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.

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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? Many standard models cannot be used to answer these questions 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.\footnote{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-}
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 an individual household follows Li (2018) and features constant elasticity of substitution (CES) preferences, product-specific taste shocks, and a utility cost borne per variety consumed. Under these assumptions, the household chooses to consume only a subset of the total available products. When tastes for products, adjusted for 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.

To move from an analysis of an individual household to an analysis of aggregate spending, we introduce a continuum of households that are identical except for the ordering of their preferences across products. We assume that all households have tastes that decline identically from their favorite product to their second favorite, and so on, so all households have identical taste distributions. However, the actual identities of these first- and second-favorite products 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 reduces its price, it expands sales to existing customers with a constant elasticity, but it 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.

The closed-form analytical solutions for various aggregates that arise from our particular parametric assumptions in turn deliver precise conclusions about identification. This is important 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 estimated.


derson households, it is common for multiple products to be simultaneously purchased in a single category, as we shown in Appendix A.3.
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 various configurations are consistent with the data.\footnote{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.}
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.3

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? Surprisingly, 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.4 Even more broadly, our model demonstrates how any given trend in concentration can

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3For 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.

4Similar conclusions also obtain when we compute aggregate market power trends separately for each of the product
be associated with an increase or a decrease in aggregate market power depending on the underlying structural forces driving the trend.\footnote{Interestingly, this means our framework can accommodate comovement between concentration and aggregate markups from changes in preferences alone, unlike a representative CES setup.}

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 (2018) and Arkolakis, Demidova, Klenow, and Rodriguez-Clare (2008). We extend this to an environment with heterogeneity in which different households have heterogeneous but potentially correlated tastes for different 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.\footnote{For example, Handbury and Weinstein (2014) emphasize the need to account for differences in variety availability when comparing the price level across U.S. cities. Redding and Weinstein (2016) demonstrate how welfare measures can be biased if they do not account for heterogeneity in consumer tastes across products. Atkin, Faber, and Gonzalez-Navarro (2018) use similar scanner data on grocery purchases to calculate the welfare gains associated with entry of global retail chains into the Mexican market.}

Unlike most of that tradition, however, 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 like Feenstra (1994) or Broda and Weinstein (2004, 2006).\footnote{While representative agent CES models can be rationalized through an underlying discrete choice representation with heterogeneity (Anderson, de Palma, and Thisse (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.\footnote{See, for example, Hausman (1996), Petrin (2002), and Brynjolfsson, Hu, and Smith (2003).} 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). The typical IO approach allows for substantial flexibility in household demand but also typically requires rich data on product characteristics and is computationally intensive to estimate. 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 groups, although there are a few exceptions such as photographic supplies.
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, Paciello, and Pozzi (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, Lee, and Moreira (2018a,b) show 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, Dorn, Katz, Patterson, and Reenen (2017) and Furman and Orszag (2015). Our finding that household and aggregate concentration trends move in opposite directions is reminiscent of Rossi-Hansberg, Sarte, and Trachter (2018), who demonstrate that concentration trends also diverge when comparing measures done at the zip-code 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, Redding, and Weinstein (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, Midrigan, and Xu (2018), Stroebel and Vavra (2019), Anderson, Rebelo, and Wong (2018), and Burstein, Grassi, Carvalho, 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, Gaynor, and Morton (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
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. 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 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.

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.

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.

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.
In our baseline analysis, we define a product as a Universal Product Code (UPC). Appendix Figure A8 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, although each generic has a unique UPC, all generics are assigned the same brand in order to preserve the anonymity of the stores in the Nielsen sample. Sales of generics are large and growing, so their inclusion, by construction, distorts concentration measures that define products as brands. 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 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).

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:

$$H_{i,c,t}^{HH} = \sum_j (s_{i,j,c,t})^2. \quad (2)$$

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12 See, for example, Dube, Hitsch, and Rossi (2018). Our robustness checks using the brand definition of product exclude generics. Results using UPCs also remain qualitatively robust if we exclude generics.

13 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.
Next, we take the weighted average across households to generate the Household Herfindahl for product category $c$:

$$H_{c,t}^{HH} = \sum_i share_{i,c,t} H_{i,c,t}^{HH},$$  \hspace{1cm} (3)

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

$$share_{i,c,t} = \frac{\sum_j (\omega_{i,t} E_{i,j,c,t})}{\sum_i \sum_j (\omega_{i,t} E_{i,j,c,t})},$$  \hspace{1cm} (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:

$$H_t^{HH} = \sum_c share_c H_{c,t}^{HH},$$  \hspace{1cm} (5)

where $share_c$ 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 $H_t^{HH}$ and reveals a nearly monotonic increase in household concentration from 2004-2016. In Appendix A.3, we show that this increase in concentration is also associated with a decline in the average number of products consumed per household within a product category. We delay interpreting the quantitative magnitude of these changes until we develop our model in Section 4 but note now that fitting this series with a linear trend yields a precise and highly significant estimate.

