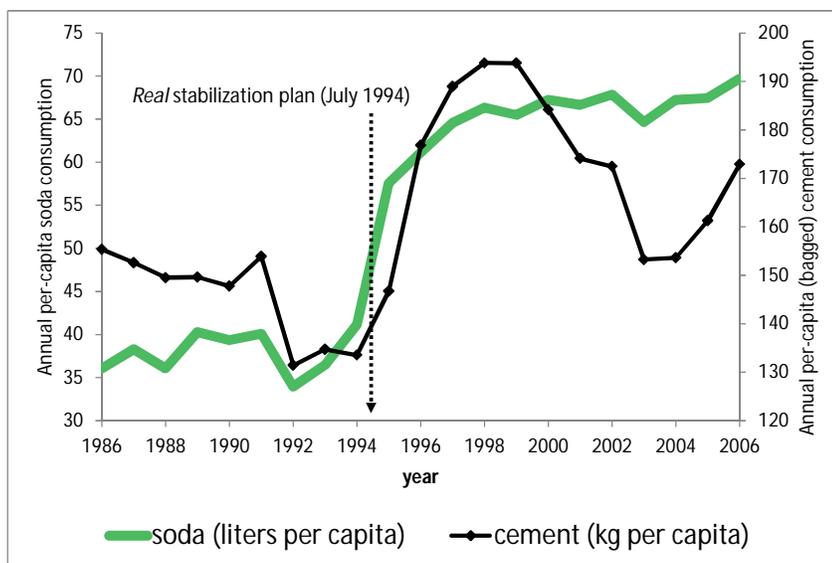

Figure 2: The evolution of prices (in constant Brazilian R$/liter) and category volume shares (in percent, summing to one) by type of brand (Premium versus Generic), for soda sold in family-size bottles through the self-service channel across the seven Nielsen regions, in the period Dec-96 to Mar-03. Source: Nielsen.

Figure 3: Annual aggregate per capita consumption of soft drinks (in liters per person) and of bagged cement (in kilograms per person). (Cement sold in bags, as opposed to sales in bulk, filter out any large-scale construction activity, such as