

Cosmetics and Fragrance Marketing and Management Master's Degree Program

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Capstone 2014 White Paper **ACCESSIBLE BEAUTY**

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"I certainly am interested in accessibility, clarity, and immediacy."

PAUL MULDOON (POET)

"I believe in accessibility. I believe in honesty and a culture that supports that. And you can't have that if you're not open to receiving feedback."

MINDY GROSSMAN (CHAIRMAN AND CEO, HSN)

Introduction

On the last day of the 44th World Economic Forum Annual Meeting, leading financial experts offered a "cautiously optimistic" outlook on the global economy. One expert, Laurence Fink, Chairman and Chief Executive Officer, Blackrock, USA said, "The U.S. economy is going to be fine;" however he warned that the world will exist in a state of significant volatility, adding, "This doesn't mean we will end up in a bad place. But there will be a lot of disruptions" (World Economic Forum, 2014). These disruptions stem from a variety of global changes that will come together to create a new global landscape in 2030.

With experts from the National Intelligence Council, Standard Chartered Bank, and the World Economic Forum predicting significant economic changes by 2030, how will the average U.S. consumer's consumption habits evolve? Furthermore, how can the beauty industry prepare for these changes and remain relevant to the 2030 consumer? This paper will introduce a new consumer group and consumption equation created through the research and analysis of economic and demographic global trends. Analysis of consumer preferences and consumption patterns reinforce tactical recommendations for the beauty industry to take in order to best prepare for the 2030 marketplace.

2030 Global Landscape

Global Economy: Research published by Standard Chartered Bank predicts the global economy will double by 2030 with Real Gross Domestic Product (GDP) increasing from \$69 trillion (USD)¹ in 2013 to an estimated \$129 trillion; however, the role of today's developed economies, including the U.S., will have changed. World growth will primarily be driven by the emerging markets, which are estimated to contribute 70% of total increases. New regional and bilateral trade agreements, coupled with the effects of globalization and the Internet will quadruple world trade to \$75 trillion from \$17.8 trillion in 2012. Trade between emerging markets will account for 40% of the total growth, up from just 18% in 2012. By 2030 the National Intelligence Council estimates that continental Asia will surpass North America and Europe combined in terms of GDP, population size, military spending, and technological investment. With an estimated GDP of \$38.5 trillion, the U.S. economy will fall behind China, where GDP is expected to reach \$58.8 trillion (Standard Chartered Bank, 2013; National Intelligence Council, 2012).

Despite the changing role of the developed markets in 2030, the U.S. will continue to play a vital part in the global economy. With private sector balance sheets largely fixed—indicating economic stability—Standard Chartered names the U.S. as the developed country with the strongest momentum going into the next decade. Furthermore, it is doubtful that any individual emerging market, even China, will attempt to usurp U.S. global leadership as emerging market perspectives are focused on reshaping regional structures (Standard Chartered Bank, 2013; National Intelligence Council, 2012).

Global Middle Class: With the number of impoverished individuals worldwide² expected to fall below 500 million by 2030, a decline of 50% from 2014, per capita income levels are expected to rise by as much as 170% in China

and India as they experience catch up growth (National Intelligence Council, 2012; Standard Chartered Bank, 2013). A 2011 report issued by Ernst & Young Global Limited (EY) supports this claim, estimating new middle class consumer growth of 3 billion people by 2030, representing a growth in demand from \$21 trillion in 2011 to \$56 trillion (EY, 2011). Maria Pinelli, Global Vice-Chair Strategic Growth Markets for EY explains: "There is a huge potential for middle class consumerism in rapid-growth economies."

Meanwhile, today, the American middle class has already lost its distinction as the most affluent middle class segment in the world, becoming victims of rising income inequality. For the past decade, U.S. GDP growth has been driven by the top 10% of earners, with median middle class income remaining flat (+0.3%) since 2000, compared with 20% growth in Britain and Canada in the same time period (Leonhardt & Quealy, 2014). This disparity has prompted President Obama to proclaim, "Inequality is the defining challenge of our time." If this pattern persists, living standards will continue to converge between the U.S. and today's emerging markets.

