

# 6 Views of retailers and other interested parties

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6.1. We sought the views of retailers, trade associations and consumer bodies. This chapter summarizes the comments we received from these parties.

## **Chemists**

### **Boots The Chemists Ltd**

6.2. Boots, a subsidiary of The Boots Company plc (TBC), gave written evidence and attended a hearing. It told us that TBC was responsible for buying, warehousing and supplying merchandise to its stores, in addition to central administration and marketing. Boots and its subsidiary, Boots Stores Ltd, owned the 1,084 stores, about 600 of which sold fine fragrances. It did not sell fragrances in its smaller stores because there was insufficient space to stock what it felt was a wide enough range of products.

6.3. Boots said that it fitted out its stores in a uniform way with fittings being updated and upgraded as they wore out. It had developed counters and fittings specifically for the sale of fine fragrances, taking account of market research. These counters were usually situated adjacent to the skincare and cosmetics counters in a prominent part of the store (usually near the front). Boots itself decided on this location, not the fragrance houses, and believed that having cosmetics, skincare and fine fragrances in a prominent part of the store was an important element in signalling to its customers what sort of retailer it was.

### ***Selective distribution***

6.4. Boots said that in the past fragrance houses had refused authorization for some of its stores. A typical reason for refusal had been the existence of other authorized outlets in the same locality. Under the EC exemption Decisions this was no longer a legitimate ground for refusal. Boots supported the concept of selective distribution, provided that a uniform set of minimum standards was applied fairly to all retailers. Fine fragrances were sold on imagery and the retailers which sold them incurred high costs in order to sustain that imagery. If operated properly, selective distribution should ensure that the products were not sold on an opportunistic basis, in unsuitable premises and by poorly-trained staff. Although the system limited the number of outlets selling fragrances, Boots did not think that consumer choice would be affected in any particular locality. Boots believed that the fittings in all its stores were of a standard which complied with the requirements of selective distribution. Boots said that it was at present seeking to agree with suppliers that all stores fitted out to the Boots standard should be considered as meeting those requirements of selective distribution relating to the nature of a store's fittings, leaving it to the suppliers to consider only whether the individual store complied with those criteria relating to the locality in which it was situated. Boots believed that it was fair that suppliers should be able to impose stocking requirements on their authorized retailers.

### ***Discounting***

6.5. Boots criticized those unauthorized retailers which did not comply with the criteria for selective distribution, saying that they tended to enter the market with only a limited range of fragrances which they would sell on an opportunistic basis-eg only for the Christmas and Mother's Day periods-at discounted prices and without appropriate levels of service or selling environment. It did not in any way object to price competition but commented that such retailers operated on a lower cost base and generated a purely price-promoted business, free riding on the image benefits provided by authorized retailers. Boots said that in the fine fragrance market price did not influence overall demand for fine fragrances. Discounting a particular fragrance was only effective when that product was being sold at higher prices elsewhere so that consumers were able to make a comparison. In effect, this only moved market share from one retailer to another and was unlikely to increase the overall fragrance market. Boots thought that consumers bought fine fragrances because of their exclusive image and that a particular fragrance product's association with high fashion and style would be devalued if its prices fell significantly. Fragrances were part of the gift market and if a particular product's image was damaged consumers would choose other gifts. As relatively expensive products they were also affected by the general economic situation and the amount of discretionary income available.

6.6. Boots said that although its general policy was to retail products at the recommended prices in all stores, at local level it matched the price of any competitor which was selling at a lower price. It also planned promotional activities and in December 1992, after a difficult trading year, it had conducted a national pre-Christmas campaign on 29 fine fragrance products at a 25 per cent reduction from previous prices (see

paragraph 3.99). Some of its competitors had retaliated but some did not and Boots believed that it had gained market share in that period. It had also run a package of special offers ahead of Mother's Day. Reaction to these campaigns from the suppliers had varied. Boots said that the gross margins on fine fragrances were at the low end of the scale in the context of Boots' business while costs were at the high end. Although there was a wider benefit for Boots' image in retailing fine fragrances it would have to consider whether to stop selling them if the fall in gross margins became permanent and widespread. Boots thought that fine fragrances were unlikely to be sustainable in the long term if retail prices fell by 25 per cent nationally and there were no other changes in the market.

### ***Self-service***

6.7. Boots said that it had removed some of the counters in its Bromley store. This was an experiment designed not to move to self-service but rather to provide customers with greater accessibility to product testing before approaching a consultant. Customers were able to test and select their own fragrances from shelves at the side of the store and pay for them at nearby counters where consultants would offer advice if necessary.

### ***Recommended resale prices***

6.8. Boots said that fragrance houses had never tried to enforce their RRPs. Unauthorized retailers which sold fine fragrances at discounted prices used RRPs as a bench-mark to emphasize the low price of their products. The comparison between the two was artificial because they had never sold fragrances at the recommended price. Boots favoured the abolition of the RRP which, it believed, would make things harder for these companies by making them advertise any price-cutting by reference to their own previous or ongoing prices. It could not see why the fragrance houses should have any objection to the abolition of RRPs, which it thought would have little effect on retail prices. Retailers would not wish to be considered uncompetitive and there would therefore be a tendency for prices to converge.

### ***The grey market***

6.9. In Boots' opinion the fragrance houses had been very ineffective in seeking to cut off supplies to the grey market. It believed that some of the grey-market stock was supplied direct by fragrance houses or their distributors (not necessarily in the UK) in order to meet short-term sales targets. In the medium term this was destroying their market by devaluing the products' image.

### ***Cosmetic & Perfumery Retailers Association***

6.10. At the time of our inquiry a Boots employee was the Chairman of the Cosmetic & Perfumery Retailers Association (COPRA). Boots described COPRA as a low-key gathering with no decision-making power. Boots had accepted the Chairmanship in the hope that COPRA's members could agree to put pressure on the fragrance houses to be more effective in enforcing their selective distribution networks, so stopping supplies to the grey market, but COPRA had proved to be ineffective in this respect.

### ***Connors Chemists Ltd***

6.11. Connors told us, in written evidence, that it was the largest multiple chemists group in Northern Ireland with 17 large, modern, open-plan chemists shops situated in prime shopping towns throughout the province. It placed great emphasis on personal customer service which included healthcare counselling and trained advice on skincare and it was an authorized retailer for most of the major fragrance houses. Fine fragrances were always located in its perfumery areas in prime sites by agreement with the suppliers on an individual store basis.

### ***Selective distribution***

6.12. Connors said that fine fragrances had a high price bracket, exclusive distribution and specialized counter service. A selective market, by definition, necessitated selective distribution and fine fragrance consumers did not expect to find fragrances in every type of retail outlet. Connors thought that it was essential that fine fragrances were sold by trained consultants and that the full product range was available. Connors employed and trained all its own fine fragrance staff.

### ***Retail prices***

6.13. Connors had always sold fine fragrances at the RRP's in all its outlets. It thought that price discounting of these products was irrelevant except during the six weeks prior to Christmas and just before Mother's Day when gift shoppers might be temporarily attracted to lower prices. Throughout the rest of the year price discounting would have no significant effect on sales. Regular fine fragrance users would always continue to support the ongoing service provided by trained consultants. Duty-free outlets played no significant part in the Northern Ireland fine fragrance market.

### **Lloyds Chemists plc**

6.14. In written evidence Lloyds told us that it was the second largest chemists chain in the UK, the second largest drugstore chain and, through Barclay Enterprise, a large wholesaler to independent chemists. It had a total of over 300 authorized retailer agencies with ten of the fine fragrance houses.

### ***Selective distribution***

6.15. Lloyds considered that the selective distribution system benefited suppliers, retailers and consumers. Suppliers knew that the product was being sold in acceptable conditions with the correct degree of exclusivity; retailers were encouraged to invest in staff, store standards and fixtures in the knowledge that the exclusive range they were selling was only available from retail outlets of a certain standard; and consumers judged the exclusive value of the product by the ambience in which it was sold, the price, advertising and packaging. Lloyds thought that if the product's image were devalued sales would fall.