government spending on infrastructure.) Sources: Brazilian trade associations for soft drink makers and for cement producers, ABIR and SNIC respectively.
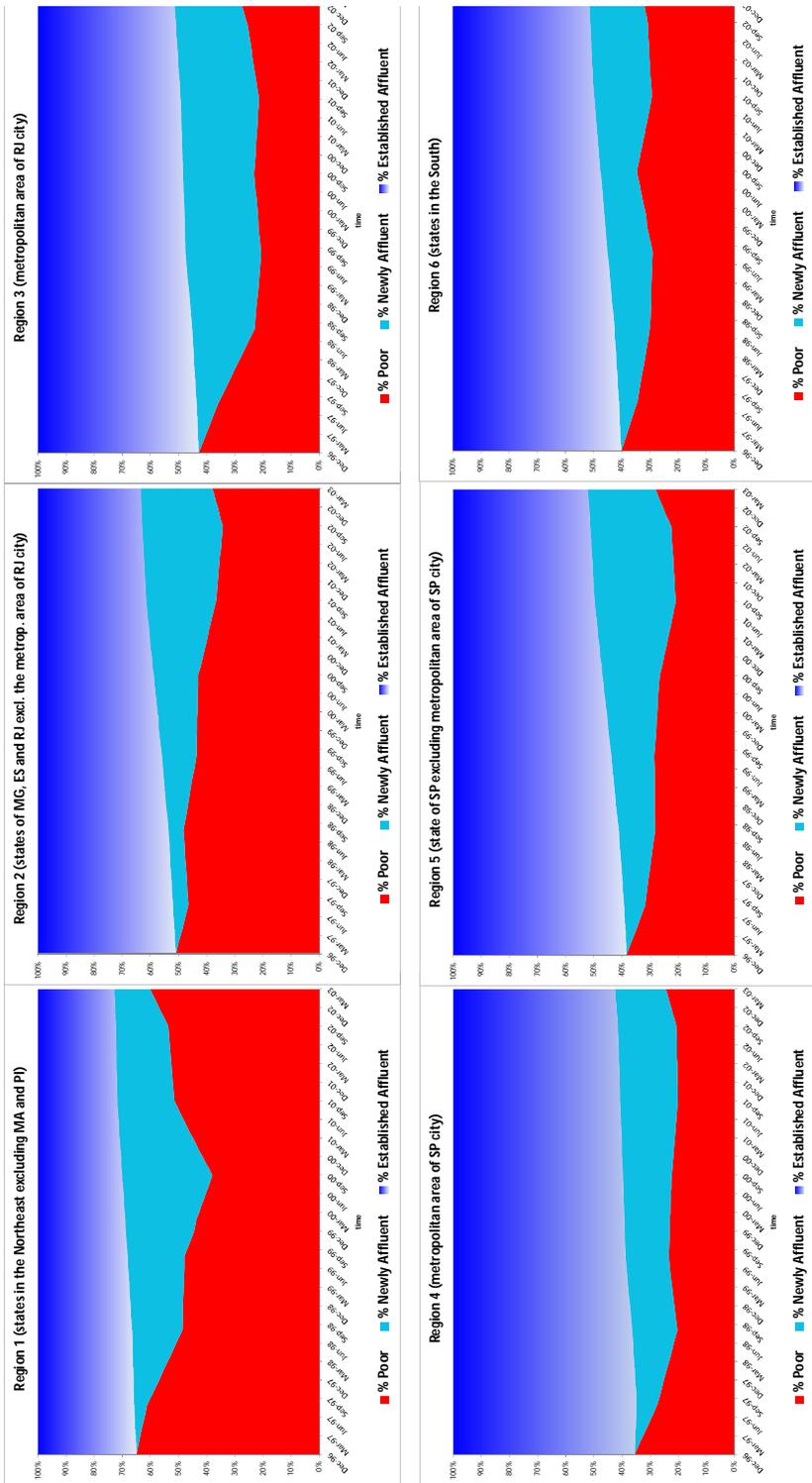
Figure 4: The rise of "newly affluent" households: Proportion of urban households in each of three constructed socioeconomic groups ("Established Affluent," "Newly Affluent" and "Poor"), as defined in the text, by region in the period Dec-96 to Mar-03. The smallest region by number of households, region 7 (Federal District and states of GO and MS), is not shown for lack of space (the pattern is similar to region 2). Sources: IBOPE LatinPanel, IBGE PNAD.
