

THE ECONOMIC THEORY OF LUXURY GOODS

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Abstract.

The main idea of the study is the research about the connection between theory of luxury goods and their practical aspects in the economy. This kind of goods are completely different than any other that exists on the market. In the theoretical part will be an explanation of what they are luxury goods and how their understanding has changed over time. The next step is to introduce and explain the concepts such as Giffen's Paradox and Veblen's Effect. These concepts explain how the theory works with practice about luxury goods.

Theoretical goal of this article is to explain how luxury goods are understood in economics as well as their understanding of customers changed over time. The practical aim is to check whether the theoretical approach to economics luxury is a reference in practice. It is worth to look through the eyes of customers on the theoretical aspects, because the patterns can be adjusted by the economic context. The study method was applied interview with the clients of a luxury brands, because they are only an attempt to correct research. This is because they participate in the economy of luxury.

The value of the research is their novelty, as well as the ability to being implement by the managers of luxury brands.

Keywords: luxury goods ; Giffen's Paradox ; Veblen's Effect.

Type of the paper: Empirical study.

JEL Classification: M21, M31, E21.

Introduction

There is no doubt that luxury goods have for centuries aroused in the minds of men the same desire to possess, subordinating all the thoughts, aspirations, aims and ambitions of man, directing him to successively acquire exclusive goods. Luxury is more than a term for a beautiful, expensive thing, it is a concept almost divine. Anyone who owns luxury products, from antiquity to modern times, suddenly becomes possessed of the qualities that glorify and dispense it into the minds of the outsiders, acquires traits that may not even possess such as wisdom, strength, pride, and courage. A man with luxury goods becomes a charismatic person, worth following for many people, trustworthy and wonderful in every possible way. Luxury goods, are not just things, are instruments that properly used can give its owner many new opportunities.

Luxury goods

In economics, a luxury good is one in which demand grows more and faster than an increase of the income of a potential buyers. It stands in opposition to "necessity" goods, for which demand grows much slower than income. Luxury goods are often the highest quality (Beierlein, 2014). Luxury services and goods are relative because it depends on many factors and prospects. Its relativity can be divided into: regional, temporal, economic, cultural and situational.

Regional Relativity - Depends on the regional availability of goods, some goods in some parts of the world are not very inexpensive, because they are generally available, and in other areas where they are deficient they are considered as a luxury goods such as walnuts, they are very popular in West Africa, and in Europe in the 19th century they were a luxury addition to cakes and wines (Merki, 2002).

Time Relativity - is a change in the perception of goods as a luxury over time. These changes determine social trends and technological progress. Technological progress has also made the above-mentioned regional good lose value because new methods of producing and transporting goods from the most distant corners of the world have made luxury goods ever more popular, such as tea, spices, sugar, tobacco, coffee and chocolate. The process of change is fastest in the case of products, that its prestige is determined by technological advances such as computers or mobile phones. Interestingly, the process is also going in the opposite direction, which means that products that were once considered to be everyday are now called luxury items such as natural flax, handmade shoes or down comforters, nowadays replaced by artificial textiles and mass production. Luxury goods are not stable and over time lose or gain their value (Heine, Sikora, 2013). In the twentieth century, the luxury embodied other objects that today are everyday objects:

- 1900: piano, radio, turntable, sewing machine, Ford T
- 1910: Fur cap, electronic clock, pen with nib, Kodak camera, transatlantic journey and Cadillac car.
- 1920: a fur coat, a gin, a vacuum cleaner, a washing machine and cinema movies with sound
- 1930: Sports ticket for example on baseball game, canning, running water and sewer at home
- 1940: television, refrigerator, plane trip, university diploma
- 1950: color television, credit card, Disneyland, cabriolet
- 1960: home stereo system, 35mm camera, works by Andy Warhol
- 1970: jeans pants, VCR player and VHS cassette, solar home heating
- 1980: chalet, BMW car, microwave oven, home computer, champagne
- 1990: TV pilot, mobile phone, Internet access, stock market investment, SUV car
- 2000: Flat screen TV, yacht, Maybach car, telephone with color display
- 2020: space tourism, transatlantic journey with own means of transport, eternal youth (Sacharidou, 2006).