6.16. Lloyds said that removing the selective distribution system would not make the fine fragrance market any more competitive; instead it would destroy the market entirely. In its view the market did not need to be made any more competitive as there were already many suppliers and many alternatives to fine fragrances, all of which were widely available. It estimated that fine fragrances were available in up to 2,000 retail outlets in the UK. The competition in the market was illustrated by the fact that despite selective distribution, margins earned on these products were lower than on toiletries, and fine fragrances needed more investment in numbers of staff, staff training, shop fixtures and stock.

6.17. Lloyds told us that it had on certain occasions, with the permission of the fine fragrance houses concerned, sold fine fragrances to customers of unauthorized outlets. In particular, it had recently come to an arrangement with Lauder under which customers of nominated unauthorized branches could order specified Lauder fragrances and have them delivered either by post or through the unauthorized outlet concerned. The sale was credited to the authorized branch which supplied the goods and all such sales were recorded and details passed to Lauder. No stocks were held in unauthorized branches.

### ***Recommended resale prices***

6.18. Lloyds told us that it normally abided by suppliers' RRP's but reduced prices when price-cutting by competitors affected its sales and customer loyalty. Its main competitor, Boots, had been affected by Superdrug's campaign and when Boots offered reduced prices in November/December 1992, Lloyds reluctantly followed by cutting the prices of 12 of its best-selling fine fragrance lines. It commented that suppliers did not approve if their fragrances were retailed at less than the suggested retail price.

### ***The grey market***

6.19. Lloyds said that there was reasonably easy access to fragrances on the grey market, although the supply could be limited in quantity, range and availability. It had purchased small quantities of fine fragrances directly from grey-market suppliers.

### **The Garden Pharmacy**

6.20. The Garden Pharmacy, an authorized outlet in central London, said that it was a medium-sized retailer which had been selling fine fragrances for about ten years. By choice it stocked almost the full range of all the major brands in order to maintain a prestigious image. Although there was no pressure by the fragrance houses to do so, the pharmacy usually sold its fine fragrances at the RRP, at a margin slightly below its overall trading margin. It did, however, reduce prices when necessary, eg on overstocked lines. It thought that without selective distribution, outlets like The Garden Pharmacy would be unable to compete with other retailers which would be able to 'cherry-pick' the best two or three lines per brand (usually accounting for over 80 per cent of the sales of that brand). If selective distribution were abolished the market was likely to decline and the pharmacy and similar outlets would have to restrict their stock to a few profitable lines resulting in less choice for the consumer.

### **Tanna Chemist**

6.21. Tanna Chemist (Tanna), a pharmacy in South-East London which was not an authorized retailer, saw nothing wrong with the selective distribution system provided that the authorized outlets were prepared to stock the whole range of the suppliers' products, both fine fragrances and other items such as cosmetics and skincare. Department stores, the main stockists of fine fragrances, provided specialist counters for the fragrance houses' products. Tanna thought that it was not in the public's interest for fine fragrances to be sold in drugstores and small chemists shops which did not have this amenity or sell the whole range of products.

## **Department stores**

### **Allders Department Stores Ltd**

6.22. Allders, which is part of Allders Limited, a privately-owned group, gave written and oral evidence. It said that nine of its 18 stores stocked fine fragrances; with the exception of one situated in Hull, these were all in southern England.

### ***Selective distribution***

6.23. Allders considered that fragrances should be sold in a luxury ambience and by trained consultants. Its perfume departments were prime sites, usually situated near the front of the store, which it thought made an important statement about the type of stores they were. In December 1992 in one of its stores it had sold fragrances in makeshift conditions in another department. This had been a hasty reaction to market conditions at the time. Allders had been criticized by the fragrance houses about it and now considered that in the long term this type of presentation would harm the products' image and affect demand. Allders stocked a wide range of references and thought that this was an important part of customer service. It saw some items as being seasonal and therefore adjusted its stock levels accordingly.

## ***Consultants***

6.24. Allders shared the cost of some of its consultants with the fragrance houses concerned. On average this was on a 50:50 basis although the proportions differed between houses and stores. In its `flagship stores' a higher proportion of costs was likely to be paid by the supplier.

## ***Unauthorized retailers***

6.25. Allders thought that environment, customer service and width of range offered, including skincare and make-up, were of prime importance in the sale of fragrances. Department stores had invested in these factors over many years but unauthorized retailers which sold at cut prices had destabilized the market. Ultimately this would lead to fewer products being sold. Superdrug's perfume counters were quite attractive in themselves but the rest of the environment detracted from the products' image. It was this, rather than the price at which fine fragrances were sold in Superdrug, which was damaging.

## ***Recommended resale prices***

6.26. Allders reacted at store level to local competition, ie within 10 to 15 miles of the store in question, and cut prices to match it, but most prices were set from Head Office. When it had sold at below RRP the suppliers had not been willing to help out by reducing the wholesale prices. Allders also cut prices when selling off discontinued ranges. It saw RRP's as reflecting the fragrance houses' expert judgment of the value of the product. Although the decision to abolish RRP's would lead to some overall price reduction, this would be slight because the retailers' margins on fine fragrances were already relatively low. Prices would probably stabilize at somewhere between the existing RRP's and the prices being charged by discounters. If RRP's were removed every retailer would have to create its own bench-mark for prices and discounters would find it more difficult to make claims in their advertisements about savings.

## ***Wholesale prices***

6.27. Allders said that it had frequently raised with the UK distributors the difference in the prices it paid for fragrances compared with the much lower prices paid by Allders International. It had always been told that it was the decision of the parent companies of the fragrance houses to charge lower prices to duty-free retailers. It had not been able to negotiate with fragrance houses on trade prices.

## ***Stocking requirements***

6.28. Allders thought that the stocking requirements imposed by the fragrance houses were justifiable. Even if these requirements were no longer a requisite it would carry the majority of products in order to provide whatever the customers required. It monitored the age of its stock and consultants were trained to rotate the stock so that shelves were filled from the back. Allders would not expect any of its stock to be more than six months old.

## ***Debenhams plc***

6.29. Debenhams, which is wholly owned by The Burton Group plc, gave written evidence and attended a hearing. It told us that it had 86 stores, 84 of which sold fine fragrances, and operated cosmetics departments in two stores which it did not own. It regarded cosmetics, including fragrances, as important to the strategy of the department store. Debenhams viewed cosmetics, fine fragrances and beauty products as an integrated customer offer which had common retail requirements. They required an attractive, prestigious environment occupying prime space; informed, experienced staff; and a wide selection of brands and products to maximize customer choice. Given the retail synergy of cosmetics, fine fragrances and beauty products, adjustments could not be made to the retailing of one element without major repercussions to the others. Cosmetics provided just under 9 per cent of Debenhams' turnover, about half of this being fine fra-

grances. Debenhams said that consumers were trading up from mass-market to fine fragrances partly because of the fall in the real prices of the latter.

### ***Selective distribution***

6.30. Debenhams supported the selective distribution system as approved by the EC Commission on the grounds that it ensured that a wide range of premium fragrances and cosmetics were available in a suitable environment with advice from trained staff, to the benefit of customers. It considered that there was fierce competition between retailers within the system. Debenhams hoped that the fragrance houses' overhaul of their distribution networks following the EC exemption Decisions would safeguard standards of retailing.

### ***Retail costs and margins***

6.31. Debenhams believed that, as part of the service to customers, stores should offer a full selection of fragrance brands and product types, sizes and concentrations. Furthermore, the customer expected a premium-quality retail environment. This was demonstrated by the significant sales uplifts achieved following investment in improved counters. This required a major investment in stock and space, but was necessary to maintain both customer choice and the premium perception of the product. Substantial costs were also incurred on specialist sales staff, the fragrance houses bearing a part. Debenhams regarded knowledge of the products and knowledge of customers' specific needs as important to the sale of fine fragrances, though even more important to the sale of skincare products. Debenhams said that retail margins on fine fragrances, cosmetics and skincare were low (see Appendix 5.4) while costs were high.

6.32. With one minor exception, Debenhams bought all its fragrance requirements on the suppliers' standard terms. It had tried to negotiate discounts but found the fragrance houses to be strongly resistant to reducing wholesale prices, although they contributed to Debenhams' costs in upgrading some counters as well as to staff costs. Prices in the UK were broadly similar to those in other EC countries at the rates of exchange in force at the time of the inquiry, but some 10 to 15 per cent higher than in the USA.