Individual Empowerment and Global Connectivity: In 2013, more than 70% of the world's population owned at least one mobile device and it is forecasted that by the end of 2014, in Sub-Saharan Africa, Southeast Asia, South Asia, and the Middle East, more people will have mobile network access than electricity at home (National Intelligence Council, 2012). Technological advancement and greater access to social media empowers individuals in ways previously unavailable. For example, according to the 2030 Global Trends report issued by the National Intelligence Council, Muslim women have recently adopted social media as a way of connecting with each other in "safe spaces" to discuss issues such as women's rights, gender equality, and the role of women within Islamic Law. They predict that as technology advances so will connectivity, giving individuals a



Figure 1. An increase in global migration due to aging Western populations will strengthen global connectivity.

stronger voice through the power of informal networks, creating a shift in power away from today's hegemonic authorities.

An increase in global migration due to aging Western populations will also strengthen global connectivity. In 2013, only two countries, Japan and Germany, had a median age over 45. By 2030, this number will increase to over 20 developed countries, triggering migration from younger economies to fill entry and lower level jobs. In America, the percentage of young people will continue to grow through 2030; however, their percentage of the total population will decline from 14.0% in 2012 to 12.8%, creating the same need for international migration (National Intelligence Council, 2012).

As these global trends shape the economic and demographic realities of the United States, they will force the U.S. consumer to adapt to a new environment.

The Evolution of America

U.S. Economy: With average household income rising just 2.1% in the U.S. between 2000 and 2009, the U.S. middle class is struggling to maintain its standard of living (De La Cruz, 2012). According to a report issued by the U.S. Census Bureau, the median household income in the U.S. remained flat at \$51,017 in 2012 with 15% of the population living in poverty³, an increase from 11.3% in 2000 (Hargreaves, 2013). Meanwhile, the Bureau of Labor & Statistics has reported an average U.S. inflation rate of 2.4% over the past 10 years. This economic stagnation has left consumers wary of the future. Researchers from LIS (a group that maintains the Luxembourg Income Study Database) and The Upshot (a *New York Times* website that covers policy and politics) reported that polls show just 30% of Americans believe the country is heading in the right direction (Leonhardt & Quealy, 2014).

If current trends continue, the projected average household income in 2030 will be

just \$85,000. These are meager gains when taking into account an 8% increase in the cost of healthcare and the cost of college education doubling that of today (De La Cruz, 2012; JP, 2012). Many Americans will face decreases to disposable income over the next 15 years; wasteful spending will not be an option for these consumers. Those who do retain significant disposable income will become post-recession survivors, changing their habits to protect themselves against financial instability. Americans are already changing their behaviors in order to survive in the post-recession U.S. economy. The Federal Reserve Bank of New York reported a decline of \$24 billion in credit card balances in the first quarter of 2014. This contrasts greatly with the increase in student loan debt, which rose by \$31 billion in the same time period, quadrupling in value since 2003. Housing loans also increased by \$116 billion, primarily due to lower rates of foreclosure (Kedmy, 2014). These are indications that U.S. consumers are changing their priorities. As the cost of education, healthcare, and other necessities continue to increase, consumers will adapt their spending patterns.

The Progressive Rationalist: Global connectivity, migration, and new economic realities will cause the behaviors of previously separate consumer groups to collide, forming one new group—the Progressive Rationalists. By 2030, purchase behavior will no longer be defined by traditional demographics such as income level, age, or race. For example, regardless of the reason—be it necessity or the elimination of wasteful spending—both low income and affluent consumers will expect high quality and design at a competitive price. Through the laws of supply and demand, the decline in disposable income for all consumers will elevate the value of each dollar spent and each purchase will be subject to higher scrutiny than ever before.

The Progressive Consumption Equation: The Progressive Consumption Equation identifies the path to purchase that the Progressive Rationalist will follow. This equation is based on the historical habits of the U.S. consumer. In the Nineties many companies relied on brand cache to succeed, particularly in fashion and beauty, where logos and advertisements were almost more important than the products themselves. Brands such as Tommy Hilfiger, Calvin Klein, and Nike gained popularity for their underground culture and shocking advertisements. However, as technology advanced and consumers gained more access to product information through bloggers, product reviews, and online editorial, they no longer

$$\text{CURRENT CONSUMPTION EQUATION}$$

$$[\text{FUNCTIONAL NEED}] + \text{PERFORMANCE} = \text{PURCHASE}$$

Figure 2

$$\text{PROGRESSIVE CONSUMPTION EQUATION}$$

$$[\text{FUNCTIONAL NEED} + \text{HIGHER ORDER NEEDS}] + \text{PERFORMANCE} = \text{PURCHASE}$$