### 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, Dorn, Katz, Patterson, and Reenen (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:

$$s_{j,c,t} = \frac{\sum_i (\omega_{i,t}E_{i,j,c,t})}{\sum_i \sum_j (\omega_{i,t}E_{i,j,c,t})},$$  \hspace{1cm} (6)$$

and the Aggregate Herfindahl in category $c$ as:

$$H_{c,t}^{\text{Agg}} = \sum_j (s_{j,c,t})^2.$$  \hspace{1cm} (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:

$$H_t^{\text{Agg}} = \sum_c \text{share}_c H_{c,t}^{\text{Agg}}.$$  \hspace{1cm} (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 view these divergent trends and resulting fragmentation of the product space as characterizing a rise in niche consumption.

The decline in aggregate concentration might, at first, seem at odds with the rise in sales concentration measured in Census data by papers including Autor, Dorn, Katz, Patterson, and Reenen (2017). Our aggregate concentration measure, however, captures expenditures at the product level
whereas Census-based estimates aggregate products up to the producer level.\textsuperscript{14} The resulting trends may therefore differ significantly, particularly in the face of changes in the number of goods each manufacturer produces.

In Appendix A.4, 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.

\subsection{3.4 The Pervasive Rise of Niche Consumption}

This rise in niche consumption – the increase in the Household Herfindahl and decrease in the Aggregate Herfindahl – is highly robust to various measurement related choices. For example, Appendix Figures A6-A12 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.

Is the rise of niche consumption driven by shifts in the importance of different groups, such as old and young or rich and poor? While there are differences in the level of concentration across different

\textsuperscript{14}The categories within which we calculate concentration are also far less aggregated and cover a smaller set of economic activity than what is done in most Census-based studies. Further, our data begin in 2002, far later than the 1970s or 1980s start date commonly found in that literature.
groups, the trends are primarily driven by within group variation. To show this, we re-calculate annual Household and Aggregate Herfindahls using only expenditures by households with particular demographic characteristics such as income bracket, race, education, and age. Figures 2a and 2b 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.

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 3 shows that the rise of niche consumption is pervasive across product categories, with three-quarters of product categories exhibiting increases in $H_{c,t}^{HH}$, 80 percent of product categories exhibiting decreases in $H_{c,t}^{Agg}$, and growth in the niche ratio in over 90 percent of the categories.

In Appendix Figure A13, 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 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. Finally, Appendix Figure A14 shows that the rise in niche consumption is found within roughly two-thirds of the individual retailers in our data.

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15While we primarily emphasize trends, the level differences in household concentration are similar to those documented in Hansen and Singh (2015). For example, older households, households with less members and poorer households have more concentrated spending. See also Bornstein (2018) for an analysis of age-specific results.

16To improve visual exposition, Figures 3 and 4a 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.
so the aggregate patterns we observe are not simply driven by shifts in where households shop.17

Figure 3: 2004-2016 Concentration Growth Within Category

(a): Household Concentration

(b): Aggregate Concentration

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 3 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 4a, 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 4b 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 percent-

17We have also explored the importance of changes in the frequency of shopping and bulk purchasing emphasized in Coibion, Gorodnichenko, and Koustas (2017) and found they were unimportant for these trends.
age points more growth in their niche ratios, with the relationship again significant at the 1 percent level.\textsuperscript{18} The relationship between variety growth and the niche ratio becomes even steeper if we weight retailers by size.

\textbf{Figure 4: Growth in Number of Products vs. Growth in Niche Ratio}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{Figure4.png}
\caption{(a): Product Groups (b): Retailers}
\end{figure}

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 5\textsuperscript{a} 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 5\textsuperscript{b} shows that when focusing only on continuing products, aggregate concentration actually rises instead of declines.\textsuperscript{19}

Together these results all imply that whatever forces are driving the rise in niche consumption, they are pervasive across demographics, geographies, retail chains, and product categories.

\textsuperscript{18}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.

\textsuperscript{19}We can further decompose intensive margin concentration trends into price versus quantity effects. Appendix Figure A15 shows that changes in quantity rather than price are more important.
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.

