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## TESTING AND ANALYSIS OF CONDITIONS UNDER WHICH IS REALIZED VEBLEN EFFECT

**Summary:** *In the context of empirical studies Veblen effect exists when consumers are willing to pay a far higher price than the real for certain goods. Some studies show that Veblen effect can be empirically important in the marketing of luxury goods. Analyzing Veblen effect, it shows that individuals tend to emphasize the status by expressing the material display of wealth. However, it happens that the individuals who are willing to pay a high price for certain goods thereby becoming indebted. In such circumstances Veblen effect hasn't be achieved since it needed to achieve a balance in the relationship between the price and the status of consumers. Veblen effect does not depend on the nature of competition among enterprises. Veblen effect depends on the equilibrium of price and status and the determinants which affect the interaction between price, quality and quantity, with assumptions that the quality is not necessary for the existence of Veblen's effect, but affect other characteristics of balance between status and prices. Veblen goods have Veblen effect if a large number of people note the conspicuous consumption.*

**Key words:** *status, price, balance, quality, quantity, Veblen effect*

**JEL Classification:** *D10, D11, D43*

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## INTRODUCTION

If we consider the law of supply and demand, a price increase will decline demand curve. However, there are exceptions to this law. One of these exceptions defined Torsten Veblen (Thorstein Veblen), the first explorer of the relationship between consumption and status demand.

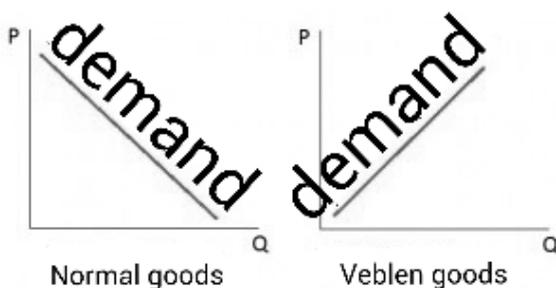


Figure 1. The demand curve of normal goods and Veblen goods (Author)

In the first graph can be seen that a price increase (P) reduces the demand for good (Q), so that the demand curve (D) has a downward direction. While, on the second graph can be seen that a price increase (P) growing demand for good (Q) and the demand curve (D) has a growing direction.

Therefore, Veblen goods have a positive demand curve. That is that higher price of a product means greater demand. This effect is often present at luxury goods such as expensive cars, watches, suits, so that reduction in prices of these commodities could affect the loss of exclusivity and status. According Veblen effect, demand for a goods falls when its price falls because then it is available to wider public and no longer indicates the status of those who wanted to emphasize themselves through the ownership of goods that wider masses could not afford. Therefore, the aim of this paper is to identify and analyze the conditions under which Veblen effect is achieved. The paper raised a number of hypotheses that are interconnected:

1. Veblen effect should be defined over consumption and status, and not through consumption and prices;

2. The balance between price and status should be performed, and not presumed;
3. Veblen goods haven't always produced Veblen effect;
4. Interaction among price, quantity and quality are the determinants that affect Veblen effect;
5. In order to effectively signaled to the wealth, a large number of people must see conspicuous consumption.

Veblen effect is empirically important for the marketing of luxury goods (Bagwell and Bernheim 1996, 349). Veblen goods, regardless of whether they will produce Veblen effect or not, can serve companies to increase their value by gaining extraprofits.

### 1. VEBLENOV EFFECT – FUNCTION

Some goods such as expensive perfumes and wines are also Veblen goods, so reducing the price of these goods decreases tendency of people who prefer to emphasize the status by buying these goods, because they are no longer understood as status goods only. Whereas, the increase in prices of these goods increases the perception of status, exclusivity and benefits in relation to the wider masses.

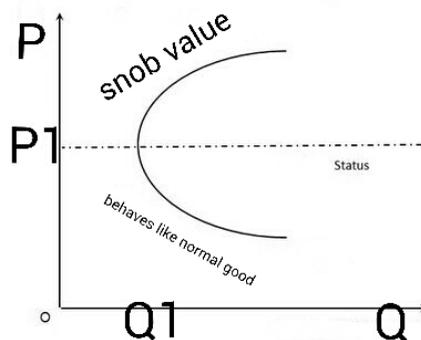


Figure 2. The demand curve due to changes in price- the Veblen effect (Author)

The chart shows that goods above the price  $P_1$  act as Veblen goods, while goods below the price  $P_1$  act as a normal good. Respectively, above the price  $P_1$  curve demand has growing direction.

