



Brand mimicry

The monarch and the pipevine swallowtail are the Hermès and Louis Vuitton of the butterfly world – other butterflies imitate them. Non-toxic butterflies, through genetic mutation over generations, come to resemble toxic species so that predators are fooled into leaving them alone. The viceroy butterfly, for example, shares the monarch’s colors, and appears at the same time of year in similar habitats.

Nike shoes are among the most counterfeited products on the market. The imitations, made in well-equipped factories in Putian, China, are in many ways indistinguishable from the real thing, and by some estimates one of every three Nike shoes on the market is a fake.

Products from luxury brands such as Louis Vuitton, Hermès, and premium watch makers such as Rolex and Panerai are also widely counterfeited. On the web you can find a large and growing underworld marketplace for knock off bags, copy pens, replica watches and many other products that are expertly copied. I started to observe this global underground marketplace about a year ago, after this New York Times Magazine article on fake products. Here are some aspects of it that puzzle me.

1) Imitations of many luxury brands are priced at about 2% of the genuine article, and the better imitations – some of which even experts cannot tell apart – are priced at about 5% of the real thing. From a marketing standpoint, this price differential is a real head scratcher. Why would the maker of a fake product forego up to 99% of the price the customer is willing to pay for the real thing? Generic pharma companies, for example, have learned over the years that it does not make sense to offer generics at 5% of a formerly patented product’s price, when you can charge 90% of its price and still capture a significant share of the market. Similarly, grocery stores have learned to price their private labels just under the umbrella of branded goods. So why do counterfeiters of luxury goods leave so much money on the table? Why not capture a greater share of the brand premium? One answer is they face stiff competition from other counterfeiters. And since their products are indistinguishable from those of other counterfeiters, price wars spiral out of control, cutting their margins.

2) Another puzzling aspect of this market is that unlike other products, prices appear to be cost rather than demand-supply driven. Take the delicately named “replica” watch market. In this market, the price for a copy of a \$95,000 Patek

Philippe is \$288, and the price of a fake Swatch Irony is also \$288. If a fake is free-riding on the brand equity, why does it not capture some of the premium associated with the brand?

3) Price variance, it turns out, is almost entirely due to the components. Again, in the watch market, a knock-off with a Swiss movement is priced around \$100 more than the same watch with a Chinese-made movement, regardless of the value of the genuine piece it is knocking off. In other words, a fake Swiss watch with a genuine Swiss movement costs more than a fake Swiss watch with a non-Swiss movement. There are also clone movements that are reverse-engineered Swiss movements made in China, which are priced somewhere between the fake-fakes, and the real fakes. Price varies as a function of the components rather than demand for the brand or the original product being knocked off.

The makers of high quality counterfeit products have the skills and the ability to make pretty good products at reasonable prices. What they appear to lack is their own design capabilities and access to customers who are willing to pay for a product on its own merits rather than on the basis of the brand. If counterfeiters had their own design capabilities and customers were able to recognize quality and pay for it without recourse to the brand, would counterfeiters need to copy? Would they not make better margins playing in markets where pricing is driven by demand and supply rather than component costs?

It is very likely that the counterfeit explosion we are witnessing is a passing phase – a stage in the evolution of manufacturers in China who have mastered production technology but not yet the marketing and design techniques that will give them access to customers worldwide. In markets as in nature, mimicry is a matter of evolution.

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