Following Li (2018), we assume that households must pay a fixed cost per consumed product, which implies they only consume a subset of available products despite their CES preferences that embed a love-of-variety. As in Arkolakis, Demidova, Klenow, and Rodriguez-Clare (2008), we assume each household’s tastes for products, adjusted for price, are distributed Pareto, which allows us to write the Household Herfindahl analytically. Further, we assume a particular function form for the rank function that specifies how the preference ordering of products differs across households, which allows us to write the Aggregate Herfindahl analytically. 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 $E$ on a continuum of varieties $k \in [0, N]$ to maximize:

$$U_i = \left( \int_{k \in \Omega_i} \left( \gamma_{i,k} C_{i,k} \right)^{\frac{\sigma - 1}{\sigma}} dk \right)^{\frac{\sigma}{\sigma - 1}} - F \times (|\Omega_i|)^{\epsilon}, \quad (9)$$
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 $k$, and the term multiplied by $F$ captures a fixed cost that increases exponentially in the measure of varieties consumed.\footnote{To ease notation, we do not include a household subscript $i$ for each $k$, but importantly note that $k$ is an arbitrary household-specific index of products, and so the same $k$ may represent a different actual product for each different household. This is unimportant for the analysis of individual households, but will be crucial when we move to the aggregate analysis.}

We write the price of product $k$ as $p_k$, so $\tilde{\gamma}_{i,k} = \gamma_{i,k} / p_k$ captures the price-adjusted taste of household $i$ for $k$. We assume price-adjusted tastes are distributed Pareto:

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

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 Household Herfindahl. We also assume $\epsilon > 1/(\sigma - 1) - 1/\theta$, which implies that higher fixed costs $F$ lead to less purchased products $|\Omega_i|$. Household $i$ will consume the set of goods with $\tilde{\gamma}_{i,k} \in [\tilde{\gamma}^*, \infty)$ for some $\tilde{\gamma}^* \geq b$.

The ideal price index in this environment will be equal for all households and is defined as:

$$P_i = \hat{P} = \left( \int_{k \in \Omega_i} (\tilde{\gamma}_{i,k})^{\sigma-1} \, dk \right)^{\frac{1}{\sigma}} = \left( 1 + \frac{1 - \sigma}{\theta} \right)^{\frac{1}{\sigma}} b^{-1} \times \left( \frac{|\Omega_i|}{N} \right)^{\frac{1}{\theta}} \times \left( \frac{|\Omega_i|}{N} \right)^{\frac{1}{\theta}}. \quad (10)$$

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 (10) reduces to more standard expressions in special cases. For example, consider $\theta \to \infty$, which implies that households value all products identically at $b$, i.e. $\tilde{\gamma}_{i,k} = b$ for all $k$. In such a 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:

$$U_i = \frac{E}{\tilde{P}} - F \times (|\Omega_i|)\epsilon.$$  

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

$$|\Omega_i| = |\Omega| = \left( \frac{\left(\frac{1}{\sigma - 1} - \frac{1}{\theta} \right) \left(1 + \frac{1}{\sigma} \right)^{\frac{1}{\sigma - 1}} N^\frac{1}{\sigma}}{\tilde{P} \epsilon} \right)^{(\epsilon - \frac{1}{\sigma} + \frac{1}{\theta})^{-1}},$$  

(11)

where $\tilde{P} = F/(bE)$ is a parameter that shifts with spending, aggregate prices, and variety costs.\textsuperscript{21} Importantly, the optimal choice of varieties yields a “cutoff” taste $\tilde{\gamma}^*$ that satisfies:

$$G(\tilde{\gamma}^*) = 1 - \frac{|\Omega|}{N},$$  

(12)

and the share of household $i$’s expenditure on variety $k$ is then given by:

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

(13)

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

### 4.2 Household Herfindahls

Given equation (13), it follows that the Household Herfindahl $H_{\text{HH}}^i$ will be equal for all $i$ and can be written as:

$$H_{\text{HH}}^i = H_{\text{HH}}^i = \int_{k \in \Omega_i} (s_{i,k})^2 dk = N \int_{\tilde{\gamma}_{i,k}^*}^{\infty} (P_{i,k}^{\tilde{\gamma}_{i,k}})^{2(\sigma - 1)} dG(y) = \frac{(\eta + 1)^2}{4\eta} \frac{1}{|\Omega|},$$  

(14)

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 $|\Omega|$, 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.

