

A Study on Why Luxury Goods Sell and their Effects on the Economy

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Abstract. Despite recent global economic downturns starting from 2008, luxury goods have maintained their popularity as some of the most popular products in the world, while the sales of other goods have fallen significantly. In fact, the sales of luxury goods have increased in many cases. The aim of this paper is to identify the causes to this phenomenon, and go more in-depth into the consumer psychology of buying luxury goods. Recent statistics concerning the modern economy were examined, particularly the sales of luxury goods and their consistency in sales. After, the sales of luxury goods were studied from the perspective of consumer psychology. Luxury goods are not bought for the same reasons that normal or inferior goods are, as they do not adhere to the conventional wisdom of economical decision making. Instead, consumer decision making plays a huge role in the sales of luxury goods, particularly status consumption, and the motivations for status consumption were identified according to different types of motivations. By analyzing this data, the economic effects of luxury goods were identified. Because their primary consumer base is not affected severely by economic hardships, the sales of luxury goods are able to maintain a consistency not found in other goods. This trickled down into growth for the suppliers of these luxury brands as well, because the increase in demand for supply by luxury goods makers was able to offset the decrease in demand by normal goods makers. In addition, luxury goods have spawned the counterfeit “industry”, which also plays a huge economic role. The findings in this paper will help shed some light on the complicated economics of luxury goods and their effects on the economy.

Keywords: Luxury Goods, Consumer Psychology, Status Consumption, Counterfeit Goods

1. Introduction

The world today allows a consumer to make an unlimited amount of choices when choosing to buy a product. Even when buying a simple pair of jeans, there are a vast number of brands that may be considered, ranging from Levi's to True Religion. A frugal-minded person may opt to buy a cheap pair of jeans that simply get the job done; as long as they fit, the person may not mind which brand the pair is from. However, many people will often spring for the pair of jeans that come from brands with "name value", i.e., the brands that are well known and possibly charge a great deal more for their products.

What motivates people to buy products from more well-known or expensive brands? Is it because they are willing to pay more for quality? Or is it because they simply the fact that names of those brands are well known?

Luxury goods have cropped up in most product categories, with "premium" versions of common items such as handbags, jeans, vehicles, and more receiving a great deal of attention for their exorbitant prices. While so-called "brand name" products-which will be the main focus of this paper-have existed since the globalization of the economy, they have recently branched out from products that were mainly acquired by the affluent to products that are being bought by middle class families as well. In short, they have become objects of desire regardless of social status.

As such, this paper will analyze the popularity of luxury goods from the perspective of upper-middle class families, for which brand name goods are not completely out of reach but still give quite a bit of thought before splurging on them. For obvious reasons, taking into account the positions of the people for whom money is no object would not be practical, as they would buy brand name goods because it would not make a dent in their wallets.

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This paper will discuss these luxury goods in closer detail, focusing on why they manage to sell so well despite their considerably higher prices and will analyse the effects of luxury goods in specific product categories as well as the economy overall.

2. Background Information

2.1. Definition of Luxury Goods

In economics, luxury goods are defined as products that increase in demand as income gets higher. In short, they are goods that are not necessary but desirable.

To go more in-depth, we can take a look at the meaning of luxury: "something adding to pleasure or comfort but not absolutely necessary" (Webster, 2004; 429). This definition reflects the fact that while brand name goods in a product category potentially offer more utility to a buyer despite a higher price tag.

For the purposes of this paper, we will focus on product categories that contain relatively large sample sizes, such as handbags, jeans, clothes, and jewelry. From these product categories, brand names that are generally considered boutique or upscale will be mentioned. Some examples of notable brands that will be discussed in this paper include Louis Vuitton, Gucci, and True Religion.

2.2. The Current State of Luxury Goods

It is true that due to the global economic downturn that started in 2008, the sales of general goods fell notably in recent years. However, with the resurgence of the worldwide economy, the sales of luxury goods are once again on the rise. According to Wood (2011) from The Guardian, the sales of LVMH (Moët Hennessy • Louis Vuitton), a multinational apparels and accessories company from France, increased by 13% in the six-month period prior to June 2011.

In fact, in China, the world's fastest growing economy, sales of luxury goods have increased dramatically over the given years.



Figure 1 Mainland China Continues to be Fastest Growing Market for Luxury (Bain&CO. 2011)

As can be seen from the figure, China has been recording year-over-year increases in the sales of luxury goods from approximately 20% to 31%. An interesting fact to note is that even during the global economic depression from the period starting in 2008, the sales of luxury goods in China continued to increase at an astonishing rate. This goes on to show that the demand for luxury goods is pretty constant, even though the economy may not be stable.