Economic Relativity - is the difference in the perception of a luxury item depending on the prosperity of a particular person, for example, most people consider a watch costing EUR 500 for a normal thing, there are those who consider it a luxury as well as those for which even a watch for EUR 50 000 is not a luxury thing. Economic dependence also depends on the economy of the state or the entire region. For example, in European countries, a laptop is not a luxury, but in developing countries, for example, Africa is considered as the peak of luxury and a determinant of its well-being (Matsuyama, 2002).

Cultural Relativity - in every culture, luxury is understood as something that is neither ordinary nor necessary. This relativity does not depend on the availability of good but on the amount of demand for it. This means that one culture perceives one good as luxury, and another as ordinary or unnecessary, unwanted and useless. The example is champagne, which is a luxury commodity in Europe but in Muslim countries where alcohol is forbidden because of the religion, is an undesirable and superfluous commodity. Another example is the luxury Maserati car, which, in the eyes of a member of the savage tribe living in the Amazon basin, is completely useless. Each social group has its own synonyms of luxury, symbols of good taste and taste that the elites of a given group determine in order to classify their social status. Desires for luxury goods derive from cultural determinants that vary according to demographic variables such as age, sex or education. It follows that often members of the same cultural

family differ in the way they perceive luxury goods, which for some are prestige, and others for meaninglessness and not valuable. An example of this is another dimension of meaning, for example, a brand-name purse for a woman following trends and conscious fashion is synonymous of a luxury and prestige, and the same purse in the eyes of a much older woman, although raised in the same circle of European culture finds it as a supplement that is impractical, expensive, decadent, and extravagant. One can conclude from this that the characteristic symbols of luxury are the result of "learning" society, whether or not it is. Managers of prestige brands try to link their goods with values that are common to everyone and last forever, e.g. diamonds are a symbol of love and beauty (Berthon, 2009).

Situational Relativity - Depending on the situation, the same goods can be perceived as luxurious, necessarily needed, or ordinary. This relativity often refers to oriental food such as sushi, which is traditionally served in European countries as a very expensive meal, but in Japan this is the cheapest dish, and thus very common (Heine, Sikora, 2013)

Characteristics of luxury goods

Western civilization has unified the notion of luxury goods through the superior qualities that every luxury good has to possess. Every luxury property, regardless of its determinants, has several characteristics:

- excellent quality, craftsmanship, handmade item,
- very high price, which is abstract for most of the society,
- exception, rarity, individuality and uniqueness, not everywhere available,
- esthetic and peculiar beauty, good arouses admiration, the perception of beauty,
- inheritance, knowledge passed down through generations, tradition of manufacture,
- history of the brand the longer the better because it arouses trust and admiration,
- no practical utility, luxury is not necessary for existence (Kapferer, 1997).

Luxury goods, as described by J. Kapferer, "provide the owners with additional pleasure, act simultaneously on all senses and constitute an imminent distinguishing element of the ruling classes" (Kapferer, 1997). Psychological motives often determine the purchase of prestige goods, which are the determinant of wealth, good taste and nobility, and those who possess it makes social awakening and respect. Functionality and usability do not determine it purchase, so these goods are rarely treated as a practical or as the basic goods. Luxury goods are bought because they carry hedonistic and symbolic values. They are products that are unique, of high quality, emotionally attractive, and attract the attention of others (Mortelmans, 2005).

Researchers of luxury have linked the characteristics of luxury goods with character traits and, at the same time, the motives for buying customers:

- attention = willingness to demonstrate, for example, social status, nobility or good taste of the owner,
- note = snobbery, desire to show off the wealthy of the owner,
- social values = willingness to follow fashion and trends, the loyalty to the designer,
- emotional value = hedonism and love for beauty,
- high quality = perfectionism, craftsmanship, the best materials used in the production (Vigneron, 1999).

Consumers of luxury goods differently perceive them, because of cultural differences, in some environments prestige and glamour are respected and admired, while in other they cause disgust and mischief. Regardless of how perceiving luxury goods, they present four types of values that function within the luxury of goods. The first is the financial value that represents the price and is a specific investment of capital. Another is functional value that directly relates to quality, performance, uniqueness, usability and individuality of luxury. The third type of values are individual values that are related to material, emotional and hedonistic values. The last, fourth, value is the social value, e.g. the prestige, the demonstration effect and the manifestation of social status (Wiedmann, Hennings, Klarmann, 2012).