How well does this model fit household spending data? Interpreting our model as applying to each household’s spending decisions for a given product category $c$ in a given year, we have the testable prediction from equation (14) that $H_{\text{HH}}^{i,c}$ is proportional to $1/|\Omega_{i,c}|$. Indeed, when we pool categories,

\textsuperscript{21}When $N = 1$, this expression is the same as that in Li (2018) after substituting in his special case for $b$. 

17
years, and households and regress $\ln |\Omega_{i,c}|$ on $-\ln H_{i,c}^{HH}$ (with category-year fixed effects), we get a coefficient of 0.89, which is close to the model-consistent value of 1, and a large $R^2$ of 0.82. The upper left panel of Figure 6 shows a binscatter (with category-year fixed effects) of the 54 million observations underlying this regression to demonstrate that linearity with a coefficient of 1 is a close approximation to the raw data. In the upper right panel, we estimate these regressions separately for each category in 2016 and plot a histogram of the estimated slopes. The values are largely clustered around the model-consistent value of 1.

Next, rather than estimating the slope, we constrain it to equal 1 and back out the $\eta_c$ values implied for each category. The model imposes the restriction that $0 < \eta_c < 1$ and the bottom left panel of Figure 6 shows that this restriction is satisfied in every category. The values of $\eta_c$ range from lows of 0.08 (Baby Food) and 0.10 (Carbonated Beverages) to highs of 0.69 (Greeting Cards) and 0.97 (Yeast).

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22 This specification has large explanatory power even though it only allows $\eta$ to vary across category-years and not across households. With arbitrary heterogeneity in $\eta$ across households within category-years, there would be as many parameters as observations so it would be trivial to perfectly fit the data.

23 The value of 0.08 for baby food implies that the typical household in this category has spending which is almost 4 times more concentrated than if that household spent evenly on all the baby food products they consumed, while the value of 0.97 for yeast implies that household spending in that category is essentially evenly divided across products. With homogeneous tastes across products (i.e. $\theta \to \infty$) – the setup in many standard models – we cannot capture this large extent of sectoral heterogeneity in concentration.
Finally the lower right panel shows that the $R^2$’s from these restricted regressions are generally high. Overall, we conclude that the empirical relationship between household-level concentration measures and the number of consumed products is consistent with the relationships implied in our model.

### 4.3 Aggregation

In order to account for divergent trends in household and aggregate concentration measures, we must specify how tastes for particular products differ across households. 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. Households will consume all goods with $r_{i,j} \leq |\Omega|$.

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

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

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 cumulative distribution function (CDF) of product ranks $R(r)$, integrating over all households and products. Without loss of generality, we assume $\alpha < 1/2$ and write:

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

(16)

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 $R(r_{i,j}) \leq |\Omega|/N$.

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24Note that in contrast to the arbitrary household-specific product index $k$ above, the product index $j$ is common to all households.

25Replacing $\alpha$ with $1 - \alpha$ in all instances in equation (16) 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.
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.\(^\text{26}\) 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 \( \tilde{\gamma}_{i,j} = G^{-1} \left( 1 - R(r_{i,j}) \right) \), the spending share of household \( i \) that is dedicated to product \( j \) can be written as a function of \( j \)'s rank:

\[
s_{i,j} = P^{\sigma - 1} \tilde{\gamma}_{i,j}^{\sigma - 1} = (Pb)^{\sigma - 1} \left( R(r_{i,j}) \right)^{-\frac{\sigma - 1}{2}} = \frac{1}{2} N^{\frac{\rho - 1}{2}} |\Omega|^{-\frac{\rho + 1}{2}} \left( R(r_{i,j}) \right)^{-\frac{\rho - 1}{2}},
\]

if \( R(r_{i,j}) \leq |\Omega|/N \), and zero otherwise. To determine the products for which the share \( s_{i,j} \) in equation (17) jump 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 (16) under the assumption that \( 0 \leq \frac{|\Omega|}{N} < \frac{\alpha}{2(1-\alpha)} \), we get:

\[
r^* = \left( 2\alpha (1 - \alpha) |\Omega|N \right)^{\frac{1}{2}}.
\]

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. 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.\(^{26}\)

\(^{26}\)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.
Solving for this cutoff, \( j^* = r^*/(1 - \alpha) \), we get:

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

(19)

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 (15) into the expression (18), and using the definition of \( j^* \) in equation (19), we can write the highest value or cutoff random draw \( x_j^* \) that yields positive consumption of \( j \) as:

\[
x_j^* = \frac{1 - \alpha}{\alpha} (j^* - j).
\]

