

# The Rise of Niche Consumption\*

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## Abstract

Over the last 15 years, the typical household has increasingly concentrated its spending on a few preferred products. However, this is not driven by “superstar” products capturing larger market shares. Instead, households increasingly purchase different products from each other. As a result, aggregate spending concentration has decreased. We develop a model of heterogeneous household demand and use it to conclude that increasing product variety drives these divergent trends. When more products are available, households select products better matched to their tastes. This delivers welfare gains from selection equal to about half a percent per year in the categories covered by our data. Our model features heterogeneous markups because producers of popular products care more about their existing customers while producers of less popular niche products care more about generating new customers. Surprisingly, our model matches the observed trends in household and aggregate concentration without any change in aggregate market power.

**JEL-Codes:** E21, E31, D12, D4

**Keywords:** Product Concentration, Niche Products, Market Power, Markups, Long-tail

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# 1 Introduction

We show that over the last 15 years, the typical household has dedicated an increasing share of its expenditures to a few preferred products. At the same time, households are increasingly buying different products from each other. Thus, aggregate spending concentration has declined even as household spending concentration has risen. We develop a novel model of heterogeneous household demand to interpret these new facts and explore their implications. In the model, as new products are introduced, households can choose consumption bundles better suited to their particular tastes, resulting in welfare gains from better selection. We fit our model to the data for more than one hundred separate product categories and conclude that rapid growth in product availability has led to sizeable welfare gains that cannot be identified with standard representative agent macro models.

We begin our analysis by using the Nielsen Homescan dataset that covers a large fraction of spending on groceries and other household nondurables to study the shopping behavior of thousands of households from 2004-2016. We measure household-specific product spending shares within narrow categories like “Coffee” and “Cosmetics” and demonstrate that these shares have steadily become more concentrated over time. This fact on its own might point toward an increasing importance of “superstar” products, but a similar analysis of aggregate spending paints a different picture. Pooling households together, we see that total spending on these same products over the same period has in fact become more evenly distributed. These diverging household and aggregate concentration trends imply that even though each household increasingly focuses spending on its own preferred products, households also increasingly differ in which products they consume. We refer to this greater fragmentation of the product space as a rise in “niche” consumption.

The rise in niche consumption is robust to a variety of specification and measurement choices as well as to the inclusion of a variety of controls for observables. Interestingly, the divergence between household and aggregate concentration is not driven by a widening gap between rich and poor households, between consumers in one region and another, or by differences between households grouped according to various other demographic characteristics. Rather, we find that household consumption bundles are becoming more differentiated even when measured within cities, within store chains, and within demographic groups defined by income, race, education, age, and household size. Niche consumption also grows in almost all product categories.

What then drives these divergent trends, and should we care about them? As discussed below, these trends in concentration are of similar magnitudes to firm-level concentration trends which have received significant attention in recent years. Nonetheless, it is difficult to assess the importance of these trends without a model that links them to underlying fundamentals. Standard models cannot be used for this purpose since they rule out the differential trends in household and aggregate concentration by assumption. For instance, any representative household model will exhibit identical household

and aggregate concentration. Standard discrete choice models imply that household spending within categories is completely concentrated on a single product.<sup>1</sup> Instead, we build a model of consumers that have a love-of-variety and whose preference orderings for particular products differ from each other.

Our model of individual household demand follows Li (2019). It features constant elasticity of substitution (CES) preferences, product-specific tastes, and a utility cost borne per variety consumed. Households take the distribution of prices as given and typically choose to consume only a subset of the total available products. When taste-adjusted prices are distributed Pareto, we obtain a closed-form expression relating the Household Herfindahl index – the concentration measure we use in our empirical analyses – to structural parameters of the model. In Li (2019), however, households all have identical tastes and agree on the ranking of products, so there is no capacity for the divergent household and aggregate trends that we find in our empirical results.

The key innovation in our model comes from our novel and analytically tractable specification of household heterogeneity, which is crucial to jointly match household and aggregate product demand patterns and to speak to the rise in niche consumption in the data. We introduce a continuum of households with correlated but heterogeneous preferences for different products in a way that yields closed-form solutions for both household and aggregate spending concentration. In particular, we assume that all households have tastes that decline identically from their favorite product to their second favorite, and so on, so that all households have identical taste *distributions*. However, the actual identities of these first- and second-favorite products are allowed to differ from one household to the next.

We introduce a “rank” function, which maps each product to a relative position in each household’s tastes. A household’s rank for a given product is a weighted average of that product’s aggregate component, which is common across all households, and a random household-specific component. If the aggregate component receives all the weight, the environment collapses to a representative household economy with all households consuming the same products and with equal household and aggregate spending concentration. Conversely, if the household-specific component receives all the weight, there will be uniform aggregate spending across products and low aggregate concentration, even if individual household spending is highly concentrated. We analyze an empirically-disciplined intermediate case and obtain another closed-form expression relating the Aggregate Herfindahl to structural parameters in the model.

Interestingly, we next show that in this intermediate case, different products in the economy face different elasticities of demand even though household preferences are CES. This is because when a product’s price is reduced, sales to existing customers expand with a constant elasticity, but the product

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<sup>1</sup>Dynamic discrete choice models with temporal aggregation could likely also speak to our primary empirical facts, which focus on annual household spending. However, even when looking at individual shopping trips made by one-person households, it is common for multiple products to be simultaneously purchased in a single category, as we shown in Appendix A.3.

also attracts new customers who previously did not purchase the product at all. The relative strength of these forces varies with products' market shares, which generates variable elasticities of demand and implied markups. Our model assumptions allow us to characterize analytically the distribution of elasticities as well as the implied aggregate markup in the economy.

Our closed-form analytical solutions for various aggregates rely on particular parametric assumptions, but the model is nonetheless flexible enough to match product-level spending distributions both for individual households and for the economy as a whole quite well. It is important in our setting to have analytical expressions for observed empirical moments because key structural parameters including the elasticity of substitution, the utility costs of variety, and the shape of the taste distribution are all either unobserved or are challenging to estimate directly in the data. Even the total number of available products, a key input into our model, cannot be confidently counted in the Nielsen data. As we demonstrate in Appendix A.3, the level and trend growth in the total number of products are highly sensitive to the choice to include or exclude products accounting for tiny amounts of aggregate spending. Therefore, we use the model's analytical expressions, together with key moments from the data, to compute changes in the value of structural parameters and assess the implications of these changes for welfare.

We find that even when we allow for simultaneous movements in all structural parameters, matching the observed divergence between household and aggregate concentration can *only* be achieved with sizable growth in the number of varieties, a rate of roughly 4.5 percent per year. This increase in available varieties leads households to endogenously consume more products and enjoy welfare "gains from variety", as is standard in CES environments. In our model, an increase in the total number of varieties available also allows households to select a subset of products better matched to their particular tastes and thus to enjoy what we call "gains from selection".

The strength of these two effects depends on the elasticity of substitution and the shape parameter governing the asymmetry of tastes, which can be identified given data on aggregate markups. For plausible targets for the aggregate markup, we find that the increase in product availability necessary to hit the divergence between household and aggregate concentration leads to large welfare gains, which are mostly driven by the gains from selection. For example, if we hold all other parameters fixed in our preferred calibration and introduce 4.5 percent annual growth in the number of available products into our model, we calculate that consumption-equivalent welfare grows by 0.56 percent per year for expenditures in the categories covered by our data, and that 93 percent of this growth comes from gains from selection. Since these gains from selection need not be captured by typical matched-model price indices used by national statistical agencies, our model reveals how expanding product availability in an environment with heterogeneous tastes may generate significant unmeasured gains in standards of living.

While an increase in variety availability is necessary to generate the divergence between household

and aggregate concentration, the model implies that this increase is not sufficient to match all the empirical trends we document. In particular, an increase in variety availability, on its own, will actually cause household concentration to fall mildly, even though aggregate concentration will fall by much more. We therefore use the model to infer additional changes in the fixed cost per variety, the elasticity of substitution, and the shape of the taste distribution to exactly match both the observed trends in Household and Aggregate Herfindahls, as well as the relationship between the Household Herfindahl and the number of varieties consumed by individual households.

We emphasize that, unlike the increase in the number of available varieties, changes in these other structural parameters are not fully identified and multiple configurations are consistent with the data.<sup>2</sup> However, we consider various combinations of parameter changes in addition to the increase in available varieties necessary to exactly match empirical trends, and the model consistently delivers substantial unmeasured welfare gains that arise primarily from households choosing product bundles that better suit their unique preferences. Thus, we conclude that while the increase in product availability on its own is not sufficient to fully fit the empirical trends, this increase drives almost all of the welfare effects associated with these trends. The model thus implies a crucial role for product entry in driving the rise of niche consumption, and we provide several additional pieces of empirical evidence that support this relationship.<sup>3</sup>

This conclusion that there has been an important welfare relevant increase in product availability arises from fitting trends to a notion of the “average category” in the data. However, we also apply our model separately to each of the roughly 100 product groups in the data to infer category specific changes in welfare and product availability. We find that the conclusions we arrive at from redoing the analysis category-by-category are broadly similar to those reached when matching average trends. However, there is some interesting heterogeneity across product groups, with the largest gains from selection arising for coffee, disposable diapers, and snacks, and with losses for eggs, cottage cheese, and photographic supplies. Nevertheless, our model implies that the large majority of sectors experienced significant increases in product variety and resulting welfare gains from selection, while changes in other structural parameters have more limited effects on welfare.

In the final part of the paper, we explore the implications of the rise of niche consumption for aggregate market power. Concentration is often used as a proxy for market power, and as described above, markups in our model are endogenous and vary across products so that market power has the potential to move with concentration. So what then happens to aggregate market power in response to the same inferred changes in structural parameters that drove the rise of niche consumption? Sur-

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<sup>2</sup>For example, the model makes clear that changes in the elasticity of substitution and in the shape parameter governing the taste distribution cannot be separately identified using our data on spending. We focus, therefore, on scenarios where only one of these two parameters changes.

<sup>3</sup>For example, restricting to a balanced panel of products substantially attenuates the rise of niche consumption. And while we again emphasize that measuring variety availability in the data is at best challenging, we find that there is a strong correlation at the category level between empirical measures of observed variety growth and that implied by the model.

prisingly, not much. In particular, as we demonstrate analytically, increases in product availability do not on their own change the aggregate markup because they have two offsetting effects arising from competition and selection. New products constitute new competition for the incumbents, which causes them to charge lower markups. However, since the new consumed products on average are better tailored to the tastes of households that choose to consume them, they have higher markups than the products they replace. In the aggregate, these two opposing forces exactly offset each other.

By contrast, changes in the elasticity of substitution and in the shape of the taste distribution have the scope to affect aggregate market power, but the changes suggested by our model are not large enough quantitatively to meaningfully alter the picture. Our model demonstrates that the significant trends in household and aggregate product concentration need not indicate any changes in aggregate market power.<sup>4</sup> Even more broadly, our model demonstrates how any given trend in concentration can be associated with an increase or a decrease in aggregate market power depending on the underlying structural forces driving the trend.

We proceed as follows. Section 2 discusses the related literature, Section 3 demonstrates the empirical divergence between household and aggregate spending concentration, Section 4 develops a theoretical heterogeneous household model to interpret this empirical evidence, and Section 5 concludes.

## 2 Related Literature

Our work touches on and draws connections between a number of important themes in recent research. Our model in which individual households have CES preferences, heterogeneous Pareto-distributed tastes for different varieties and consume an endogenous subset of these varieties follows Li (2019). Our theoretical contribution is to maintain analytical tractability even when extending this setup much further to an environment with heterogeneity in which households have different but potentially correlated tastes across products. This allows us to speak to the increasing divergence between household and aggregate concentration. Our basic approach follows in the tradition of the macro and trade literature that uses a CES structure to study the implications of expanded product availability.<sup>5</sup> The heterogeneous and asymmetric preferences in our model imply that expanding the set of available products benefits consumers through a selection effect that is above-and-beyond the standard love-of-variety gains in symmetric representative agent models.<sup>6</sup>

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<sup>4</sup>Similar conclusions also obtain when we compute aggregate market power trends separately for each of the product groups, although there are a few exceptions such as photographic supplies.

<sup>5</sup>For example, Handbury and Weinstein (2014) emphasizes the need to account for differences in variety availability when comparing the price level across U.S. cities. Redding and Weinstein (2016) demonstrates how welfare measures can be biased if they do not account for heterogeneity in consumer tastes across products. Atkin *et al.* (2018) uses similar scanner data on grocery purchases to calculate the welfare gains associated with entry of global retail chains into the Mexican market.

<sup>6</sup>While representative agent CES models can be rationalized through an underlying discrete choice representation with heterogeneity (Anderson *et al.* (1987)), this requires idiosyncratic tastes to be drawn from an i.i.d. Gumbell distribution and aggregates to an environment with symmetry.

Our analysis also relates to a large literature in industrial organization (IO) quantifying the welfare gains from new varieties.<sup>7</sup> Within this literature, our result that information on the decomposition of aggregate demand across households can help pin down gains from product availability has close parallels with [Quan and Williams \(2018\)](#). Our approach requires household level spending data but requires no information on product characteristics, and it delivers simple analytical solutions. This means that unlike the typical IO approach, our methodology scales tractably, and we can apply it to a variety of different sectors and markets. Of course, this tractability comes at the cost of additional parametric structure. While our approach is more flexible than typical symmetric representative agent models and is able to fit spending patterns for most sectors in the data, we view it as a complement rather than a substitute to detailed IO studies of particular markets.

On the empirical side, a recent macro literature has explored the importance of product availability and concentration trends for various empirical phenomenon. In concurrent work, [Michelacci et al. \(2019\)](#) document cyclical fluctuations in household variety adoption and model this phenomenon using a discrete choice model. Their empirical focus is on higher frequency business cycle effects, and their theoretical framework is very different from ours, but they reach similar conclusions about the important role of product selection for welfare. [Argente et al. \(2018a,b\)](#) shows that product introduction plays a key role in understanding patterns of firm growth. [Jaravel \(2019\)](#) argues that innovation and product entry plays an important role in inflation differences across groups. Several important papers document changes in top sales shares and industrial structure, including [Autor et al. \(2017\)](#) and [Furman and Orszag \(2015\)](#). Our finding that household and aggregate concentration trends move in opposite directions is reminiscent of [Rossi-Hansberg et al. \(2018\)](#) and [Hsieh and Rossi-Hansberg \(2019\)](#), both of which demonstrate that concentration trends also diverge when comparing measures done at the local and national levels.

Given heterogeneity across households, our structure generates heterogeneous markups because some producers adjust sales by selling more to existing customers while others adjust by selling non-zero amounts to more customers. To our knowledge, [Levin and Yun \(2008\)](#) is the only other paper in the recent literature that emphasizes this mechanism, though it also relates to [Hottman et al. \(2016\)](#), who emphasize heterogeneity in the degree to which price declines for one product cannibalize sales for others in multiproduct firms. Our emphasis on differences across firms in the importance of the intensive versus extensive margin contrasts with the more commonly used frameworks for generating variable markups, such as the nested-CES setup in [Atkeson and Burstein \(2008\)](#), linear demand in [Melitz and Ottaviano \(2008\)](#), translog preferences in [Feenstra and Weinstein \(2017\)](#), and [Kimball \(1995\)](#) kinked-demand curves as incorporated in [Gopinath and Itskhoki \(2010\)](#).

