

How Apple's Pricey New iPhone X Tests Economic Theory; Smartphones, among the most common consumer products, are locked in a luxury price war

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FULL TEXT

Thorstein Veblen was a cranky economist of Norwegian descent who coined the phrase "conspicuous consumption" and theorized that certain products could defy the economic laws of gravity by stoking more demand with superhigh prices.

His 1899 book, "Theory of the Leisure Class," made him famous in his time and more than a century later his ideas are embodied in products like Hermès handbags, Bugatti cars and Patek Philippe watches.

Now Apple and Samsung are testing whether the social commentator's theory on what has come to be known as the "Veblen good" can work for one of the most common of all consumer products—the phone.

The gambit is striking because prices tend to fall in technology and products become obsolete fast. In this case, though, it just might work in its own way.

Typically, raising the price of a good lowers demand for it. If beef becomes too expensive, people will buy more chicken.

Mr. Veblen's theory posits that some consumers want a product even more when the price rises because the expense broadcasts status, taste and wealth.

By unveiling the new iPhone X last week with a price of \$1,000, Apple Inc. is pushing the envelope even further than Samsung Electronics Co., which unveiled the \$950 Note 8 phone this year. Rather than trying to attract consumers with cheaper prices, the companies are fighting for customers with expensive price tags.

The starting price of the new flagship iPhone X is about 50% more than the \$650 starting price of last year's iPhone 7. The most expensive version of the iPhone X, with 256 gigabytes of storage, will cost 19% more than last year's most expensive device, the iPhone 7 Plus, with the same memory.

Apple and Samsung have found themselves here partly by necessity. Smartphone makers are running out of new customers. Data from IHS Markit estimates there are just under 100 smartphones per 100 people in the U.S. and about 92 smartphones per 100 people in Europe. (Many people own more than one phone.) By 2020, there will be about 84 smartphones per 100 people globally, IHS projects.

To generate more revenue the big smartphone makers increasingly need to push on price.

"They can create a super-premium model and perception of super-premium that pushes those buyer types into the stratosphere," said Steven Haines, chief executive of Sequent Learning Networks, which advises companies on product management. "This is classic product management."

Such segmentation is normal in mature industries, said Mr. Haines, comparing smartphones to what happened with the auto industry, where luxury cars with high prices became a status symbol as car ownership became commonplace.

Apple has made the case that the technology in its new phone justifies the price. Chief Executive Tim Cook said the iPhone X will feature "more powerful technologies than we've ever put in an iPhone before."

That includes a host of new components and features, including a 5.8-inch organic light-emitting diode display, a new depth-sensing camera system for facial recognition, and gyroscopes and accelerometers for augmented reality—a platform that puts virtual images of items like an IKEA sofa onto the smartphone screen so users can see how it would look in a living room.

The components cost an estimated \$581, up from \$248 for components in the iPhone 7, according to Susquehanna International Group. The gap suggests Apple's profit margins on the new device are slimmer than on existing lines.

Still, conspicuous consumption appears to be a growing factor in the economics of smartphones. The market research group NPD, which tracks sales of new iPhones, finds spikes in sales volumes when new phones are launched. The biggest spikes came for iPhones that were the most visibly distinct, such as 2014's iPhone 6, the model in which Apple changed the shape, enlarged the device and raised prices by \$100.

The iPhone 6 "made it obvious, even at a quick glance, which consumers had the latest and greatest device when they pulled out their phone to check an email or answer a call," wrote Eddie Hold, the president of Connected Intelligence, a group at NPD that studies mobile technology.

"You talk to people, and you hear this lust for a product," said Horace Dediu, an industry analyst at Asymco and a former Nokia Corp. business development executive. "Technology has risen in our lives to become a reflection of us."

Still, Mr. Dediu said the iPhone X isn't a pure example of Veblen's theory because demand will be driven by the device's functionality, not simply price.

While some new iPhones that look different will be bought to show off, he doesn't think anyone is sitting inside the company's headquarters thinking: How do we create that phenomenon?

"They're focused on making the best phone in the world," Mr. Dediu said.

Putting out an iPhone 8 and an iPhone X at the same time suggests Apple is trying to create a prestige factor, said Elizabeth Currid-Halkett, a professor at the University of Southern California who studies consumer culture.

"They're clearly trying to demarcate the iPhone X from the other versions, and surely there's a desire to make it a status good," she said, noting that the iPhone X doesn't appear to offer significantly greater utility to most consumers than the other iterations of the iPhone.

"Are you getting some extra utility out of this good?" said Ms. Currid-Halkett. "I think the answer is no. I don't think a new animated emoji is better functionality. But it's cool."

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