(20)

4.4 The Aggregate Herfindahl

We now use equations (17) and (20) to integrate spending shares across households \( i \) to get the aggregate spending share on good \( j \):

\[
s_j = \frac{1}{|\Omega|} \int_{j=0}^{j^*} s_j^2 dj = \frac{\eta + 1}{2} \int_{0}^{\eta^{-\frac{1}{\eta}}} \int_{0}^{x_j^*} (R ((1 - \alpha) j + \alpha x))^{\eta^{-\frac{1}{\eta}}} dx + \int_{x_j^*}^{1} \int_{0}^{\eta^{-\frac{1}{\eta}}} (R ((1 - \alpha) j + \alpha x))^{\eta^{-\frac{1}{\eta}}} dx \frac{1}{N}
\]

(21)

Using equations (19) and (21), we immediately obtain the Aggregate Herfindahl:

\[
H_{\text{Agg}} = \frac{2}{2\eta + 1} \left( \frac{1}{|\Omega|} \right)^{\frac{1}{2}}
\]

(22)

where we define \( \bar{N} = Na/(1 - \alpha) \). Aggregate concentration declines monotonically with \( \bar{N} \). 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 \( H_{\text{HH}} \) and \( H_{\text{Agg}} \) and implies an important role for increases in \( \bar{N} \).

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 using the same weights as were used in equations (3)-(5). We then solve for the two remaining free parameters, \( \eta_c \) and \( \bar{N}_c \), to match \( H_{\text{HH}}^c \) and \( H_{\text{Agg}}^c \) in equations (14) and (22). Figure 7 then plots the market share distribution across products implied by our model in equation (21) (the red dashed line) against the actual market share distribution in the data (the solid blue line). We
weight across categories and do this for total spending in Figure 7a as well as separately for a number of product categories in Figure 7b. In several categories such as cereal and yogurt, the model fits extremely well, while it is notably less successful in others such as greeting cards or canned seafood. Overall, however, we consider these good fits as validating our use of the model, particularly given the distributions are fully determined by only three parameters and reflect parametric assumptions and functional forms chosen largely for analytical convenience.27

4.5 Elasticities of Demand, Markups, and Aggregate Profits

The previous sections develop analytical expressions for our key empirical objects: $H^{HH}$, $H^{Agg}$, 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 4.6. 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

27 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 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 7, strike us as more compelling.
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:

$$s_j = \frac{1}{N} \int_0^{x_j^*} s_{i_{x,j}} dx,$$  \hspace{1cm} (23)

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 (23) with respect to $p_j$ to get:

$$\frac{\partial s_j}{\partial p_j} = \frac{1}{N} \left( \int_0^{x_j^*} \frac{\partial s_{i_{x,j}}}{\partial p_j} dx + s_{i_{x,j}} \frac{\partial x_j^*}{\partial p_j} \right),$$  \hspace{1cm} (24)

where the right hand side of equation (24) follows from Leibniz’s rule. The first term can be solved using equation (17) as:

$$\frac{\partial s_{i_{x,j}}}{\partial p_j} = (1 - \sigma) \frac{s_{i_{x,j}}}{p_j},$$  \hspace{1cm} (25)

where we take the aggregate price index $P$ as fixed. Moving on to the second term, we can evaluate equation (17) at the marginal household with taste $x_j^*$ to get:

$$s_{i_{x^*,j}} \frac{\partial x_j^*}{\partial p_j} = \eta + \frac{1}{2} N \frac{\eta - 1}{|\Omega|} (R(r^*))^{\frac{\eta + 1}{2}} \frac{\partial x_j^*}{\partial p_j},$$  \hspace{1cm} (26)

Substituting equations (25) and (26) back into equation (24), we get:

$$\frac{\partial s_j}{\partial p_j} = (1 - \sigma) \frac{1}{p_j} \frac{1}{N} \int_0^{x_j^*} s_{i_{x,j}} dx + \frac{1}{N} s_{i_{x,j}} \frac{\partial x_j^*}{\partial p_j} = (1 - \sigma) \frac{s_j}{p_j} + \frac{\eta + 1}{2N|\Omega|} \frac{\partial x_j^*}{\partial p_j}.$$  \hspace{1cm} (27)

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.\(^{28}\) To compute $\partial x_j^* / \partial p_j$, we

\(^{28}\)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.
start with the relationship:

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

(28)

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 \( \gamma_{i,j} = \gamma^* \) yields:

\[ \frac{dx_j^*}{dp_j} = -\frac{\theta}{j^*} |\Omega| N \frac{1}{p_j}. \]  