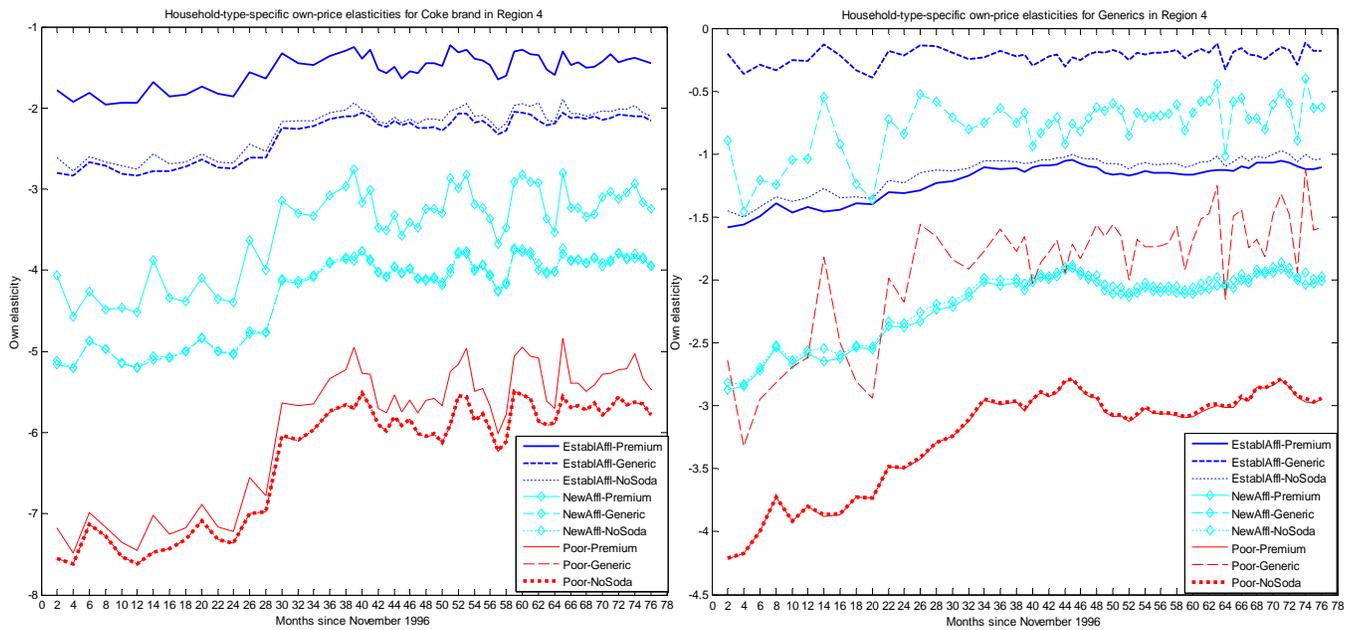
Figure 5: Evolution of own-price elasticities for Coke brand (left panel) and Generics (right panel), by household type, in region 4 (São Paulo Metro). Source: baseline model.
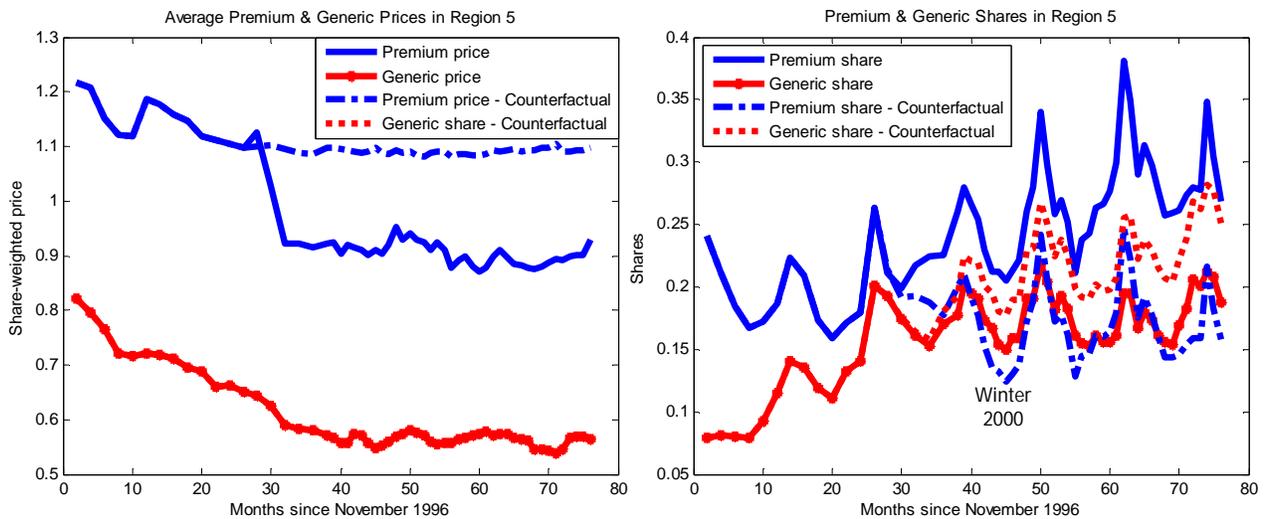
Figure 6: Actual against counterfactual price and share paths for premium brands and generic brands in region 5 (São Paulo Interior). Prices in the left panel and shares in the right panel. The counterfactual scenario considers premium brands not cutting prices in mid 1999. Source: baseline model.
