THE "SCARCITY EFFECT" AND FINE WINE

Sandy Hook & gun demand: The impact of perceived scarcity

One of the most notable consequences of last year's tragic events at Sandy Hook was the dramatic increase in demand for guns that it precipitated. Firearm background check submissions hit an all time high in the days following the shooting, stimulated by a desire to beat an anticipated tightening in gun control legislation. This episode serves to highlight one of the most powerful forces influencing consumer behavior: the impact of perceived scarcity.

We examine the role of scarcity in the marketing of fine wines

In this report, we look at the role of scarcity-based marketing strategies in the fine wine industry. Drawing on academic research from the fields of psychology, economics and game theory, we examine why perceived scarcity is such a draw to consumers and why certain consumers respond more strongly to perceived scarcity than others. We explain why scarcity-based marketing strategies are economically optimal for high-quality wine producers, but not for low-quality producers. And we assess whether a wine's scarcity is indeed a reflection of its quality.

The scarcity principle

A large number of studies have focused on the scarcity principle, including seminal pieces by social psychologist, Robert Cialdini. In simple terms, opportunities seem more valuable to us when they are less available. According to basic psychology, the impact of scarcity on desirability is driven by two factors:

- First, we are programmed to believe that things that are difficult to obtain are more valuable. Thus, the availability of an item serves as a "shortcut" cue to its quality.
- Second, when something becomes less accessible, the freedom to have it is lost. On a subconscious level, whenever free choice is limited or threatened, the need to protect our freedom makes us want it significantly more than before. Thus, when a product becomes scarce, our freedom to have it is threatened, increasing its desirability.

Susceptibility to scarcity effect varies across consumers

One of the more interesting aspects of the scarcity principle is that is does not appear to affect consumers uniformly. In general, individuals who don't like uncertainty and those with a high need for cognitive closure are more likely to take quick decisions based on shortcut cues. Conversely, consumers that are familiar with a product are less likely to be motivated by scarcity.

Wine collectors are particularly prone

It is fascinating to consider proneness to scarcity in the context of the wine collecting world. Although there are a large number of highly knowledgeable wine collectors, the wine world is complex and multifaceted. It is hard to believe that many people have a true understanding of every region's appellations, brands, winemakers and vintages etc. As such, wine collectors are regularly venturing into uncertain territory. This lack of familiarity with the product makes them more susceptible to shortcut cues. In addition, wine collectors often have a high level of risk aversion (collectors are more analogous to hoarders than speculators, and are seeking the security of ownership, not the thrill of trading) and dislike ambiguity, helping to explain why scarcity-based marketing resonates with them.

Particularly American wine collectors

Certain cultures appear to be more prone to the scarcity effect than others. In their paper *The Impact of Perceived Scarcity of Wine on the Purchase Intentions of French and American Consumers*, James Kellaris and Jae Min Jung model the fine wine buying habits of French and American consumers under different degrees of scarcity. The results show that American consumers are more likely to be lured by the perception of scarcity. This cultural difference may be explained by a number of factors. The French culture discourages acquisition for its own sake. Per capita income is lower in France and tax rates are higher, so consumerism is less entrenched. French consumers' greater familiarity with wine in general might also explain why perceived scarcity plays a lesser role in their buying decisions. Either way, these cultural differences throw some light on why scarcity-based advertising appeals are more prevalent and more successful in the United States than in other less consumerist societies.

Does scarcity-based marketing make economic sense for wineries?

The existence of the scarcity effect and its impact on the desirability of wine is pretty clear. However, it is less obvious why marketing strategies based on scarcity make full economic sense for wineries. In the face of excess demand, why wouldn't a winery increase its price in order to get more quickly to demand-supply equilibrium, thereby raising its profits? There are a number of fine wines that quickly trade at a significant premium to their release price in the secondary market, which is essentially profit foregone by the winery. One also has to wonder why lesser quality producers do not play the scarcity game and whether evidence of scarcity is a good indication of a wine's quality.

Game theory suggests that it does

In their paper *The Making of a Hot Product: A Signaling Explanation of Marketers' Scarcity Strategy*, game theorists Axel Stock and Subramanian Balachander provide some profound answers to these questions. The key lies in the fact that consumers are separated into informed buyers (innovators) and less informed buyers (followers). In the case of wine, informed buyers are the early adopters – collectors and trade. They buy first, know the wine's quality and do not look to outside information, or shortcut cues, to guide their buying decisions in future vintages. But they do become somewhat price sensitive. Less informed buyers are new collectors, who are seeking out information to guide their buying decisions. By adopting a scarcity-based strategy which guarantees a consistent allocation to early adopters but severely restricts access to new buyers, the producer is able to signal efficiently to new buyers that the quality of its wine is high, without affecting early adopters. By contrast, signaling through price would impact both new buyers and early adopters, with potentially negative ramifications for demand. In this model, the release price settles at the "full information price" - the equilibrium price that fully-informed early adopters are willing to pay. Excess profit from new buyers is not extracted but maximum profit from informed early adopters is – an economically optimal outcome.

For high quality producers, but not low quality producers

In Stock and Balachander's model, low quality producers cannot sustain a scarcity-based strategy. Informed buyers will not repeatedly buy a low quality product. Without this core buyer base, a low quality producer cannot sustain a scarcity strategy for long and remain economically viable. It will just end up hoarding inventory.

QED: Scarcity = Quality

If only high quality producers can sustain a scarcity-based strategy, as this model posits, the natural conclusion is that sustained scarcity DOES credibly signal to uninformed buyers that the quality of a product is good. It's not just marketing spin.

Conclusions

For readers who are still with us, this paper underlines three important points:

1. Management of scarcity is not just a naïve marketing strategy. It is deeply rooted in consumer psychology.
2. Proneness to scarcity varies from population to population. U.S. wine collectors are particularly well disposed to respond to scarcity-based marketing.
3. Scarcity-based strategies are economically optimal for high-quality wine producers, but not for low-quality producers. *Ceteris paribus*, sustained scarcity is a good indication of a wine's quality.

References

Robert Cialdini: *Influence: Science and Practice* 5th Edition (2008)

Alex Stock and Subramanian Balachanger: The Making of a "Hot Product": A Signaling Explanation of Marketers' Scarcity Strategy. *Management Science* 51 (8) 1181-1192 (2005)

James Kellaris and Jae Min Jung: The Impact of Perceived Scarcity of Wine on the Purchase Intentions of French and American Consumers. *ANZMAC Conference* (2003)