Our framework delivers analytical expressions for the full distribution of markups, a topic of increasing focus, such as in the work of [De Loecker and Eeckhout \(2017\)](#), [Edmond et al. \(2018\)](#), [Stroebel](#)

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<sup>7</sup>See, for example, [Hausman \(1996\)](#), [Petrin \(2002\)](#), and [Brynjolfsson et al. \(2003\)](#).

and Vavra (2019), Anderson *et al.* (2018), and Burstein *et al.* (2019). We note, however, that our model can easily deliver large trends in aggregate and household concentration without requiring any change in aggregate market power. Our work is therefore consistent with the skepticism expressed in Syverson (2018) and Berry *et al.* (2019) of the simple linkage often made between concentration trends and market power.

Finally, although the underlying causes are potentially different, the rise in niche consumption of retail goods parallels the increasing segmentation or polarization witnessed in culture and digital content (Aguado *et al.* (2015); Alwin and Tufis (2015)), in political ideology (Pew Research Center (2014); Gentzkow *et al.* (2017)), in jobs and income (Autor *et al.* (2006); Piketty *et al.* (2016)), and in the geography of where households consume (Davis *et al.* (2017)).<sup>8</sup> Our findings indicate that, along with these other manifestations of fragmentation in modern life, even our grocery purchases increasingly differ from the national average.

### 3 Diverging Household and Aggregate Concentration

We start this section with a discussion of the aspects of the data that are particularly salient for our analysis, relegating a more detailed description to Appendix A.1. We then present our key finding that the concentration of household spending across products increased while, at the same time, aggregate concentration among the same goods decreased. Finally, we provide evidence that these trends are associated with product churning.

#### 3.1 AC Nielsen Homescan Data

We use Homescan data from AC Nielsen to measure household-level shopping behavior.<sup>9</sup> The data set contains a weekly household-level panel for the period 2004-2016. The panel has large coverage, with roughly 170,000 households in over 22,000 zip codes recording prices for almost 700 million unique transactions covering a large fraction of non-service retail spending.

Products are allocated by Nielsen into three levels of category aggregation: roughly 1304 product modules, 118 product groups, and 11 department codes. For example, "vegetables - peas - frozen" are a typical product module within the "vegetables - frozen" product group within the "frozen foods" department. Our baseline analysis focuses on annual spending by all households in the Nielsen sample and computes household spending shares across products within product groups, but all results are qualitatively robust to instead calculating household product spending shares within the more disaggregated product modules or within the more aggregated department codes. We focus on the

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<sup>8</sup>The fact that our results are not driven by a widening gap between the goods purchased by rich and poor households or between consumers in one region and another is also consistent with the finding in Bertrand and Kamenica (2018) that cultural distance between rich and poor has not grown over time.

<sup>9</sup>These data are available for academic research through a partnership with the Kilts Center at the University of Chicago, Booth School of Business. See <http://research.chicagobooth.edu/nielsen> for more details on the data.



full sample of households for a number of reasons discussed in Appendix A.2, but this is relatively conservative since the magnitudes of our trends increase when we restrict to a balanced panel of households.<sup>10</sup>

In our baseline analysis, we define a product as a Universal Product Code (UPC). Appendix Figure A10 demonstrates, however, that the key trends we identify are robust to instead defining a product as a "brand". Nielsen assigns UPCs to brands, which are more aggregated than UPCs but are still fairly disaggregated. "Pepsi", for example, is a brand and includes many different flavors and package sizes of the Pepsi drinks. "Caffeine Free - Pepsi", however, is considered a distinct brand. The UPC is our preferred notion of a product in part because UPCs are directly assigned by the manufacturer, whereas the brand variable is constructed by Kilts/Nielsen in a way that involves judgment and may differ across categories and over time. Further, this choice helps to eliminate a measurement issue caused by generic products when working with more aggregate brands. Generic products (e.g. store brands rather than national products) are all assigned the same generic brand label by Nielsen in order to preserve the anonymity of the stores in the Nielsen sample. However, these products can be differentiated by their unique UPCs when working with that product definition. Sales of generics are large and growing, so their inclusion, by construction, distorts concentration measures that define products as brands.<sup>11</sup> Finally, some of our analyses decompose expenditure changes into price and quantity effects, which is straightforward for the case of UPCs but not for brands.

We also note that our analysis focusing on product level concentration treats all products symmetrically within a category and does not treat differently products produced by the same manufacturer from those produced by different manufacturers. This is primarily because data limitations discussed in Appendix A.4 make it infeasible to accurately measure products produced by the same manufacturer. However, even if data was available to group UPCs produced by the same manufacturer together, it is not obvious that new niche product varieties which cater to particular idiosyncratic tastes should enter differently in household preferences depending on the nature of the production process. That is, it is not clear that grouping multi-product firms together would be a preferable specification, even if it was empirically feasible.

We restrict our analysis to the set of product modules in the data for all years during 2004-2016. We exclude modules that enter or exit since this reflects changes in Nielsen's measurement – not actual household behavior – and could therefore lead to spurious changes in measured concentration. We also exclude fresh produce and other items without barcodes (these are labeled as "magnet" items in the data).

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<sup>10</sup>All results weight each household using sampling weights provided by Nielsen, which are designed to make the Nielsen panel demographically representative of the broader U.S. population. Appendix Figure A2 shows that aggregate spending growth in our sample tracks government data on aggregate spending growth in comparable categories. In the appendix we also discuss the relevance for our results of additional measurement-related issues, such as the (unimportant) role of online shopping.

<sup>11</sup>See, for example, *Dube et al. (2018)*. Our robustness checks using the brand definition of product exclude generics.

### 3.2 Household Spending Concentration

We begin our analysis by exploring how the concentration of household spending across products has changed over time. For each household  $i$ , UPC  $j$ , and product group  $c$  we calculate total expenditure  $E_{i,j,c,t}$  in year  $t$  and associated expenditure share:

$$s_{i,j,c,t} = \left( \frac{E_{i,j,c,t}}{\sum_j E_{i,j,c,t}} \right). \quad (1)$$

Our primary measure of household product concentration for a product category  $c$  at time  $t$  is the Herfindahl and equals the sum of the square of these expenditure shares:<sup>12</sup>

$$\mathcal{H}_{i,c,t}^{\text{HH}} = \sum_j (s_{i,c,j,t})^2. \quad (2)$$

Next, we take the weighted average across households to generate the Household Herfindahl for product category  $c$ :

$$\mathcal{H}_{c,t}^{\text{HH}} = \sum_i \text{share}_{i,c,t} \mathcal{H}_{i,c,t}^{\text{HH}}, \quad (3)$$

where we use weights capturing household  $i$ 's share of aggregate spending in category  $c$ :

$$\text{share}_{i,c,t} = \frac{\sum_j (\omega_{i,t} E_{i,j,c,t})}{\sum_i \sum_j (\omega_{i,t} E_{i,j,c,t})}, \quad (4)$$

and where  $\omega_{i,t}$  is a household's sampling weight provided to make the Nielsen sample representative of aggregate consumption. Finally, we calculate the overall Household Herfindahl by averaging the category-specific Household Herfindahl in equation (3) across all categories:

$$\mathcal{H}_t^{\text{HH}} = \sum_c \text{share}_c \mathcal{H}_{c,t}^{\text{HH}}, \quad (5)$$

where  $\text{share}_c$  is the average share of category  $c$  in total spending across our entire sample.

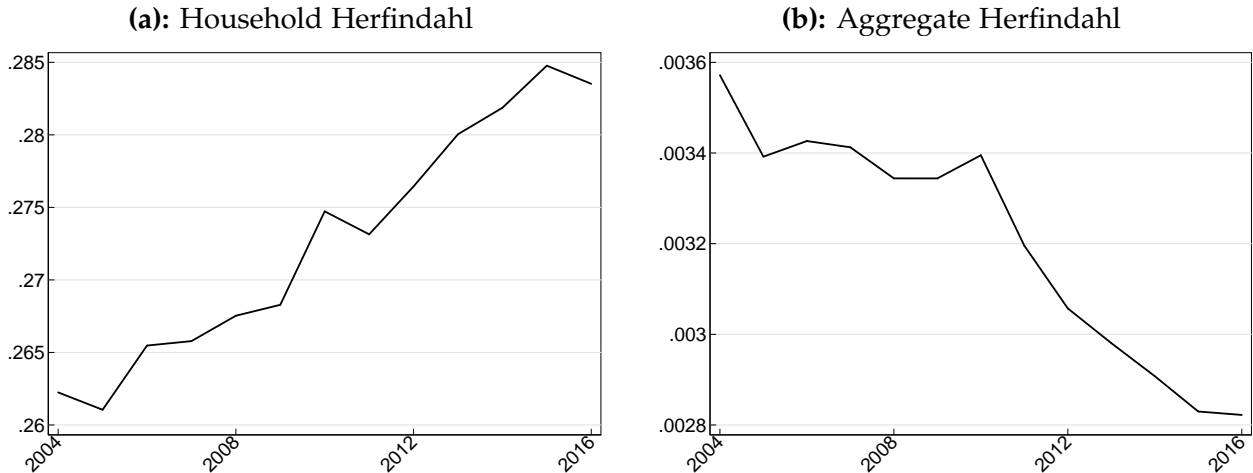
Unlike the weights used in equation (3), we use fixed category spending shares over time in equation (5) to focus on concentration changes occurring within categories, rather than those emerging from shifts in spending across categories with different average levels of concentration. We do this to better interact with recent interest in changing market power and technological disruption, typically perceived to be occurring within sectors. However, our results are robust to instead allowing compositional shifts across categories to influence our concentration measures.

Figure 1a plots  $\mathcal{H}_t^{\text{HH}}$  and reveals a nearly monotonic increase in household spending concentration

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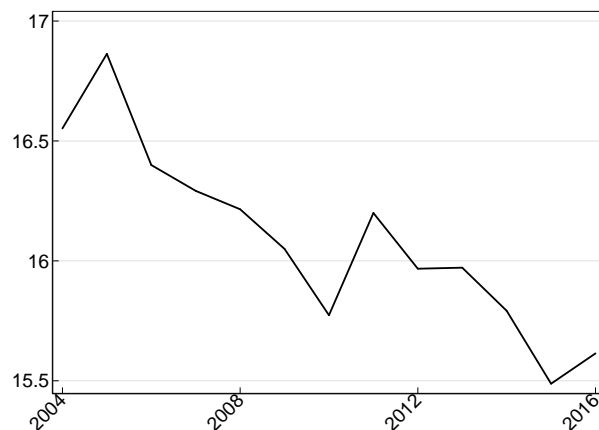
<sup>12</sup>All results in the paper hold for alternative concentration measures such as the share of spending accounted for by the top 1 or the top 2 products. We use the Herfindahl as our primary concentration measure as it can be more easily interpreted through the lens of the structural model described in Section 4.

**Figure 1: Household Product Concentration**



from 2004-2016. The increase in concentration is associated with a decline in the average number of products consumed per household within product categories. Figure 2 shows the average number of UPCs purchased per household constructed using the same weights as were used in equations (3) and (5). We delay interpreting the quantitative magnitude of these changes until we develop our model in Section 4 but note now that fitting these series with linear trends yields precise and highly significant estimates.

**Figure 2: Ave # UPCs Purchased by Each Household**



### 3.3 Aggregate Spending Concentration

What underlies this increase in the concentration of household expenditures? One possible explanation is that there has been an increase in the importance of "super-star products", along the lines of the rise

of "super-star firms" documented in [Autor et al. \(2017\)](#). This explanation, natural though it may be, finds no support in our data: we demonstrate in this subsection that at the same time the typical household's expenditures have grown more concentrated across products, aggregate spending has in fact become more evenly distributed across these same products.

We sum spending on product  $j$  in category  $c$  across all households in our data and define the aggregate market share of  $j$  in  $c$  as:

$$s_{j,c,t} = \frac{\sum_i (\omega_{i,t} E_{i,j,c,t})}{\sum_i \sum_j (\omega_{i,t} E_{i,j,c,t})}, \quad (6)$$

and the Aggregate Herfindahl in category  $c$  as:

$$\mathcal{H}_{c,t}^{\text{Agg}} = \sum_j (s_{j,c,t})^2. \quad (7)$$

Just as with the Household Herfindahl, we average these category Herfindahls using fixed category expenditure weights over time to generate the Aggregate Herfindahl of overall spending:

$$\mathcal{H}_t^{\text{Agg}} = \sum_c \text{share}_c \mathcal{H}_{c,t}^{\text{Agg}}. \quad (8)$$

Figure 1b plots this Aggregate Herfindahl and shows that the trend in product spending at the aggregate level is the reverse of what we see at the household level: aggregate spending concentration is declining, not rising. How can it be that aggregate concentration is declining if households are individually concentrating their spending on a smaller number of products? These divergent trends imply that households are concentrating more and more spending on their top products over time, but that these top products increasingly differ across households. We call these divergent trends and resulting fragmentation of the product space a rise in niche consumption.

Are these trends big or small? One simple way of contextualizing their scale is to compare them to the trends in firm concentration that have received significant attention in the recent literature including [Autor et al. \(2017\)](#). In Census data the Herfindahl of firm sales in the median 3-digit manufacturing sector grew by 0.5 percent annually from 2002-2012. By comparison, we find annual household-product level Herfindahl growth of 0.65 percent and aggregate product-level Herfindahl growth of -1.94 percent in our data.

The decline in aggregate concentration we find might, at first, seem at odds with the rise in sales concentration measured in Census data. Our aggregate concentration measure, however, captures expenditures in a different set of sectors, spans a different time period, and aggregates to the product level whereas Census-based estimates aggregate products up to the producer level. The resulting trends may therefore differ significantly. Appendix A.4 relates our findings to this recent literature on rising market concentration in the U.S. census data. We first show that production concentration

measures from the Census for the relevant NAICS categories – “Food Manufacturing” (code 311) and “Beverage and Tobacco Product Manufacturing” (312) – are in fact flat or declining during the years covered in our sample. Next, we use a mapping of UPCs to manufacturers to generate a comparable producer-level concentration measure based on the sales in our Nielsen data. We offer a number of important caveats, including that the UPC-to-manufacturer mapping is highly imperfect for this purpose, but nonetheless find similar trends in manufacturer concentration in Nielsen and Census data. We therefore conclude that our results are broadly consistent with the Census-based literature. Whether producer or product concentration is of greater interest depends, of course, on the question at hand. Our theory below will treat each good as produced and marketed independently such that it maps most naturally to our product-based concentration measure.

Finally, it is important to note that while the decline in the number of products consumed by the typical household contributed to the rising Household Herfindahl measure, it is much more difficult to measure the equivalent notion for the aggregate economy. As we show in Appendix A.3, the existence of thousands of products with tiny amounts of overall sales and incomplete coverage of households and stores in the data render a simple product count highly volatile, dependent on assumptions, and sensitive to measurement error. In contrast, household and aggregate concentration as well as household-level variety statistics are much less sensitive to this issue. We therefore treat the total number of products available for purchase as unobservable, and in Section 4 we show that our model can be used to infer product availability using these other more robust empirical statistics.

### 3.4 Robustness to Measurement and Composition

The rise in niche consumption – the increase in the Household Herfindahl and decrease in the Aggregate Herfindahl – is highly robust and is not driven by either measurement choices or by obvious composition effects. Appendix Figures A8-A14 show that these divergent concentration trends continue to hold if we exclude generics, compute concentration using more disaggregated categories (modules instead of groups), define products as brands instead of UPCs, use time-varying category weights, use alternative concentration measures instead of the Herfindahl, focus on a balanced panel of households over time, or condition on household size. While the increase in household concentration and decline in aggregate concentration holds across all specifications, the exact levels of concentration and quantitative magnitude of trends unsurprisingly varies somewhat with measurement choices.<sup>13</sup> However, targeting the theoretical model we develop below to match these alternative empirical results generates very similar conclusions, so in that sense our conclusions are robust to all of these measurement choices.