(29)

Inserting this into equation (27), we have:

\[ \frac{\partial s_j}{\partial p_j} = (1 - \sigma) \frac{s_j}{p_j} - \frac{\eta \theta}{2 \left(1 - \left(\frac{i}{j^*}\right)^\eta\right)} \frac{1}{p_j}. \]  

(30)

Equation (30) implies that product \( j \)'s price elasticity of demand \( \epsilon_j \) can be written as:

\[ \epsilon_j = 1 - \frac{\partial s_j}{\partial p_j} \frac{p_j}{s_j} = \sigma + \left(1 - \left(\frac{i}{j^*}\right)^\eta\right)^{-1} \frac{\theta}{2 - (\sigma - 1)} > \sigma. \]  

(31)

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 elasticity of demand increases as market share falls.\(^\text{29}\)

Figure 8 plots aggregate product market shares \( s_j \), the elasticity of demand \( \epsilon_j \), 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 \( j \to j^* \) and a product approaches the point where it is dropped from the aggregate consumption bundle, the elasticity approaches infinity, i.e. \( \epsilon \to \infty \). The markup \( \mu_j \) then be written (in gross terms)

\(^{29}\)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 echoes 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.
Figure 8: Elasticity of Demand for Good \( j \)

as:

\[
\mu_j = \frac{\varepsilon_j}{\varepsilon_j - 1} = \frac{\sigma + \frac{\theta(\eta+1)}{2j^*s_j}}{\sigma + \frac{\theta(\eta+1)}{2j^*s_j} - 1} \tag{32}
\]

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 equations (21) and (31), it can be written as:

\[
\mu^{\text{Agg}} = \frac{\int_0^{j^*} s_j dj_j}{\int_0^{j^*} s_j \frac{\varepsilon_j - 1}{\varepsilon_j} dj_j} = \left[ \frac{\theta + (\sigma - 1)^2}{\sigma^2} - \frac{1}{2} \frac{\eta \theta^2}{\sigma^2} \left( \frac{\eta + 1}{2 + \theta} \right) \right] \times 2F_1 \left( 1, 1; \frac{1}{\eta}; \frac{1}{2 + \theta} \right)^{-1}, \tag{33}
\]

where \( 2F_1(\cdot) \) is the hypergeometric function.\(^{30}\) Importantly, while this aggregate profit share is a relatively complicated function of \( \sigma \) and \( \theta \), it is not a function of \( \hat{N}, F \), or \( e \).\(^{31}\)

\(^{30}\)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 \( n = 0 \).

\(^{31}\)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.
4.6 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:

\[
\mathcal{H}^{HH} = \frac{(\eta + 1)^2}{4\eta} \frac{1}{|\Omega|} \quad (34)
\]

\[
\mathcal{H}^{Agg} = 2\frac{(\eta + 1)}{2\eta + 1} \left( \frac{1}{2\bar{N}|\Omega|} \right)^\frac{1}{2} \quad (35)
\]

Since \(\mathcal{H}^{HH}, \mathcal{H}^{Agg},\) and \(|\Omega|\) are directly observable in the data, this produces a system of two equations – (34) and (35) – that can be solved to determine \(\eta\) and \(\bar{N}\) for each year. Figure 9 shows the time-series for \(\bar{N}\) 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 \(\bar{N}\). From 2004-2016, \(\eta\) falls by 2 percent while \(\bar{N}\) rises by 70 percent.

Figure 9: Implied Drivers of the Aggregate Rise of Niche Consumption

As above, we can interpret our model as applying at each individual sector and apply equations (34) and (35) 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 9, this allows us to generate time series for these parameters for each sector. Figure 10a plots the distribution of implied growth (in percent terms) from 2004-2016 of $\eta$ for each sector, and Figure 10b plots the same for the implied growth of $\tilde{N}$.

**Figure 10: Implied Drivers of the Sector-Level Rise of Niche Consumption**

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

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

It turns out that our aggregate results represent well the sectoral results. Growth in $\tilde{N}$ is essential for explaining the rise in niche consumption even at the sector level, while $\eta$ typically has not 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.\(^{32}\)

How do these implied growth rates for the number of available varieties in each sector compare to

---

\(^{32}\) $\tilde{N}$ 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.
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 11 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 10b. The values are broadly consistent and clustered around the 45 degree line, which provides some direct confirmation of the model’s inference.

