An overview of the theory of Microeconomics (consumer behaviour and market structures) in fast food marketing

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1. Introduction

The current global fast food marketplace is characterized by different players’ competing for the attention of consumers who are much diversified. The diversity in effect determines their behaviour and attitude towards different products and services offered by fast food companies. The microeconomic theory of consumer behaviour provides the framework for analyzing and understanding buyer behaviour (Schiffman and Kanuk, 2000). Schiffman and Kanuk (1997) define consumer behaviour as “the behaviour that consumers display in searching for purchasing, using, evaluating and disposing of products, services and ideas.” Schiffman and Kanuk (1997) further elaborated on their definition by explaining that consumer behaviour is therefore the study of how individuals make decisions to spend their available resources (time, money, effort) on consumption-related items.

Since consumers all over the world are dynamic especially with regards to their taste and preferences of food, it is important for fast food firms to understand the behaviour of consumers so as to develop strategies to respond to them effectively. Consumer behaviour is a complex process involving the activities people engage in when seeking for, choosing, buying, using, evaluating and disposing of products and services with the goal of satisfying needs, wants and desires (Belch and Belch, 2004). A number of factors; both internal and external have been found to influence consumer behaviour. These factors range from short-term to long-term emotional concerns (Hirschman, 1985; Hoch and Loewenstein, 1991). Understanding the process of how a purchase decision is reached is fundamental as this forms the foundation that can be used to analyze the impact of any given product in specific markets. Consumer buying decisions are also essential for developing the marketing strategies of firms. This is because the behaviour of consumers towards specific fast food products and services tends to affect the cost, profit and revenue of the firm.

The study of consumer behaviour is very important to marketers because it enables them to understand why people buy, so that they can effectively develop strategies that will predict consumer buying behaviour in the marketplace. The knowledge of consumer buying behaviour enables marketers to know why consumers buy particular products, when, where, how they buy it, how often they buy it, and also how they consume it as well as dispose it.

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The main objective of this paper is to examine the conceptual and theoretical tools in microeconomics (consumer behaviour and market structures) that will enhance the marketing practices of managers in the fast food industry.

2. The Economic Model of Consumer Behaviour

The interdisciplinary approach of consumer behaviour largely emphasizes on factors that influence the decision making process of consumers. According to Hamansu (2008), ‘the main objective of the study of consumer behaviour is to provide marketers with the knowledge and skills that are necessary to carry out detailed consumer analyses which could be used for understanding markets and developing marketing strategies’. Hence, the microeconomic theory of consumer behaviour as developed by Alfred Marshall is significant. The theory is based on the assumption that the individual is a rational buyer who has perfect information about the market, fully aware of his desires and needs and able to determine the best way to satisfy them. The global fast food industry fits into this market structure because it is monopolistic in nature. Given certain conditions, consumers behave in a similar fashion and every buying decision is a logical process with the ultimate goal of obtaining optimum value for the money they spend. Price is regarded as the strongest motivation. The theory deals with the influence of only price and income on consumer behaviour.

According to the Marshallian economic model, individual buyers will spend their income on goods that will offer the greatest satisfaction, depending on their taste and the relative prices of other goods. This brings to bear the income and substitution effect of consumer behaviour. In the Marshallian theory exists as a cardinal output the marshallian utility function. If a consumer can gain utility $U$ such that:

$$U = XY$$

Where $X$ and $Y$ represent quantities of two fast food brands

The consumer gets utility by having both fast food brand $X$ and fast food brand $Y$ as compliments, in increasing quantities, and is happiest when he or she has an infinite number of both $X$ and $Y$ (Colander, 2008). If the consumer is willing to exchange one unit of money for $\lambda$ units of utility, then, obviously, $\lambda$ is the marginal utility of money. In equilibrium, the marginal utility of money must be equal to the marginal utility of expenditure. The consumer's decision problem can be presented as:

$$z = u(x) - \lambda p'x,$$

Here, $z$ represents the maximum satisfaction whiles $x$ and $p$ are the consumption and the price vectors respectively, and $\lambda$ is the marginal utility of money. The values of $\lambda$ and $p$ are known. This equation represents Marshall’s ideology of maximum net satisfaction (Biswa, 1977).