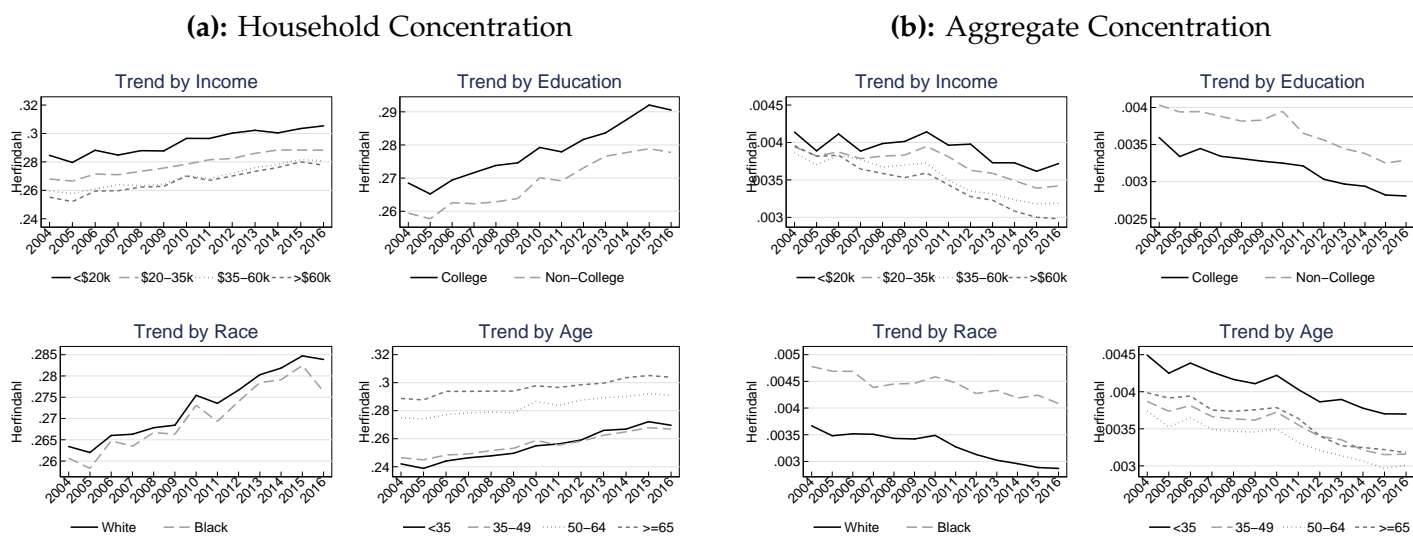
Is the rise of niche consumption driven by shifts in the importance of different groups, such as

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<sup>13</sup>Aggregate brand concentration exhibits more volatility but an overall decline from 2004-2016. However, we again refer to the discussion in 3.1 about how Nielsen’s method for brand assignment does not allow for a consistent measurement of concentration. Brand-level evidence should be interpreted with caution relative to our main UPC specification.

old and young or rich and poor? While there are differences in the level of concentration across different groups, the trends are primarily driven by *within* group variation. To show this, we recalculate annual Household and Aggregate Herfindahls using only expenditures by households with particular demographic characteristics such as income bracket, race, education, and age. Figures 3a and 3b show that rising household and declining aggregate concentration occurs within demographic groups. The rising Household and falling Aggregate Herfindahls do not simply owe to changes in composition across groups with different levels of concentration. Appendix Figure A13 further shows that we also see a rise in niche consumption when restricting to a balanced sample, so changes in the composition of the household sample over time do not drive our results.<sup>14</sup> Our results are also similar if we forsake Nielsen weights and instead weight households equally.

**Figure 3: Trends within demographic group**



As a simple summary statistic for the prominence of niche consumption, we consider the ratio of the Household Herfindahl to the Aggregate Herfindahl. A higher value for this “niche ratio” means that household consumption is more segmented into different niches. Figure 4 shows that the rise of niche consumption is pervasive across product categories, with three-quarters of product categories exhibiting increases in  $\mathcal{H}_{c,t}^{HH}$ , 80 percent of product categories exhibiting decreases in  $\mathcal{H}_{c,t}^{Agg}$ , and growth in the niche ratio in over 90 percent of the categories.<sup>15</sup>

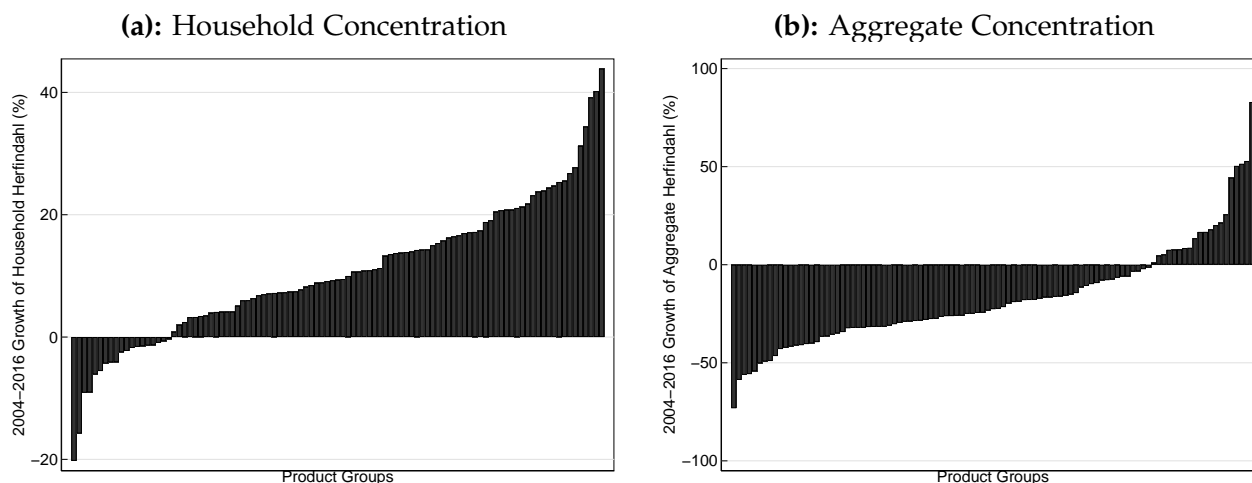
In Appendix Figure A15, we also show that the rise of niche consumption is occurring in the vast majority of locations, implying that shifts in the relative economic importance of cities and regions or differences across regions are not behind our findings. The niche ratio is highest in cities like

<sup>14</sup>Trends are actually stronger in the balanced panel specification. See Appendix A.2 for discussion and interpretation.

<sup>15</sup>To improve visual exposition, Figures 4 and 5a drop 5 outlier categories whose variety counts more than double or decrease by more than 50 percent from 2004-2016: “Frozen Juices”, “Yeast”, “Canning Supplies”, “Greeting Cards” and “Photographic Supplies”. This does not affect any conclusions.

Chicago, Washington DC, Tampa, Los Angeles, and Boston and lowest in Des Moines, Little Rock, Las Vegas, and West Texas, but it is increasing in most locations. Appendix Figure A16 shows that the rise in niche consumption is found within roughly two-thirds of the individual retailers in our data, so the aggregate patterns we observe are not simply driven by shifts in where households shop. Appendix Figure A17 shows the patterns hold even *within* retailers so that patterns are not driven by compositional changes in which retailers households shop at.

**Figure 4: 2004-2016 Concentration Growth Within Category**



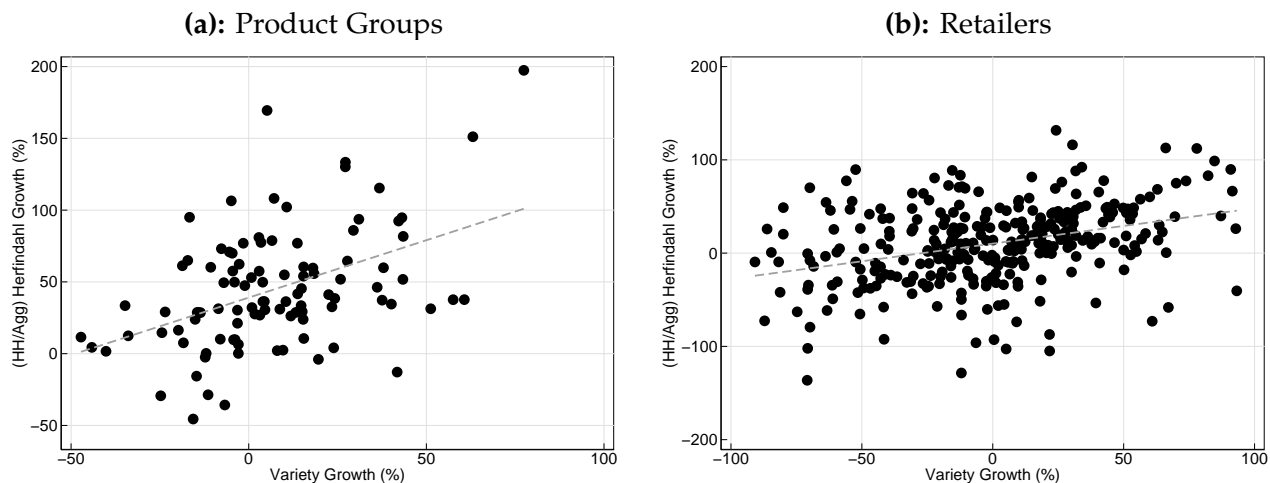
The level of the niche ratio is highest in “Cosmetics” and “Fragrances-Women” and is lowest for “Charcoal” and “Dough Products”. The rise in niche consumption is pervasive, but it is also clear from Figure 4 that there is substantial heterogeneity across categories in the extent of its ascent. The niche ratio has grown most rapidly for “Coffee”, “Hardware, Tools”, “Fresheners and Deodorizers”, and “Disposable Diapers”. It has declined by most for “Cottage Cheese”, “Eggs”, “Milk”, and “Bread and Baked Goods”.

### 3.5 The Role of Product Churn

Interestingly, there is a common observable linking together the categories with the most rapid increases in niche ratios: they are also the categories that appear to have the fastest growth in the number of available products. We emphasize this relationship as it will be central to the mechanism in our model in Section 4 and its implications for welfare. As we noted above and elaborate in Appendix A.3, inference about the growth of aggregate product varieties in these data are highly sensitive to the treatment of products receiving trivial amounts of sales. In Figure 5a, however, we include products consumed by at least two households with total sales of at least \$50 and plot the growth in each product group’s niche ratio against the growth in that group’s number of varieties. Categories with 50 percentage points more growth in the total number of products sold had, on average, 40 percentage

points more growth in their niche ratios, with the relationship statistically significant at the 1 percent level. Figure 5b shows that a similar relationship also holds when comparing across retailers: retailers with 50 percentage points more growth in the number of products sold exhibited roughly 20 percentage points more growth in their niche ratios, with the relationship again significant at the 1 percent level.<sup>16</sup> The relationship between variety growth and the niche ratio becomes even steeper if we weight retailers by size.

**Figure 5: Growth in Number of Products vs. Growth in Niche Ratio**



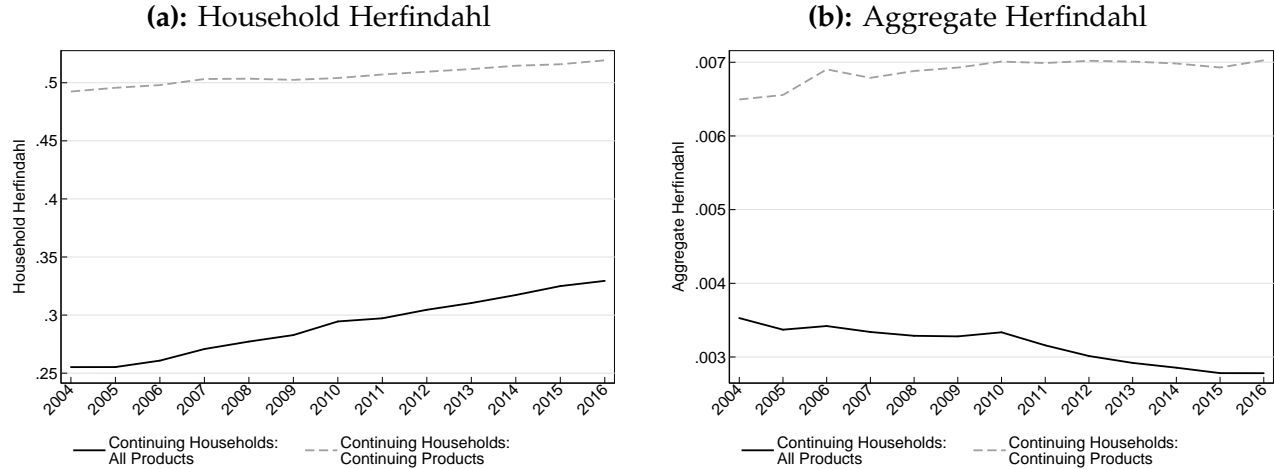
We now provide additional evidence that product churn plays a key role in the rise of niche consumption by comparing concentration trends measured only among “continuing” products that are purchased by a household in two consecutive years with those measured using all spending by that household. For each household  $i$  that is observed in both  $t$  and  $t + 1$ , we measure concentration of “continuing products” by using only those that are purchased by that household in both  $t$  and  $t + 1$ . These continuing products account for about 30 percent of transactions and 40 percent of spending. We also calculate Herfindahls for those same households using all their spending. We form an index by chaining together changes in these Herfindahls from  $t$  and  $t + 1$  and pin down the level using the values in the initial period. Figure 6a shows the upward trend in household concentration is much stronger when using all UPCs than when restricting to continuing products, growing by 29 percent compared to 5 percent. This implies a large role for product entry and exit in generating household concentration increases. Figure 6b shows that when focusing only on continuing products, aggregate concentration actually rises instead of declines.

Together these results all imply that whatever forces are driving the rise in niche consumption,

<sup>16</sup>To reduce the influence of outliers, we exclude retailers with absolute log variety changes above 2, which drops 6 out of 334 retailers. Results are similar for alternative thresholds. The panel of retailers is unbalanced, and growth rates for the remaining 328 retailers are calculated from their first to their last observation in the sample. Results are very similar if we instead calculate growth rates from 2004-2016 for the 179 retailers which are in the sample continuously.



**Figure 6: 2004-2016 Concentration growth for continuing vs. all products**



they are pervasive across demographics, geographies, retail chains, and product categories.

## 4 Modeling the Rise of Niche Consumption

In this section, we develop a model that is able to match the rise of niche consumption documented in Section 3. We use the model to identify the key driving forces of this trend and to evaluate the resulting implications for welfare and markups.

The basic problem of an individual household follows Li (2019). Households have CES preferences which embed a love-of-variety but must pay a fixed cost per consumed product, which implies they only consume a subset of available products. If we assume each household’s taste for products, relative to their exogenous price, is distributed Pareto, then we can analytically characterize the concentration of each household’s spending across products.

Our key theoretical contribution is the introduction of household heterogeneity into this framework. This innovation is crucial for matching the joint distribution of household and aggregate product spending and, thus, for speaking to the rise of niche consumption. We do so by introducing a rank function in the basic household problem that allows the preference ordering of products to differ across households while still allowing us to derive closed-form analytical expressions for aggregate spending concentration. Using these analytical expressions, we confront the model with empirical trends from 2004-2016 and demonstrate that an increase in the number of available products is required to quantitatively match the rise of niche consumption. In the model, this increase leads to significant welfare gains as it implies that consumers can choose a consumption bundle better tailored to their tastes without raising their fixed cost expenditures.