Luxury goods in the economics theories

There are only two types of goods in which the reverse right of demand is acting. According to the classic view, the higher the price of a product, the more demand is reduced. This is not a reference in practice to the lowest rank goods such as bread and rice, because according to Giffen's paradox, when consumers have very low incomes and yet they buy a good that has a high price, then the good must have no substitutes and be necessary to meet the needs of the lowest order. An example may be the rise in the price of bread in the second half of the nineteenth century in the United Kingdom, in spite of rising prices, demand also increased, especially in the poorest households, where bread expenses were very high in relation to total expenditure (Blaug , 1994).

The proportional phenomenon of Giffen's paradox is Veblen's effect on luxury goods and the richest social groups. It depends on the fact that the demand for luxury goods increases with their price, in this case it is combined with prestige, so it means that the fewer people have to pay for the right property, because it is expensive, the more luxurious and desirable it become. The cause of this phenomenon is the desire to show off of the richest social groups their social and economic status by means of their luxury goods. Researcher Veblen, said that simultaneously with the development of society arose the so-called "Vacuum

class", which is unproductive and does not contribute to the development of society, but is the main consumer of luxury goods. This class was present in all highly-hierarchy societies. T. Veblen believed that the cult of money and material goods influenced the very popular ostentatious consumption, idleness, and ambition of the wealthy people to possess luxury goods, which often leads to conflicts and bloody wars. Veblen's theory was only relevant to people who did not contribute anything to the development of society, and so it was sporadic, for the owners of luxury goods were royal families, politicians, educated people, and those with a lot of the money because of their own work (e.g. establishing their own companies). Veblen described what ostentatious consumption was and introduced this term into the theory of economics. As ostentatious consumption we call the attitude when we base on our own prestige and value on the desire to impress others with luxury goods, it is necessary to achieve mental comfort and inner complacency. The price elasticity of luxury goods is very small and if it change, it can only goes up, never down. Prices of luxury goods do not fall and there are no price promotions, it does not affect the demand and behaviour of its consumers (Veblen, 1971).

Income elasticity of demand is measured by the response of the demand for change in income. As a rule, income growth generates an increase in demand, but there are goods for which, on the contrary, means that with income growth decreases demand. Such goods are subordinate, for which there are slightly more expensive but better quality substitutes. As for luxury goods, the income elasticity of demand is always greater than 1, it means that the relative change in demand is usually greater than the relative change in income, which in practice means that the demand for luxury goods is quite flexible. Luxury goods are linked to Engel's law, which says that in the household, savings or higher-income goods appear only when there is a high income and basic needs are fully satisfied. One of Engel's curves defines the link between income growth and the rise in demand for luxury goods. Engel's laws refer, however, to middle-income families, who, with rising incomes, become affluent families (Varian, 2001).

Methodology

The survey is focused on selected by interviewer persons that represent interesting and tested qualities. The survey omits persons that do not have features which are being studied. An example is the study of the phenomenon of luxury goods, while respondents are the only owners of the exclusive items, are the observers of the luxury market or are the supporters of it. Every respondent had own, individual opinion about luxury goods. Individuals who for various reasons are not interested in luxury industry, were excluded from the study because they do not have the relevant experience and a clear opinion about the exclusive goods and luxury market(Lynn, 2014).

The survey was sent by email to people who are actively participating in the life of luxury industry, as well as fans of it. In a survey 134 people participated. The survey was conducted in January 2017 and in February 2017. Respondents had a very high degree of freedom of expression, because they could modify the questions and add their own observations and comments. Subjects were men and women, diverse in age, as the youngest tested person was 18 years old and the oldest 76. Age and gender had little significance as a major determinant. The main factor was the wealth of a person who can afford to be an owner of luxury goods.

Results

Respondents mostly associate the luxury product with the product made with the best materials and with the highest precision (34%). Another group of people identified an exclusive product with a well-known brand (28%). Much less popular was the response, indicating that the luxury product was a very expensive and hardly accessible product (8%). A small group of people pointed out that luxury goods are addressed to a narrow clientele (18%) and it is an attest to the high social status of its holder (12%).