6.33. Debenhams said that although in the short term it might be able to match lower retail prices on a local basis, in the long term it could not afford to sell fine fragrances at lower prices without compromising the range, service and quality of the environment presented to the customer. It would have to prune its total cosmetics, skincare and fragrance costs, eg by cutting down on some of the peripheral products, concentrating on key lines and reducing the space and staffing devoted to the area. Debenhams' Chief Executive had written to the fragrance houses in autumn 1992 complaining that their policy of charging high prices in the UK, compared with other countries, was fuelling the grey market and putting great strain on authorized retailers. But Debenhams had found that more recent information showed that UK prices were now broadly in line with, and in some cases below, other European countries although still above the USA.

### ***Recommended resale prices***

6.34. Debenhams said that it did not allow any supplier to dictate retail selling prices. However, it believed that if a retailer was committed to selling fragrances in an appropriate environment, with a suitable range and depth of stock, it would generally need to charge recommended prices to make a reasonable return. Its retail prices were usually in line with suppliers' recommendations, although prices were temporarily reduced (mainly to account holders) during promotional periods. It had a policy of refunding the difference in price if customers found a fragrance product cheaper at another local retailer. If RRP's were abandoned retailers' marketing costs would increase because retailers would necessarily have to invest in personnel to develop marketing strategies to respond to price movements.

## ***The grey market***

6.35. Debenhams said that the grey market had always existed but until the advent of the discount stores prices on the grey market had been higher than the manufacturers' prices. It believed that there were three major sources for grey-market supplies. The first was through agents in small, relatively undeveloped countries which bought the stock from the manufacturer, ostensibly to distribute in their own area, and then sold it to other countries. The second was through duty-free operators which had purchased more than they were able to sell, eg before the Gulf War. The third was through overseas retailers which were able to sell to the UK at a price higher than their purchase price but still lower than the UK retail price. Debenhams said that the fragrance houses' attempts to reduce grey-market supplies varied.

## **House of Fraser (Stores) Ltd**

6.36. HoF gave written evidence and attended a hearing. It told us that it had 59 stores not including Harrods (which was managed separately although part of the same group), all of which sold fine fragrances, together with cosmetics and skincare products. HoF considered that, for its business, the sale of fragrances could not be viewed in isolation. They were marketed as part of the whole range of beauty products, and departments in the stores were planned accordingly. By contrast with cosmetics, which were sold throughout the year at a relatively steady rate, fine fragrances were highly seasonal products, some 50 per cent being sold in a two-month period before Christmas. The range of fragrance products was, however, available throughout the year within the same attractive environment as the other beauty products; this was an important element of the marketing strategy of the fine fragrance houses and of retailers such as HoF.

6.37. HoF pointed out that this strategy inevitably gave rise to significant retailing costs. In the first place, departments devoted to beauty products took up substantial areas in prime positions within stores which were themselves in premium locations and so involved high rental costs. Secondly, staff costs were relatively high, not just in terms of the numbers but also because of the special training required. Thirdly, providing a range of fragrance products throughout the year while sales were mainly before Christmas led to significant stockholding costs.

## ***Selective distribution***

6.38. HoF considered that the selective distribution systems operated by the main fine fragrance suppliers were necessary to the maintenance of this style of retailing, making available a wide range of products in high-quality surroundings with knowledgeable service. Abandonment of these systems could be expected to lead to a reduction in choice for the consumer through retailers 'cherry-picking'-selling only products with a high turnover at cut prices-and making it uneconomic for traditional retailers to continue to carry the full range. There could also be a reduction in the number of new products because the substantial costs of launching them might not be recoverable within a reasonable period.

6.39. HoF also considered that, while greater retail competition resulting from abandonment of selectivity might create a short-term increase in sales, dropping the requirements for high-quality retail presentation and service which were an important part of the selective systems would in due course lead to a decline in sales, due to the products being devalued in the consumers' eyes. HoF said at the hearing that it had not yet decided whether to sign the fragrance houses' new retailer agreements. It subsequently told us that it had decided, subject to a number of issues including the outcome of our inquiry, that it would enter into the new agreements.

## ***Retail margins***

6.40. HoF told us that its retail margins on fine fragrance products, which averaged around [ \*] per cent, were on the low side in relation to the whole range of products it sold. On the other hand, the return per square foot on cosmetics (including fragrances) was above average. Fragrance houses had resisted proposals for reductions in wholesale prices, although they were prepared to negotiate on the proportion of sales staff employed and paid for by them rather than by the retailer.

## ***Recommended resale prices***

6.41. HoF generally observed RRPs which enabled it to achieve adequate retail margins to continue providing the high-quality service and environment required for the sale of these products. It matched lower prices offered by other retailers only in response to approaches from individual customers. Price promotions had largely been limited to special post-Christmas promotions on particular fragrances. It had reduced the prices of certain products after Christmas 1992 in order to dispose of excess stock, and commented that the two fragrance houses whose products had been involved had not been happy about this, although they had not taken any adverse action against HoF. HoF considered that RRPs had little effect on most retailers except as a guide to the price which they needed to achieve to produce required retail margins. If RRPs were abandoned HoF would still need to achieve similar retail margins. The abolition of RRPs would therefore have little effect on HoF's prices, but if it led to greater price cutting by others it would tend to devalue the products.

6.42. The availability of fragrances at lower prices through duty-free outlets did not have the effect of devaluing the products because customers knew that VAT was not paid and because the circumstances surrounding foreign travel were special.

## ***The grey market***

6.43. HoF said that some grey-market stock was available because the price differential across Europe meant that it could be bought at lower prices in other European countries and resold here. Some stock was the result of an auction of excess stock from duty-free outlets at a time when there were fewer visitors coming into the UK. The grey market had existed for several years but the fragrance houses had only begun to be concerned about it when the UK domestic market started to decline. If the grey market were abolished fragrance houses would have a significant drop in volumes.

## ***John Lewis Partnership***

6.44. John Lewis gave written evidence and arranged a visit to one of its stores. It told us that it had 21 stores selling fine fragrances. Retailing fine fragrances required a high level of service and expert advice to the customer, who was often choosing not simply a fragrance, but a range of beauty products to be used together. The customer also expected the retailer to stock a wide assortment of fragrances and the full range of products in each fragrance. Retailing costs were therefore high, while gross retail margins were below the average for the department store business as a whole.

## ***Recommended resale prices***

6.45. John Lewis said that it used suppliers' RRPs as a guideline for fragrance pricing. However, its fragrance prices, as with all its pricing, were subject to each shop being fully competitive within a local area, in accordance with its 'never knowingly undersold' undertaking. It did not consider that retailers could sustain significantly lower prices in the long term without reducing the level of service and choice to the customer.

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\*Figure omitted. See note on page iv.

Fine fragrance customers would not regard the loss of service and choice in return for lower prices as a good bargain.

## **Selfridges Ltd**

6.46. Selfridges, a subsidiary of Sears plc, gave written evidence. It regarded perfumery as an important contributor to its business. The products of each fine fragrance house had to be marketed in the style and ambience appropriate to the image of that house. This required heavy investment in shop fittings, fully trained and qualified staff, and advertising and promotion. Advertising costs were borne by the fragrance houses; retailers assisted them in meeting the other costs.

### ***Recommended resale prices***

6.47. Selfridges said that a marketing strategy based on the image of luxury was best achieved through added value in the form of presentation and service; aggressive discounting was to be avoided. Selfridges generally followed retail prices recommended by manufacturers but was not put under any pressure to do this. It offered gifts with purchase and more product at the same price; it also operated a price pledge of not being undersold by other retailers. The mark-on between cost and selling price was lower for perfumery than for many other areas of the store.

## **James Beattie PLC**

6.48. Beattie, a department store with eight outlets in the Midlands and North-West, told us that it stocked a wide range of products from the main fragrance houses.

### ***Selective distribution***

6.49. Beattie believed that fine fragrances should be sold through selected outlets whose ambience and image was in keeping with the prestige of the products. Sale through these outlets protected the consumer from poor-quality products, particularly those which were out of date and counterfeit. Stocking full ranges of items available and advice from trained consultants were also important in the sale of fragrances. Price was not necessarily a relevant consideration in this market.