One of the key analyses of "consumer behaviour" is the interaction between price changes and consumer demand. Fast food market all over the world is not a monopoly-controlled by one firm; there are other firms' competing for a share of consumers income. Aside the internationally known fast food chain firms, there are also local fast food joints found on the streets and corners of most busy cities in different countries. The product fast food firms’
offer can be seen as close substitutes which satisfy the same need. In most cases, the contents of the products are the same except the branding that differentiates them. From elementary economics, we learn that a reduction in the price of a fast food brand will result in a rise in the quantity demanded of that brand, ceteris paribus. However, this rise in the quantity demanded is due to the total price effect, which can be subdivided into two separate parts, the substitution effect (where both goods are substitutes) as in the case of fast food brands and the income effect (the amount of money the consumer wants to spend).

The substitution effect refers to the extra purchase of the fast food brand after the price falls, and it is relatively cheaper than other substitutes in consumption. The income effect refers to the rise in real income (purchasing power) now that the price of one commodity is lower within the bundle of commodities purchased by the consumer. This extra real income can potentially be used to buy more of all other commodities, including the fast food brand that has experienced a price fall (Mankiw, 2004).

\[ \text{Total price effect} = \text{substitution effect} + \text{income effect} \]

Consumers face trade-offs in their purchase decisions, since their income is limited and choices are numerous. In order to make choices, consumers must combine budget constraints (what they can afford), and preferences (what they would like to consume) (Colander, 2008). A budget constraint, means what a consumer can purchase is constrained by income. The slope of the budget constraint measures the rate at which a consumer can trade off one brand of fast food for another, and the relative prices of the two brands. Budget constraints are determined by both the income of the consumers, and the relative prices (Colander, 2008).

If a consumer equally prefers two product bundles of fast food, say fast food X and Y, then the consumer is indifferent between the two bundles. The consumer will get the same level of satisfaction (utility) from either bundle. The indifference curve shows that all the fast food brands are equally preferred, or have the same utility or same level of satisfaction. The slope of indifference curve is the rate at which a consumer is willing to trade one fast food brand for another, which is also known as the marginal rate of substitution (MRS).

Perfect substitutes have straight-line indifference curves. This means that as consumers get more of the good, they trade off with the substitute at a constant rate because they are indifferent between them (example fast food X and Y). Generally speaking, the better substitutes goods are, the straighter the indifference curve. The fast food market is such that, the consumer has lots of options and the products are usually undifferentiated (especially products of small scale enterprises operating in that sector) with little variations in taste. The consumer therefore has varied options to choose from and they could opt for more alternatives.

3. The optimal choice of Consumers’

It is essential to combine what a consumer can obtain (budget constraint) and the preferences (indifference curve). The optimum is the highest point on the indifference curve that is still within the budget constraint. This will usually occur where the indifference curve is tangent to budget constraint. At the optimum point, \( \text{MRS} = \text{relative prices of goods} \) since \( \text{MRS} = \text{slope of indifference curve} \), and \( \text{relative price} = \text{slope of budget constraint} \). The marginal rate of substitution is the rate at which consumers are willing to trade-off, and is equal to rate at which they can trade (Mankiw, 2004).
Changes in income will undoubtedly affect the optimal choice. The budget constraint will shift parallel to the original - upwards for an increase in income, and downwards for a decrease in income (Colander, 2008). The new equilibrium for a higher income will be on a higher indifference curve, and since income is higher, those customers who could not patronize more of fast food could now consume more since their disposable income has increased. For normal goods like fast food, as income increases, more of it will be preferred. But for inferior goods, as income increases, less of it will be chosen, ceteris paribus.