Figure 3

used brand recognition as their only purchase influencer. Retail venues such as Sephora, as well as the proliferation of social media, have significantly changed the way consumers shop for beauty. There is now a focus on in-store trial and play as well as the availability of instant recommendations from friends and beauty experts. In response to this shift, the beauty industry introduced hero products such as Benefit's "They're Real" Mascara and Urban Decay's Naked Palettes, building product loyalty as the first step towards brand loyalty. This model has been successful, with skin care and color cosmetics brands focusing on creating high quality, specialized products that meet a specific functional need. These products are used to attract consumers to a brand with the hope that they will build a gateway to further sales opportunities. Today's purchase equation—which focuses on building hero products—can be described as the following equation: functional need (FN) plus product efficacy (PE) equals purchase (Pu) (FN+PE = Pu) (see Figure 2).

In order to speak to the Progressive Rationalist of 2030, brands will need to build upon today's equation. Functional need and efficacy will be mandatory requirements on the path to purchase, but The Progressive Consumption Equation takes into account the new value of disposable income by adding in higher order needs (HON). As a result, the equation will evolve to: higher order need (HON) plus functional need (FN) plus product efficacy (PE) equals purchase (Pu) (HON + FN + PE = Pu) (see Figure 3).

Higher order needs are outside influencers that create enough additional value to allow the consumer to justify spending their disposable income on one product over another. These needs include convenience, clarity around sustainability, price point, or even brand

name. Each individual will have their own set of higher order needs and use them to guide their path to purchase. A consumer who values sustainability will purchase more expensive products if they are recycled or organic while a consumer who places a premium on brand name will buy Kraft Macaroni and Cheese instead of the local market private label. Successful brands of the future will identify the needs of their consumers in order to bring value through these needs.

Through comprehensive research, three key needs were identified as the most common and valuable needs of the Progressive Rationalist: convenience, clarity, and cash. To successfully execute the Progressive Consumption Equation in beauty, products should meet a specific functional need, such as a wrinkle reducing eye cream, be a top rated performer in the category and be ethically sourced, available for same day delivery, and competitively priced. By focusing on these three key needs, beauty brands can position themselves to succeed in 2030.

Convenience

The 2013 Capstone group that presented Digital Marketing predicted that in the near future, mobile and on-the-go purchase would be ubiquitous, and purchase points would exist everywhere the consumer was (Videira, A., Boyce, A., & Cifrese, A., 2013). By 2020, there will be 2.5 billion smart phones in the world, representing nearly half of the global adult population (Van Belleghem, 2013), each providing a unique point of purchase. In this new world, where every desire is in the palm of the consumer's hand, convenience will take on a new meaning.

One example of a brand model that has identified a way to bring true convenience to the consumer is Subway. Subway has progressed beyond that of a typical fast food chain. It is an established brand that has continuously redefined itself through innovation. The Subway brand was established in 1974 and expanded to 2,000 locations by 1988 using a traditional franchise model. In 1993, a local businessman from small town Iowa brought forth an idea that changed the Subway model, introducing non-traditional franchise locations with his proposal of a shop in his local gas station convenience store. Don Fertman, Subway's chief development officer initially dismissed the idea as he felt the combination of fresh food and gasoline would not be successful. Despite the dismissal, the local entrepreneur opened his own sandwich shop and returned to Subway one year later proving

that the venture was profitable. In light of this success, Fertman reconsidered his original opinion and the first non-traditional Subway location was opened. Today, non-traditional locations include over 10,000 gas station convenience stores, a Detroit high school, and a riverboat in Germany (Hollier, 2011). During the first quarter of 2012, the Subway chain hit two important milestones—25,000 restaurants across the U.S., and operations in 100 countries. The current restaurant count is more than 41,000 locations (Subway.com, 2014). In 2013, Subway was ranked the #2 fast food chain in the U.S. and Fertman attributes much of Subway's success to their focus on local markets. They handle each market separately through a system of local developers who work with franchisees to understand their local market far better than the corporate office. With each location specifically created to meet the demand of the local consumer, they achieve convenience without saturation. Subway has found that franchisee operated stores are better maintained and provide superior service because there is someone in each store who truly cares about that specific location (Hollier, 2011).