**Figure 11: Consumed Variety ($j^*$) Growth: Model vs. Data**

![Graph showing consumption variety growth](image)

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 Aggregate Herfindahls given the empirical decline in $|\Omega|$, but as shown in equation (11), 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 (11) shows that if $N$ increases, declines in $|\Omega|$ must reflect declines in measured real expenditures $\left( E \left( 1 + (1 - \sigma) / \theta \right)^{1/\sigma} b \right)$, increases in effective costs per number of products consumed ($F$ or $\epsilon$), or declines in an “effective curvature” of utility term $\left( \frac{1}{1 - \sigma} - \frac{1}{\theta} \right)$.\(^{33}\) 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 $\epsilon$.\(^{34}\) The exact change required to hit the data depends on the particular calibration, but as we show in the next

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\(^{33}\)Real measured expenditures equal $E$ divided by the expression labeled “Average Price” in equation (10).

\(^{34}\)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 $N$. 

28
4.7 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 equals 1.15 in 2004, or \( \mu^{\text{agg}} \). We then use equation (33), together with our implied value for \( \eta \), to calculate the implied values \( \sigma = 4.7 \) and \( \theta = 7.9 \).\(^{35}\) 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 9, 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 gains of approximately 7.0 percent, or 0.56 percent per year. That is:

\[
U_{2016} = \frac{E}{P_{N_{2016}}} - F \times(|\Omega|_{N_{2016}})^c = 1.070 \times \frac{E}{P_{N_{2004}}} - F \times(|\Omega|_{N_{2004}})^c,
\]

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 9. 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 (10) and emerge when \( |\Omega|/N \) decreases, implying that households consume

\(^{35}\)This value for the aggregate markup is the preferred value in Edmond, Midrigan, and Xu (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 \( a = 0.36, \epsilon = 2, E = 35, b = 1, \) and \( F = 0.055 \). \( E \) is set to match average household category expenditures. Given \( b \) and \( \epsilon \), we choose \( F \) to match \( |\Omega| \).
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 $|Ω|$ show up as standard love-of-variety effects on welfare, even if selection effects $|Ω|/N$ 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 $|Ω|$, or negative, as in the others which do match this decline in $|Ω|$, 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 $|Ω|$, $F$, or $ε$. Finally, in specifications where we change $σ$ or $θ$, 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 one simply viewed our data through the lens of a representative household model with CES preferences, it might be natural to only consider the love-of-variety losses in column 3 of Table 1 and misleadingly conclude that welfare declined from 2004-2016, since the typical household consumes fewer varieties in 2016 than in 2004. 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. Alternatively, one could calibrate a representative agent model purely to aggregate variety counts. However, as we emphasize in Appendix A.3, aggregate variety growth cannot be measured with much precision so this exercise produces a huge range of potential conclusions.

|         | Total $d \ln E$ | Average Price $\left(\frac{1+\theta-\sigma}{\theta}\right)^{\frac{1}{\sigma}}$ | Gains from Variety $\frac{1}{|Ω|^{\frac{1}{\sigma}}}$ | Gains from Selection $\frac{1}{|Ω|/N}^\frac{1}{\theta}$ | Fixed Costs $-F \times (|Ω|)^{\varepsilon}$ |
|---------|-----------------|---------------------------------|----------------------|-----------------------------|-----------------------------|
| (i)     | ↑ $N$           | 0.56%                           | 0%                   | 0.08%                       | 0.52%                       | -0.05%                     |
| (ii)    | ↑ $N$, ↑ $ε$    | 0.47%                           | 0%                   | -0.13%                      | 0.62%                       | -0.02%                     |
| (iii)   | ↑ $N$, ↑ $F$    | 0.46%                           | 0%                   | -0.13%                      | 0.62%                       | -0.04%                     |
| (iv)    | ↑ $N$, ↑ $F$, ↑ $σ$ | 0.45%                     | -0.001%             | -0.14%                      | 0.62%                       | -0.03%                     |
| (v)     | ↑ $N$, ↑ $F$, ↓ $θ$ | 0.47%                     | -0.003%             | -0.13%                      | 0.63%                       | -0.04%                     |

The welfare effects of increased product selection do depend importantly on $θ$, which as noted
above, we pin down by targeting an aggregate markup of 1.15 together with the initial \( \eta \) value in Figure 9. Figure 12 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 12 shows that welfare effects remain large for a wide range of markup calibration choices.

**Figure 12: Robustness of Welfare Calculations to Calibration of \( \theta \) and \( \sigma \)**

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. Categories 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.