A change in price will change the slope of the curve. A fall in price will rotate the budget constraint outwards, and an increase in price will rotate the budget constraint inwards (Perloff, 2007). Thus a change in price will change both the relative prices of the two products and also the amount that can be bought, ceteris paribus (income) (Mankiw, 2006).

4. Marketing implications of the Consumer Behaviour theory

The value of the consumer behaviour theory in behavioural sciences can be viewed from varied viewpoints (Gould, 1979). The marshallian model indicates that the lower the price of say fast food brand X, the greater the sales. However, if the price of fast food brand Y (a substitute brand), is lowered compared to fast food brand X, the greater the sales of fast food brand Y - all other things being equal. Also, if the real income is higher, the sales of a fast food brand will be higher, provided it is not an inferior product, then; greater volumes of sales will follow as promotional expenditure is increased - ceteris paribus (Perloff, 2007). The firm will be able to influence its market share marginally by regulating the price at which it charges for its products.

Consumers play an important role in the economy since they spend most of their incomes on goods and services produced by firms. It is important for firms to understand the ultimate objective of the consumer. While firms are assumed to be maximizing profits, consumers are assumed to be maximizing their utility or satisfaction by consuming more goods and services (Mankiw, 2006). Nevertheless, consumers, like firms, are subject to constraints – their consumption and choices are limited by a number of factors, including the amount of disposable income. The decision to consume is described by economists within a theoretical framework usually termed the theory of demand.

The demand for a particular product by an individual consumer is based on four important factors. Firstly, the price of the product determines how much of the product the consumer buys, given that all other factors remain unchanged. In general, the lower the product's price the more a consumer buys that product. Secondly, the consumer's income also determines how much of the product the consumer is able to buy, given that all other factors remain constant. In general, a consumer buys more of a commodity the greater is his or her income. Thirdly, prices of related products are also important in determining the consumer's demand for the product. Finally, consumer tastes and preferences also affect demand.

The aggregate of all consumer demands yields the market demand for a particular commodity; the market demand curve shows quantities of the commodity demanded at different prices, given all other factors. As price increases, quantity demanded falls. Of all these, the firm operating in the monopolistic market as in the case of fast food industry can only control the price of its product (Mankiw, 2004). The firm can, to some extent influence the taste and preference of consumer through advertising.
Furthermore, individual consumer demands thus provide the basis for the market demand for a product. The market demand plays a crucial role in shaping decisions made by firms. Most important of all, it helps in determining the market price of the product under consideration which, in turn, forms the basis for profits for the firm producing that product. The quantity of fast food supplied by an individual firm in any country depends on profit and cost considerations. These firms will produce the profit maximizing output. Therefore, the total production of individual fast food firms will yield the market supply for a particular commodity; the market supply curve shows quantities of the commodity supplied at different prices, given all other factors. Hence, following the first law of supply as the price increases, the quantity supplied increases - ceteris paribus. The interaction between market demand and supply curves determines the equilibrium or market price that the firm can charge.

5. Is the consumer rational?

Although, the view of marketers on the consumer behaviour theory is rooted in the fields of psychology and economics, marketers see the theory of consumer behaviour as a modern development of economics. Marketers tend to embrace a more cognitive psychological approach to the behaviour of consumers by abandoning the rigid axioms of the economic model of consumer behaviour in order to portray in a realistic manner the behaviour of consumers (Silberberg 1990). In the microeconomic model of consumer behaviour, the consumer’s tastes and preferences (which cannot be observed) are elaborated upon, unlike factors that can be observed and measured such as constraints and opportunities. Tastes and preferences are difficult to observe, hence, the theory assumes that they remain constant in the period that they are measured – which does not reflect reality, and this constancy is a simplifying of assumptions. Hence, there should be a structure of preferences to adequately predict the changing choices of the consumer who is faced with changing opportunities and constraints. The structure of preferences as described by the theory of consumer behaviour is normative because instead of describing how consumers actually behave, it describes how they ought to behave.