### ***The market***

6.50. Beattie told us that the main changes in the market in the last five years had been the increase in the number of new fragrance launches and range extensions and the subsequent increase in stock investment. Many fragrance houses had cut back on the number of consultants they employed in Beattie's stores and this put more onus on its own fine fragrance staff. It was difficult to remain competitive within the market, whilst maintaining profitability. It was also difficult to provide the amount of training required for the increasing number of launches. Beattie had experienced an increase in the amount of counterfeit and grey-market merchandise returned by customers who were unhappy with products they had purchased elsewhere.

### ***Retail prices***

6.51. Beattie generally sold at RRP. However, its policy was to match competitors' prices within the local market-place. The new price would be marked on the price label but it would not be advertised or brought to the customer's attention in any other way. During the Christmas 1992 period Beattie had matched Boots' prices and sold selected products at 25 per cent below the RRP in all its stores. Only one fragrance house had allowed Beattie a comparable discount on the wholesale price. Beattie thought that although in the short term discounting might benefit consumers purchasing an established brand, in the long term the brand would cease to be desirable and ultimately would disappear from the market.

## **W Eaden Lilley & Co Ltd**

6.52. W Eaden Lilley & Co Ltd (Eaden Lilley), an independent department store, likened the fine fragrance market to the prestige motor car market. It said that authorized retailers carried a full range of products all year round, kept them in the proper condition and sold them with the advice of trained consultants in an environment appropriate to their standing in the market-place. Eaden Lilley thought that allowing certain selected items from manufacturers' ranges to be used as virtual loss leaders by non-accredited dealers was against the consumer's long-term best interests. Fine fragrances were not everyday commodities and responded to market forces that were not associated with discount stores and supermarkets. Eaden Lilley's Managing Director was Chairman of the Perfumery Committee of Associated Independent Stores, a buying group with over 500 outlets and sales exceeding £800 million, and Eaden Lilley said that its views reflected those of the membership of this group.

## **Tyrers Ltd**

6.53. Tyrers Ltd, a small family-owned department store, considered that the value of fine fragrances, as luxury products, depended on their exclusivity, not their intrinsic worth, and thought that without selective distribution the market would cease to exist. It emphasized how much time, money and effort was expended by authorized retailers throughout the year in developing the market in terms of consumer research and promotions, and in stocking a full range of fragrances and related products. Because the majority of fragrance sales was made in December, unauthorized retailers were able to take advantage of the authorized retailers' efforts, claiming that they were acting in the customers' best interests. This claim could be objectively tested by monitoring the extent to which fragrances were available in their stores outside the main selling season. Selective distribution ensured customer service all year round. The fragrance market was open and any company was free to introduce a new fragrance at a lower price.

## **Duty-free retailers**

### **Allders International Limited**

6.54. Allders International, which like Allders Department Stores is part of Allders Limited, gave written and oral evidence.

### ***Duty-free outlets***

6.55. Allders International saw fine fragrances as a very important part of its business. It told us that it had 17 duty-free outlets and 12 outlets operating on ships and ferries. Its stores were generally built to the high standards of the fragrance houses and the houses' locations within the store were a subject of negotiation. On ships like the QE2 a similar process was adopted but on smaller ships and ferries where space was constrained some houses would not be represented or would have a very limited range of products. In all duty-free shops a much higher volume of fragrances was sold over a given period than in department stores. Airport retailing was a high-volume but relatively low-margin business.

6.56. Allders International also supplied airlines and shipping lines with fragrances. It had to check with the fragrance houses first that these customers were acceptable as retailers of their products. These were obviously different types of selling environment but were acceptable to the fragrance houses because of the luxury of travel, the style of advertising in sales brochures and the fact that the staff were trained to sell fragrances. The style of selling between different airlines varied and tended to be more effective on the big scheduled airlines.

6.57. Alders International said that it was always trying to improve the performance and standards of its duty-free shops. This applied to the whole outlet, not just the perfumeries. It thought that trained consultants were essential to the selling of fine fragrances. In its shops some of these consultants were employed by Alders International and some by the fragrance houses. Similar staffing arrangements were adopted by manufacturers of other luxury goods. All staff on ships were employed by Alders International.

6.58. Alders International commented that US companies had made substantial inroads into the market with new brands. This had helped retailers' negotiations with the existing (French) suppliers and made the market more competitive.

### ***Duty-free market***

6.59. Alders International thought that although duty-free sales replaced UK sales to some extent, there was also a significant element of extra business. Passengers were likely to spend more than they would at home and might experiment with a new fragrance and, if they liked it, buy it on the domestic market later. Duty-free outlets, particularly the bigger and more important ones, were seen as the fragrance houses' 'window on the world' and reinforced the image of the products in the high street.

6.60. Alders International said that during the 1992 Christmas period its business had been eroded by discounting in the domestic market, particularly at the smaller regional airports where customers were probably more price-sensitive.

### ***The tendering process***

6.61. When inviting tenders for a concession at an airport the appropriate authority would set out in the tender document the general parameters within which the retailer could expect to operate. The authority would provide information such as projected passenger figures and any proposed site changes. The bid would involve different rentals for different types of product as they were based on the product's margin and turnover figures. Contracts varied considerably even when the same authority was involved and would sometimes be underpinned by a guaranteed minimum sum which the retailer was prepared to pay per customer.

### ***Retail prices***

6.62. Alders International said that fragrance prices in BAA-controlled shops were set at 21 per cent below the domestic RRP and this would apply to all BAA terminals. In non-BAA duty-free airport shops and on UK ferries and ships prices were 20 per cent below the domestic RRP. Eastleigh airport, although a BAA airport, competed on price with Jersey and prices were set by regular price surveys of shops in Jersey. The fragrance houses accepted that prices in duty-free outlets would be lower.

### ***Wholesale prices***

6.63. Alders International said that the prices it paid fragrance houses for particular products were significantly lower than those paid by Alders for the same products for sale on the domestic market.

### ***Stocking requirements***

6.64. Alders International told us that stocking decisions for duty-free outlets were difficult. The confined space, exacerbated by the varying requirements of the multinational clientele, made it very different from stocking for the domestic market. Its decisions were influenced by the fragrance houses and in some cases it did hold larger ranges and higher levels of stock than it would choose to.

## ***The grey market***

6.65. Allders International thought that a large amount of grey-market stock had originated at the time of the Gulf War when fewer people had travelled overseas and there was surplus stock available. The recession in the USA had also been mentioned as a contributory factor. Allders International had been told by certain fragrance houses of a few cases where products it had sold wholesale to other duty-free retailers had found their way on to the grey market.

## **Forte Retail Services**

6.66. Forte, a part of Forte Airport Services which is a division of Forte (UK) Limited, gave written evidence and attended a hearing. It said that it operated 16 duty-free outlets at Heathrow, London City and provincial airports. It also operated seven duty-paid drugstores where a more limited number of fragrances was sold.

## ***Duty-free market***

6.67. Forte thought that the duty-free market encouraged consumers to buy more fragrances overall and therefore increased the size of the home market. This was only partly due to lower prices. The unique selling environment was also a contributory factor. Holidaymakers at airports, with time to browse and money to spend, were often introduced to fine fragrances for the first time. Forte said that as far as it was able to in the confined space available, it tried to create the luxury ambience which it thought essential to the sale of fine fragrances. Counters were standard sizes and Forte designed its own fixtures and fittings. These were uniform throughout its outlets and the fragrance houses were not involved in their design, although they did approve the positioning of their own products. There was an element of self-service in all Forte's duty-free outlets except the tiniest, but this was only a back-up to the counter service to help people who were in a hurry. Perfumeries were usually situated near the front of the store in order to give an indication of the type of products on sale there and this location was the highest-selling product area in both duty-free and duty-paid shops.

6.68. Forte aimed to stock as wide a range as possible of a particular fragrance house's products, in relation to that house's importance in its total turnover. Consumers varied in their requirements: some, particularly those at Heathrow where there was predominantly business traffic and passengers might be described as being more sophisticated, were likely to buy several items and to require advice from a consultant. In the charter market consumers tended to have a more preconceived idea of what they wished to buy. Forte had no way of knowing what percentage of its sales were made to UK residents.

6.69. Forte said that it was experiencing some fall in sales, apparently because of the extent of discounting in the domestic market. At some airports passengers had been seen comparing its prices with those shown by discounters in newspaper advertisements. Forte believed that price contributed to the luxury image of fragrances and that, in general, if prices were lowered, although in the short term demand might increase, in the long term the products would become less desirable.