1. What is the luxury product for you?

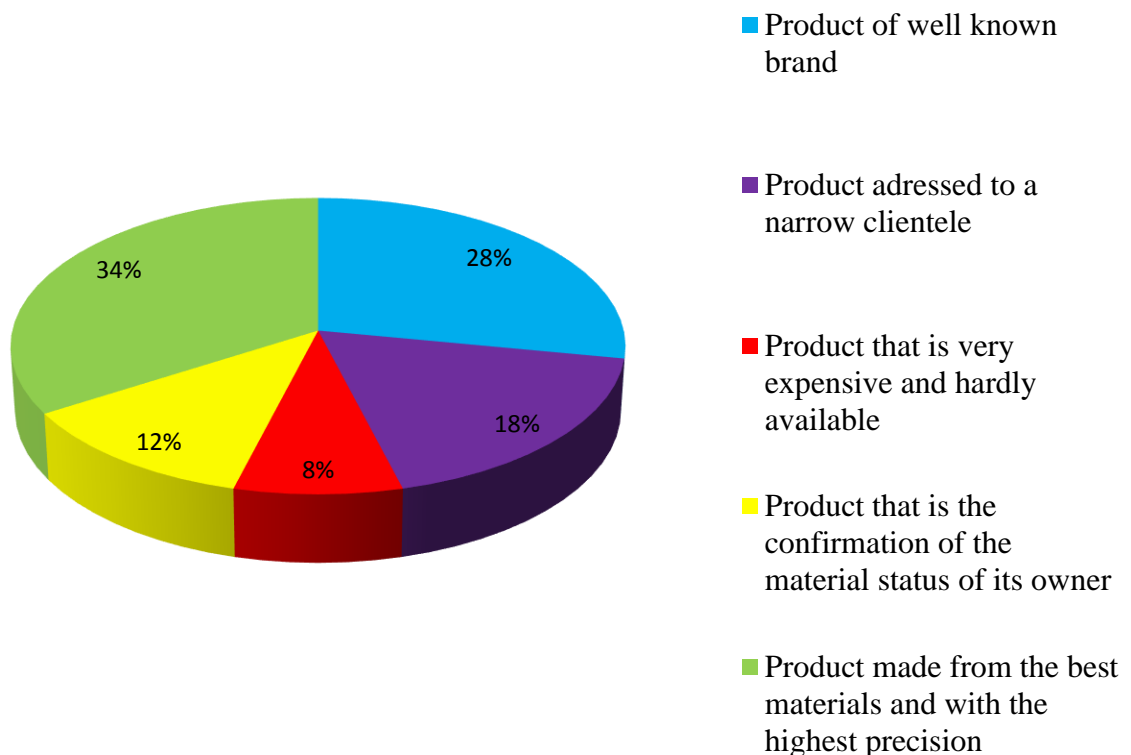


Fig. 1. Explanation of what Luxury goods are for its clients.

(Source: Own adaptation based upon data from the survey)

Nearly half of the respondents said that when they buy the luxury product the main determinant is the brand (41%), with half the group saying that the purchase decision was decided by the opinion about the product (21%). Another factor that facilitated the decision to purchase was own experience of the buyer (14%) and advertising influence (9%). The most notable factor was the quality of a product (7%), packaging (5%) and least significant price (3%).