The theory of consumer behaviour asserts that, the consumer as a rational person who endeavours to spend his or her income on products and services that yields the greatest level of satisfaction or utility. The trends and impact of marketing does not support the issue of rationality of the consumer as indicated in the theory of consumer behaviour. For example, in the fast food industry, consumers do not always engage in a rational behaviour but rather random behaviour. This is mainly because of the influence of advertising appeal and sales promotion which tends to make consumers buy on impulse without having to go through a lot of rational or mental deliberations on alternative options or the opportunity cost of the purchase decisions. Consumers are faced with so many alternatives of products and services. The brands that are put in the market are usually more important than the product itself. Currently, consumers encounter a wide range of products of different brands in similar product categories, hence, making it a lot more difficult to differentiate among products to make choices. Also, according to Poiesz (1993), the consumer is faced with a muddle communication messages on a daily basis that challenges their ability to receive and interpret the relevant information in the message. Poiesz (1993) further elaborates that, lately, consumers face less perceived risk when buying products, hence, they do not engage in an elaborate decision making process to reduce the risk associated with purchases.
6. Market structure and its implications on the profit, cost and revenue of fast food companies

In the fast food industries in different countries, there are a lot of options for consumers to choose from. The international fast food market follows the monopolistic market structure. They have the following characteristics:

- all the firms produce similar but not perfectly substitute products
- There are many producers and many consumers in a given market, and no business has total control over the market price.
- Consumers perceive that there are non-price differences among the competitors' products.
- Firms have a free entry and exit of the industry or market
- Producers have a degree of control over price, it means that none of them are price takers

The fast food industry might be said to be marginally inefficient because the firm produces at an output where average total cost is not a minimum and the market might be said to be a marginally inefficient market structure because marginal cost is less than price in the long run.

Figure 1: Short run position of the fast food firm

As indicated in the short run position above, when the firm is in equilibrium, it can maximize its profits and produce a quantity where the firm's marginal revenue (MR) is equal to its marginal cost (MC). In the short run, the firm is able to collect a price based on the average revenue (AR) curve. The (AR) curve also represents the demand curve (the total demand of the market). The difference between the firm’s average revenue and average cost gives it a profit. The profit in the short run is termed as abnormal profit and it is represented by the shaded area between P2 and AC/P1. The abnormal profits attract the attention of potential firms and hence this profit cannot be sustained in the long run.
A closer look at the fast food industry in most international markets confirms the assertion above. There are often lots of small scale market entrants who sell burgers, sausages among others (the brand names are usually varied and the products also reflects the culture of the country). These small scale firms sometimes operate close to large fast food chain brands. They compete though on a milder note to get the attention of consumers and scrap part of the profits (although sometimes marginal) of the large firms. However, an aggregate of all the new entrants will significantly affect the profit in the long run.

In the fast food market, firms have the freedom of entry and exit; therefore new firms will enter when there is an abnormal profit been earned by existing firms. The new entrants in the market increase supply and hence cause a fall in price. As the price falls, the AR and MR curves shift inwards because the revenue from each sale is now less. The shifts in the curves are depicted in Figure 2 below.

**Figure 2: Shifts in AR and MR as a result of the new entrants**

Furthermore, the availability of more fast food substitutes from the presence of new entrants in the market causes the new AR1 (D) curve to be more price elastic. Hence, the firm reduces output to a point where MC = MR (Q2). At this output, AR1 = AC and the firm will make normal profit. This is shown in the figure below.

![Figure 2: Shifts in AR and MR as a result of the new entrants](Source: Authors impression, adapted from Mankiw (2004))
The diagram in figure 4 gives rise to the long run equilibrium position of the fast food firm. The equilibrium position in the long run is depicted in the explanation diagram in figure 4 below.

