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LVMH

Selective distribution and luxury industries: key drivers of competitiveness, jobs and growth in Europe

I. About LVMH

A world leader in the business of luxury, the LVMH group brings together 74 exceptional Houses, which create products that convey *savoir-faire* and preserved heritage while remaining firmly anchored in modernity. LVMH currently employs 156,000 people across the world, including around 60,000 in Europe.

It is the only group present in all five major sectors of the luxury market: Wines & Spirits, Fashion & Leather Goods, Perfumes & Cosmetics, Watches & Jewelry and Selective Retailing. The Group brings together world-renowned brands such as Louis Vuitton, Christian Dior or Moët & Chandon, as well as smaller and newer brands, such as Acqua di Parma, Nicholas Kirkwood and Maison Francis Kurkdjian.

II. About European luxury industries

Based on art, culture and creativity, luxury industries are driven by continuous innovation, a relentless focus on quality, sustainability, highly-skilled employment and strong exports abroad. **We are animated by a constant strive for the highest quality in all we do**, from products and services all the way to the experience offered to consumers.

Luxury industries are a European success story: 70% of the world's top 25 companies are European. In 2018, European high-end and luxury industries reached an annual turnover of €820 billion[1], which represents over 5% of the EU's GDP. They also employ over 1.2 million people directly in Europe[2].

Based on production in Europe**, luxury industries export on average over 60% of their total production**[3]. In addition to being export-driven, **luxury industries are also strong drivers of tourism and contribute to the attractiveness of European city centres**. Indeed, because many of our companies are deeply rooted in Europe's cultural heritage, tourists come to visit Europe's most emblematic monuments, and often do not leave without bringing back a *souvenir* of their trip, which they often find in our boutiques located in the cities' historic centres, while enjoying a personalised customer experience.

III. How luxury industries distribute their products

A central element of the competitiveness and longevity of our brands is the degree of control they have been able to maintain over their value chains, from the production to the retail experience we offer to our customers.

As a matter of fact, there has always been a need to ensure that the creativity, innovation, and *savoir-faire* behind our products are delivered to our customers in a quality environment, which allows for a personalised and tailor-made experience.

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[1] The worldwide market of luxury goods is €1,71 trillion, 70% of which is European. The European luxury industry therefore represents €820 billion.
[2] Ibid. NB: this figure dates from 2013. Updated 2018 figures, which will be presented in the fall of 2019, estimate employment to have risen to over 1.3 million direct employees.
[3] Frontier Economics, The contribution of the high-end cultural and creative industries to the European economy (2014). Read full report here.

In order to do so, luxury industries have developed distribution systems which, despite differences in the nature of the products, have in common the following criteria:

1) **Relentless focus on quality:** our products are always the result of a creative impulse, which is brought to life by our craftsmen, who are the depositaries of traditional – sometimes century-old – know-how. Therefore, the excellence of our products needs to be reflected in the environment in which they are sold. Whether in our brick and mortar shops, on our websites, or now also via social networks, customers need to be able to engage with our brands in a way that perpetuates the aura of our products, and the dreams and magic that they inspire.
2) **Tailor-made service and seamless retail experience**: in addition to presenting products of exceptional quality to our customers, we also want to offer them a personalised, tailor-made retail experience. Customers have the possibility to engage and collaborate with our staff in order to turn a product into an expression of their individuality. With the development of the Internet and the creation of an "omnichannel" experience for our customers (see next section), substantial investments have been made to offer the most innovative retail experience to our customers, both on- and offline.
3) **Wide range of products available to consumers everywhere:** despite the exclusive character of our products, our brands continuously offer a wider range of products to meet consumer expectations for innovative, exclusive, creative, and sustainable products. While our brands start competing on new product segments regularly, they need to be able to preserve a retail environment that is consistent with their history and creative vision. Without compromising on this aspect, we strive to reach out to our customers and offer our products to them in the most accessible manner (see next section on the omnichannel experience).
4) **Guarantee of authentic products:** when entering one of our brand's or authorised distributors' stores or websites, our customers need to have the guarantee that they will be presented with original and authentic products. This criterion has become increasingly pertinent over the years with the development of the Internet. Indeed, increasingly professionalised counterfeiters have been able to trick unsuspicious customers into buying fake products that were presented as authentic, causing a real risk to their health and safety.