Here, we offer simplified expressions for the key objects in the model. Interested readers can find detailed derivations of all analytical results in Appendix B.1.

## 4.1 Household Problem

We assume that a continuum of households  $i \in [0, 1]$  spend  $E_i$  on a continuum of varieties  $k \in [0, N]$  to maximize:

$$U_i = \left( \int_{k \in \Omega_i} (\gamma_{i,k} C_{i,k})^{\frac{\sigma-1}{\sigma}} dk \right)^{\frac{\sigma}{\sigma-1}} - F \times (|\Omega_i|)^{\epsilon}, \quad (9)$$

where  $\Omega_i$  is the set of products consumed by  $i$  (with  $|\Omega_i| \leq N$ ),  $\gamma_{i,k}$  is a household-specific taste for product  $k$ ,  $\sigma$  is the elasticity of substitution across products, and where the final term captures a fixed utility cost that increases exponentially in the measure of varieties consumed. The corresponding ideal price index is:

$$P_i = \left( \int_{k \in \Omega_i} (\gamma_{i,k} / p_k)^{\sigma-1} dk \right)^{\frac{1}{1-\sigma}}, \quad (10)$$

where the price of product  $k$  is  $p_k$ .

Along the lines of the concept of “random tastes” in the discrete choice literature, we specify the distribution of each household’s tastes over the set of products. For analytical tractability, however, we follow Li (2019) and specify the cumulative distribution function (CDF)  $G_i(\cdot)$  over price-adjusted tastes,  $\tilde{\gamma}_{i,k} = \gamma_{i,k} / p_k$ , rather than over tastes themselves. When applying our static model at a given point in time, there is no substantive difference between assuming a distribution of prices, tastes, or price-adjusted tastes. However, when we apply our model to dynamic applications like the analysis of concentration trends, any changes in the distribution of prices must be accompanied by changes in tastes if the distribution of price-adjusted tastes is assumed constant. This assumption is not required in order to solve numerically for consumption decisions in the model, but imposing this assumption (together with some additional parametric assumptions discussed below) will allow us to obtain closed form expressions for key household and aggregate magnitudes.<sup>17</sup> Given the specification of the fixed cost in (9), household  $i$  will consume a measure of varieties  $|\Omega_i|$  equal to:

$$|\Omega_i| = N (1 - G_i(\tilde{\gamma}_i^*)), \quad (11)$$

where  $\tilde{\gamma}_i^*$  denotes the “cutoff” or minimum price-adjusted taste of consumed goods. We can then re-write the price index (10) as:

$$P_i = \left( N \int_{\tilde{\gamma}_i^*}^{\infty} (\tilde{\gamma}_i)^{\sigma-1} g_i(\tilde{\gamma}_i) d\tilde{\gamma}_i \right)^{\frac{1}{1-\sigma}}, \quad (12)$$

where  $g_i(x) = d(G_i(x)) / dx$ .

---

<sup>17</sup>Further, we demonstrate numerically in Appendix B.2 that our key counterfactual, which examines adjustment to changes in the number of varieties, requires only small changes in tastes in order to preserve the price-adjusted taste distribution. Put differently, the departure in our main counterfactual from the more standard assumption of fixed tastes is not large.

## 4.2 Pareto Distribution

In order to obtain closed-form solutions for the household's problem, we now assume that household  $i$ 's price-adjusted tastes are distributed Pareto, or:

$$Pr(\tilde{\gamma}_{i,k} < y) = G_i(y) = 1 - (y/b)^{-\theta}, \quad (13)$$

where  $y \geq b > 0$  and where we assume  $\theta > 2(\sigma - 1)$ . Since larger  $\theta$  means a flatter distribution of tastes, the latter condition simply ensures that tastes are not "too concentrated" relative to  $\sigma$  and that the model delivers a finite Herfindahl for household  $i$ . We also assume  $\epsilon > 1/(\sigma - 1)$ , which implies that higher fixed costs  $F$  lead to less purchased products  $|\Omega_i|$  and guarantees the existence of an interior solution  $|\Omega_i| < N$  when  $N$  is sufficiently large.

Substituting expression (11) for the measure of consumed varieties and expression (13) for the distribution of price-adjusted tastes into the ideal price index (12) for household  $i$ , we can write:

$$P_i = \underbrace{\left(1 + \frac{1 - \sigma}{\theta}\right)^{\frac{1}{\sigma-1}} b^{-1}}_{\text{Average Price}} \times \underbrace{(|\Omega_i|)^{\frac{1}{1-\sigma}}}_{\text{Variety Effect}} \times \underbrace{\left(\frac{|\Omega_i|}{N}\right)^{\frac{1}{\theta}}}_{\text{Selection Effect}}. \quad (14)$$

The price index has three terms, each with an intuitive interpretation. We refer to the first term as the average price since it summarizes the full distribution of price-adjusted tastes for available products, as if there were a single purchase price for one unit of the full bundle. It varies with the shape  $\theta$  and scale  $b$  of the Pareto distribution as well as with the elasticity of substitution  $\sigma$ . The second term is the standard love-of-variety term in CES models, which decreases with the measure of consumed products and increases with the elasticity of substitution (given  $|\Omega_i| > 1$ ). Finally, the third term represents a selection effect from the fact that when households only consume a subset  $\Omega_i$  of the full measure  $N$  of products, they choose the subset they like best. This term increases in the share of available products that are consumed and decreases in the extent to which households prefer some products to others.

The price index (14) reduces to more standard expressions in special cases. For example, consider  $\theta \rightarrow \infty$ , which implies that households value all products identically at  $b$ , i.e.  $\tilde{\gamma}_{i,k} = b$  for all  $k$ . In this case, the expression reduces to  $b^{-1}|\Omega_i|^{1/(1-\sigma)}$ , which is the standard price index for symmetric CES preferences. Alternatively, imagine some products are preferred to others,  $\theta < \infty$ , but all products are nonetheless purchased, so  $\Omega_i = N$ . In this case, the last term reduces to 1 as there are no selection effects and the average price term fully captures the impact of heterogeneity in the desirability of products.

The properties of the CES price index imply we can re-write equation (9) as:

$$U_i = \frac{E_i}{P_i} - F \times (|\Omega_i|)^\epsilon.$$

Household  $i$  chooses  $|\Omega_i|$  to maximize utility. The first order condition implies that the optimal number of products is:

$$|\Omega_i| = \left( \frac{\left(\frac{1}{\sigma-1} - \frac{1}{\theta}\right) \left(1 + \frac{1-\sigma}{\theta}\right)^{\frac{1}{1-\sigma}} N^{\frac{1}{\theta}}}{\tilde{F}_i \epsilon} \right)^{\left(\epsilon + \frac{1}{1-\sigma} + \frac{1}{\theta}\right)^{-1}}, \quad (15)$$

where  $\tilde{F}_i = F/(bE_i)$  is a parameter that shifts with spending, aggregate prices, and variety costs.<sup>18</sup> Importantly, the optimal choice of varieties yields a “cutoff” taste  $\tilde{\gamma}_i^*$  that satisfies:<sup>19</sup>

$$\frac{|\Omega_i|}{N} = 1 - G_i(\tilde{\gamma}^*) = \left(\frac{\tilde{\gamma}_i^*}{b}\right)^{-\theta}. \quad (16)$$

Note that under our parameter restriction  $\epsilon > 1/(\sigma - 1)$ , the exponent on  $N$  on the right-hand-side of equation (15) is less than one. This implies that as the mass of possible varieties expands, the mass that household  $i$  consumes expands by a proportionately smaller amount. That is, households purchase a smaller share of all available products when the set of available products is larger. Writing (16) as  $(|\Omega_i|/N)^{1/\theta} = (\tilde{\gamma}_i^*/b)^{-1}$  shows that the “Selection Effect” in price index (14) grows with  $\tilde{\gamma}_i^*$ , the price-adjusted taste of the least-preferred product that is consumed.<sup>20</sup> Finally, the share of household  $i$ 's expenditure on variety  $k$  is then given by:

$$s_{i,k} = \begin{cases} (P_i \tilde{\gamma}_{i,k})^{\sigma-1}, & \tilde{\gamma}_{i,k} > \tilde{\gamma}_i^* \\ 0, & \tilde{\gamma}_{i,k} \leq \tilde{\gamma}_i^* \end{cases} \quad (17)$$

with  $\int s_{i,k} dk = 1$ .

### 4.3 Household Herfindahls

Given equation (17), it follows that the Household Herfindahl  $\mathcal{H}_i^{\text{HH}}$  can be written as:

$$\mathcal{H}_i^{\text{HH}} = \int_{k \in \Omega_i} (s_{i,k})^2 dk = N \int_{\tilde{\gamma}_i^*}^{\infty} (P_i \tilde{\gamma}_{i,k})^{2(\sigma-1)} dG_i(\tilde{\gamma}_{i,k}) = \frac{(\eta + 1)^2}{4\eta} \frac{1}{|\Omega_i|}, \quad (18)$$

where we introduce the variable  $\eta = 1 - 2(\sigma - 1)/\theta$ . The above parameter restrictions imply  $\eta \in (0, 1)$ . For fixed  $\theta$  and  $\sigma$ , which implies fixed  $\eta$ , household concentration declines monotonically with the number of consumed varieties. And for fixed  $|\Omega_i|$ , concentration declines monotonically with  $\eta$ . All else equal, flatter taste distributions (higher  $\theta$ ) or less substitutability across products in preferences (lower  $\sigma$ ) reduce Household Herfindahls.

<sup>18</sup>By “aggregate prices,” we are referring here to the location parameter  $b$ . When  $N = 1$ , this expression is the same as that in Li (2019) after substituting in his special case for  $b$ .

<sup>19</sup>The fact that households only consume a subset of the varieties in our environment follows directly from our specification of the fixed cost. This same feature arises in Michelacci *et al.* (2019), though it is generated less mechanically in their setup. In their environment, consumers pay a cost to try a product and there is uncertainty as to whether they will like it.

<sup>20</sup>We note that the most-preferred product that is consumed has an infinitely high price-adjusted taste.

## 4.4 Testing the Model at the Household Level

How well does this model fit household spending data? If we condition on the number of products  $|\Omega_i|$  purchased by household  $i$ , equation (17) yields a testable relationship between  $i$ 's spending shares on particular products  $k$  and  $i$ 's ranking of those particular products from  $[0, N]$ . For analytical tractability, our model assumes a continuum of products but in Appendix B.1.7 we provide formulas which convert the continuous relationship in equation (17) to a discretized version which we then use to test against the data. Specifically, we interpret the spending share on discrete product  $K$  as the total spending share by household  $i$  on all continuous products  $k$  in the span of  $[(K - 1) / |\Omega_i|, K / |\Omega_i|]$  and obtain:

$$s_{i,K}^{|\Omega_i|} = (|\Omega_i|)^{-\frac{\eta+1}{2}} \left[ K^{\frac{\eta+1}{2}} - (K - 1)^{\frac{\eta+1}{2}} \right], \quad (19)$$

where we note that the spending share on the  $K$ th discrete product is a function of both  $|\Omega_i|$  and  $\eta$ .<sup>21</sup> The share spent on the most preferred good (i.e.  $K = 1$ ) simplifies to:  $s_{i,1}^{|\Omega_i|} = (|\Omega_i|)^{-\frac{\eta+1}{2}}$ . Given values of  $\mathcal{H}_i^{\text{HH}}$  and  $\Omega_i$ , we then choose  $\eta$  to solve equation (18). For example, applying this formula to the average values for  $\mathcal{H}_i^{\text{HH}}$  and  $\Omega_i$  over all categories implies  $\eta = 0.0672$ . Given the parsimony of the relationship in equation 19, we can use it to test our model's fit of household level spending patterns over the entire product space.

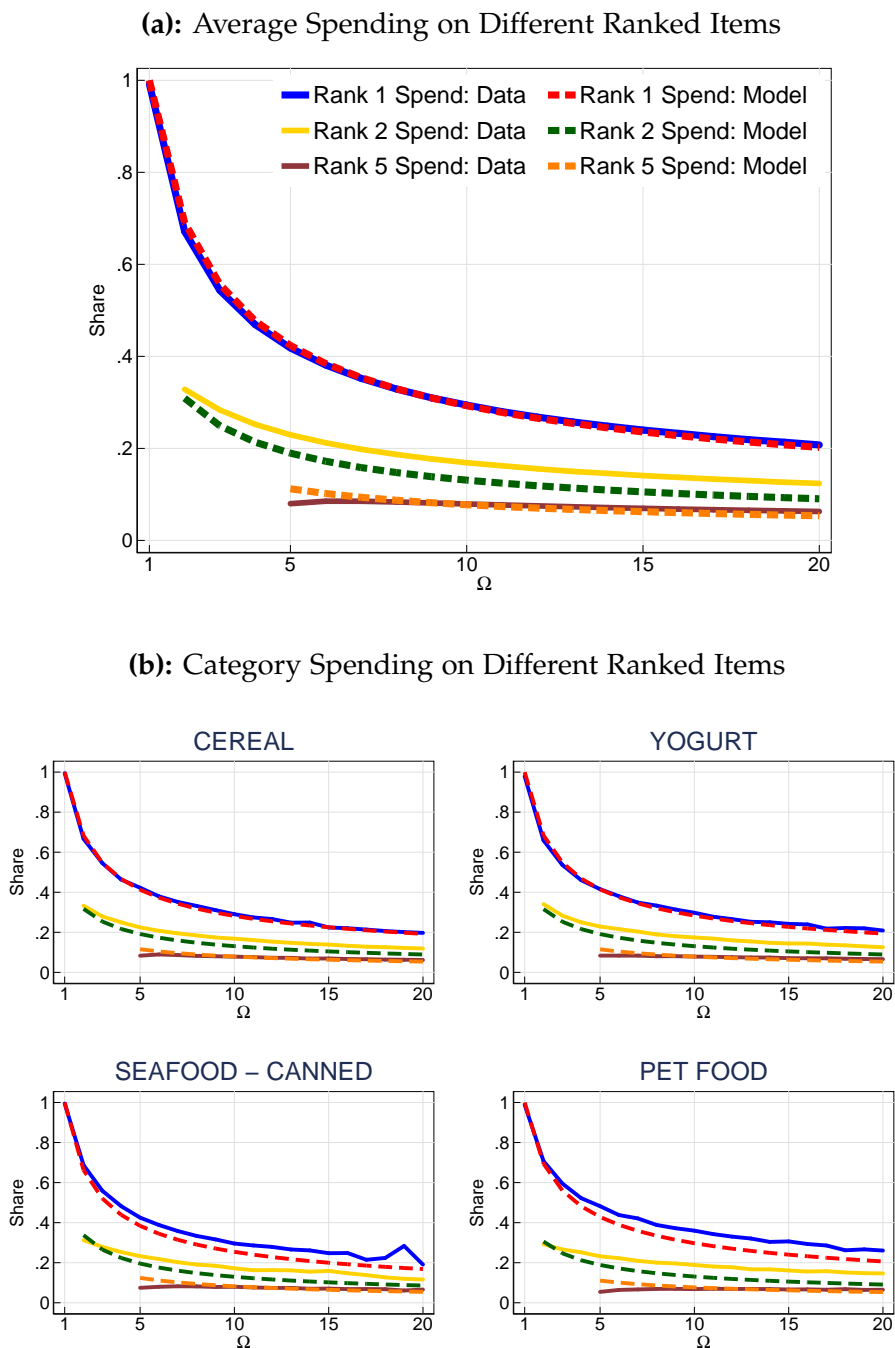
Panel (a) of Figure 7 plots the average spending shares in both the model and data on a household's top, second, and fifth ranked goods as a function of the total number of goods consumed by that household.<sup>22</sup> The solid lines measure the average of these shares in our data, taken across all households and weighted by their total spending, whereas the dashed lines simply plot the theoretical relationship implied by our model as shown in equation (19). For example, the solid and dashed lines in blue and red at the top of Figure 7 both equal 1 when  $|\Omega_i| = 1$  at the far left of the plot, which must be true by construction. After all, if a household only buys one good, then that top good must by definition account for 100 percent of their spending. The far right side of the plot shows that for households who buy 20 products ( $|\Omega_i| = 20$ ), the top product they purchase accounts for approximately 20 percent of their total spending in both the data and the model. The fact that the solid blue and dashed red lines nearly perfectly coincide for all values of  $|\Omega_i|$  implies that our model of household spending does a great job capturing the degree to which households concentrate spending on their single most preferred product.

