

NETWORK MARKETING: A PRODUCT CHARACTERISTIC APPROACH

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ABSTRACT

Network Marketing Organizations (NMOs) are firms that employ independent distributors to buy and resell their products at retail and also to recruit new distributors. Amway Corporation, Shaklee, and Mary Kay Cosmetics are some of the more commonly known NMOs.

An interesting question that research on NMOs should look into is which products are more likely to be sold by these firms. The purpose of this research is to identify the characteristics which make a product more suitable for distribution through NMOs. Following Nelson (1974), we differentiate between experience and search attributes of a product. Search attributes are those product attributes that can be easily verified by inspection (e.g., color, style, size etc.). On the other hand, some product attributes (experience attributes) can be ascertained only after using the product (e.g., quality, reliability, durability etc.). Most goods have both experience and search attributes. Nelson (1974) points out that the correlation of consumer preferences is usually lower for search goods than for experience goods. Tirole (1988) also distinguishes between vertically and horizontally differentiated product characteristics. He defines a product characteristic space to be vertically differentiated if all consumers agree over the preferred mix of characteristics. For example, quality is a vertically differentiated product characteristic because most consumers agree that higher quality is preferable. As Tirole (1988) points out, everyone agrees that a more powerful computer is preferable to a less powerful computer or that a Volvo is preferred to a Hyuandi. In general, for most experience characteristics, there is a natural ordering over the product characteristic space that most consumers agree on. For search characteristics however, the preference ordering usually depends on the particular consumer. Consumers differ in their choice of colors. The style of a particular dress, too, may appeal to some but not to others. These are cases of horizontal differentiation.

An important characteristic of Network Marketing firms is that they perform little or no mass media advertising (see Coughlan and Grayson 1998). Instead, they mainly rely on word of mouth messages generated by their distributors and consumers to convey the characteristics of their products. Besides, most NMO distributors carry only a few samples of some of the products sold by their firm. Now, when the search characteristics of a product are relatively more important, (e.g., for products like clothes and shoes) the consumer often likes to

inspect, compare and try on the different variants that are available. NMOs provide little scope for trying out the different brands of these products and instead rely heavily on word of mouth advertising. However, since consumer preferences about the search attribute is assumed to be idiosyncratic, they cannot be transmitted by word of mouth advertising. Such products are therefore better sold through retail outlets.

Pre-purchase inspection and comparison of experience products however does not help the consumer ascertain the experience quality of a product. As pointed out by Nelson (1974), the advertisement message of the producer of an experience product, too, is without information content because the producer has an incentive to exaggerate the quality of his product. Thus the consumer has no way of inferring the actual quality of a product that is sold at a retail outlet. If the firm does Network Marketing, it is the NMO distributors who inform the consumers about the characteristics of the firm's product. In the absence of any costs of lying, these distributors too would have an incentive to maximize their monetary gains by exaggerating about the quality of the firm's product. However when these distributors sell to their close friends and acquaintances there are high costs of misleading information. While the distributor might make a few extra dollars by cheating his friends he also stands to lose their friendship and trust. For these reasons, most people would not enter the distributorship business unless they genuinely liked the products and believed in their qualities. As Biggart (1989) says, "... Perhaps more important however is the personalized way in which the product is presented, ... Because much direct selling goes on among members with existing social relations, the message can be powerful indeed: people are more likely to believe a friend than an impersonal media message." Coughlan and Grayson (1998) also point out that buyer seller relationships are of great importance in determining the success of a distributor. Frenzen and Davis' (1990) study has also supported the argument that the strength of social relations between the buyer and seller has a strong correlation with the likelihood of a sale. Thus it seems that for experience goods, information obtained from a friend working in an NMO is more credible and persuasive than the information obtained from media advertising. In fact, empirical evidence shows that word of mouth information from friends and relatives is more influential in consumers' purchase decisions than is any other form of advertising (see for example, Korgaonkar, Karson, and Akaah 1997).

In this paper, we assume that all products have both experience and search attributes. However the relative importance that the consumer assigns to these attributes varies from one product to another. We find that a firm producing a product whose search attributes are relatively more important, will choose traditional methods of retailing. However for products for which experience

attributes are more important, there are two countervailing forces at play. Network Marketing, using word of mouth messages, conveys the experience attributes better. However traditional retailing causes product awareness among a larger set of people. The relative magnitudes of these two effects determines which distribution method dominates.

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