In periods of recession and frugality should be less demand for Veblen goods and more for lower prices goods (Google 2015). However, during the recession turned out that, in addition to the increased demand for cheaper goods, there is also growing demand for Veblen goods. Increased demand for Veblen goods inherent to the consumers, whose spending is not proportional to their status. That is why money directed to the consumption of Veblen goods is provided by borrowing. Therefore this study is to investigate whether Veblen goods products Veblen effect when are purchased by consumers, whose spending is not proportional to their status.

Consumers prefer to buy some goods to show social status or success. Consumers prefer to buy goods that, they think, reflect their success and it explains why when you raise the price of a goods, increases the demand for them. In the case of perfectly inelastic demand, price rises will not cause any drop in demand.

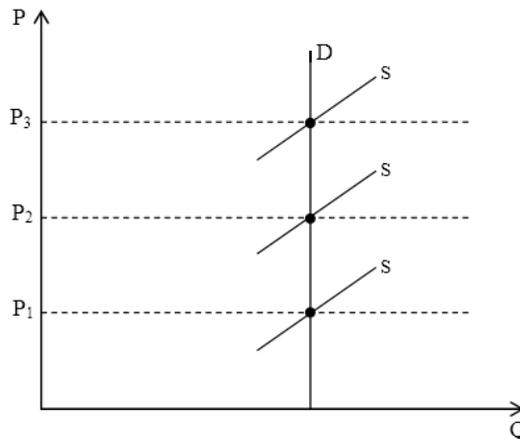


Chart 3. The perfect inelasticity of demand and Veblen effect (Author)

So the price change from P1 to P3 will not cause any drop in demand. This statement is from the empirical importance for business strategy of company and in the marketing of luxury goods because there is no risk of declining demand.

## **2. ANALYSIS OF THE FIRST AND THE SECOND HYPOTHESIS**

According to Thorstein Veblen, wealthy individuals often buy highly distinctive goods and services in order to emphasize their wealth which, they think, stand out a higher social status. Veblen analysis gave rise to the considerable amount of research on «the status». In the context of empirical studies Veblen effect exists when consumers are willing to pay far higher price for certain goods. Some studies show that Veblen effect can be empirically important in the marketing of luxury goods. Statement given by marketing manager: «The real price of our shoes with which we were supposed to go to the market amounted to 338.096 USD. Observing our customers we decided to go out to the market with a price of 676.193 USD. If we opted for the first option, the sale would be halved and continued to be downward trend in». Studies indeed have shown that the image of the glamorous goods can be destroyed through their sale at lower prices. (Downey, 1993, 95). And also «bloated price», that is, the price much higher than the marginal costs, can enable companies to gain extraprofits, so it is in the interest of many companies to keep a policy of «bloated prices».

Analyzing Veblen effect we conclude that individuals are seeking to highlight the status expressing it with the material display of wealth. However, there are also individuals who are willing to pay a high price for certain goods and thus become indebted. Also, unduly expensive goods for individual consumers who have material wealth are an indicator of the high cost and extravagance. Therefore, in the analysis of Veblen, Veblen effect should be defined over consumption and status, and not through consumption and prices. The price paid for the goods may affect the status, being in balance, but this relationship should not be assumed than it should be constructed. This is especially important considering that Veblen

claims that individuals that purchase expensive goods prefer to signal their wealth, and as a result should be achieved a balance between price ratio and wealth. Which means:

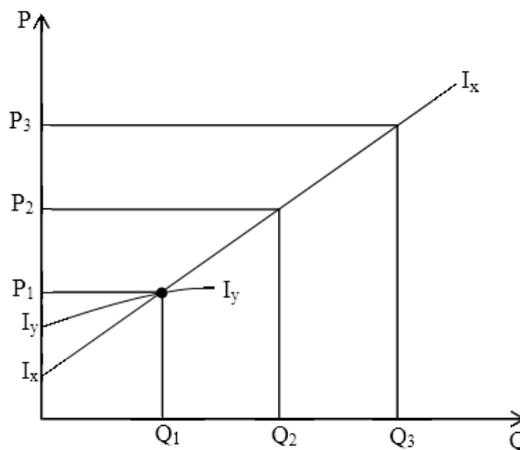
$$\begin{aligned} \text{consumption} \times \text{status} &\sim \text{consumption} \times \text{price} \\ \text{status} &\sim \text{price} \end{aligned} \quad (\text{Author})$$

