

Wile E. Coty: Frantically trying to catch the definition of “luxury”

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I. Introduction

1. Last year, the European Court of Justice (ECJ) found that it was lawful for Coty to prevent one of its distributors from selling its products via third-party online market places.⁵² In doing so, the ECJ argued that it was important that the products were “luxury goods” and that, in this context, banning sales via online market places can be a proportionate way of preserving their “aura of luxury” and so their “actual quality.”

2. Since the judgment, several practitioners have asked: should the ECJ’s conclusion apply to “non-luxury” products, too? And, if not, how can we distinguish a luxury product from a non-luxury product?

3. This article briefly sets out an economics perspective on these issues. For the reasons set out below, economics strongly suggests that:

– first, the competitive effects of Coty-like selective distribution agreements do not depend on whether the products are luxurious; and

– second, the ECJ’s conclusion should apply to non-luxury products because the characteristics of luxury products that the ECJ identified as being relevant to its conclusion also exist in other branded products.

II. The competitive effects of Coty-like selective distribution agreements do not depend on whether the products are luxurious

4. From an economics perspective, whether selective distribution agreements harm or benefit consumers depends on whether they reduce or increase intra-brand (distribution) and/or inter-brand (wholesale) competition. Any such reduction in competition is unlikely to arise if the parties involved in the agreement do not have market power.

5. The competitive effects of Coty-like selective distribution agreements, and hence the potential harm or benefit to consumers of them, do not depend on whether the products in question are luxurious. One could have a lot of competition in the supply of a luxury product and a little competition in the supply of a non-luxury product, and we are not aware of any empirical evidence to suggest that supply chains involving luxury products tend to be less competitive than supply chains involving non-luxury products.

⁵² <https://curia.europa.eu/jcms/upload/docs/application/pdf/2017-12/cp170132en.pdf>.

III. The characteristics of luxury products that the ECJ identified as being relevant to its conclusion exist in other branded products

6. Putting the competitive effects of the Coty-like selective distribution agreements to one side, the ECJ's judgment means that whether a product is "luxury" is significant in the legal assessment of the lawfulness of Coty-like selective distribution agreements.

7. Our reading of the judgment is that the ECJ identified two characteristics of luxury products as being relevant to its conclusions:

- the first ECJ characteristic: the actual quality of a luxury product is affected by the strength of its allure, image, and reputation, not just its material characteristics; and

- the second ECJ characteristic: how a luxury product is displayed can affect the strength of its allure, image and reputation—and, in doing so, affect its actual quality.⁵³

8. That is, our reading of the judgment is that either: (a) the ECJ defines products as "luxury" in the assessment of Coty-like agreements if they have these characteristics; and/or (b) the ECJ would reach similar conclusions in relation to Coty-like agreements involving "non-luxury" products that have these characteristics.

9. Either way, the empirical question raised by the judgment is: to what extent do different products possess the two characteristics set out above? Below, we set out how an economist would go about answering this question and, in doing so, argue that the characteristics are likely to exist—albeit to different degrees—in other branded, but not necessarily luxury, products.

1. Which products have the first ECJ characteristic?

10. Clearly, it is an empirical question whether the actual quality of a luxury product is affected by its image, not just its material characteristics. There are two broad methods for measuring whether a product has the first ECJ characteristic.

- One method is to examine whether its demand is higher than would be expected given its price and material characteristics. If it is higher, the evidence is consistent with the presence of an "x-factor" connected to its image, which consumers value and are willing to pay for.

- Another method involves measuring the extent of investments made by companies in advertising and marketing. Clearly, these activities do not contribute to the material characteristics of a product, and only make commercial sense when consumers value the effect that such investments have on a product's image.

11. This type of approach suggests that a wide range of branded products, not just luxury products, would likely possess the first ECJ characteristic.

12. A simple example is over-the-counter pharmaceuticals i.e., medicines sold directly to consumers without a prescription. It is common to find branded pharmaceuticals sold at a price premium to therapeutically equivalent generic pharmaceuticals in the same dosage strength and form. Another simple example is processed foods. It is common to find branded foods sold at a price premium to equivalent supermarket own-label foods, although in blind taste tests, consumers cannot tell the difference between them.