## ***Consultants***

6.70. The staffing of Forte's duty-free outlets was a mixture of Forte employees and consultants employed by the fragrance houses and the proportions varied according to the size of outlet. Both categories of staff were given training by the fragrance houses. The time spent on this would depend on the size of the unit concerned and the consultant's previous experience and in all cases it would be followed by regular sessions to update staff on product developments. Forte said that these staffing arrangements were similar to those for other luxury products.

### ***Retail prices***

6.71. Forte said that UK duty-free prices were currently probably the lowest in Europe, although Amsterdam airport was generally the cheapest. BAA's policy was that fragrances in its duty-free outlets should be sold at 21 per cent lower than the UK domestic RRP. In order to generate sales of the lower-selling brands Forte had run a continuous promotion in many of its shops for the last three years. This involved selling one reference from a minimum of 20 brands at any one time, from a list of about 30 lower-selling brands, for at least 30 per cent lower than the RRP. The fragrance houses had selected the brands concerned and sold to Forte at a lower price so that it made the usual margin on the discounted products.

6.72. As far as its duty-paid drugstores were concerned, Forte usually sold at RRP but there was no pressure from the fragrance houses for it to do so. The prices of fragrances on aircraft were usually lower than in duty-free shops because they had no rental charges to pay and therefore were able to take a lower gross profit margin. On charter airlines, in particular, staff were trained to sell fragrances and testers were available. However, their range of products was very limited.

### ***Retail margins***

6.73. Forte regarded gross margins as high in the duty-free business (although they were not so high on fine fragrances as on spirits) but considered that gross margins were not high in the domestic market.

### ***Wholesale prices***

6.74. Forte had different channels of supply for its duty-free and duty-paid outlets. In most cases the former were supplied direct from the fragrance house headquarters where sales teams supplied duty-free outlets throughout the world. Its drugstores, as part of the home market, were supplied from the UK at significantly higher prices. Forte thought that the price difference was due to the fact that prices to duty-free outlets did not take account of the running costs of the UK distributor, or of advertising and point-of-sale material costs.

### ***Recommended resale prices***

6.75. Forte said that over the last five years the fragrance houses had changed their attitude and no longer tried to influence retail prices. It thought that it was the image of price-cutting which the fragrance houses disliked, such as was created by large posters advertising cut prices, rather than the fact that the prices being charged were below the RRP. Because its duty-free prices were based on reductions from the RRP Forte would not be in favour of the abolition of RRP. At present on liquor and tobacco the Airport Authority conducted quarterly surveys and then calculated the average high-street price for each product. Carrying out a similar exercise on fragrances, where there were many more references, would be more difficult. Forte thought that removing the RRP would generally result in more variation in price, even between department stores, as was the case at present on other products where there were no RRP. Prices were, however, unlikely to fall significantly because the cost of selling would not change.

### ***The grey market***

6.76. Forte thought that fragrances became available on the grey market as a result of surplus stock in other countries. This could either be at times of recession when retailers miscalculated demand and were left with more than they could sell or through distributors purchasing over their requirements in order to sell the products on. Sales on to the grey market could also be a short-term answer for the manufacturers when they had surplus stock. Up until the Christmas 1992 period the fragrance houses did not appear to have been very successful in their attempts to prevent supplies reaching the grey market but since then Forte had heard of several overseas agencies being closed because of their grey-market activities.

## **Supermarkets**

### **Asda Group plc**

6.77. Asda said that it retailed a wide range of food and non-food products in its 204 superstores located throughout Great Britain and had a substantial and growing health and beauty business. In addition it had pharmacies operating in 40 stores and was hoping to increase this number.

6.78. Asda told us that it was attracted to the fragrance market for a number of reasons: its affinity to Asda's existing product ranges; a belief that gross margin structures offered scope for more competitive pricing; and evidence from duty-free sales on aircraft that customers were prepared to purchase fragrances in a different environment from the traditional department store. It had introduced trials into seven stores in 1991 and as a result of their success had expanded its operation into 152 stores by December 1992. Asda sourced its fragrances from the grey market. It said that this had enabled it to sell the products at up to a third off conventional retail prices, whilst earning a satisfactory gross margin.

### **Gateway Foodmarkets Limited**

6.79. Gateway Foodmarkets Limited (Gateway) said that its experience of selling fine fragrances was limited. It had approached the fragrance houses in 1988/89 but had been refused supply on the grounds that the sale of fragrances in supermarkets was incompatible with the products' image. Gateway thought that the refusal was also based on the manufacturers' belief that it would sell fragrances at below the RRP. During the 1992 Christmas season it had, as an experiment, sold products sourced from the grey market in its Somerfield stores, which it said were positioned in the high-quality segment of the market. It had not approached the fragrance houses on this occasion because it was aware of Superdrug's failure to obtain direct supply. Gateway had sold a range of 14 products, all of which had gone out of stock before Christmas. They were sold at below the RRP, and only from kiosks because of their high value.

### **J Sainsbury plc**

6.80. J Sainsbury plc told us that after giving the matter considerable thought it had decided not to comment.

### **Tesco Stores Limited**

6.81. Tesco, which gave written evidence and attended a hearing, said that since 1991 it had been selling fine fragrances in the Health and Beauty World areas at 25 of its larger superstores. Most of its new stores were superstores and differed from its standard supermarkets by being single-storey, and by having over 25,000 square feet of selling space, a wider range of products and a car park. Tesco believed that its Health and Beauty World areas with their high-quality fittings took it ahead of its direct competitors and the rest of the retail industry, including Boots and many department stores.

### ***Selective distribution***

6.82. Tesco complained that it had been excluded from the fine fragrance suppliers' distribution systems and had therefore been forced to rely on the grey market. The principal disadvantages of this were that it could not get reliable information about changes in demand (which were essentially dictated by the suppliers), and was unable to obtain supplies of fine fragrances on the usual commercial terms. Continuity of supply was not assured and it was not always possible to meet requirements for particular brands, sizes or types of fragrance. The relatively low prices of grey-market supplies were far outweighed by these disadvantages.

6.83. Tesco said it considered that a monopoly situation within the meaning of section 6(1)(c) of the Fair Trading Act 1973 existed in favour of fine fragrance suppliers in the UK. It thought that these companies followed policies which were in their essential features identical and tended to prevent, restrict or distort competition. The main features of these policies were:

- marketing with a luxury image, using advertising and expensive packaging and presentation;
- relatively high prices; and
- distribution through selected retailers only.

6.84. Tesco said that it did not quarrel with the projection of a luxury image by advertising and other promotional devices. It considered, however, that a selective distribution system was not necessary to marketing with a luxury image. It suggested that the EC Commission Decisions approving distribution systems operated by YSL and Givenchy were influenced by considerations relevant to skincare and cosmetic products rather than to fine fragrances. The retail supply of fine fragrances did not require the use of trained staff. The combination of features described above produced adverse effects on competition that were not justified by any objective or acceptable need and, further, the adoption of the same features by all the suppliers of fine fragrances magnified those adverse effects.

6.85. In Tesco's view the selective distribution system prevented effective competition between retailers and favoured traditional forms of distribution at the expense of more up-to-date forms of distribution. But the demand structure created by the promotional effort of the suppliers made it essential for any retailer wishing to offer a successful range of fragrances to have access to premium-priced products.

6.86. Tesco told us that some of the suppliers which it had approached had failed to respond to its request for authorized status, or had not done so in a timely manner. Further, Tesco considered that some of the reasons given by fine fragrance suppliers for rejecting its approaches were vague and irrelevant to modern out-of-town superstores, and that the criteria had been applied in a discriminatory manner. For example, it had been said that the sale of food was incompatible with the sale of fine fragrances, yet food was sold by stores authorized to sell fine fragrances (for example, Boots). Another reason given was that the Tesco superstores were large out-of-town shopping facilities, yet neither size nor being outside towns had prevented other stores from being authorized. Tesco believed that its approach was not inconsistent with the suppliers' desire to maintain the luxury image of their premium-priced products.

6.87. Tesco suggested that the underlying motive of suppliers was to maintain retail prices. The threat posed by Tesco was not that the image of the suppliers' products would be damaged by their sale in Tesco's superstores but Tesco's ability to achieve high sales volumes by cutting prices.