This is the essence of this theory, if it prefers to emphasize richness through consumption. Example - assume that the price paid for the car should represent 1/10 of money that an individual owns in cash. A member of the upper class will buy Veblen goods to underline that differs from the lower class and will be ready to pay for a certain good in proportion to its richness. However, here arises attitude that requires further analysis, and it is probably based on the socio-psychological point of purchasing of Veblen goods. That is that the material emulation occurs in the lower class. Such individuals are buying Veblen goods to be, in their beliefs, coalesced with the upper class «now we are even» - psychological basis or to be easier accepted in society that they can use to truly thrive class - social grounds. For them, the price they pay for the car is not 1/10 of money they have in cash, but is much more, for example. ½ or even their own money + debts. This is especially common in modern conditions. On the one hand, the members of the upper class voluntarily expose to costs to differentiate from members of the lower class and thereby to discourage the imitation from the members of the lower class. While on the other hand, members of the lower class voluntarily create costs beyond their means to replicate the members of the upper class of society. In any case, the greatest benefit is realized by companies that offer luxury goods gaining extra profits.

### 3. ANALYSIS OF THE THIRD HYPOTHESIS

Veblen effect involves the purchase of certain goods at a much higher price to emphasize the status of the individual. Model of conspicuous consumption generates Veblen effect and can highlight the status of the individual. However, the payment of excessive prices for certain goods is not a reliable indicator of wealth. Wealthy individuals instead are willing to buy a large quantity of goods at a lower price. So in this paper we examine under which conditions the Veblen effect is defined as an individual's willingness to pay a higher price in order to emphasize his status. This paper examines whether the status of each individual depends on the perception of his wealth among social groups. Certain individuals have signaled their wealth through the value of its assets, others through conspicuous consumption. This paper seeks to show that Veblen effect does not occur when the model that satisfied standard «signs of wealth» is about having a high profile goods for people with less wealth. Because when to display indifference lines with different levels of wealth they can would not be crossed or would be crossed only once.

a)



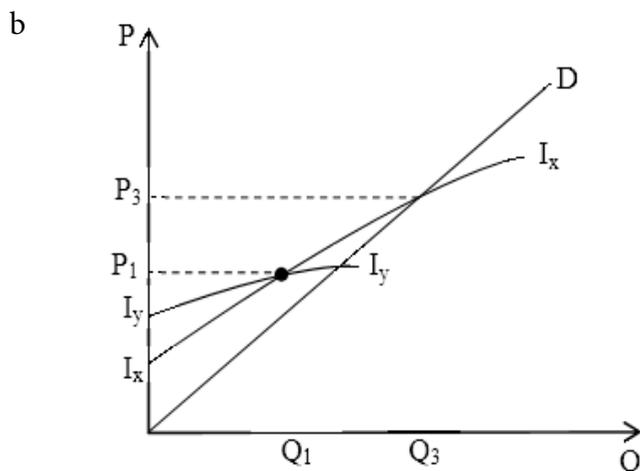


Chart 4. Behavior of indifference lines with different proportions of wealth a) and b) (Author)

The first and second chart shows that lines of indifference that are presented by budget lines  $I_x$  and  $I_y$  intersect only at the level of prices  $P_1$ . Consumer preferences for luxury goods shown in the budget line  $I_y$  will not be able to follow the growth of the level of prices on the  $P_2$  and  $P_3$  due to budget restrictions. Budget brands represent goods that are sold at a price equal to marginal cost. While luxury brands are sold at a price above marginal cost. If we analyze it in terms of goods of the same quality, individuals who prefer to emphasize their status will buy luxury brands. Veblen effect depends on the individual's property. If we take that consumption reduces expenditure of one good to the other goods, diminishing marginal rates of substitute are higher for households with lower resources. Therefore, consumption is more expensive for households with lower wealth. As a result, the relation between prices and the status is not in balance.

#### 4. ANALYSIS OF THE FOURTH HYPOTHESIS

Every consumer cares about the quality of the goods that he consumes. Consumers have a wide range of consumption. However, there is always a

group of products for which its quality is primarily important. Formulation of the usefulness means that a higher quality implies a perfect replacement for a larger amount. For the analysis of Veblen's effects, by functioning of model of conspicuous consumption will be analyzed by the difference between quality and quantity. Veblen effects is based on conspicuous consumption that will highlight the status of the individual, creating a special treatment among social groups. This paper does not examine the validity of Veblen's effects than individually analyzing the conditions under which one creates. This paper analyzes the social contacts that are created on the basis of perception of individual wealth by society. If we consider that through social contacts the resources available to the household can not be directly observed but can form an assumption based on the observed actions of households, buying Veblen goods is the best indicator highlighting the status of the individual. Conspicuous goods can be produced by many companies.