Next, the yellow solid and green dashed lines plot household spending shares on their second-ranked goods. This share is undefined when households only consume a single good, but ranges from about 0.3 to 0.1 as  $|\Omega_i|$  ranges from 2 to 20. Households in the data spend a bit more on their second

<sup>21</sup>We include a superscript  $|\Omega_i|$  on  $s_{i,K}$  to emphasize that the spending share associated with any given product with rank  $K$  depends on the total amount that the household consumed. For example the spending share of top good ( $K = 1$ ) will be 100 percent for a household buying only one good, and smaller for households buying multiple goods.

<sup>22</sup>We plot three ranks to preserve readability of the figure, but there is nothing special about these particular ranks. In Appendix Figure A6, we show that a focus on additional product ranks leads to similar conclusions.

Figure 7: Model Fit to Distribution of Spending by Product Rank for Households with Different  $\Omega$



ranked good compared to what is predicted by the model, but the shares never deviate by more than a few percentage points. The solid brown and dashed orange lines show that the share spent on the fifth-ranked good, in both the data and the model, hovers quite close to 10 percent for all plotted values of  $|\Omega_i|$ .

Figure 7b repeats this exercise for the individual categories of cereal, yogurt, canned seafood, and

pet food. We pick category-specific values of  $\eta$  again using using equation (18) together with category-specific concentration and variety counts. The lowest implied  $\eta$  in the plotted categories is 0.053 for pet food and the highest is 0.189 for seafood-canned. Although the model fits more closely for cereal and yogurt, the dashed lines are fairly close to their solid counterparts in all cases. Thus, even though our model makes strong parametric assumptions in order to deliver analytical tractability, Figure 7 provides strong evidence that our model captures the key patterns of individual household spending we focus on in the data.<sup>23</sup>

## 4.5 Aggregation

In this subsection, we aggregate spending across different households  $i$  to study aggregate concentration measures. For tractability, we equalize expenditures across households  $E_i = E$ , which implies that  $|\Omega_i| = |\Omega|$ ,  $P_i = P$ , and  $\mathcal{H}_i^{\text{HH}} = \mathcal{H}^{\text{HH}}$ . The only remaining difference across households is that they prefer different goods. In other words, whereas the distribution of price-adjusted tastes is identical for all households, the identity of the good at any point in that distribution – the household’s favorite and least favorite goods, say – can differ.<sup>24</sup>

We index all products in the economy by  $j \in [0, N]$ , and assume each household  $i$  assigns each product  $j$  a “rank”  $r_{i,j}$ , where lower ranks indicate higher price-adjusted tastes.<sup>25</sup> Households will consume all goods with  $r_{i,j} \leq |\Omega|$ .

We introduce the following rank function for each household  $i$ :

$$r_{i,j} = (1 - \alpha)j + \alpha x_{i,j}, \quad (20)$$

where  $j$  identifies a common aggregate rank for a product,  $x_{i,j}$  is an i.i.d. draw from the uniform distribution with support  $[0, N]$  representing a household-specific taste component, and  $\alpha \in (0, 1)$ . If  $\alpha$  is close to zero, the model approximates a representative agent model where all households rank products in the same order. If  $\alpha$  approaches 1, tastes are purely idiosyncratic and resulting aggregate spending will be evenly distributed over all consumed products even if individual household tastes are very concentrated. Thus, even though all households have identical distributions of taste-adjusted prices, this rank function allows for different households to have different ranks for the exact same product  $j$ .

To compute the aggregate spending share on product  $j$ , we need to know the CDF of product ranks  $R(r)$ , integrating over all households and products. Without loss of generality we assume  $\alpha < 1/2$ ,

<sup>23</sup>Appendix A.5 derives additional testable implications of the household model and further corroborates its close fit to the data.

<sup>24</sup>Or more formally, while the most-preferred product for each household will have an infinite price-adjusted taste, the identity of that product will differ due to heterogeneous tastes.

<sup>25</sup>Note that in contrast to the arbitrary household-specific product index  $k$  above, the product index  $j$  is common to all households.

and then  $R(r)$  can be written as:<sup>26</sup>

$$R(r) = \begin{cases} \frac{1}{2} \left( \frac{r}{N} \right)^2 \frac{1}{\alpha(1-\alpha)}, & 0 \leq r < \alpha N \\ \frac{r}{N} \frac{1}{1-\alpha} - \frac{1}{2} \frac{\alpha}{1-\alpha}, & \alpha N \leq r < (1-\alpha)N \\ -\frac{1}{2} \left( \frac{r}{N} \right)^2 \frac{1}{\alpha(1-\alpha)} + \frac{r}{N} \frac{1}{\alpha(1-\alpha)} - \frac{1}{2} \left( \frac{\alpha}{1-\alpha} + \frac{1-\alpha}{\alpha} \right), & (1-\alpha)N \leq r \leq N. \end{cases} \quad (21)$$

Note that this CDF satisfies the properties that  $R(0) = 0$ ,  $R(N) = 1$ ,  $R(r)$  is continuous at  $r = \alpha N$  and  $r = (1-\alpha)N$ , and  $R(r)$  is monotonically increasing. Household  $i$  will consume good  $j$  if and only if  $R(r_{i,j}) \leq |\Omega|/N$ .

There are three distinct regions in  $R(r)$  with different functional forms. If households only consume goods with ranks in the first region, this implies that there is no single product in the economy that is purchased by all households. If households consume so many varieties that some have ranks in the second region, this implies that at least one product is purchased by everyone. Finally, if even the worst possible product in the economy is purchased by at least one household, then the ranks of some consumed goods will fall into the third region.<sup>27</sup> As long as  $0 \leq \frac{|\Omega|}{N} < \frac{\alpha}{2(1-\alpha)} < \frac{1}{2}$ , it can be shown that all consumed products in the economy will have an  $r$  value confined to the first region of  $R(r)$ . This is the empirically relevant region of the parameter space, since the number of varieties purchased by an individual household is orders of magnitude less than the aggregate number of varieties, and there are no varieties in the data that are consumed by all households. To simplify the analytical expressions that follow, we thus impose this parameter restriction for the remainder of the analysis.

Noting that  $\tilde{\gamma}_{i,j} = G^{-1}(1 - R(r_{i,j}))$ , the spending share of household  $i$  that is dedicated to product  $j$  can be written as a function of  $j$ 's rank:

$$s_{i,j} = P^{\sigma-1} \tilde{\gamma}_{i,j}^{\sigma-1} = (Pb)^{\sigma-1} (R(r_{i,j}))^{-\frac{\sigma-1}{\theta}} = \frac{\eta+1}{2} N^{\frac{\eta-1}{2}} |\Omega|^{-\frac{\eta+1}{2}} (R(r_{i,j}))^{\frac{\eta-1}{2}}, \quad (22)$$

if  $R(r_{i,j}) \leq |\Omega|/N$ , and zero otherwise. To determine the products for which the share  $s_{i,j}$  in equation (22) jumps from positive to zero, we solve for the rank of the marginal, or least-preferred, variety that is consumed in positive quantities by household  $i$ . Note that this good's identity will differ across households, but its rank  $r^*$  will be the same and satisfies  $R(r^*) = |\Omega|/N$ . Substituting into equation

<sup>26</sup>Replacing  $\alpha$  with  $1-\alpha$  in all instances in equation (21) yields the corresponding  $R(r)$  for the alternative case of  $\alpha > 1/2$ . Furthermore, this leaves the rank function unchanged for the first of the three regions of  $R(r)$ , which will be the focus of our analysis.

<sup>27</sup>More specifically, the product with the best aggregate taste shock is  $j = 0$ . The worst possible idiosyncratic rank for this product occurs when  $x_{i,j} = N$ , in which case  $r = \alpha N$ , so if we are in the first region of the parameter space, even the best product is not purchased by some households. Conversely, the product with the worst aggregate taste shock is  $j = N$ . The best possible idiosyncratic rank for this product occurs when  $x_{i,j} = 0$ , in which case  $r = (1-\alpha)N$ . This means that if we are in the third region of the CDF, this worst product will still be consumed by some household.



(21) under the assumption that  $0 \leq \frac{|\Omega|}{N} < \frac{\alpha}{2(1-\alpha)}$ , we get:

$$r^* = (2\alpha(1-\alpha)|\Omega|N)^{\frac{1}{2}}. \quad (23)$$

Under our parameter restrictions, individual households each consume only a fraction of the total products available  $N$ , but the exact products consumed will differ across households. However, even when aggregating across all households, there are some products which are not consumed by any household.<sup>28</sup> This means that for the economy as a whole, there is a difference between the measure of available goods  $N$  and the measure of goods that are actually consumed, which we denote with  $j^*$ . This marginal consumed good for the economy as a whole,  $j^*$ , is that  $j$  for which the best possible idiosyncratic taste draw (a draw of  $x_{i,j} = 0$ ) yields rank  $r^*$  for the household with that zero draw. Solving for this cutoff,  $j^* = r^* / (1 - \alpha)$ , we get:

$$j^* = \left( \frac{2\alpha|\Omega|N}{1-\alpha} \right)^{\frac{1}{2}}. \quad (24)$$

Importantly, since  $r_{i,j}$  is strictly increasing in  $j$ , all goods with  $j \leq j^*$  will have positive aggregate sales and all goods with  $j > j^*$  will have zero aggregate sales. Finally, substituting in the definition of the rank function from equation (20) into the expression (23), and using the definition of  $j^*$  in equation (24), we can write the highest value or cutoff random draw  $x_j^*$  that yields positive consumption of  $j$  as:

$$x_j^* = \frac{1-\alpha}{\alpha} (j^* - j). \quad (25)$$

#### 4.6 The Aggregate Herfindahl

We now use equations (22) and (25) to integrate spending shares across households  $i$  to get the aggregate spending share on good  $j$ :

$$\begin{aligned} s_j &= \frac{1}{\int_i E d i} \int_i E s_{i,j} d i = \frac{\eta+1}{2} N^{\frac{\eta-1}{2}} |\Omega|^{-\frac{\eta+1}{2}} \int_0^{x_j^*} (R((1-\alpha)j + \alpha x))^{\frac{\eta-1}{2}} \frac{dx}{N} \\ &= \frac{\eta+1}{\eta j^*} \left( 1 - \left( \frac{j}{j^*} \right)^\eta \right). \end{aligned} \quad (26)$$

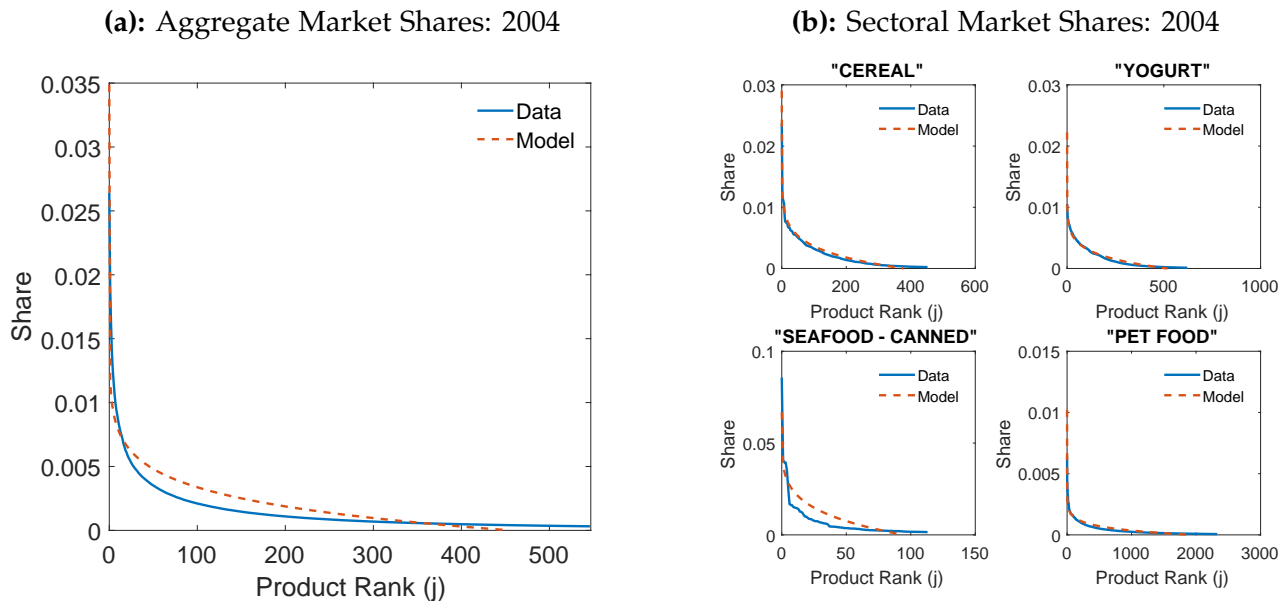
Using equations (24) and (26), we immediately obtain the Aggregate Herfindahl:

$$\begin{aligned} \mathcal{H}^{\text{Agg}} &= \int_{j=0}^{j^*} s_j^2 d j = \left( \frac{\eta+1}{\eta j^*} \right)^2 \int_{j=0}^{j^*} \left( 1 - \left( \frac{j}{j^*} \right)^\eta \right)^2 d j \\ &= \frac{2(\eta+1)}{2\eta+1} \left( \frac{1}{2N|\Omega|} \right)^{\frac{1}{2}}, \end{aligned} \quad (27)$$

<sup>28</sup>One way to interpret this is that technologies for these unconsumed products exist, but they are not produced due to a lack of demand.

where we define  $\tilde{N} = N\alpha/(1 - \alpha)$ . Aggregate concentration declines monotonically with  $\tilde{N}$ . For fixed  $\theta$  and  $\sigma$ , aggregate concentration declines monotonically with the number of consumed products. And for fixed  $|\Omega|$ , concentration declines monotonically with  $\eta$ . Importantly, changes in  $|\Omega|$  and  $\eta$  move the Household Herfindahl and Aggregate Herfindahl in the same direction. As we discuss in the next subsection, this imposes strong restrictions on the set of possible forces which can explain the opposite empirical trends for  $\mathcal{H}^{\text{HH}}$  and  $\mathcal{H}^{\text{Agg}}$  and implies an important role for increases in  $\tilde{N}$ .