6.88. Tesco considered that the present system of distribution was contrary to the public interest in the following ways:

- price competition was limited at retail level;
- there were suggestions that the suppliers were abusing the system to maintain fine fragrance prices at an unacceptably high level;
- inter-brand competition was limited;
- entry to the market, by new suppliers or new retailers, was made more difficult. As regards the former, new products manufactured by lesser-known suppliers had little real chance of being launched successfully unless they were marketed in retail outlets that also sold the premium-priced products; this enhanced the competitive position of retailers admitted to selective distribution systems, to the detriment of those excluded;
- competition between different forms of distribution was limited; and
- as a result of the above, consumers were being forced to pay more for fine fragrances than would otherwise be the case.

## ***Pricing***

6.89. Tesco agreed that the price of fragrances contributed to their luxury image, but believed that a 20 per cent price reduction would not affect this image. It aimed to sell fine fragrances at a price broadly in line with that offered by duty-free outlets at airports, but in a superior selling environment. It was able on the basis of this pricing policy to achieve satisfactory margins. Tesco believed that the marketing and distribution policies of the suppliers were responsible for maintaining very high prices and very high retailers' margins.

## **Other retailers**

### **Superdrug Stores plc**

6.90. Superdrug, a wholly-owned subsidiary of Kingfisher plc, gave written evidence and attended two hearings. It told us that it was the second largest retailer of healthcare and beauty products in the UK, with 680 stores nation-wide. Superdrug said that its commercial strategy for the 1990s was to expand its traditional focus on essential healthcare and beauty products (such as toothpaste and shampoo) to a wider range of personal care products, especially pampering products such as skincare. In furtherance of this strategy it wished to become an authorized retailer of fine fragrances.

6.91. Superdrug said that repeated approaches which it had made by telephone to leading fragrance houses in the five years up to 1991 to discuss supply terms had been rebuffed. In November 1991 it had embarked on a trial of fine fragrance sales, using supplies obtained from grey-market sources, and had submitted formal applications for authorized status. Its fragrance sales were made only through selected stores which it had refitted for the purpose. Its aim had been to demonstrate its long-term commitment to fragrances by investment in retail display facilities; to show that it could meet the criteria set by the fragrance houses; and to test consumer reaction to Superdrug as a stockist of fine fragrances. During the period of our inquiry Superdrug increased the number of outlets in which it sold fine fragrances from 20 to 42, and told us that it planned to increase this to 60 outlets by the end of September 1993. Superdrug had been able to obtain a reasonably broad range of fragrances from grey-market sources but said that these sources would not be satisfactory as a long-term source of supply, as Superdrug would be unable to guarantee its customers a full range of products and back-up services from the manufacturers. It wished eventually to sell fine fragrances in 200 outlets but this would not be viable through the grey market.

### ***Authorized retailer status***

6.92. When Superdrug first gave evidence to us it complained that every one of the 25 fine fragrance houses to which it had initially applied for authorized retailer status had indulged in delaying tactics. For example, it said, some houses had informed Superdrug that they were still redrafting their retailer agreements in the light of the EC Commission's Decisions and that no new applications could be considered until this exercise had been completed. Others refused to consider its application until it ceased sales of grey market merchandise. Only three houses had agreed to supply Superdrug. All of these were relatively small suppliers to the UK market. As regards two of the three houses, Superdrug did not consider that the chances of a successful launch of their products merited the costs of entering into supply agreements. However, Superdrug had entered into an agreement with the third company.

6.93. When Superdrug came to the second hearing at the MMC in July 1993 it told us that more fragrance houses had now carried out evaluations of its stores, although a number appeared to be waiting for the outcome of our inquiry and two were still redrafting their retailer agreements. Superdrug thought that these were not valid reasons for refusing its application. YSL had been one of the fragrance houses which had evaluated a Superdrug store and had told Superdrug that it had come very close to satisfying the pass mark on the store-related criteria. Superdrug said that YSL's marking was stricter than that required by the EC Commission and the assessment form contained criteria that had not been approved by the Commission. If the marking were adjusted to take account of this, Superdrug would pass the evaluation. A meeting had

been arranged with YSL to discuss how Superdrug could make improvements with a view to reaching YSL's required standard on store-related criteria. However, YSL had said that Superdrug's name was incompatible with the YSL brand names and had told Superdrug that it would refuse Superdrug's application in any event. Superdrug commented that the proposed meeting to discuss in-store criteria was therefore unlikely to serve any practical purpose.

6.94. Forty Superdrug stores had also been evaluated by Dior but Superdrug had been told that it had failed to achieve the minimum qualitative criteria. Superdrug said that it had been given inadequate information about the reasons for this and had received no indication of the actual marks it had achieved. It was therefore impossible to know what improvements it should make. Dior, Chanel, Sanofi and Dunhill had also said that Superdrug's image was not compatible with their respective brand names. Superdrug said that none had substantiated their views with evidence of its alleged lack of standing.

6.95. Superdrug drew our attention to a meeting it had had with Muelhens at which Muelhens had said (and recorded in its own minute of the meeting) that there was a risk that if it supplied Superdrug and Superdrug discounted its products other retail customers would also discount and in order to maintain their margins would demand lower wholesale prices. Superdrug believed that this was an indication of retailer pressure on a fragrance house not to supply Superdrug.

6.96. Superdrug argued that, judged against the EC Commission Decision authorizing Givenchy's selective distribution system, it was an appropriate channel for retailing fine fragrances. In particular, it considered that its stores met the requirements for suitably experienced staff; suitably fitted outlets in attractive locations; suitable storage conditions; stocking a good range of competing fine fragrance brands; effective display of products; and minimum turnover.

6.97. Superdrug complained that the UK fine fragrance suppliers applied the criteria set out in the EC Commission Decision in ways which were discriminatory and difficult to justify objectively. For example, taking account of the floor space devoted to fine fragrances discriminated against small shops, while taking account of the proportion of non-fragrance products in the shop discriminated against department stores, which stocked a wide range of products. Other criteria were highly subjective.

6.98. Superdrug observed that every one of the assessment forms it had seen contemplated that the retailer's point of sale already included a fragrance offering. It wondered how a retailer could satisfy the manufacturers' admission criteria without already having a fragrance offering. It seemed that the retailer had to build an offering of fragrances sourced on the grey market before submitting its application for authorized status. Given the apparent unavailability of operating on the grey market, Superdrug complained that the manufacturers had been unfair to criticize Superdrug for taking this approach, or to mark it down for stocking an insufficiently wide range of products or for having (which it disputed) insufficiently trained sales staff; only the manufacturers themselves could guarantee the full ranges of products and staff training.

6.99. Superdrug considered that responses from some fragrance houses indicated covert adoption of illegal criteria for approving retail outlets. Two responses suggested a concern to limit the numbers of authorized stockists and other responses suggested a desire to ensure that RRP's were maintained.

6.100. Superdrug believed that the fragrance houses' application of selective criteria was inconsistent. Superdrug provided us with a number of examples of authorized retail outlets which, Superdrug said, clearly failed to meet the standards required of Superdrug by the fragrance suppliers. In particular, one multiple retailer had sold fine fragrances from self-service displays at three of its stores. Thus, although a perfume consultant was available, a customer was not guaranteed the level of individual attention traditionally expected of fine fragrance retailers. Superdrug considered that the sale of fine fragrances on aircraft and ships also departed from the criteria to which Superdrug was subjected. Superdrug stressed that it did not endorse the lowering of standards to these levels; it merely wished to highlight the contrast between the fragrance houses' strict approach towards Superdrug and their relaxed attitude towards other retailers. It said that this created suspicion as to the manufacturers' real motives.

### ***The advertising issue***

6.101. Superdrug complained that in September 1992 some newspaper and magazine publishers had refused to accept its pre-Christmas advertisements for fine fragrances. Superdrug said that it was surprised as some of the publishers had previously accepted Superdrug advertisements for its exclusive haircare products. In Superdrug's view the publishers were not prepared to jeopardize their profitable relationships with the fragrance houses, which, it believed, had threatened to withdraw their advertising from publications which agreed to carry its advertisement. Superdrug drew our attention to a newspaper article quoting one publisher's admission that such threats had been made. Superdrug said that after its first fine fragrance advertisement had been refused (on the grounds that the advertisement quoted brands and prices and was not in keeping with the image of the publication concerned), an alternative, generic style of advertisement had been developed. In January 1993 Superdrug's advertising agency had approached six newspaper and magazine publishers about including this advertisement. Superdrug said that it had aimed to produce an advertisement which was in keeping with the image of the publications concerned. With one exception, publishers had either not responded or had refused the advertisement.