IV. Embracing the digital revolution without compromising on quality

In 2010, at the time of the adoption of the Vertical Block Exemption Regulation (VBER) and Guidelines on Vertical Restraints (VGL), luxury industries were still trying to figure out how the growth of the Internet, and e-commerce in particular, were compatible with their business model. The main fears were how to maintain a luxury retail environment and to safeguard the luxury retail experience we strive to offer to our customers. It seemed that, at the time, the technology behind the Internet was not yet sufficiently developed in order to deliver that experience (in terms of infrastructure, connectivity, hardware, software etc.).

A lot has happened in less than ten years. As a result of substantial investments into innovative retail practices, luxury industries have embraced the growth opportunities offered by the development of the Internet, to the benefit of our customers:

"Luxury consumers have high expectations, regardless of the communication or distribution channel used to connect with them, and the development of e-commerce has enabled the luxury industry to propose new, tailor-made services to its clients, such as solutions that respect their privacy and ensure safe payment, personalized curated content, on- and off-line advice with dedicated, trained staff, high-

quality delivery, guarantee of authenticity, fast and seamless returns and high-class after-sale service and advice"[4].

Today, virtually all luxury brands sell their products online in one way or another. However, as highlighted in the European Commission's e-commerce sector inquiry final report, what differs is how companies have chosen to sell online. For luxury companies, while a vast majority of them have decided not to sell, directly or indirectly, via online marketplaces[5], their products are still widely available online via their own websites or via their authorised distributors' website.

However, luxury industries did not just embrace e-commerce as a source of growth, increased consumer choice, and reinforced contact with our customers. They invested into the creation of a real **"omnichannel" luxury experience, which enables high quality distribution networks of luxury products in which the complementary on- and offline experiences** allow customers of luxury goods to fully experience the universe of a brand in line with their expectations.

This trend will be even stronger in the upcoming years, especially in a context where competition among our industries becomes increasingly about the experience, pushing our companies to invest in innovative retail technologies that will further merge the digital and physical experiences.

Indeed, Bain & Company estimates that by 2025, the online channel will represent 25% of the market's value, up from 10% today. Approximately half of all luxury purchases will be digitally enabled thanks to new technologies along the value chain, and nearly all luxury purchases will be influenced by online interactions[6][7].

However, **as we develop our online presence, we also encounter a series of new challenges**. Other major Internet companies have emerged as gatekeepers between our customers and us. These include search engines, social networks, and online marketplaces. These actors have enabled us to engage and communicate with our customers in a more personalised and regular fashion. However, their position as "point of first contact" for the consumer implies new constraints on brands' ability to freely define the experience for their customers, and puts pressure on intra-brand competition as well as competition between brands. This situation was fuelled by the exemption of liability for the content that they host, which they obtained at the early stages of their development and have been able to maintain, despite the very different nature and size of their businesses compared to when this exemption was adopted.

As a result, some online intermediaries sell or promote branded products next to their counterfeit versions, causing consumer confusion and, in some cases, significant health risks. Therefore, as these actors have grown to become an unavoidable component of digital engagement, they have challenged our brands' ability to remain visible and engaged online while safeguarding the qualitative environment and engagement with our customers. In this context, **the interpretation of the VGL proves to be increasingly challenging**. A clarification now would be most welcome, before it becomes even more difficult to interpret in a fast-moving retail landscape.

V. The evaluation of the VBER and VGL

Selective distribution has allowed for European luxury companies to distribute their products in an environment that is compatible with the luxury image of our products. As such, the VBER and VGL have given us the legal certainty we needed that we could – under certain conditions - benefit from the block exemption when setting up our selective distribution networks.

[4] ECCIA, Securing the leadership of the European Cultural and Creative Industries in the Digital Area (2017).
[5] Essentially because of their inability to comply with our qualitative criteria (see section III)
[6] Bain & Company, 2018 Luxury Goods Worldwide Market Study (2018).
[7] Figures presented by Mc Kinsey show that already now, 70% of all luxury sales are influenced by online (see here for McKinsey's report on "Apparel, Fashion & Luxury Group: The age of digital Darwinism").

As such, the benefits of having a European framework by far outweigh the costs of not having one. Indeed, without selective distribution, the only effective way for luxury companies to continue to sell their products while respecting the above-mentioned criteria, would be to integrate their distribution. Such a distribution model is very expensive to set up and maintain, which would have two immediate disadvantages:

1) Less competition: only the bigger companies with the financial means to integrate their distribution would be able to maintain their luxury image, which could lead to two-speed competition and make it very difficult for smaller and newer companies to ever compete with the bigger ones. This situation would have negative consequences for both big companies (it should be noted that even LVMH's biggest brands do not hold a significant part of the market) and smaller ones, which could not thrive without a competitive environment.
2) Fewer points of sale: there would be fewer shops because of the costs associated with running your own shop under an integrated distribution model.