13. Although any specific example has limitations and wrinkles, it would be very surprising to find that image matters only to luxury products of the type sold by Coty (such as perfume and cosmetics). If this were the case, why do brand owners make significant investments in advertising and marketing, and why are consumers willing to pay more for branded products?

53 Ibid, para. 25.

14. Indeed, the evidence suggests that the most valuable brands cover a wide range of products, including but not limited to technology, car manufacturing, and clothing. For example, a recent study by Brand Finance (specialists in measuring brand value) shows that companies such as Apple, IBM, Microsoft, BMW, Toyota, Volkswagen, and Zara appear in the top 50 most valuable brands in the world in 2018.⁵⁴

15. Therefore, our conclusion is that there is no distinction in economics between luxury and non-luxury products in terms of the first ECJ characteristic.

2. Which products have the second ECJ characteristic?

16. Again, it is an empirical question whether the way a product is displayed can affect the strength of its image, and so its actual quality.

17. So, following the methods set out above, one could try to measure the extent to which the demand for a product is affected by changes or differences in the way a product is presented, as opposed to other factors (namely, its price or material characteristics), or measure the extent of investments made by companies in the way products are presented.

18. As in the case of the first ECJ characteristic, this type of approach suggests that a wide range of branded products, not just luxury products, would possess the second ECJ characteristic. Simple examples include car manufacturing (we see car show rooms, not car parks), clothing and cosmetics (we see department store concessions, not bargain buckets). Indeed, some would argue that the strength of any branded product's image is, by definition, affected by how it is "displayed."

IV. Impairing the actual quality of a product versus impairing the value of the brand (and so all products within the brand portfolio)

19. The judgment focuses on the effect of a selective distribution agreement on the actual quality of a specific product category, such as perfumes, rather than all product categories within a brand portfolio.

20. Would it ever make sense to reach the conclusion that a selective distribution agreement is a proportionate way to preserve the actual quality of products within one product category (say perfumes), and reach the opposite conclusion for products in another product category (say handbags), both belonging to the same brand portfolio? (By same "brand portfolio," we mean the brand name that is visible and identifiable to consumers.)

21. Though it would be possible in theory to reach the opposite conclusion, the circumstances are likely to be rare in practice. Two conditions would need to hold.

– The two ECJ characteristics would need to be absent from handbags, when they are present in perfumes. For example, in relation to the first characteristic, this could happen when branding successfully increases the demand for perfumes, but not for handbags. But it is hard to see why such a situation would persist, because one would expect the brand owner either to change the way handbags are branded (to increase demand) and/or cease investment in any product-specific advertising and marketing (to reduce cost).

– And even if the two ECJ characteristics are absent, it would also need to be the case that the way handbags are displayed does not affect the image of and so demand for perfumes. Without this, a selective distribution agreement for handbags may be a proportionate way of preserving the actual quality of perfumes.

22. To help illustrate this second condition, imagine a consumer looking to buy Brand X perfume walks past a "low rent" store selling Brand X handbags. For the second condition to hold, one would need to find that the presence of the Brand X handbags does not affect the image of and so the consumer's demand for Brand X

54 <http://brandfinance.com/knowledge-centre/reports/brand-finance-global-500-2018>.

perfume. Again, this is an empirical issue, but casual observation suggests that positive or negative brand image can start with a single product, but ultimately affect the brand portfolio.

V. Conclusion

23. Based on the discussion set out above, our conclusions are as follows.

– First, from an economics perspective, whether a product is luxury or not does not determine either the competitive effects of a Coty-like selective distribution agreement, or whether a product possesses the two product characteristics the ECJ considered relevant to its conclusions.

– Second, a wide range of branded products are likely to possess the two product characteristics the ECJ considered relevant to its conclusions, not just luxury products.

– Third, in view of this, it makes sense from an economics perspective to evaluate the potential importance of preserving “image” and the “actual quality” of a product by objectively measuring the extent to which firms invest in branding and how consumers respond to branding, rather than attempting to distinguish a luxury product from a non-luxury product in a subjective way.

– Fourth, the circumstances in which a selective distribution agreement is a proportionate way of preserving the actual quality of one product category within a brand portfolio, but not another product category in a brand portfolio, are likely to be rare.

– Fifth, given the likely challenges associated with working out whether a product contains the two ECJ characteristics, discriminating between selective distribution agreements based on whether the products possess them may be at least as challenging as undertaking an assessment of the competitive effects of them. ■