According to Bain and Company's recent Luxury Goods Worldwide Market Study (2011), the sales of luxury goods bounced back in 2010, and a 10 percent increase in the sales of luxury goods was expected in 2011. While the increase in the number of luxury goods in China may be accounted to the fact that China is one of the world's fastest growing economies and has numerous newly rich entrepreneurs eager to spend their money, Bain and Company's studies show that the demand for luxury goods has gone up in more mature markets as well. This is significant because it implies that even those people who have been buying luxury goods for years still come back for more. The reason for this behaviour is what this paper will try to uncover, focusing on various aspects of the luxury goods business including the goods themselves as well as the consumers that buy them.

3. Consumer Psychology of Luxury Goods

3.1. Status Consumption

Status consumption can be summarized as the acquisition of products by consumers for the value of "status" that they may provide. This idea is well-expressed by Scheetz (8), who classifies status consumption in his study by saying:

"For our study, "status" is the characteristic of a product or brand that makes it desirable, beyond its standard utilitarian value. This definition revolves around the idea that each product or brand has two separate components of utility: utilitarian value, or the product's inner quality, and conspicuous value, or the product's "status." Products labelled as "high status" are products that, when used or consumed in the presence of others, make others think more positively of the user. Products labeled as "low status," then, are all other products—including products that leave spectators ambivalent, products that make others think less of the user, and products that are not used in front of others."

There are many theories on why consumers practice status consumption. According to Heinemann (2008), some of the general classifications given to these motivations are basic human motivations, societal group motivations, international motivations, culture based motivations, and Chinese and Indian motivations.

Below is a table showing some of the motivations that drive consumers toward status consumption. While it is impossible to list all of the possible motivations for status consumption, the ones shown in the figure are some plausible reasons.

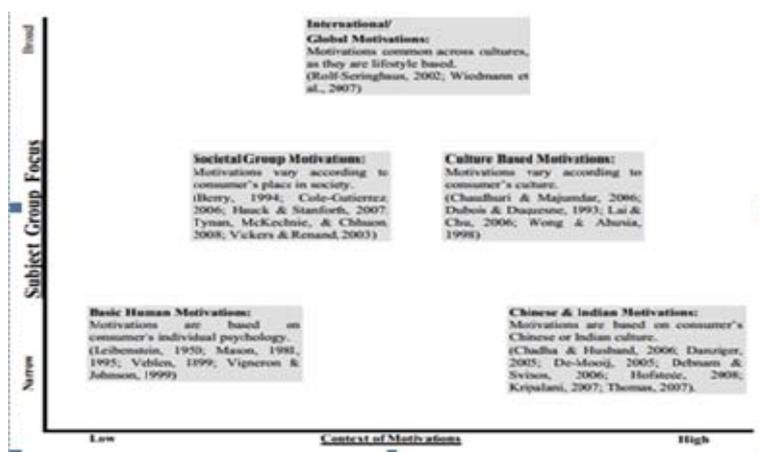


Figure 2 Schematics Description of the Luxury Purchase Motivations (Heinemann, 2008)

3.2. Basic Human Motivations

Heinemann (2008, 17) describes basic human motivations by saying "This school of thought focuses narrowly on the human being. It identifies that what motivates humans is based on instincts and individual expression, so context is low."

3.3. Societal Group Motivations

Societal group motivations are explained by Heinemann (2008, 19) as follows: "This school of thought shows a graduation in thinking. It acknowledges that a person's social group (within society) will impact upon their perception of luxury, and that their social group will entail motivation to purchase luxury products. Therefore motivations are regarded as relating to a context, and the subject matter has moved from individuals to societal groups."

3.4. International/Global Motivations

Furthermore, international/global motivations are listed by Heinemann (2008, 20) as "This grouping of literature represents a drastic shift in the definition of the consumer's group. The perspective has progressed from a societal intra-cultural group, to where the larger cultural group as a whole becomes subject for discussion. Thus it follows the argument of the last literature-grouping, where a consumer's group will influence the motivation to purchase luxury products, but now the consumer's group is larger and involved in a global context. This grouping falls in the middle of the continuum as it acknowledges culture as a potential

factor influencing motivation to consume luxury products for the first time. However, this group openly disregards culture as influencing motivation to consume luxury products in favour of common human needs, similar to earlier literature-groupings."

3.5. Cultural Based Motivations

Cultural based motivations are characterized by Heinemann (2008, 22) to be "This literature-grouping continues the focus of the last grouping, where authors regard luxury purchase motivation as an intercultural-issue and not just a psychological one. This writing point becomes stronger here as evidenced by the use of national-culture as a strong writing context, and the resulting natural outcome of focus on the subject group of consumers within these national-cultures."

Thus, by looking through the definition and examples of status consumption, it can be considered human instinct to want to show off what they buy, pervading a sense of "high status" to others. This may explain why people prefer to buy luxury goods.