From figure 4, it is seen that, the firm still produces where marginal cost and marginal revenue are equal; however, the demand curve (and AR1) has shifted due to the entrance of other firms in the market and increased competition. The abnormal profit that the firm earns in the short run (as indicated in figure 1) attracts other firms into the market to compete. The fast food firm can no longer sell its goods above average cost and therefore it can no longer
claim an economic profit. Therefore in the long run, the firm breaks even because the AC = AR = D. At that point, \( P = Q^2 \) and the fast food firm is able to supply just enough to break-even.

7. Strategies for competitive advantage

The marketing significance of monopolistic competition is that, it generates a situation where fast food firms have to invest in **advertising** and the creation of **brand names** in order to maintain and increase its market share. The brand name serves as a source of differentiation for the consumers. The fast food firms must guarantee the quality of their product through rigorous advertising campaigns. The advertising also helps reduce the cost to consumers as they do not have to weigh the tradeoffs of numerous competing brands.

Faced with a monopolistically competitive industry, consumers must collect and process information on different fast food brands in order to select their preference out of many brands. In many cases, the cost of gathering information to select the best brand can exceed the benefit of consuming it. Promotional activities such as advertising, discounts and sales promotion induces customers into spending more on fast food because of the emotional appeal rather than rational factors. Therefore, both below and above the line communication mix could be adopted to make the product of the firm competitive and consequently obtain a higher share of the market. There are unique information processing costs associated with selecting a brand in a monopolistically competitive market such as that pertaining to the fast food industry. Consumers use information obtained from advertising not only to assess the single brand advertised, but also to infer the possible existence of other brands in the market.

Each fast food firm independently sets the terms of exchange for its product. The firm gives no consideration to what effect its decision may have on competitors. The fact that there are "many firms" gives each fast food company the freedom to set prices without engaging in strategic decision making about other companies. This requirement ensures that each firm's actions have a negligible impact on the market. The firm can raise it prices without losing all its customers and can also lower prices without triggering a potentially damaging price war with competitors.

The fast food firm derives market power from the fact that it has fairy few competitors. Mostly, the competitors do not engage in strategic decision making and the products that are sold are undifferentiated from each other (thus, small scale fast food outlets usually recognized within local communities or a limited area without proper business), except for the large fast food chains which usually use branding, thus, packaging, logos and names to different their products, although the contents of the products are mostly the same. The market power also means that fast food firms face a downward sloping demand curve in the monopolistic market. Therefore, the demand curve is highly elastic although not "flat". Buyers know exactly what goods are being offered, where the goods are being sold, all differentiating characteristics of the goods and the price of the commodity.

However, the number of firms that the fast food market can support in the equilibrium depends on factors such as fixed costs, economies of scale and the degree of product differentiation. For example, the higher the fixed costs the fewer firms the market will support. Also the greater the degree of product differentiation, the more the firm can separate itself from the other firms and the fewer firms there will be in market equilibrium. Product differentiation arises from the manipulating of the elements of the marketing mix. According
to Kotler (2011), the marketing mix is still relevant in today’s business environment and it provides the building blocks around which all marketing activities revolve. The marketing mix includes product, price, promotion, place, physical evidence, people and process. These elements are elaborated below.

- The product aspect of the marketing mix refers to the tangible object, or an intangible service, that is produced on a large scale by the fast food firms. Intangible products are often service-based. The quality of a product is an integral part of brand identity especially when fast food firms want to obtain a large part of the market. In the fast food market, individual firms produce goods that are close but not perfect substitutes. The taste of these goods differs from one fast food outlet to another. Hence, because the taste of the product matters in consumer decisions, the contents of fast food must be of good quality to influence consumer preference.

- Price refers to the amount a customer pays for the product. McDonald and Sharp (2000) stated that price can be used as a reason by consumers when buying products. This is done mainly in two ways; firstly, the consumer either go for the lowest price in order to escape financial risk or the highest price in order to achieve product quality. The price of a product is determined by factors such as market share, competition, material costs, product identity and the customer's perceived value of the product. In the monopolistic market, firms have a degree of control over price, because they are not price takers, they can therefore manipulate their pricing strategy although it does not have repercussion on the profits of competitors. The perception of consumers about the non-price differences among competitors' products in the monopolistic market can be influenced through the use of the elements of the promotion mix. However, the pricing strategy must not have serious implications for the overhead cost of the firm.