### 4.8 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 extremely 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 (32), but changing them leaves the aggregate markup exactly constant,

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36In doing so, we assume each sector’s aggregate markup also equals 1.15. If we instead impose a common \( \sigma \) and only use heterogeneity in \( \theta \), to match sectoral variation in \( \eta \), we find similar welfare conclusions. To save space, and to minimize the influence of measurement error, we exclude small categories which account for less than 0.5 percent of all spending.
Table 2: Sectoral Welfare Growth Associated with Rise in Niche Consumption, 2004-2016

<table>
<thead>
<tr>
<th></th>
<th>Annual %ΔU with:</th>
<th>Annual %ΔU with:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ΔN, ΔN*, ΔF</td>
<td>ΔN, ΔN*, ΔF</td>
</tr>
<tr>
<td></td>
<td>AN, AN*, AN*ΔF</td>
<td>AN, AN*, AN*ΔF</td>
</tr>
<tr>
<td>(1) Coffee</td>
<td>2.37</td>
<td>3.31</td>
</tr>
<tr>
<td>(2) Disposable Diapers</td>
<td>1.66</td>
<td>1.13</td>
</tr>
<tr>
<td>(3) Snacks</td>
<td>1.40</td>
<td>1.47</td>
</tr>
<tr>
<td>(4) Prepared Deli Foods</td>
<td>1.39</td>
<td>1.44</td>
</tr>
<tr>
<td>(5) Pet Food</td>
<td>1.37</td>
<td>0.99</td>
</tr>
<tr>
<td>(6) Skin Care Preparations</td>
<td>1.36</td>
<td>1.26</td>
</tr>
<tr>
<td>(7) Soup</td>
<td>1.33</td>
<td>1.07</td>
</tr>
<tr>
<td>(8) Detergents</td>
<td>1.30</td>
<td>0.89</td>
</tr>
<tr>
<td>(9) Breakfast Food</td>
<td>1.21</td>
<td>0.96</td>
</tr>
<tr>
<td>(10) Pizza</td>
<td>1.15</td>
<td>0.78</td>
</tr>
<tr>
<td>(11) Carbonated Beverages</td>
<td>1.08</td>
<td>0.9</td>
</tr>
<tr>
<td>(12) Oral Hygiene</td>
<td>1.03</td>
<td>1.01</td>
</tr>
<tr>
<td>(13) Canned and Bottled Juice Drinks</td>
<td>1.01</td>
<td>0.71</td>
</tr>
<tr>
<td>(14) Light Bulbs and Electric Goods</td>
<td>1.00</td>
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<tr>
<td>(15) Household Supplies</td>
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<td>(16) Housewares and Appliances</td>
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</tr>
<tr>
<td>(17) Personal Soap And Bath Additives</td>
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</tr>
<tr>
<td>(18) Cookies</td>
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</tr>
<tr>
<td>(19) Condiments and Gravies</td>
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<td>0.84</td>
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<tr>
<td>(20) Butter and Margarine</td>
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<td>0.35</td>
</tr>
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<td>(21) Cereal</td>
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<td>(22) Liquor</td>
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</tr>
<tr>
<td>(23) Jams and Jellies</td>
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<td>(24) Medications</td>
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<td>(25) Yogurt</td>
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<td>(26) Laundry Supplies</td>
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<td>(27) Cheese</td>
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<td>(28) Batteries and Flashlights</td>
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</tr>
<tr>
<td>(29) Candy</td>
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<td>0.63</td>
</tr>
<tr>
<td>(30) Prepared Frozen Foods</td>
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<tr>
<td>(31) Milk (non-packaged)</td>
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</tr>
<tr>
<td>(32) Wrapping Materials And Bags</td>
<td>0.62</td>
<td>0.30</td>
</tr>
</tbody>
</table>

since \(j^*\) drops out of equation (33). 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 then the \(j\)th good in an economy with a high \(j^*\). This can be seen in equation (31), 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 (33) 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. In specifications where 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 gener-
ally, echoing the arguments in Syverson (2018) and Berry, Gaynor, and Morton (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 $\Delta \mu$ with: | $\Delta N, \Delta \delta, \Delta F$ | $\Delta N, \Delta \sigma, \Delta F$ | $\Delta N, \Delta \delta, \Delta F$ | $\Delta N, \Delta \sigma, \Delta F$ |
| (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) Light Bulbs and Electric Goods | -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           | 0.00            | (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 | 0.02         | -0.02           |
| (21) Liqueur                    | -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) Package 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 would be difficult to find using standard statistics such as measured price indices. 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.
References