The decision of targeting its production on budget brands or status brands companies made on the basis of detailed financial analysis, evaluation, market research and others. Each firm produces a product which is branded so that social groups could easily identify the manufacturer. Branding does not directly affect service, or if it was an inconspicuous branding context, then there would be no purpose of branding or branding would be irrelevant. Conspicuous goods should have a certain level of quality that can not be imitated and details on these goods, that opt consumers to purchase these goods at certain prices. Given that all social groups have access to the brand labels, the quantity and quality of goods, it can be easily inferred total expenditure on household products and the total volume of quality.

In this part of the analysis will be examined consumer's indifference to the quality and to the particular choice of the company. The consumer may buy conspicuous good from one manufacturer or several manufacturers. If households are indifferent to offer of several different manufacturers of conspicuous goods, the consumer decision to purchase them is issued based on the evaluation of their quality. Indifferent consumers should be target group for marketing strategies. Assumptions about the quality are not necessary for the existence of Veblen's effects, but affect on other

characteristics of balance between status and prices. There is no rational consumer who would have spent more than the minimum amount required to purchase a certain quantity of inconspicuous goods. While on the other hand, the consumer may be willing to spend far more than it is in proportion to his wealth to purchase conspicuous goods.

Consumers are completely indifferent between all consumer packages containing the same total number of quality units at the same price.

Veblen effects also occurs because it is impossible to deter imitation, so households pay bloated price for conspicuous goods.

If the final price is low enough, then it may be impossible to deter imitation with consuming high quality and quantity. For now it will be assumed that the large enough quantity and the quality are not enough to deter imitation. The existence or non-existence of Veblen's effects depends on the signaling of wealth over the price, quantity and quality. Certain households prefer to differentiate from others by choosing a larger quantity at available lower price, rather than they opt for a smaller quantity.

Certain consumers buy conspicuous goods of the lowest available quality with bloated prices. Households when faced with the choice of higher prices or lower prices of brands of the same quality, the household will always choose a lower price brand. Same as that, Veblen effects do not depend on the nature of competition among enterprises, but depend on the conspicuous consumption of the individuals who thus prefer to emphasize their status and material wealth.

That so celebrity people use a multitude of Veblen goods together, trying to emphasize their status: a suit, shoes, perfume, watch and driving a car and thus manage to show the amount of Veblen goods at the disposal, so therefore imitation is impossible. The perception of their wealth among social groups is shown with amount of glittering assortment of conspicuous goods. If having a Versace dress is not enough to make a distinction between the rich and those who aspire to be rich, those who prefer to signal wealth will also wear Manolo Blank (Manolo Blahnik) shoes. If even thus can not be differentiation they can use a fountain pen (Heaven Gold Pen). Note - brands of Veblen goods are taken randomly. Use of conspicuous goods

will increase until it satisfies Veblen effects. This behavior goes in favor to households that will signal their wealth more with many assortments of goods, and will not choose only one assortment. Meaning that to achieve the Veblen effects must be used amount and the brand. However, if you have a fixed amount and the brand, Veblen effects still will not be in balance as long as companies are free to have a range of different quality, and hence the different prices. Here would be an example of the Mercedes S-class and depending on the quality of different model has a different price. Mercedes S 350 Blue TEC costs 123,056 USD, while the S 63 AMG L 4 MATIC costs 252,350 USD. The perception of wealth by social groups will be different. Wider groups will see that this is a Mercedes S-Class, but only those who understand better will know that these two cars differ more than twice at the price. Therefore, we can conclude that here may be possible imitations. An individual who prefers to emphasize its status will have to increase the range of conspicuous goods. It should also be noted that the imitator can buy a used Mercedes S 350 Blue TEC at a price of 92,275 USD. In this case wider groups will not notice whether it is a new or old model of S-class and whether it comes to the most expensive or the cheapest model of the S-class. Veblen effects mean emphasizing individuals by their richness and status through consumption of Veblen goods, but not consumption of Veblen goods from those who are only pretending to be rich. As previously stated Veblen effects depend on balance of price and status, and the determinants that are influenced by are interaction of price, quantity and quality. With the proviso that if we isolate these determinants individually it can be concluded that “bloated” price of conspicuous goods may discourage imitators and Veblen effects can be achieved while at the same was not cared about the quality or quantity of these goods. Then, the amount of conspicuous goods can discourage imitators and Veblen effects can be achieved, provided that the amount directly is related to the price, and the quality in this case must not have an effect on the quantity in order to achieve Veblen effects. If the quality is only improved without changing the price, Veblen effects will not be achieved because an individual buys Veblen goods without a good-quality care then to highlight the status. Also, as long as companies are free to vary in quality Veblen effects can not be achieved if it does not involve other determinants. A company may,