It is recommended that the beauty industry build upon Subway's unique franchisee model through Hyper-Accessibility. With Hyper-Accessibility, companies will utilize micro-franchisees who buy into brands and set up highly localized points of distribution. This model will provide brands with a low risk strategy that will expand their sales team beyond beauty advisors and account specialists. These micro-franchisees can identify optimal and unique distribution opportunities for their market, such as local boutiques or hosted parties that would otherwise be too small for the corporate office to manage. In addition, micro-franchisees will be empowered to execute localized sales techniques and offer a customized product assortment. Through Hyper-Accessibility, brands will be able to collect local consumer insights across the country, identifying key trends before they emerge nationally. For minimal capital, brands will gain a footprint in communities that were previously only accessible via the Internet.

Clarity

According to the Charting Our Water Future report, published by McKinsey & Company in partnership with the 2030 Water Resources Group, by 2030, there will be a 40% gap between the global supply of water and the world's collective demand (Charting Our Water Future, 2009). The International

Water Management Institute backs up this claim, citing that by 2025, two-thirds of the world's population, or six billion people will live under water-stressed conditions (Evans, 2011; U.S. Census, 2014). Advancements in technology and the accessibility of information through global connectivity will continue to highlight the impact of everyday purchases on the environment, creating highly scrutinized consumption behavior. A recent GoodPurpose global study revealed that 44% of global consumers feel they have more power and influence today versus five years ago (Edelman, 2012). The informal networks of 2030 will provide individuals with even more power and influence and the Progressive Rationalists will use their collective power to make a difference in the world.

This voice will not be limited to the consumer. Social entrepreneurship is currently on the rise, and not expected to slow down. New business models such as Benefit Corporations (commonly referred to as B-Corps) unite businesses around the world to use their collective power to solve social and environmental challenges. Method, a cleaning supply brand, is a B-Corp that illustrates how a brand can deliver beyond functional needs and performance. They have created an entire line of non-toxic homecare products that claim to be more powerful than a bottle of sodium hypochlorite while using 100% post-consumer recycled plastic for their packaging.

Progressive Rationalists will understand their individual impact on the world. Consumers will not want to stop using beauty products, but they will want to do so with less environmental and social impact. In order to address this need, the beauty industry should provide clarity around three key operational business aspects: sustainability, profit, and social responsibility.

Everlane, an online clothing retailer, has made clarity a priority, providing radical transparency to the consumer. In 2012, the brand shocked the fashion industry by providing a simplified cost breakdown of a designer tee shirt. They then compared this cost with a typical designer's suggested retail price, revealing that the average designer markup was more than seven times the manufacturing cost (see Figure 4).

Everlane typically doubles the cost of creating a garment and takes pride in providing complete transparency on every product it creates. Everlane CEO Michael Preysman has shown the industry that "sometimes making 100% profit is enough" (Soller, 2013).

According to Jessica Blotter of Fast

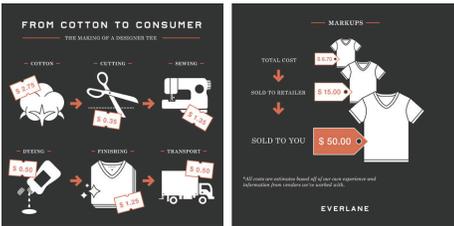


Figure 4

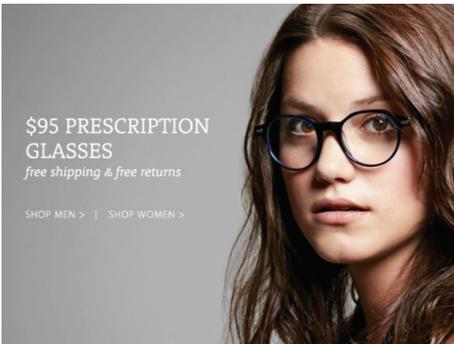


Figure 5

Company, “If your brand story does not authentically and meaningfully contribute to the well-being of society or the environment, your brand will not be viewed as important.” To meet the needs of the Progressive Rationalist, the beauty industry must not only continually improve upon sustainability efforts and social responsibility, but also do so in an authentic manner and effectively communicate this to consumers. Effective communication will be extremely important as brands will need to own their story, otherwise they will leave themselves open to brands such as Everlane, who will highlight any lack of clarity.