**Figure 8: Model Fit on Aggregate Category Data**



How well do these model-based relationships fit aggregate sales distributions in the data? To assess this, we start by measuring  $|\Omega_c|$  in the data as the average number of products consumed per household within a category  $c$  using the same weights as were used in equations (3)-(5). We then solve for the two remaining free parameters,  $\eta_c$  and  $\tilde{N}_c$ , to match  $\mathcal{H}_c^{\text{HH}}$  and  $\mathcal{H}_c^{\text{Agg}}$  in equations (18) and (27). Figure 8 then plots the market share distribution across products implied by our model in equation (26) (the red dashed line) against the actual market share distribution in the data (the solid blue line) in 2004.<sup>29</sup> We weight across categories and do this for total spending in Figure 8a as well as separately for a number of product categories in Figure 8b. In several categories such as cereal and yogurt, the model fits extremely well, while it is notably less successful in others such as canned seafood. Overall, however, we consider these good fits as validating our use of the model, particularly given that the distributions are fully determined by only three parameters and reflect parametric assumptions and functional forms chosen largely for analytical convenience.<sup>30</sup>

<sup>29</sup>We concentrate on a single year since our model is static. Results are similar if we instead use data from 2016 or pool all years.

<sup>30</sup>Appendix Section B.3 offers a version of our model that builds from a linear demand system as in Melitz and Ottaviano (2008), rather than the CES demand system assumed above. In this case, we also obtain analytical expressions for key statistics such as Household and Aggregate Herfindahls. Most of the qualitative inferences from confronting the model with

## 4.7 Elasticities of Demand, Markups, and Aggregate Profits

The previous sections develop analytical expressions for our key empirical objects:  $\mathcal{H}^{\text{HH}}$ ,  $\mathcal{H}^{\text{Agg}}$ , and  $|\Omega|$ . We will show that these expressions can be used to draw important conclusions about the forces driving the rise of niche consumption, but we defer this analysis until Section 4.8. First, in this subsection, we additionally develop an expression for the ratio of aggregate revenues to costs, what we refer to as the “aggregate markup”. The aggregate markup is useful on its own as a gauge of market power, but further, we will use this expression to calibrate our model and quantify the welfare implications of the rise in niche consumption.

In typical CES environments, the elasticity of demand and markups are fully determined by the exogenous elasticity of substitution  $\sigma$ . By contrast, the elasticity of demand in our model depends both on this standard “intensive margin” force as well as on an endogenous “extensive margin” force that arises from the possibility for products to gain new customers (or lose existing ones). Since these forces are of different importance for products with different aggregate market shares, the model generates heterogeneity in demand elasticities across products and in their resulting markups. This also implies that existing estimates of the elasticity of substitution, such as those offered in [Broda and Weinstein \(2004\)](#), cannot be applied in our context.

To solve for the price elasticity of aggregate demand for product  $j$ , we start by expressing its total sales as the integral of each household’s spending on  $j$ , taken over all households:

$$s_j = \frac{1}{N} \int_0^{x_j^*} s_{i_x,j} dx, \quad (28)$$

where we use the notation  $s_{i_x,j}$  to denote the spending share of a household with taste draw on product  $j$  equal to  $x$ . Since  $j$  will only be purchased by those households with a sufficiently high idiosyncratic taste for it, we need only integrate from households drawing  $x_{i,j} = 0$  to the marginal household that draws  $x_{i,j} = x_j^*$ .

We take the partial derivative of  $s_j$  in equation (28) with respect to  $p_j$  to get:

$$\frac{\partial s_j}{\partial p_j} = \frac{1}{N} \left( \int_0^{x_j^*} \frac{\partial s_{i_x,j}}{\partial p_j} dx + s_{i_{x_j^*},j} \frac{\partial x_j^*}{\partial p_j} \right), \quad (29)$$

where the right hand side of equation (29) follows from Leibniz’s rule. The first term can be solved using equation (22) as:

$$\frac{\partial s_{i_x,j}}{\partial p_j} = (1 - \sigma) \frac{s_{i_x,j}}{p_j}, \quad (30)$$

where we take the aggregate price index  $P$  as fixed. Moving on to the second term, we can evaluate

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the data are the same across both model specifications. The CES model is our benchmark in large part because the match between its predictions and the data, as explored in Figure 8, strike us as more compelling.

equation (22) at the marginal household with taste  $x_j^*$  to get:

$$s_{i_{x_j^*},j} \frac{\partial x_j^*}{\partial p_j} = \frac{\eta + 1}{2} N^{\frac{\eta-1}{2}} |\Omega|^{-\frac{\eta+1}{2}} (R(r^*))^{\frac{\eta-1}{2}} \frac{\partial x_j^*}{\partial p_j}. \quad (31)$$

Substituting equations (30) and (31) back into equation (29), we get:

$$\frac{\partial s_j}{\partial p_j} = (1 - \sigma) \frac{1}{p_j} \frac{1}{N} \int_0^{x_j^*} s_{i_{x_j},j} dx + \frac{1}{N} s_{i_{x_j^*},j} \frac{\partial x_j^*}{\partial p_j} = (1 - \sigma) \frac{s_j}{p_j} + \frac{\eta + 1}{2N|\Omega|} \frac{\partial x_j^*}{\partial p_j}. \quad (32)$$

Our analytical expressions thus far rely on the assumption that the full distribution of price-adjusted tastes in our model is given exogenously as Pareto. However, since we have a continuum of products, we assume that the influence of an infinitesimal price change on the overall distribution of demand is marginal and so our analytical expressions continue to hold.<sup>31</sup> To compute  $\partial x_j^* / \partial p_j$ , we start with the relationship:

$$R((1 - \alpha)j + \alpha x_{i,j}) = 1 - G\left(\frac{\gamma_{i,j}}{p_j}\right) = b^\theta \gamma_{i,j}^{-\theta} p_j^\theta, \quad (33)$$

and totally differential the left- and right-hand sides for each product  $j$ . Evaluating the resulting expression at  $x_{i,j} = x_j^*$ ,  $r_{i,j} = r^*$ , and  $\tilde{\gamma}_{i,j} = \tilde{\gamma}^*$  yields:

$$\frac{dx_j^*}{dp_j} = -\frac{\theta}{j^*} |\Omega| N \frac{1}{p_j}. \quad (34)$$

Inserting this into equation (32), we have:

$$\frac{\partial s_j}{\partial p_j} = (1 - \sigma) \frac{s_j}{p_j} - \frac{\eta \theta}{2 \left(1 - \left(\frac{j}{j^*}\right)^\eta\right)} \frac{s_j}{p_j}. \quad (35)$$

Equation (35) implies that product  $j$ 's price elasticity of demand  $\varepsilon_j$  can be written as:

$$\varepsilon_j = 1 - \frac{\partial s_j}{\partial p_j} \frac{p_j}{s_j} = \underbrace{\sigma}_{\text{Intensive Margin}} + \underbrace{\left(1 - \left(\frac{j}{j^*}\right)^\eta\right)^{-1} [\theta/2 - (\sigma - 1)]}_{\text{Extensive Margin}} > \sigma. \quad (36)$$

In addition to the standard intensive margin term  $\sigma$ , there is a strictly positive contribution from the extensive margin, since lowering the price of a product can induce new households to start consuming the product. Low  $j$  or “mass-market” products are consumed by many households, so the intensive margin is relatively more important for them. High  $j$  or “niche” products are consumed by few households, so the extensive margin is relatively more important for those goods. As a result, the

<sup>31</sup>In Appendix B.2 we use numerical simulations which do not require any distributional assumption on tastes to verify that the approximation that follows is highly accurate.

elasticity of demand increases as market share falls.<sup>32</sup>

**Figure 9: Elasticity of Demand for Good  $j$**

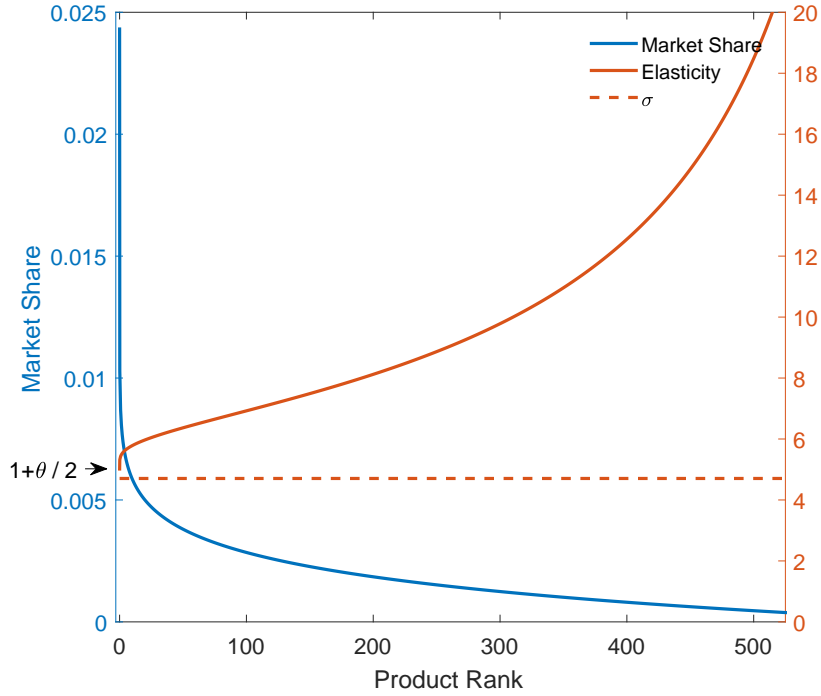


Figure 9 plots aggregate product market shares  $s_j$ , the elasticity of demand  $\varepsilon_j$ , and the elasticity of substitution  $\sigma$  as a function of the product rank  $j$ , using a version of the model economy that we calibrate as described below. Elasticities of demand rise as the product rank grows from the low values associated with large market shares to the high values associated with niche products. We note that despite the CES structure, the elasticity of demand generically differs from the elasticity of substitution  $\sigma$ . As  $j \rightarrow j^*$  and a product approaches the point where it is dropped from the aggregate consumption bundle, the elasticity approaches infinity, i.e.  $\varepsilon \rightarrow \infty$ . The markup  $\mu_j$  then be written (in gross terms) as:

$$\mu_j = \frac{\varepsilon_j}{\varepsilon_j - 1} = \frac{\sigma + \frac{\theta(\eta+1)}{2j^*s_j}}{\sigma + \frac{\theta(\eta+1)}{2j^*s_j} - 1}, \quad (37)$$

and ranges from a high of  $(1 + 2/\theta)$  for the largest market share good  $j = 0$  to a low of 1 for  $j = j^*$ .

The aggregate markup  $\mu^{\text{Agg}}$  is equal to the ratio of aggregate sales to aggregate costs. Using

<sup>32</sup>Interestingly, for good  $j = 0$ , which has the largest aggregate demand, the positive impact of  $\sigma$  on the elasticity coming through the intensive margin exactly cancels with the negative impact of  $\sigma$  coming from the extensive margin, leaving a total elasticity of  $(\theta/2 + 1)$ . This result echos a closely related point in Chaney (2008), where the impact of the equivalent parameter for the elasticity of trade flows to trade costs also fully cancels when combining the intensive and extensive margin effects.

equations (26) and (36), it can be written as:

$$\mu^{\text{Agg}} = \frac{\int_0^{j^*} s_j dj}{\int_0^{j^*} s_j \frac{\epsilon_j - 1}{\epsilon_j} dj} = \left[ \frac{\theta + (\sigma - 1)^2}{\sigma^2} - \frac{1}{2} \frac{\eta \theta^2}{\sigma^2} \left( \frac{\eta + 1}{2 + \theta} \right) \times {}_2F_1 \left( 1, \frac{1}{\eta}; 1 + \frac{1}{\eta}; \frac{2\sigma}{2 + \theta} \right) \right]^{-1}, \quad (38)$$

where  ${}_2F_1(\cdot)$  is the hypergeometric function.<sup>33</sup> Importantly, while this aggregate profit share is a relatively complicated function of  $\sigma$  and  $\theta$ , it is not a function of  $\tilde{N}$ ,  $F$ , or  $\epsilon$ .<sup>34</sup>

## 4.8 Understanding the Empirical Trends

We now confront our model with concentration measures and other moments from the data to infer which structural forces led to the rise in niche consumption. Collecting previous results, our model implies that:

$$\mathcal{H}^{\text{HH}} = \frac{(\eta + 1)^2}{4\eta} \frac{1}{|\Omega|} \quad (39)$$

$$\mathcal{H}^{\text{Agg}} = \frac{2(\eta + 1)}{(2\eta + 1)} \left( \frac{1}{2\tilde{N}|\Omega|} \right)^{\frac{1}{2}}. \quad (40)$$

Since  $\mathcal{H}^{\text{HH}}$ ,  $\mathcal{H}^{\text{Agg}}$ , and  $|\Omega|$  are directly observable in the data, this produces a system of two equations – (39) and (40) – that can be solved to determine  $\eta$  and  $\tilde{N}$  for each year. Figure 10 shows the time-series for  $\tilde{N}$  and  $\eta$  necessary to hit these observables in each year. Through the lens of the model, given the observed path for  $|\Omega|$ , matching the concentration trends requires nearly constant values for  $\eta$  and a strong upward trend in  $\tilde{N}$ .<sup>35</sup> From 2004-2016,  $\eta$  falls by 2 percent while  $\tilde{N}$  rises by 70 percent.

As above, we can interpret our model as applying at each individual sector and apply equations (39) and (40) to data on concentration trends and varieties consumed sector-by-sector. Rather than generating a single time series for  $\eta$  and a single time series for  $\tilde{N}$  for the aggregate economy, as plotted in Figure 10, this allows us to generate time series for these parameters for each sector. Figure 11a plots the distribution of implied growth (in percent terms) from 2004-2016 of  $\eta$  for each sector, and Figure 11b plots the same for the implied growth of  $\tilde{N}$ .

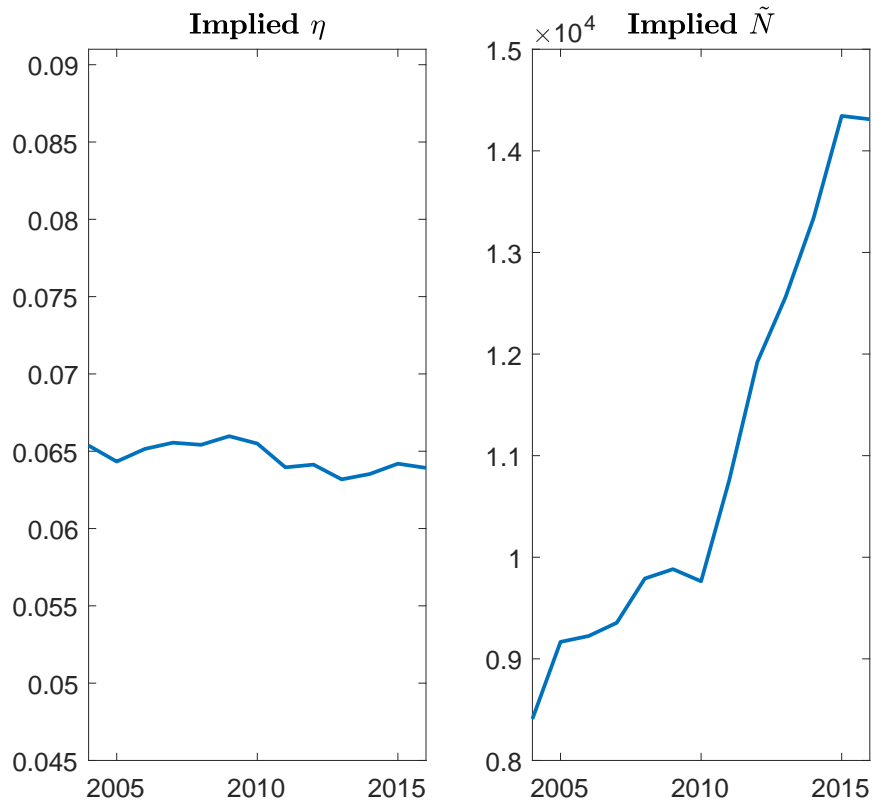
It turns out that our aggregate results are similar to those for most sectors. Growth in  $\tilde{N}$  is essential for explaining the rise in niche consumption even at the sector level, while  $\eta$  typically has not

<sup>33</sup>The hypergeometric function is defined as follows:  ${}_2F_1(a, b; c; z) = \sum_{n=0}^{\infty} \frac{(a)_n (b)_n}{(c)_n} \frac{z^n}{n!}$ .  $(x)_n$  is the Pochhammer symbol, which equals  $\frac{(x+n-1)!}{(x-1)!}$  for all  $n > 0$  and equals 1 for  $n = 0$ .