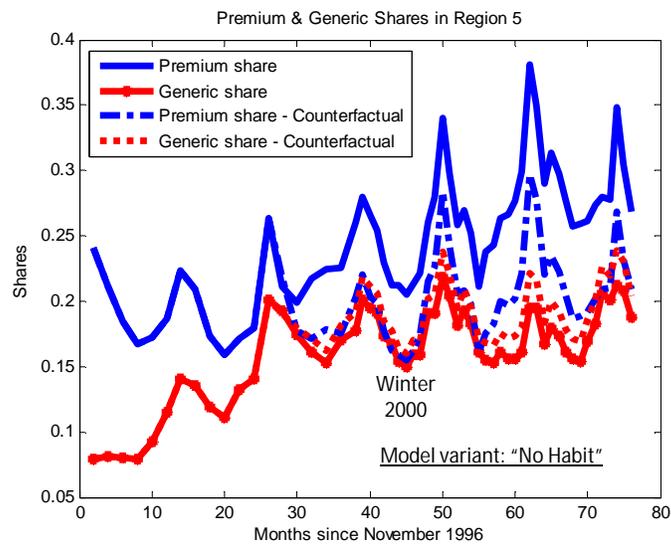

Figure 7: Share paths for premium brands and generic brands, in region 5, for the same counterfactual experiment of the earlier figure (premium brands not cutting prices in 1999), but employing the "No Habit" model variant.
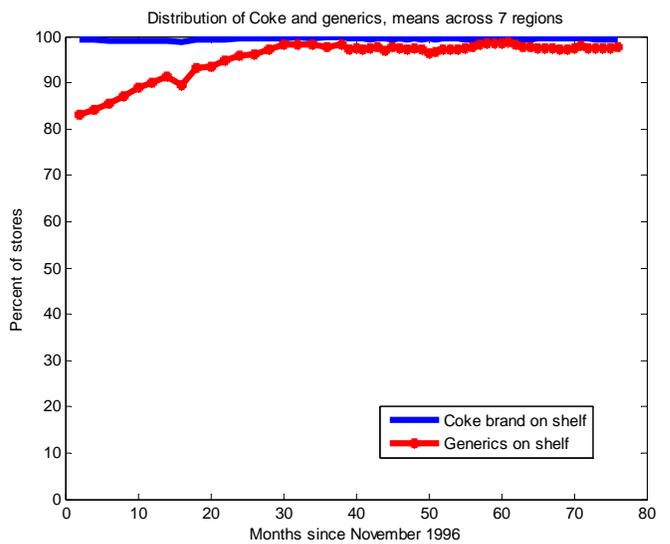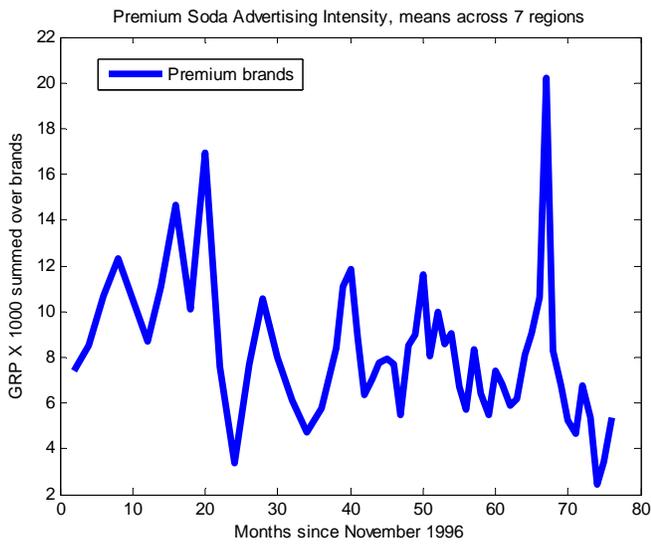
Figure A1: The evolution of premium soda media advertising intensity (in monthly Gross Rating Points, GRP, ×1000) and the proportions of stores with specific brands in stock (in percent), in the period Dec-96 to Mar-03. GRP and percentages shown are means across the seven Nielsen regions. Sources: McCann-Erickson, Nielsen.