### ***Discounting***

6.102. Superdrug considered that, whatever the detailed debates on presentational criteria or ambience, price lay at the heart of the fragrance houses' reluctance to grant it authorized status. Only when Superdrug and other discount stores had entered the market in particular towns or shopping centres had there been discounting by authorized retailers in those areas. Otherwise there had been a virtual absence of discounting below RRP's, although the price uniformity was disguised through promotional devices such as 'free gift with purchase' promotions.

### ***Superdrug's NOP survey***

6.103. In February 1992 Superdrug had commissioned NOP to conduct a survey of consumers' attitudes towards the company as a stockist of fine fragrances and to the practice of discounting fine fragrance prices. NOP had carried out over 500 interviews in 29 locations using quotas for age and social classification. The 1992 conclusions were tested by repeating the survey in April 1993 but with a larger sample size. Superdrug said that these results showed strong and increasing support for Superdrug. 81 per cent of those questioned considered that fine fragrances were too expensive; 67 per cent said that they would buy more if prices were reduced by 30 per cent; and 91 per cent were 'very likely' or 'fairly likely' to buy from Superdrug. In this context, Superdrug criticized the conclusion of Professor Weber, in his report prepared for the EC Commission (see paragraph 3.2), that if fine fragrance prices were cut, this would undermine the luxury image of the product and lead to loss of sales. Superdrug considered that there was no hard evidence to support this conclusion. Superdrug suggested that, rather than maintain fixed, uniform prices to protect the image of prestige and luxury, fine fragrance manufacturers were more concerned to observe relative price bandings, distinguishing 'premium' fragrances from their 'mid-range' counterparts. In this price framework some discounting need not degrade the luxury image of fine fragrances.

### ***The shop name***

6.104. Superdrug believed that the image criterion or shop name was the most subjective and unquantifiable of the EC-approved criteria. It said that this criterion was designed to apply to an outlet which otherwise satisfied the point-of-sale criteria but had a name which suggested a restricted decoration or service, eg a trading name incorporating the word 'warehouse'; or a name which was associated in the public's mind with a retailer format or attributes which were at odds with the manufacturer's objectives, eg a name associated with catalogue shopping. Superdrug said that it did not fall into either of these categories and was concerned that the criterion was being stretched by the fragrance houses to cover a situation for which it was never intended.

6.105. Superdrug believed that it was the public's perceptions which should determine whether this criterion was satisfied. Its recent NOP survey had shown that 91 per cent of consumers were happy to see their favourite brand of fragrance sold in Superdrug stores. 80 per cent of the respondents had agreed that they knew what brand of fragrance they were going to buy before they entered the shop. Superdrug said that it had been selling fragrances for nearly two years and there was no evidence that the brands had suffered as a result. Nor was there any evidence in the USA where drugstores had been selling grey-market fragrances for five years. In 1993 its sale of fragrances would amount to £20 million, which it estimated to be nearly 5 per cent of the market, a high enough level to show damage to the brands if there were any.

6.106. In response to a suggestion that it should hive off its fragrance stores and adopt a different name which consumers would not associate with Superdrug, it said that this would be disproportionate to the importance of the image criterion. It did not wish to lose the value of the Superdrug name and thought that if any change were required, a change in the shop sign or an addition to the name should suffice.

6.107. Superdrug said that the image criterion was only one of many and must be applied in a proportionate manner. In any event it was not in its interest to damage the fine fragrance brands as it wished to make a long-term investment in this sector and would itself stand to lose if the brands it was seeking to stock were devalued and disappeared from the market.

## **The Perfume Shop Ltd**

6.108. The Perfume Shop, a subsidiary of Merchant Retail Group plc, gave written evidence and attended a hearing. It told us that it was a chain of 11 specialist perfume shops selling men's and women's fine fragrances and related perfumed toiletries. Its shops were nation-wide and predominantly situated in major shopping centres. The chain, which had begun trading under the name of Eau Zone in 1990, had been acquired by Merchant Retail Group in 1991 and relaunched as The Perfume Shop in 1992.

6.109. The Perfume Shop said that it offered a wide range of up to 200 brands of fragrance, comprising about 1,000 references, at up to 50 per cent off the suppliers' RRPs. It tried to stock all the major brands, although this was not always possible because its supplies were obtained from grey-market suppliers which were unable to supply all products on a continuing basis.

### ***Selective distribution***

6.110. The Perfume Shop said that the selective distribution system prevented it from providing as good a service to its customers as it would wish to because of its inability to obtain supplies from the fine fragrance houses. When it first gave evidence it had not applied for authorized retailer status, partly because it believed that such applications would have been turned down because of its discounting policy and partly because it wanted to concentrate on building the business and proving that this type of outlet would be viable in the UK.

### ***Discounting***

6.111. The Perfume Shop considered that the discounting of prices in its shops had enabled it to capture a significant share of the market in the localities concerned. It said that this, together with the operations of Superdrug and some supermarket chains, had led to authorized retailers such as Boots and John Lewis discounting the prices of fragrances. The Perfume Shop said that this was a direct benefit to consumers who were able to purchase fine fragrances at cheaper prices than ever before.

## ***Recommended resale prices***

6.112. The Perfume Shop used RRP's as a bench-mark for its discounting. It thought that if they were abolished most retailers would continue to apply a similar margin to that applied at present. This would probably be higher in the better-quality outlets and would therefore result in a range of prices across different types of shops.

## **A former retailer**

6.113. The MMC received representations from a former retailer of fine fragrances. The shop had traded for seven years, specializing in fragrances and associated products such as perfumed soap, talcum powder, bath gel, etc. It had closed within the last two years.

6.114. The former retailer complained about pressure placed on retailers by fine fragrance suppliers to stock products regardless of their sales potential in the locality. He accepted the requirement, when first stocking a new brand, to take an initial stock covering the product range. The problem arose when retailers wanted to reorder certain items, and representatives of the fragrance houses put pressure on them-especially small retailers-to order other items which they already had in stock and for which there was little demand. The use of `merchandisers'-special display boxes containing non-standard containers of fragrances at special prices, mixing fast-selling brands with slower-selling brands-was another way of getting retailers to take less popular items.

6.115. The former retailer added that this pressure would cause less of a problem if suppliers were willing to take back items which were not selling. He said that suppliers strongly resisted requests from small retailers to take back such items, and when they did so, deducted handling charges of between 20 and 30 per cent. The combination of forcing sales with a reluctance to accept returned goods added significantly to the costs of small retailers and had been a factor in his decision to close the business.

## **Associations**

### **Consumers' Association**

6.116. The Consumers' Association (CA) said it hoped that our inquiry would find out whether the fragrance houses were attempting to set retail prices; unfairly refusing to supply particular outlets; and exerting pressure on magazine and newspaper publishers to refuse advertising from particular retailers. CA also hoped that we would look at some of the wider questions relating to the general future of block exemptions in the fine fragrance industry.

6.117. CA had obtained information from most major retailers, including discounters, and in September 1992 it had carried out a price survey in 70 shops around ten major urban centres. The results of the survey were summarized in the December 1992 issue of *Which?* magazine. CA had also assessed the quality of these outlets in terms of size, presentation and general facilities.

### ***The price survey***

6.118. CA said that its price survey had shown that overall, for the ten items it looked at, the high street non-discounters sold products at or near to the manufacturers' RRP's while discount stores' prices were over 20 per cent lower. Discount stores' prices were also slightly below the average price of fragrances in duty-free outlets. In addition the survey had shown that in areas where there was no Superdrug, Boots (the major `non-discounter') sold at around the manufacturers' RRP's. Where there was a local Superdrug, Boots' prices dropped by an average of 19 per cent to price levels similar to Superdrug's. CA said that this suggested Boots considered Superdrug to be a powerful and important competitor and saw price to be important to its customers. It said that Boots (and presumably other non-discounters) would suffer from more widespread

sales by Superdrug and other discounters which would force them to cut prices and therefore reduce their margins.