<sup>34</sup>We note that if each consumer's taste for each good remains fixed, and markups change for any reason, this would result in a change in the price-adjusted taste distribution and would affect the expressions above that were derived assuming that price-adjusted tastes were distributed a la Pareto. We explore this in more detail in Appendix B.2, but here note that in order to preserve the Pareto distribution of price-adjusted tastes in the face of increases in  $N$  and endogenous markups, the changes in tastes that we additionally require are relatively minor.

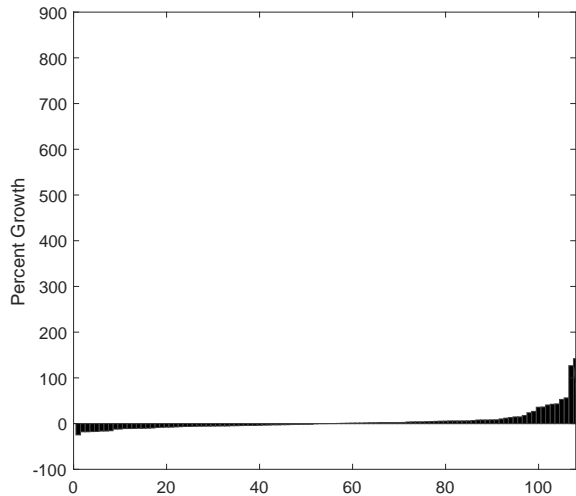
<sup>35</sup>What feature of the data implies that  $\eta$  barely moved? The proportional increase in Household Herfindahls was roughly the same as the proportional decrease in the number of goods consumed by a typical household. As can be seen in (39), this leaves little scope for any change in  $\eta$

**Figure 10: Implied Drivers of the Aggregate Rise of Niche Consumption**

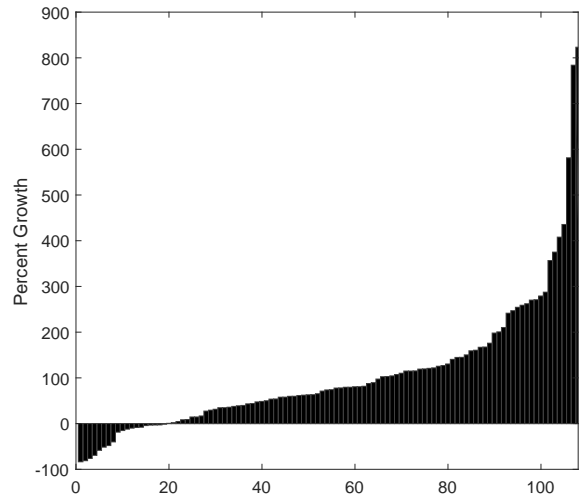


**Figure 11: Implied Drivers of the Sector-Level Rise of Niche Consumption**

**(a): Sectoral Distribution of Growth in  $\eta$**



**(b): Sectoral Distribution of Growth in  $\tilde{N}$**



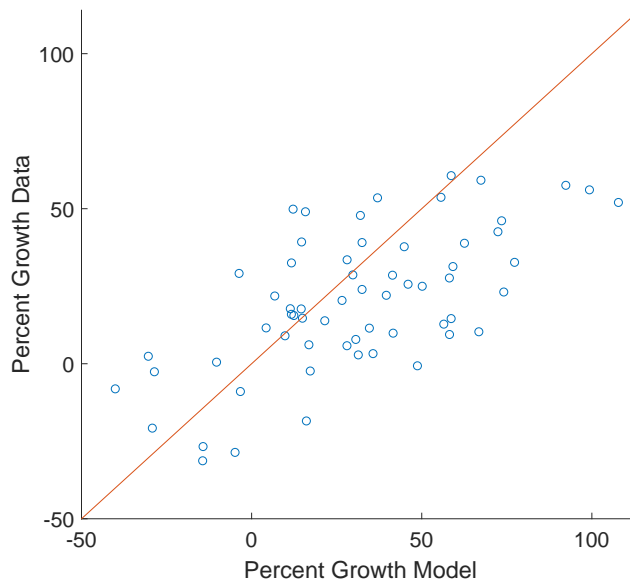
changed. Whereas  $\eta$  declined by 2 percent during 2004-2014 for the aggregate economy, the 25th to 75th percentile of sector-level growth in  $\eta$  over that period ranges from a decline of 7 percent to a rise

of 2 percent. Our inferred aggregate  $\tilde{N}$  grew by 70 percent, whereas the 25th to 75th percentiles for growth in the sectoral values ranges from 35 percent to 138 percent.

Increases in  $\tilde{N}$  can arise from increases in the importance of idiosyncratic taste shocks  $\alpha$  or in the number of available varieties  $N$ . Changes in  $\alpha$  are straightforward to interpret, since  $\alpha$  is simply an exogenous parameter governing preference heterogeneity. Our empirical results, however, show that the rise of niche consumption occurs pervasively across all of our narrowly-defined demographic groups. The within-group trends are far more important than across-group trends in generating our aggregate results. While this does not rule out increases in  $\alpha$  as a driving force, it seems unlikely that fundamental preferences within narrow groups have become dramatically more heterogeneous over a twelve-year period. Based on this logic, we hold  $\alpha$  fixed and interpret increases in  $\tilde{N}$  as increases in  $N$  in most of our model results.<sup>36</sup>

How do these implied growth rates for the number of available varieties in each sector compare to estimates from the data? As we have emphasized, measuring the total number of varieties purchased in the data can only be done with substantial noise (see Appendix A.3). However, Figure 12 plots the growth in sectoral varieties with at least \$100 in annual spending in the data against the model-implied growth in varieties for each sector  $j^*$ , the values shown in Figure 11b. The values are broadly consistent and clustered around the 45 degree line, which provides some direct confirmation of the model's inference.

**Figure 12: Consumed Variety ( $j^*$ ) Growth: Model vs. Data**



Finally, we note that while increases in  $N$  are necessary to fit the empirical patterns we emphasize, they are not sufficient. The implied increase in  $N$  matches the divergence between Household and

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<sup>36</sup> $N$  impacts the extent of selection effects while  $\alpha$  does not, so if one considers that growth in  $\tilde{N}$  is driven in part by growth in  $\alpha$ , the welfare gains discussed in the next section will be proportionately smaller.



Aggregate Herfindahls given the empirical decline in  $|\Omega|$ , but as shown in equation (15), increases in  $N$  on their own would counterfactually lead to increases in  $|\Omega|$ . This means that additional forces are required in order to fully fit the empirical trends.

Equation (15) shows that if  $N$  increases, declines in  $|\Omega|$  must reflect declines in measured real expenditures  $\left(E(1 + (1 - \sigma) / \theta)^{\frac{1}{1-\sigma}} b\right)$ , increases in effective costs per number of products consumed ( $F$  or  $\epsilon$ ), or declines in an “effective curvature” of utility term  $\left(\frac{1}{1-\sigma} - \frac{1}{\theta}\right)$ . Expenditures, however, increase in the data, and while changes in either  $\sigma$  or  $\theta$  could change the curvature term, they would have to change in a very particular way so as to match the decline in  $|\Omega|$  without leading to changes in  $\eta$ . We therefore find it most plausible that the decline in  $|\Omega|$  reflected an increase in  $F$  or  $\epsilon$ .<sup>37</sup> The exact change required to hit the data depends on the particular calibration, but as we show in the next section, this increase in fixed costs has only a modest effect on our welfare conclusions. Rather, our quantitative results are largely driven by the change in  $N$ .

#### 4.9 Implications of Rising Niche Consumption

What are the implications of the rise in niche consumption for welfare and market power? In order to assess this, we set all parameter values of the model to match key empirical moments in 2004, and then look at combinations of changes in  $N$ ,  $\sigma$ ,  $\theta$ , and the fixed costs of variety that fit the rise in niche consumption. One difficulty is that while we can identify  $\eta = 1 - 2(\sigma - 1) / \theta$ , we cannot separately identify  $\sigma$  and  $\theta$  and, as shown above, our model implies we cannot simply use existing estimates of the elasticity of demand as a proxy for  $\sigma$ . To get around this problem, we assume the aggregate markup  $\mu^{\text{Agg}}$  equals 1.15 in 2004.<sup>38</sup> We then use equation (38), together with our implied value for  $\eta$ , to calculate the implied values  $\sigma = 4.7$  and  $\theta = 7.9$ . Below, we consider robustness to this chosen target for  $\mu^{\text{Agg}}$ .

Having calibrated the key parameter values, we use the model to explore the welfare implications of several different counterfactuals. We begin by evaluating the implications of an increase in  $N$  equal to what we plotted in Figure 10, holding all other parameters fixed at their initial 2004 values. We then calculate the resulting change in household welfare, expressed as the percentage change in expenditures on the initial set of goods that would bring the same change in household utility as that delivered by the increase in  $N$ . Row (i) of Table 1 shows the resulting change in welfare, expressed as an annual growth rate. We find that a 70 percent increase from  $N_{2004}$  to  $N_{2016}$  generates total welfare

<sup>37</sup>While some technological advances such as the rise of the internet or better advertising technology might be expected to lower variety costs, it is also likely that increases in the number of available varieties  $N$  make it more costly to sort through and identify the particular products a household wants to purchase. An increase in  $F$  or  $\epsilon$  can be interpreted as a simple proxy for these latter forces when it is accompanied by the increase in  $N$ .

<sup>38</sup>This value for the aggregate markup is the preferred value in Edmond *et al.* (2018) and is close to other papers that employ a variety of methodologies. Other parameters are not important for our quantitative conclusions, but we set  $\alpha = 0.36$ ,  $\epsilon = 2$ ,  $E = 35$ ,  $b = 1$ , and  $F = 0.055$ .  $E$  is set to match average household category expenditures. Given  $b$  and  $\epsilon$ , we choose  $F$  to match  $|\Omega|$ .

gains of approximately 7.0 percent, or 0.56 percent per year. That is:

$$U_{2016} = \frac{E}{P_{N_{2016}}} - F \times (|\Omega_{N_{2016}}|)^{\epsilon} = 1.070 \times \frac{E}{P_{N_{2004}}} - F \times (|\Omega_{N_{2004}}|)^{\epsilon}, \quad (41)$$

where we change  $N$  and calculate the endogenous change in  $P$  and  $|\Omega|$ , but hold fixed all other parameters. Next, we perform similar counterfactuals but include changes in  $\epsilon$  or  $F$  to also match the change in  $|\Omega|$ . As shown in rows (ii) and (iii) of Table 1, implied welfare growth remains large at 0.46-0.47 percent, so that the effect of increasing fixed costs is quantitatively small relative to the increase in  $N$ . Finally, we add changes in either  $\sigma$  or in  $\theta$  to match the small implied decline in  $\eta$ , plotted in Figure 10. As shown in rows (iv) and (v), these additional changes have almost no effect on the results.

Table 1 also decomposes the welfare gains into four sources (that needn't sum exactly due to non-linearities). First, there are "Gains from Selection", which come from the third term in the ideal price index in equation (14) and emerge when  $|\Omega|/N$  decreases, implying that households consume products better suited to their particular tastes. These gains are the most important quantitatively. For example, in row (i), 0.52 of the 0.56 percent total annual welfare gains come from the "Gains from Selection" term. Second, changes in  $|\Omega|$  show up as standard love-of-variety effects on welfare, even if selection effects  $|\Omega|/N$  are held constant. Whether these "Gains from Variety" are positive, as in row (i) which does not match the observed decline in the number of varieties consumed by each household  $|\Omega|$ , or negative, as in the others which do match this decline in  $|\Omega|$ , gains or losses from variety are much smaller in magnitude than those from selection. Third, there are relatively minor welfare implications of changes in fixed costs brought about by changes in  $|\Omega|$ ,  $F$ , or  $\epsilon$ . Finally, in specifications where we change  $\sigma$  or  $\theta$ , there is a trivially small impact from changes in the "Average Price", which captures the changing price of purchasing a bundle of all available varieties. Overall, the conclusions from Table 1 are simple: the rise of niche consumption is associated with substantial welfare gains, and these arise almost entirely from greater selection as  $N$  increases.

If data were available at the household level to calculate a spending-weighted variety correction as in Feenstra (1994), one could properly recover welfare growth, as we show in Appendix Section B.1.8. However, the data necessary to confidently construct such measures at the individual household-level is seldom available. For instance, variety churn for the typical household in our data is incredibly large and variable and so such an exercise would produce a huge range of potential conclusions. Our approach instead is to use a model that points us to easily observable and relatively stable values from the data and specifies how to combine those values to assess changes in welfare. The approach has the additional merit of decomposing welfare gains into the terms emphasized in Table 1 and allowing us to run counterfactuals.

If, instead, one simply viewed our data through the lens of a representative household model with CES preferences, one could calculate a variety correction on aggregate spending following Feenstra

(1994). But, as is shown in Appendix Section B.1.8, the calculated welfare gains in this case would not coincide with the true household welfare gains. The Feenstra correction is derived in the context of a CES framework. Our model assumes that households individually have CES preferences, but the heterogeneity across households means that the aggregate economy in our model does not admit a representative household representation with CES preferences.

Heterogeneity in product consumption across households is crucial for capturing the divergent concentration trends in our data. Representative agent models abstract from this heterogeneity, and our results show that this can potentially lead to misleading conclusions about the welfare effects arising from changes in the number of products households consume.

