

Fine fragrances

A report on the supply in the UK
for retail sale of fine fragrances



MONOPOLIES AND MERGERS COMMISSION

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for retail sale of fine fragrances

**Presented to Parliament by the Secretary of State for
Trade and Industry by Command of Her Majesty
November 1993**

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Note by the Department of Trade and Industry

In accordance with section 83(3) and (3A) of the Fair Trading Act 1973, the Secretary of State has excluded from the copies of the report, as laid before Parliament and as published, certain matters, publication of which appears to the Secretary of State to be against the public interest, or which he considers would not be in the public interest to disclose and which, in his opinion, would seriously and prejudicially affect certain interests. The omission is indicated by a note in the text.

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1 Summary

1.1. On 19 November 1992 the Director General of Fair Trading (DGFT) asked us to investigate the supply in the UK for retail sale of fine fragrances (see Appendix 1.1).

1.2. Fine fragrances are defined in our terms of reference to mean perfumes, eaux de parfum, eaux de toilette, eaux de cologne and aftershave lotions which are supplied to retailers at a resale price exceeding £15 per 50ml. The fragrance houses supply these products only to retail outlets which, in principle, provide an ambience which accords with the luxury image of the products. This is a form of selective distribution.

1.3. Some aspects of the selective distribution systems operated by the fragrance houses are caught by Article 85(1) of the Treaty of Rome which, in summary, prohibits agreements which prevent, restrict or distort competition. The EC Commission has recently granted exemptions under Article 85(3) to the standard retailer agreements of two fragrance houses. In doing so it effectively laid down the conditions for the operation of selective distribution in the supply of fine fragrances. A key point is that any retailer meeting the qualitative criteria laid down by a given supplier must, on application, be accepted as an authorized stockist. In our inquiry we have examined the effects of the selective distribution systems on the UK public interest.

1.4. We estimate that total sales of fine fragrances in the UK in 1992 were some £230 million at wholesale prices. Two-thirds of the total consisted of sales by fragrance houses to their authorized domestic retailers, over a fifth were sales by fragrance houses to duty-free retailers and the rest were grey-market supplies, ie products which had been sold outside the authorized network. The supply is relatively unconcentrated: the largest supplier, the L'Oréal group, has about [*] per cent of the total and the top five have some 60 per cent between them. The main types of retailer are department stores and chemists, the three largest being Boots The Chemists Ltd (Boots), Debenhams PLC (Debenhams) and House of Fraser (Stores) Limited (HoF).

1.5. There is no scale monopoly but we found that a complex monopoly situation existed in that all the leading fragrance houses refuse to supply retailers whom they have not authorized. All but one of them also recommend resale prices, which most leading authorized retailers observe for most of the time.

1.6. Fine fragrances are marketed as luxury products and we accept that the suppliers need to be able to control their distribution in order to protect the brand images which consumers evidently value. There is no shortage of other fragrances at much lower prices. We found that the UK had until recently been a relatively high-price market. This situation has changed as a result of increased competition among suppliers, the fall in demand during the recession, the entry of prominent retailers selling grey-market supplies at a discount and the development of the single EC market. Wholesale prices have fallen slightly in real terms since 1990 and suppliers' profitability is variable. We noted, however, that wholesale prices to duty-free retailers are well below the level of prices to domestic retailers, and we believe that the duty-free regime generally distorts the market. Although authorized retailers place the emphasis on non-price competition, there is currently an increasing amount of price

*Figure omitted. See note on page iv.

competition as well. The market is competitive and we concluded that the selective distribution systems as a whole were not operating against the public interest.

1.7. We looked closely at the fragrance houses' arrangements for assessing retailers' applications for authorized status, giving particular attention to complaints which we received from Superdrug Stores PLC (Superdrug) and Tesco Stores Ltd (Tesco) that suppliers were exercising unfair discrimination in refusing to supply them. Although we found some anomalies, we were not persuaded that the fragrance houses were failing to implement in good faith the new arrangements approved by the EC Commission. We found no clear evidence that suppliers were using their selective distribution systems as an indirect means of seeking to maintain resale prices.

1.8. The EC Commission exemptions permit a supplier to require authorized retailers to stock at least two-thirds of the products in each brand range which they sell, and to purchase at least 40 per cent of the average level of purchases from that fragrance house achieved by all authorized outlets in the same member state in the previous year. A supplier may also require an authorized retailer to stock a number of competing brands. There is some evidence that these requirements may deter some retailers from applying for authorized status.

1.9. We have reached no adverse finding as regards the public interest. The present time is a period of transition as the fragrance houses implement the revised arrangements approved by the EC Commission. The exemptions apply until 1997 and we consider that their effects on competition should be thoroughly reviewed at that time. Meanwhile we suggest that the Office of Fair Trading (OFT) should monitor complaints from retailers and the effect of the range-stocking and minimum purchase requirements. We also suggest that the fragrance houses should set up a straightforward scheme of independent arbitration for cases where a retailer considers that any issue relating to the grant or withdrawal of authorized status has not been handled in accordance with the procedures approved by the EC Commission.