### ***Qualitative survey of retail outlets***

6.119. CA said that its survey had suggested that the fragrance houses' selective distribution criteria were being used erratically and often unfairly. In particular it had shown that:

- (a) some authorized retailers were selling fragrances in substandard surroundings, often adjacent to non-luxury products, with crude price markings, poor lighting, etc;
- (b) some gave poor service-in particular there was no guarantee of the availability of any (let alone expert) dedicated sales staff for selling fragrances;
- (c) independent chemists, in particular, rarely employed dedicated staff, many kept the products in locked cabinets and had a limited range available; and
- (d) unauthorized outlets often provided good levels of service: while this was not always the case, the best were very good, and easily comparable to the authorized outlets.

6.120. CA also noted that one researcher had been told by a chemist that fragrance houses decided the selling prices. CA could not say from its limited survey how widespread this impression was but thought the comment indicated that one of the main points of the EC Commission Decisions, that retailers should be free to set their own prices, had not been properly communicated to retailers.

### ***Article 85(3) exemptions in the fine fragrance industry***

6.121. CA was sceptical about the justification for block exemptions in this sector. It thought that two questions arose. First, how special was the fragrance industry, and secondly, would selective distribution provide the promised benefits to the consumer?

6.122. CA did not think that the factors identified in the Decisions as justifying special treatment necessarily distinguished fragrances from other luxury products. In this sense, fragrances might be no more than one end of a spectrum of consumer products which were (and ought to remain) open to free competition in the retail market. There were no criteria that justified treating fragrances differently, such as the need for professional medical advice on purchase, or after-sales service, and a Superdrug-commissioned NOP survey had suggested that consumers placed a high value on brand, and a low value on the method of sale. This did not mean that trained advice and a wide range of products were not important for some consumers-but there seemed no underlying reason not to leave this to the market to decide.

6.123. As far as the benefits were concerned, the NOP survey for Superdrug suggested that consumers did not place a high value on the alleged benefits of selective distribution. However, setting these doubts aside, CA questioned whether the system would provide these benefits anyway. Its evidence suggested that the fragrance houses would accept standards of retailing which fell below what they expected-provided that the retailers concerned did not erode the general profitability of the market by cutting their margins. In CA's view it would be very expensive for the fragrance houses to provide the consumer benefits identified in the Decisions and often the investment might not be worthwhile if indeed it was practical at all. This applied particularly to sales through local chemists which accounted for 4 per cent of fine fragrance purchases (according to NOP data); but it also applied to many duty-free outlets, which made up 31 per cent of such purchases. CA thought that either the selective distribution criteria should be enforced across the entire market, or they should be dropped altogether. Otherwise the fragrance houses could retain the benefits of selective distribution, including in particular the ability to refuse to authorize outlets which did not conform to their requirements (whether explicitly on quality of service or implicitly on pricing), without delivering the consumer benefits.

## ***Refusal to carry advertising***

6.124. CA had not researched the alleged refusal of magazine publishers to refuse advertising from discounters, but it expressed its concern about any pressure of this kind which would confirm the fragrance houses' hostility to discounting and their willingness to use almost any means to prevent it.

## ***CA's conclusion***

6.125. CA thought that fragrance houses should be forced to end their refusal to supply discounters, provided such outlets met the general qualitative standards applied to other authorized retailers within the area concerned. Fragrance houses should also be required not to put pressure on magazine publishers to refuse advertisements from discounting retailers. Finally, the industry should be required to ensure that the employees of the companies concerned were aware of the requirements set out in the EC block exemption, and that the relevant parts, notably the freedom to set prices, were effectively communicated to retailers.

## **Cosmetic & Perfumery Retailers Association**

6.126. COPRA said that it was a voluntarily-run organization with 19 members, including several of the leading authorized retailers of fine fragrances. Its aims were to provide a forum for discussion, to act as a voice for the development and maintenance of cosmetics and perfumery retailing and to negotiate with trade associations and other bodies. COPRA did not wish to express any views on our inquiry. At our request it supplied minutes of its meetings held between February 1990 and April 1993. A large part of the COPRA meetings appeared to concern regulatory matters, relations with suppliers and social events. However, we noted that the subject of pricing was raised on several occasions, mainly prompted by discounting by unauthorized retailers. At the meeting on 9 September 1992, for example, COPRA members discussed whether, in response to Superdrug's discounting, their firms would be cutting prices in the pre-Christmas period.

## **National Pharmaceutical Association**

6.127. The National Pharmaceutical Association (NPA) told us that it represented the vast majority of pharmacy proprietors in the UK, accounting for about 10,000 retail pharmacies, many of which were authorized retailers. As far as price was concerned, suppliers issued RRP's but retailers were free to set their own prices. Although price-cutting was not widespread, it did exist and benefited those customers who were prepared to shop around. The NPA made the following points in connection with pricing. Firstly, the agency agreements placed retailers under a duty to stock substantial quantities of the range of fragrance products which meant slow- as well as fast-moving lines. The costs involved in maintaining this stock would have considerable impact on retailers' margins. Secondly, when new fragrances were introduced retailers were required to stock a range of items. As fine fragrances were fashion items there was always a chance that a new product might prove unpopular and not sell, and this was a financial risk for the retailers. Thirdly, authorized retailers were required to spend time and resources on staff training.

6.128. The NPA thought that consumers required a high level of exclusivity when buying fragrances. It favoured the selective distribution system since this helped to ensure that the retailer's image was equal to that of the product. If fine fragrances were available for general distribution this could undermine consumers' perception of the products and, in the long term, reduce demand for them.

## **Magazine publishers**

6.129. We wrote to a number of newspaper and magazine publishers asking whether they had refused Superdrug's advertisements (see paragraph 6.101). Several said that they had not been offered advertising by Superdrug; others said that they had agreed to accept it. The publishers which gave evidence said that they had not been put under pressure by the fragrance houses to refuse the advertisements except that one publisher said that there had been a vague implication, resulting from conversations it had had with various

agencies, in respect of one of its magazines. Any hint of reaction from long-standing clients was not something it wanted to risk.

6.130. We held hearings with three publishers of up-market magazines which had refused Superdrug's advertisements: The Condé Nast Publications Ltd, IPC Magazines SouthBank Publishing Group and Hachette/EMAP Magazines Limited. They gave the following reasons for doing so:

- (a) Superdrug's image was not complementary to the exclusive image of the magazine concerned. Publishers wished to satisfy the requirements of their existing advertisers and would not achieve this by allowing advertisements which did not fit with the exclusive image. The quality of the advertisement was as important as the quality of the product being advertised: although Superdrug's second advertisement would have been visually acceptable, the perceived image of the company was not. To have accepted this second advertisement would have been a publicity victory for Superdrug.
- (b) The fragrance houses were excellent customers and the publishers did not wish to jeopardize their relationships with them by becoming involved in the dispute with Superdrug. Publishers considered advertising revenue from the fragrance houses to be extremely important. Particular magazines might not survive if the fragrance houses withdrew their advertising. This would be because of both the resulting lack of revenue and the change there would be in the nature of the magazine if the revenue base was replaced by other advertisers.
- (c) There was concern that Superdrug was operating outside the approved distribution systems. To accept advertisements from an unauthorized retailer would amount to facilitating the promotion of products obtained from the grey market. The publishers did not wish to become associated with the controversy surrounding this issue. They also thought that outlets relying on grey-market products might be unable to supply a full range and that the products' quality might be unreliable, eg beyond their shelf-life or counterfeit. They also considered that retailers stocking grey-market supplies did not have the sales advice or environment usually associated with quality beauty products.

6.131. Hachette/EMAP Magazines Limited and IPC Magazines Ltd told us that they had agreed or offered to accept Superdrug advertisements in some of their less exclusive magazines. Some publishers said that they would be prepared to negotiate with Superdrug for advertisements which were not for fine fragrances.

6.132. We asked Hello! Limited (Hello) about the information which had been brought to our attention by L'Oréal about contacts between Hello and Lancôme (see paragraph 7.132). Hello said that the executive concerned, Mr Proctor, had since left the company and it had no record of the events concerned. Mr Proctor told us that he had no recollection of the incident but he recalled that at about that time Superdrug had wanted to move to black and white advertising but Hello had wanted to restrict the number of black and white pages. It was therefore possible that the advertising was terminated because of this question rather than for the reason given to Lancôme.