4. Economic Impact

In 2007, luxury goods made up a \$157 billion industry according to the American Chamber of Commerce (2007). In 2004, the income for those in the top 20th percentile of the U.S. economy rose by 28.4%, with even larger gains for those in the top 5% based on statistics from the U.S. Census Bureau (2004, 44). This increase in income for the rich is what makes the luxury goods market possible. Without it, multi-million dollar pieces of jewelry or bags costing hundreds of thousands of dollars would not sell.

What does this mean for the economy in general? The luxury goods market allows the super-rich to spend money even when the worldwide economy is down. As mentioned in section 2.2, the sales of luxury goods have a remarkable tendency to stay consistent or even increase despite tough economic times. This is due to the fact that the consumers of luxury goods will always have money to spend, even when others don't.

While those who spend lavishly may be frowned upon by the general public, it is possible that their tendency to continually consume luxury goods may help the rest of the economy in general. Despite how intricate the final product may look, the manufacturing of goods begins from the acquisition of raw materials. These raw materials are usually obtained through suppliers, whose business may not be as profitable as usual because of the decrease in demand from other sectors.

When people are faced with economic hardships, they usually buy the bare minimum that they need to survive, cutting out small amenities such as cable or new clothes. However, the rich, who are the main consumers of luxury goods, rarely have to face such choices. As such, while suppliers suffer from a decrease in demand from normal goods manufacturers, the demand from luxury goods manufacturers may actually increase. This may help the economy overall; luxury goods give suppliers a reason to stay afloat while the economy for normal or inferior goods may falter.

4.1. Counterfeit Goods

The huge market for luxury goods has spawned another unexpected sector: counterfeit goods. Due to the demand for luxury goods, a bustling counterfeiting market has been established, with counterfeiters offering replicas of luxury goods at much cheaper prices than the authentic counterparts.

Table 1 Share of Counterfeit Products in Total Sales of the Sector (Vithlani, 1998)

Sector	Share of counterfeit goods as a percentage of turnover
Watches ¹	5
Medicine ¹	6
Perfumes ²	5
Aircraft spare parts (SUP) ²	10
Toys ¹	12
Music ²	33
Video ²	50
Software ²	43

Considering the table, markets with luxury brands such as watches and perfumes have been impacted significantly by counterfeit goods. While it is difficult to ascertain whether the consumers would have

bought the authentic goods if there were no cheaper counterfeits out on the market, there is no doubt that the counterfeit "industry" is booming.

While this boon in counterfeiting may seem like bad news, it actually has its benefits. According to Vithlani (1998), "Counterfeit clothing, particularly from Italy, is becoming very difficult to combat. In the past a counterfeit shirt would often fall apart or lose colour after the first wash, but there has been a significant improvement in the quality of fakes. Very often the fakes are made by the same manufacturer that is contracted to produce the original items. The copies are therefore indistinguishable from the genuine item, but are sold for less than half the price. These 'over-runs', as they are called, are difficult to stop for the trademark owner."

This anecdote provides clues on how counterfeiting affects the suppliers. Because the suppliers get to manufacture more items than they would have by just supplying luxury brands alone, they get to produce more and sell more, leading to larger profits.

In addition, counterfeiting usually requires a "middle-man", someone who will buy goods from a manufacturer and sell them to the general masses. This usually means that some people are able to make a living off of selling large quantities of counterfeit goods, providing an economic boost to people who would otherwise have had to search for other jobs.

However, counterfeiting does have its down sides, as some missed sales and lost tax revenues are inevitable. Vithlani (1998, 22) says that "First of all, industries which find themselves in direct competition with counterfeiters suffer a direct loss in sales... In addition, consumers who are deceived into believing that they bought a genuine article when it was in fact a fake, blame the manufacturer of the genuine product when it fails, creating a loss of goodwill... Thirdly, beside direct losses of sales and goodwill, one should not forget the expenditure involved in protecting and enforcing intellectual property rights..."

While companies who sell authentic luxury goods and the consumers who buy them may be impacted negatively, it is also impossible to rule out the fact that counterfeiting is turning into a form of business, providing jobs for those willing to take the risk and enter the fray.

5. Conclusion

This paper discussed luxury goods by trying to answer why luxury goods are so popular, as well as the economic impact of luxury goods. Starting with the first question on why luxury goods are so popular, it seems impossible to pinpoint this fact to a single reason. Instead, numerous factors, both economic and psychological, factor in customers' decisions to buy them.

Many luxury goods exhibit superior quality compared to goods from other brands. In these cases, luxury goods can be seen as worthwhile investments for people buying them. Automobiles, jewelry, and other goods have clear advantages for paying more. For jewelry, the gem may be clearer or cut more intricately; for automobiles, performance may be better.

In some cases, though, luxury goods offer no visible benefits for their price. Although identical products may go through different processes to be sold on the market, sometimes it is difficult to discern why people should pay such hefty premiums for the products.

In cases such as these, status consumption comes in. While there may be several different motivations for status consumption, the general goal is identical: oftentimes consumers will pay premiums for luxury goods with no significant differences in quality simply to reflect a high status.

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