- Promotion refers to all the various forms of communication that a firm may use in the marketplace. A product sold at attractive price in the market is not enough to ensure equity in a competitive market. In order to generate sales and profits, the benefits of products have to be communicated to customers, and this can be done through the promotion strategies of the firm. The holistic marketing communications programme of an enterprise is called the communication mix and it is a combination of tools such as advertising, personal selling, sales promotion and public relations tools.

- Place refers to the location where a product can be purchased. It is often referred to as the distribution channel and it puts products at outlets that are convenient to the consumers. According to Lin and Chang (2003), convenience of a brand has a significant effect on the consumer response. Consumers of fast food are usually looking for how quick and convenient it will be to have access to the offer when they need it. After all, that is the essence of the concept of “fast” food. This means that, an easy access to brand/product in store is vital when buying low involvement products such as fast foods.

- The impact that employees of a firm can have on branding cannot be underestimated. At its most obvious, the people element covers front line sales and customer service staff that have a direct impact on how the product and services rendered is perceived. Employee branding is an integral aspects of internal marketing and it includes the knowledge and skills of staff; their motivation and investment in supporting the brand.
The process part of the mix is about being ‘easy to do business with’. The more ‘high contact’ the product and the more intangible, the more important it is to get the processes right (Clarity Marketing, 2005). The process aspect of the marketing mix must be seen from the point of view of consumers. Within the components of the marketing mix, process is not only where and how customers will do business with the company but what added value is provided and how to develop relationships and provide an interactive experience. Process within the marketing mix includes not only how to promote and deliver the value created but also how to inform and support customers on an ongoing basis.

The physical evidence feature of the marketing mix includes all the tangible, visible touch points that the customer will encounter before they buy (Clarity Marketing, 2005). It includes things such as appearance and clothing of staff and the images included in the business brochure. Consumers often expect a clean, friendly environment when they enter fast food outlets. Consumers want to see evidence of the pricing of firms reflecting the product quality as well as the actual fulfilment of promises made in advertisements. The physical evidence of the fast food firm enhances its competitiveness and also contributes to providing a compelling experience for current as well as potential customers.

8. Conclusions

In conclusion, it must be emphasized that in as much as the fast food industry is monopolistic, the theory of consumer behaviour plays a significant role in the strategies that firms can adopt so command a competitive advantage. The consumer behaviour theory explains that, consumers are rational and they will like to optimize their utility. However, in a monopolistic market as in the case of the fast food industry in many countries, other variables such as the advertising and other promotional activities that the firm adopts as part of their marketing strategies has tremendous impact on the rationality of the consumer. Moreover, a number of factors also influence the decision making processes of consumers. Prominent among these factors is marketing communication and culture. The marketing communication mix has the effect of making consumers buy on impulse, thereby defiling the rationality that the consumer behaviour theory puts across. Also, since culture is not homogenous, the different cultural orientations contribute to the buying behaviour of consumers across countries.

References

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ABSTRACT
This paper provides an overview of the application of microeconomic theories in fast food marketing. The aim is to bring out the interrelationship between marketing and microeconomics with respect to the fast food industry. The paper examines some conceptual and theoretical tools that will enhance the marketing practices of managers in the fast food industry. Hence, the marketing aspects of international fast food firms are analyzed within the framework of the concept of consumer behaviour and monopolistic market structures. The paper further analyzes the market structures and its implications on the profit, cost and revenue of fast food firms. The concluding part of this paper brings out the marketing implications of the theory of consumer behaviour and market structures and also describes the strategies that firms in a monopolistic market can use to increase their bottom line, become competitive and increase their market share.

Keywords: fast food, marketing, consumer behaviour, market structures

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