Consequently, **we would advise the European Commission to maintain the existing framework**, as it has enabled our brands to turn potential challenges into opportunities offered by the creation of new distribution channels. In sum, selective distribution has allowed luxury brands to adapt to a rapidly-changing business environment, while being able to retain control over the environment in which our products are sold and maintain the excellence of the experience that our customers deserve and expect.

<u>An opportunity to reinforce the existing framework for the next decade</u>

While we are convinced that the existing framework should be maintained, we see the ongoing evaluation process as an opportunity to emphasise the need to reinforce the VBER and VGL by:

a) Ensuring a more uniform interpretation of the rules

The added-value of having a European framework should be to give businesses the legal certainty and the confidence to roll out their practices throughout the Single Market, while retaining the confidence that these rules will prevail over national legislations when interpreted by the Courts. In some cases, the lack of uniform interpretation of the guidelines by Member States has undermined that certainty.

b) Adapting to a rapidly-evolving retail landscape

The above-mentioned lack of uniform interpretation of the VBER and VGL is particularly relevant in the digital space, as Member States have applied the rules in very different ways, or sometimes even seemed to ignore those rules to create new ones that did not seem to respect the spirit of the VBER and VGL.

In a fast-moving digital environment, this has led our companies to remain cautious, hence less innovative in the way they present their products to customers.

Therefore, if the European Commission decided to reopen the VBER and VGL, we would recommend **integrating into the existing framework the recent positive clarifications that where brought by the CJEU in the Coty case[8]:**

- A selective distribution system for luxury goods designed, primarily, to preserve the luxury image of those goods complies with Art. 101(1) TFEU;
- A contractual clause which prohibits authorised distributors in a selective distribution system from using, in a discernible manner, third-party platforms for the internet sale of the contract goods, should not be considered a restriction by effect[9];

[8] Case C-230/16, Coty Germany GmbH v Parfümerie Akzente GmbH.

[9] On condition that that clause has the objective of preserving the luxury image of those goods and that the Metro criteria are met.

- A company with a market share below the 30% threshold, which establishes a selective distribution system to preserve the luxury image of its goods, should have the general legal certainty that such a system will be block exempted.

In addition, **we would also recommend integrating the useful clarifications brought by the European Commission in its Final report on the E-commerce Sector Inquiry**[10].

c) Preventing free-riding by third parties

The existing **selective distribution** framework has allowed our brands to build omnichannel distribution networks based on qualitative criteria, where goods are free to move freely between suppliers and distributors and where the online and offline experiences complemented each other.

Such a system **can only be efficient if one can prevent free-riding on the investments made both by our brands and our authorised distributors.**

Whereas some EU countries recognise the existence and validity of selective distribution systems, most do not. This creates a lack of enforceability of our selective distribution networks, especially vis-à-vis third parties.

Such practices undermine our selective distribution networks in several ways:

a) Our authorised distributors are unfairly competed against by third parties who free ride on the investments made by both our brands and our authorised distributors;
b) Our products are sold online on websites where counterfeited versions of the same products are sold, often at comparable prices. This creates confusion among our customers about the authenticity of our products and, in worst cases, puts their health at risk[11];
c) Our brand's image suffers, because we are deprived of our ability to secure the quality of the environment in which our products are sold, and of the experience we offer to our customers.

As long as selective distribution networks cannot be recognised and enforced uniformly throughout the EU, the system will never be fully effective, which will in the longer term put at risk our ability to maintain the omnichannel experience we have built.

We therefore recommend that the European Commission introduces the possibility for suppliers to enforce our selective distribution networks vis-à-vis third parties who free-ride on the investments made both by our brands and their authorised distributors, to the detriment of our customers.

Finally, as a conclusion, we believe that **any potential change brought to the current framework should me made so as to allow our companies to further improve the environment in which our products are sold, as well as the customer experience, and to give them even further legal certainty about the validity of their practices.**

[10] European Commission, Final report on the E-commerce Sector Inquiry, COM(2017) 229 final, May 2017.
[11] In the case of counterfeited perfumes or cosmetics for example.