2. Why do you buy the luxury product?

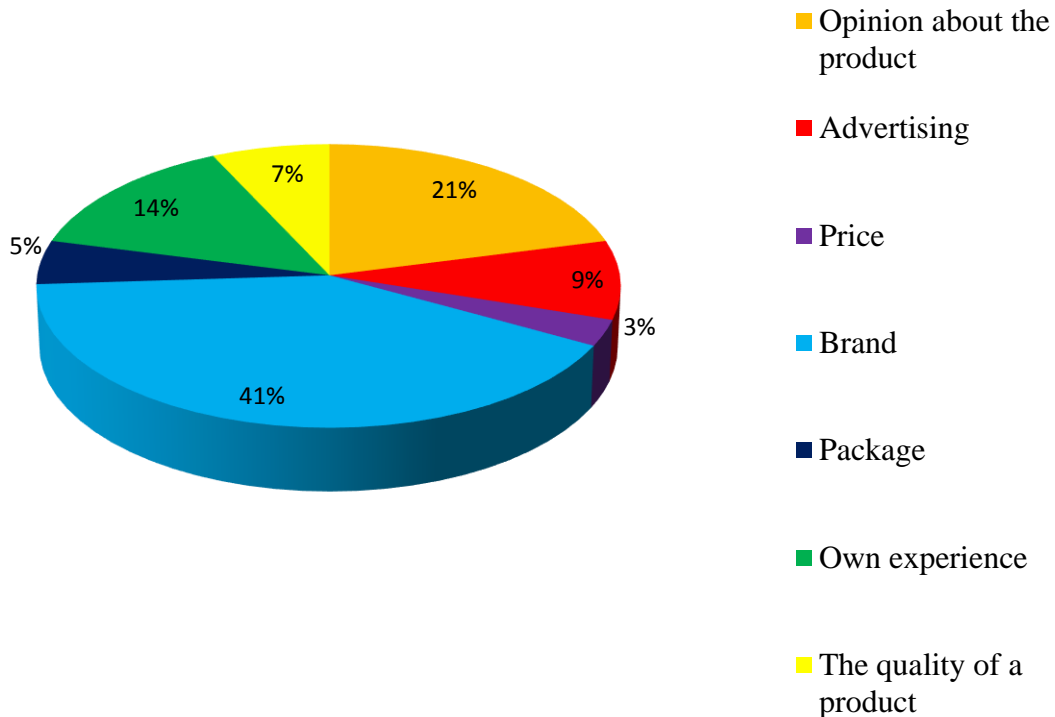


Fig. 2. Reasons why clients buy luxury goods.

(Source: Own adaptation based upon data from the survey)

Conclusions

Customers associate luxury items as a goods that are produced from the best materials and with the utmost precision. This means that clients appreciate a lot the quality of used materials and the artistry of the handmade manufacturing products. It is very important for them to buy a product that is made by the best qualified employees in the responsible companies.

Recognition of a particular luxury brand determines the customer's decision to purchase it. The biggest profits come from the brands that potential buyers know either from their own experience or from the experience of other known people. Recognizable brands are more profitable than any other lesser-known luxury brand. What is more, customers are more likely to buy a luxury brand that is recognizable even among people who are not customers of this brand than other, lesser-known luxury brands. The brand and the quality of luxury goods are the most important factors for buyers. It means that the price has no meaning for the clients. They does not pay attention to the price of the items because for them the most important is other factors.

Packaging is not important as customers choose to buy the same product that brings added value, such as the desired reaction of the environment or the timeless value of the product. This is also strictly connected to the effect of the high price. The higher amount of money is needed to make a purchase the bigger demand increase for some good. Customers finds added value not in a perfect packing, connected to the spirit of a brand but in an effect that they can create in the minds of other people.

Price is the least important factor. It follows that customers are able to pay a very high price for a branded product. The respondents evidently pointed out that price plays virtually no role in buying a luxury brand. Brand recognition, can set a very high price for their products, and yet customers will be willing to buy its goods, because they are willing to pay more for a luxury products as its shows off their wealthy and social status. Luxury products are some kind of an investment for its buyers. They invest into luxury products because they believe that the view of themselves in the eyes of others will quickly increase.

Buyers of luxury brands think of themselves differently than other consumers who do not buy luxury goods. Luxury brand clients are usually very affluent people. Most of their property comes from their own work and character traits such as industriousness, ambitiousness and perseverance in pursuit of their goals. Luxury goods serve them as a means of manifesting their social position and pride resulting from it. There is a large group of young people who consider luxury goods as a very good designation, and those who do not have them are seen as bad and not fashionably dressed.

The survey slightly shows that for the buyers of the luxury goods price does not have any meaning in the moment of buying. Price is one of the determinants of prestige and the determinant of whether or not the product is luxurious or not. An interesting phenomenon is that luxury customers are not interested in the price, and yet they want it to be high, because only then the good they buy is seen as luxurious by other people who often does not buy it, because of its very high price.

Undoubtedly, luxury customers want to buy exclusive goods because of its value over time, beauty, elegance and sophisticated taste associated with the art and craftsmanship of their production. Price is seems to be only visible sign of the not visible added value such as history of the brand or product, spirits of the company or main designer or the feeling of being somebody special.

Luxury is something that has no effect on location, historical circumstances, or economic situation, because it is governed by its own laws that are independent of anyone and nothing. The economics laws such as the Veblen Effect, the Giffen Paradox and the Engel's law perfectly describes the economy of the luxury market. The survey shows that the theory has the no doubt confirmation in the practice. The luxury does not pass away and lasts forever, only its determinants and their holders change during the time.

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