Cash

Brands that fulfill the higher order needs of convenience and clarity must not ignore the importance of price point. Progressive Rationalists may be willing to pay a premium when certain needs are addressed, but the amount of disposable income will remain finite. If consumers trade up by paying a premium for one product, they will want to balance that by trading down on another product or service. Looking beyond the beauty industry, brands such as Warby Parker and Harry’s have proactively addressed this issue, and, as a result have drastically disrupted their respective industries.

Warby Parker entered the eyeglass industry with the introduction of their innovative online direct to consumer distribution model. To purchase glasses, consumers choose up to five frames online. Samples are then shipped to the consumer’s home free of charge. The consumer has five days to deter-

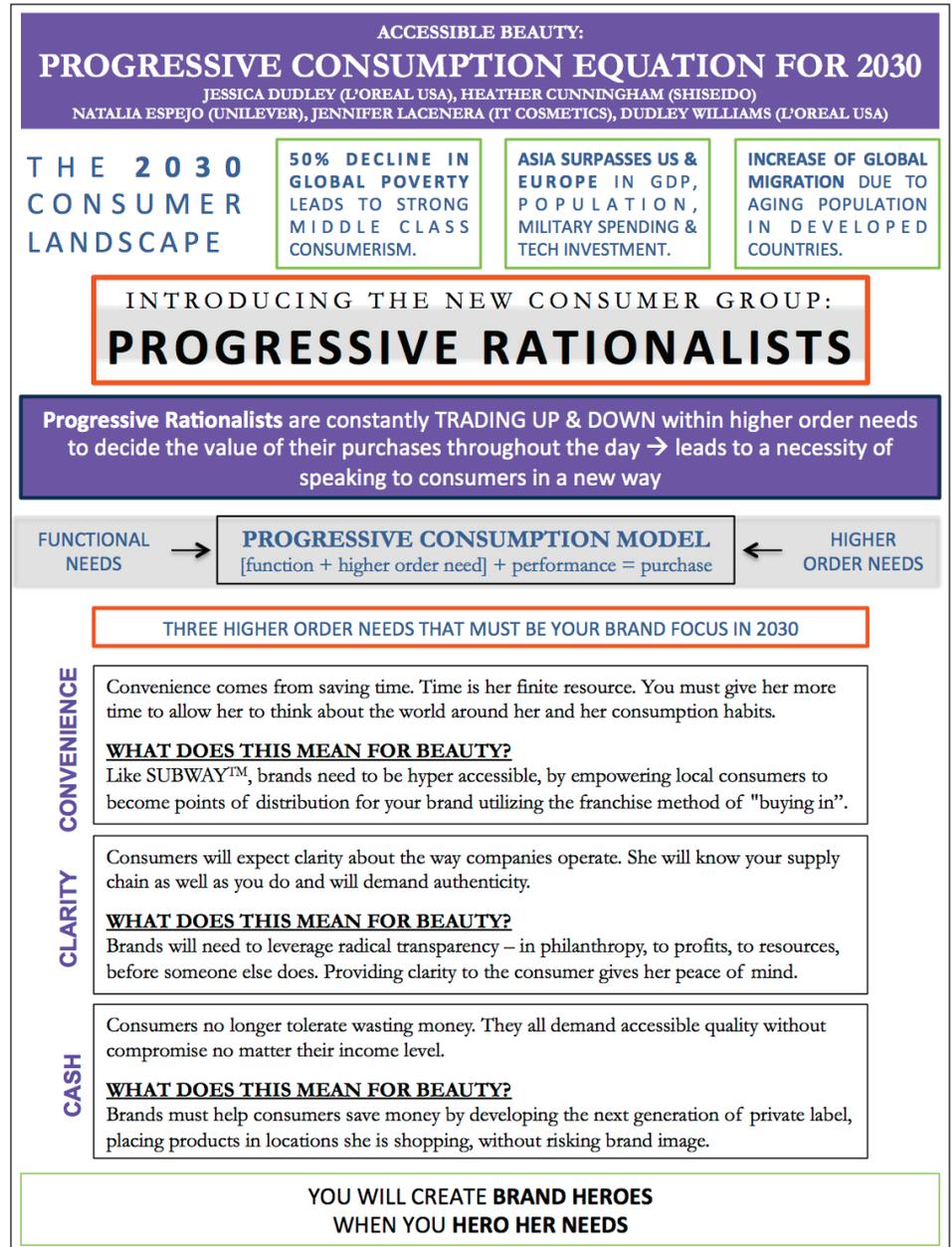


Figure 6

mine which pair they would like. Once they decide, they order directly online with their prescription and return the samples at no cost. By shipping samples to individuals in their homes, Warby Parker eliminates the need of a physical retail showroom. Without costly brick and mortar locations across the country, they are able to offer high quality frames for just \$95 and donate a pair of glasses to someone in need (see Figure 5).