through activities such as advertising or innovation in production process to increase the value of its products. However, if at the same time did not increase the price, company would not be able to take customers from its competitors. The improved package of a product, or knowledge about a product can be useful for all social groups, but improved package can not function as a signal of wealth and thereby can not attract individuals who seek to emphasize their status and differentiate from other social groups. In such cases, if the company is targeting a high class of consumers who prefer to emphasize the status, it would have to raise prices.

## **5. ANALYSIS OF THE FIFTH HYPOTHESIS**

This paper seeks to rationalize the existence and non-existence of Veblen's effects, especially during consumption the same or similar goods by the various consumers. It may be noted that it is possible to produce Veblen effects by the consumption of the corresponding sets of assortment, but also consumption of appropriate sets of assortment is not necessarily to fact Veblen's effect. Members of the upper class act in their own opinion, some prefer to highlight the wealth, while others do not. This statement tries to point that a higher class does not merely mean individuals who consume conspicuous goods, but it may be individuals who consume conspicuous goods. This statement tries to point that the lower class can consume conspicuous goods to a certain price, but at the same time is not identified with the upper class.

Shopping of conspicuous goods with "bloated" price for some people is extravagance. If an individual only once buys Veblen goods to emphasize the status, Veblen effects will not be achieved because the act is localized and of short duration. Wealthy individual can buy works of art of great value that adorn the interior of his household. Such spending may opt for personal satisfaction, but also to point out the status. The wider community does not know what is in his house, and therefore will not achieve Veblen effects. However, if the media exposes and reveals the interior, make a contribution on what kind of preciousness possesses an individual, is achieved Veblen effects. What is the essence of this statement is that if we want to

effectively signal the wealth by conspicuous consumption, it must be seen by large number of people. This work did not analyze which goods an individual will choose to be indicator of his wealth. There is a wide range of Veblen goods. However, if you are trying to achieve Veblen effects it is necessary to point out the conditions under which it is achieved. Manufacturers determine the lowest limit of price to their agents. However, manufacturers rely heavily on reputation. When a luxury brand gain a reputation on the basis of “bloated” prices, one reduced price could collapse reputation. So, consumers who prefer to emphasize the status, elect the producers of luxury goods that have defined mechanisms to maintain high prices.

## **CONCLUSION**

Based on the examination and analysis of the conditions under which Veblen effect is realized, we conclude that hypothesis are confirmed. This study confirmed the hypothesis in which Veblen effect is defined in terms of consumption and status, not over consumption and prices. The price paid for the goods may affect the status to be in balance, but this relation should not be assumed, but it should be constructed. This is especially important, given that Veblen argues that individuals who purchase expensive goods prefer to signal their wealth and it should be achieved a balance of prices and wealth to result to Veblen effect. This confirms the second hypothesis.

This study confirmed the third hypothesis that Veblen goods do not produce always Veblen effect. Veblen effect does not occur if people who met model standard “signs of wealth” are having a high profile resources with less wealth. If we take that consumption is reducing expenditure of one commodity to the other goods, diminishing marginal rates substitutes are more for households with less resources. Therefore, consumption is more expensive for households with lower wealth. As a result, the ratio of price and status is not in balance.

This study confirmed the fourth hypothesis that the interaction of price, quantity and quality are determinants that affect Veblen effect. Bloated price of conspicuous goods may discourage imitators and Veblen effect can be achieved and that without improving the quality and increasing

quantity of these goods. The amount of conspicuous goods can discourage imitators, Veblen effect can be achieved, provided that the amount is directly related to the price, while the quality in this case does not necessarily have an impact on the quantity to achieve Veblen effect. If we only isolate quality without changing the price, Veblen effect will not be achieved because an individual buys Veblen goods to highlight the status. Also, as long as companies are free to vary in quality, Veblen effect can not be achieved if it does not involve other determinants.

This study confirmed the fifth hypothesis that to effectively signal the wealth conspicuous consumption must be seen by large number of people. Since the consumption through which will emphasize the richness is preferred, the act should be localized and of short duration.

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