**Table 1:** Annualized Welfare Growth (Compensating Expenditures)

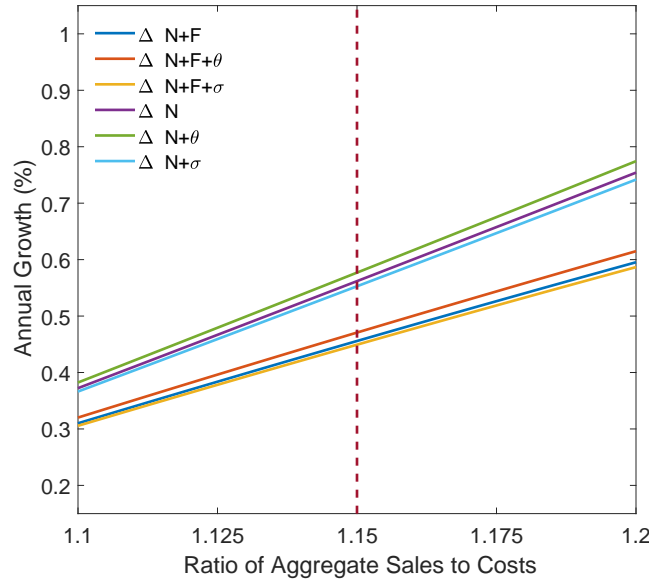
		<b>Total</b>	<b>Average Price</b>	<b>Gains from Variety</b>	<b>Gains from Selection</b>	<b>Fixed Costs</b>
		$d \ln E$	$\left(\frac{1+\theta-\sigma}{\theta}\right)^{\frac{1}{\sigma-1}}$	$( \Omega )^{\frac{1}{1-\sigma}}$	$( \Omega /N)^{\frac{1}{\theta}}$	$-F \times ( \Omega )^{\epsilon}$
(i)	$\uparrow N$	0.56%	0%	0.08%	0.52%	-0.05%
(ii)	$\uparrow N, \uparrow \epsilon$	0.47%	0%	-0.13%	0.62%	-0.02%
(iii)	$\uparrow N, \uparrow F$	0.46%	0%	-0.13%	0.62%	-0.04%
(iv)	$\uparrow N, \uparrow F, \uparrow \sigma$	0.45%	-0.001%	-0.14%	0.62%	-0.03%
(v)	$\uparrow N, \uparrow F, \downarrow \theta$	0.47%	-0.003%	-0.13%	0.63%	-0.04%

The welfare effects of increased product selection do depend importantly on  $\theta$ , which as noted above, we pin down by targeting an aggregate markup of 1.15 together with the initial  $\eta$  value in Figure 10. Figure 13 shows how implied welfare growth changes under alternative calibrations for the initial aggregate markup. The vertical dashed red line corresponds to our baseline calibration and the “Total” numbers in the first column of Table 1. For example, the yellow line intersects the red dashed line at 0.45 and corresponds to the counterfactual in row (iv) which fits the data by changing  $N$ ,  $F$ , and  $\sigma$ . The purple line intersects at 0.56 and corresponds to the experiment where we only increase  $N$ , as in row (1) of the table. Figure 13 shows that welfare effects remain large for a wide range of markup calibration choices.

What are the sectoral implications of the rise in niche consumption? As above, we do this identical calibration and counterfactual exercise at the sector level and report these results in Table 2.<sup>39</sup> Cate-

<sup>39</sup>We maintain  $E = 35$  in all categories but this is a normalization without loss of generality since we recalibrate  $F$  for each category to target that category’s  $|\Omega|$ . More substantively, we assume each sector’s aggregate markup also equals 1.15. If we instead impose a common  $\sigma$  and only use heterogeneity in  $\theta_c$  to match sectoral variation in  $\eta_c$ , we find similar welfare conclusions. To save space, and to minimize the influence of measurement error, we exclude small categories which account

**Figure 13: Robustness of Welfare Calculations to Calibration of  $\theta$  and  $\sigma$**



gories such as coffee, snacks, and soup all rank in the top 10 for welfare gains from the increase in the number of products. Not all sectors exhibit such gains, though. For example, the number of imputed product varieties declines, and leads to welfare losses, in eggs, cottage cheese, and frozen vegetables.

#### 4.10 Implications for Markups and Aggregate Profits

How large are changes in aggregate market power arising from the rise of niche consumption? It turns out they are very small. Aggregate market power does not vary at all with changes in  $N$ ,  $F$ , or  $\epsilon$ . These parameters have implications for the distribution of markups across products in the economy, since they impact  $j^*$  in equation (37), but changing them leaves the aggregate markup exactly constant, since  $j^*$  drops out of equation (38). More intuitively, this result arises from two opposing forces which exactly cancel when  $j^*$  changes. On the one hand, the  $j$ th good in an economy with a low  $j^*$  is closer to being the marginal consumed good and will therefore have a lower markup than the  $j$ th good in an economy with a high  $j^*$ . This can be seen in equation (36), which shows that the elasticity of demand is strictly increasing in the ratio of  $j$  to  $j^*$ . All else equal, this selection force raises aggregate markups. On the other hand, in an economy with greater product choice, the high-markup products account for a smaller share of aggregate spending. This competitive force from increasing  $N$  reduces aggregate markups. Equation (38) shows that in the aggregate, these opposing forces exactly cancel and the ratio of total revenues to total costs, or the aggregate markup, remains unchanged.<sup>40</sup> In specifications where

for less than 0.5 percent of all spending.

<sup>40</sup>This finding bears strong resemblance to results in Arkolakis *et al.* (2019), Edmond *et al.* (2018), and Autor *et al.* (2017) showing that in many models, entry often has a limited effect, if any, on aggregate markups. Across multiple specifications of demand and productivity, these papers demonstrate how the impact of changes in markups between existing or entering firms can cancel with changing weights of those firms in aggregate production or spending.

**Table 2: Sectoral Welfare Growth Associated with Rise in Niche Consumption, 2004-2016**

		Annual % $\Delta U$ with:			Annual % $\Delta U$ with:			
		$\Delta N$	$\Delta N, \Delta\theta, \Delta F$	$\Delta N, \Delta\sigma, \Delta F$	$\Delta N$	$\Delta N, \Delta\theta, \Delta F$	$\Delta N, \Delta\sigma, \Delta F$	
(1) Coffee		2.37	3.31	2.65	(33) Frozen Meats and Seafood	0.62	0.56	0.56
(2) Disposable Diapers		1.66	1.13	1.28	(34) Tea	0.61	1.11	0.76
(3) Snacks		1.40	1.47	1.37	(35) Canned Vegetables	0.59	0.44	0.34
(4) Prepared Deli Foods		1.39	1.44	1.33	(36) Vitamins	0.58	0.68	0.59
(5) Pet Food		1.37	0.99	1.02	(37) Beer	0.57	0.97	0.72
(6) Skin Care Preparations		1.36	1.26	1.21	(38) Pet Care	0.52	0.68	0.55
(7) Soup		1.33	1.07	1.04	(39) Hair Care	0.51	0.32	0.32
(8) Detergents		1.30	0.89	1.09	(40) Nuts	0.49	0.42	0.36
(9) Breakfast Food		1.21	0.96	1.01	(41) Crackers	0.42	0.42	0.30
(10) Pizza		1.15	0.78	0.94	(42) Cosmetics	0.41	0.92	0.50
(11) Carbonated Beverages		1.08	0.9	0.88	(43) Ice Cream	0.38	0.25	0.18
(12) Oral Hygiene		1.03	1.01	0.80	(44) Ready-to-Serve Foods	0.38	0.07	0.12
(13) Canned and Bottled Juice Drinks		1.01	0.71	0.74	(45) Household Cleaners	0.35	0.37	0.08
(14) Light Bulbs and Electric Goods		1.00	-0.62	0.50	(46) Wine	0.35	0.43	0.35
(15) Household Supplies		0.94	0.39	0.56	(47) Packaged Deli Meats	0.33	0.21	0.22
(16) Housewares and Appliances		0.94	0.01	0.57	(48) Desserts, Gelatins, and Syrup	0.32	0.15	0.09
(17) Personal Soap And Bath Additives		0.88	1.40	0.86	(49) Prepared Foods (dry mixes)	0.31	0.25	0.15
(18) Cookies		0.85	0.82	0.73	(50) Baking Supplies	0.31	0.31	0.15
(19) Condiments and Gravies		0.84	0.84	0.74	(51) Stationary and School Supplies	0.29	-0.32	-0.19
(20) Butter and Margarine		0.82	0.35	0.60	(52) Cough and Cold Remedies	0.14	0.21	0.11
(21) Cereal		0.81	0.54	0.57	(53) Spices, Seasonings, and Extracts	0.09	0.35	0.16
(22) Liquor		0.81	0.73	0.75	(54) Tobacco	0.01	-0.17	-0.11
(23) Jams and Jellies		0.78	0.82	0.65	(55) Packaged Milk	-0.01	0.27	0.08
(24) Medications		0.77	0.85	0.64	(56) Records and Tapes	-0.03	-1.43	-0.49
(25) Yogurt		0.76	0.97	0.72	(57) Salad Dressings and Mayonnaise	-0.09	-0.22	-0.30
(26) Laundry Supplies		0.74	0.58	0.42	(58) Frozen Vegetables	-0.14	-0.02	-0.19
(27) Cheese		0.74	0.95	0.82	(59) Non-Carbonated Soft Drinks	-0.17	-0.05	-0.15
(28) Batteries and Flashlights		0.71	0.08	0.22	(60) Paper Products	-0.68	-0.82	-0.71
(29) Candy		0.66	0.63	0.44	(61) Bread and Baked Goods	-0.75	-0.83	-0.79
(30) Prepared Frozen Foods		0.63	0.44	0.46	(62) Eggs	-0.91	-0.73	-0.79
(31) Milk (non-packaged)		0.63	0.69	0.59	(63) Cottage Cheese and Sour Cream	-1.22	-1.23	-1.14
(32) Wrapping Materials And Bags		0.62	0.30	0.29	(64) Photographic Supplies	-1.83	-6.48	-3.07

we also change  $\sigma$  or  $\theta$ , aggregate markups are no longer exactly fixed but resulting changes are tiny, rising by 0.02 percentage points if we vary  $\theta$  to hit the change in  $\eta$  and falling by 0.003 percentage points if we instead vary  $\sigma$  to hit the change in  $\eta$ .

Thus, even though markups are endogenous in our model and there are large diverging concentration trends, the rise of niche consumption in our model is associated with essentially no change in aggregate market power. Our model therefore shows how the economy can exhibit large changes in aggregate and household concentration without any change in aggregate market power. More generally, echoing the arguments in [Syverson \(2018\)](#) and [Berry et al. \(2019\)](#), our environment demonstrates that depending on what forces drive changes in concentration, it is possible for aggregate market power to concurrently increase or to decrease.

Finally, [Table 3](#) shows the corresponding changes in market power at the individual sector level when we again re-estimate our model sector by sector. We compute this by assuming that sector level changes in  $\eta$  are driven either entirely by changes in  $\theta$  (Column 1) or by changes in  $\sigma$  (Column 2). Overall, the conclusions mirror that from the aggregate analysis. The typical sector has essentially no change in aggregate markups, however there are a few sectors with non-trivial changes. Concentrating on the larger changes induced by  $\theta$  variation in Column 1, there are modest declines in markups in

photographic supplies, records and tapes, and lightbulbs. There are small increases in markups for coffee, soaps, tea, and cosmetics.

**Table 3:** Markup Changes Associated with Rise in Niche Consumption, 2004-2016

		Percentage Point $\Delta\mu^{Agg}$ with:		Percentage Point $\Delta\mu^{Agg}$ with:			
		$\Delta N, \Delta\theta, \Delta F$	$\Delta N, \Delta\sigma, \Delta F$	$\Delta N, \Delta\theta, \Delta F$	$\Delta N, \Delta\sigma, \Delta F$		
(1)	Photographic Supplies	-4.68	0.47	(33)	Eggs	0.05	-0.01
(2)	Records and Tapes	-0.89	0.09	(34)	Wine	0.05	-0.01
(3)	Light Bulbs and Electric Goods	-0.79	0.10	(35)	Vitamins	0.06	-0.01
(4)	Housewares and Appliances	-0.38	0.05	(36)	Snacks	0.06	-0.01
(5)	Butter and Margarine	-0.22	0.03	(37)	Milk (non-packaged)	0.06	-0.01
(6)	Detergents	-0.14	0.02	(38)	Cookies	0.06	-0.01
(7)	Household Supplies	-0.13	0.02	(39)	Canned Vegetables	0.07	-0.01
(8)	Batteries and Flashlights	-0.12	0.01	(40)	Condiments and Gravies	0.07	-0.01
(9)	Pizza	-0.12	0.01	(41)	Cough and Cold Remedies	0.07	-0.01
(10)	Disposable Diapers	-0.11	0.01	(42)	Prepared Deli Foods	0.07	-0.01
(11)	Paper Products	-0.09	0.01	(43)	Salad Dressings and Mayonnaise	0.07	-0.01
(12)	Stationary and School Supplies	-0.08	0.01	(44)	Prepared Foods (dry mixes)	0.08	-0.01
(13)	Cottage Cheese and Sour Cream	-0.08	0.01	(45)	Non-Carbonated Soft Drinks	0.08	-0.01
(14)	Tobacco	-0.05	0.01	(46)	Cheese	0.09	-0.01
(15)	Ready-to-Serve Foods	-0.03	0.00	(47)	Pet Care	0.09	-0.01
(16)	Breakfast Food	-0.03	0.00	(48)	Crackers	0.10	-0.01
(17)	Pet Food	-0.03	0.00	(49)	Candy	0.12	-0.02
(18)	Bread and Baked Goods	-0.03	0.00	(50)	Laundry Supplies	0.12	-0.01
(19)	Canned and Bottled Juice Drinks	-0.02	0.00	(51)	Frozen Vegetables	0.12	-0.02
(20)	Cereal	-0.02	0.00	(52)	Baking Supplies	0.12	-0.02
(21)	Liquor	-0.02	0.00	(53)	Spices, Seasonings, and Extracts	0.13	-0.02
(22)	Prepared Frozen Foods	-0.01	0.00	(54)	Jams and Jellies	0.13	-0.02
(23)	Packaged Deli Meats	-0.01	0.00	(55)	Medications	0.14	-0.02
(24)	Hair Care	0.00	0.00	(56)	Oral Hygiene	0.15	-0.02
(25)	Frozen Meats and Seafood	0.00	0.00	(57)	Packaged Milk	0.16	-0.02
(26)	Wrapping Materials And Bags	0.01	0.00	(58)	Yogurt	0.18	-0.02
(27)	Carbonated Beverages	0.02	0.00	(59)	Beer	0.20	-0.03
(28)	Soup	0.02	0.00	(60)	Household Cleaners	0.22	-0.03
(29)	Skin Care Preparations	0.03	0.00	(61)	Cosmetics	0.25	-0.03
(30)	Desserts, Gelatins, and Syrup	0.05	-0.01	(62)	Tea	0.25	-0.03
(31)	Ice Cream	0.05	-0.01	(63)	Personal Soap And Bath Additives	0.37	-0.05
(32)	Nuts	0.05	-0.01	(64)	Coffee	0.46	-0.06

## 5 Conclusions

This paper empirically documents a rise in what we call "niche" consumption. Households are increasingly concentrating their spending. This pattern, however, does not appear to be driven by the emergence of superstar products. Rather, households are increasingly buying different goods from one another. The increase in segmentation seen in many other walks of modern life also applies to consumption: our grocery baskets look less and less similar. As a result, aggregate spending has become less concentrated.

We develop a new model of product demand in order to explore the drivers and implications of the rise in niche consumption. In our model, households choose how many products to consume, spend different amounts on each good, and differ from other households in their choice of which products to buy. The model delivers simple analytical expressions for household and aggregate concentration indices, and these closed form solutions allow us to match the model to data and infer the drivers of our

empirical findings. Increases in product availability played a critical role in the divergent concentration trends, and led to welfare gains from households being able to consume a subset of products that better satisfied their tastes. This welfare effect is not found in standard statistics such as the price indices produced by national statistical agencies. Finally, our model delivers endogenous and heterogeneous markups. Matching the trends in household and aggregate concentration carries implications for the distribution of markups, but does not imply changes in aggregate market power.

Our model highlights the importance of greater product choice but treats the set of available products as an exogenous parameter. We suspect the nature of product introduction and development, however, reflects recent progress in supply chain integration, big-data marketing research, targeted advertising, and the growing importance of online sales. Unpacking the product innovation process and relating it to these important trends is a fruitful avenue for future research on consumption behavior and the measurement of consumer welfare.

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