Warby Parker is a brand that is offering the price point of a private label but the quality and design of a high-end brand. Competitors such as Lens Crafters have been forced to retaliate by creating their own \$99 offerings in order to compete.

Warby Parker Co-Founder Jeff Raider

partnered with Andy Katz-Mayfield to create Harry’s, applying a similar online, direct-to-consumer model within the razor industry. Harry’s has taken the notion of cheap razors and elevated it to include high quality, design, and style. Their tagline of “respecting the face and wallet, since like...right now” is executed through accessibly priced offerings that are half the price of their competition. These brands were introduced by outsiders who exploited the weaknesses of each industry’s stagnated distribution model. They created affordable products in creative ways by disregarding industry conventions. This is the same way innovative giant Apple changed the face of both the technology and music industry with its own accessible-distribution model.

In the beauty industry, private label is following a similar model and making significant inroads, recently becoming one of the fastest growing segments of the mass market. In 2013, private label skin care represented 10% of the overall mass skin care market, growing 4.4% from the prior year versus market growth of just 1.8%. Furthermore, private label color cosmetics, while small in absolute value, saw an astounding 71% growth (IRI, 2013). Within prestige beauty, private labels such as Sephora are creating changes to the way prestige consumers shop in luxury with their upcoming offerings of innovative single-use products, including sheet masks, nail polish, and eyeliner. These small, affordable products provide an easy way for the consumer to test products without making a large monetary investment. Traditional wholesalers have historically been unable to offer profitable products in small sizes due to prohibitively high production costs. As direct to consumer retailers, private labels are able to recognize 100% of retail sales revenue, typically 40% more than what wholesaler brands receive.

In order to compete with these private label offerings, brands will need to make strategic shifts in their business models. An immediate and tactical solution that will protect market share and enable brands to compete in this arena is to partner with retailers and build their own private label options. Established brands will provide manufacturing and supply chain expertise to the retail partner, sharing selling expenses in order to alleviate financial constraints. The Progressive Rationalist is continuously weighing her needs, trading up and down based on value. By offering a private label option, companies will enable consumers to trade up and down to their products across all price points and distribution channels seamlessly.

Conclusion

Global and domestic shifts in economics, changes in demographics, and rapidly evolving technological advancements will place the beauty consumer of 2030 in a vastly different reality than the one that brand marketers are familiar with today. To evolve with the Progressive Rationalist, brands must challenge industry conventions, just as Subway, Everlane, and Warby Parker have done.

Brands that leverage the Progressive Consumption Equation will connect with Progressive Rationalists and speak to their higher order needs. Hyper Accessibility allows brands to meet the consumer locally, innovate outside of the boardroom, and provide a new

level of convenience. Providing radical transparency will give consumers clarity around brand sustainability, price points, and social commitments, minimizing the risk of competitive spin. Finally, brands that enter private label will position themselves to be available when the consumer trades up and trades down.

Progressive Rationalists will no longer invest in brands or products alone. The path to purchase has changed and brands must incorporate higher order needs into their business strategy in order to create the value that the consumer demands. ■

Endnotes

1. All dollar amounts (\$) are given in US dollars, unless otherwise indicated.
2. Impoverished individuals are defined as those earning less than \$1.25 per day.
3. Living in poverty is defined as a family of four earning below \$23,493 per year, or an individual earning below \$11,271 per year.

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Industry Experts Interviewed:

Grant, Karen. Vice President and Global Beauty Industry Analyst, NPD

Sobel, Jessica. Sustainability Manager, Unilever

Rothstein, Ashley. Prestige Cosmetics Buyer, ULTA

Lo, Betty. Vice President, Nielsen

Haan, Alison. Vice President, Sephora Color