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**CASE STUDY OF L'ORÉAL:
INNOVATION AND GROWTH STRATEGY**

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*July 2005
Working Paper 05-06*



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Case Study of L'Oréal: Innovation and Growth Strategy

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Abstract

L'Oréal is the world leader in cosmetics and beauty products with revenues of \$15.5 billion. The company has been able to grow twice as fast as the industry average and has reported double-digit profit growth for the 20th consecutive year in 2004. Its market leadership has been sustained through continuous product innovation, brand renewal and international expansion. This paper examines L'Oréal's innovation and growth strategies in order to identify its key success factors and learn best practices in strategic innovation, brand management and globalization strategies

JEL classification: L63, M10

Key words: L'Oréal, innovation, growth strategy, cosmetics

1. Introduction

L'Oréal is the world leader in cosmetics and beauty products with revenues of \$15.5 billion as of 2004. The company makes and sells over 500 brands and more than 2000 products in all sectors of the beauty business including hair color, permanents, styling aids, body and skin care, cleansers and fragrances. About 13% of all cosmetics purchases made around the world are L'Oréal brands. Its brand portfolio of 17 core brands hold leading positions in nearly every cosmetics subcategory and includes some of the most recognized brands such as Lancôme, L'Oréal Paris, Maybelline, Garnier, Helena Rubenstein, Biotherm and Redken. Despite its French origin, more than 80% of company sales are generated outside of France.

Exhibit 1: The World's Top 10 Beauty Companies in 2004

| Company | Beauty Products Revenue |
|---------------------|-------------------------|
| 1. L'Oréal | \$15.5 billions |
| 2. Proctor & Gamble | 13.0 |
| 3. Unilever | 8.7 |
| 4. Shiseido | 5.3 |
| 5. Estee Lauder | 5.1 |
| 6. Avon Products | 4.5 |
| 7. Beiersdorf | 3.8 |
| 8. Johnson&Johnson | 3.7 |
| 9. Alberto Culvo | 2.8 |
| 10. Kao Corporation | 2.8 |

L'Oréal has been able to grow twice as fast as the industry and has reported double-digit profit growth for the 20th consecutive year in 2004 (See Exhibit 2 and 3). According to Le Journal des Finances, L'Oréal was the highest performing share on the French stock market with its value worth 86.5 times what it was 25 years ago.

Exhibit 2: L'Oréal like for like sales growth versus industry average, 1995-2004

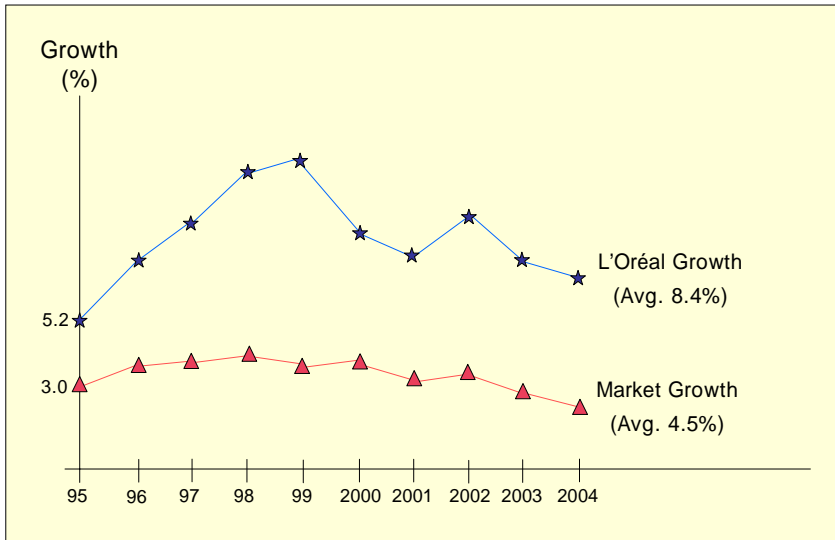
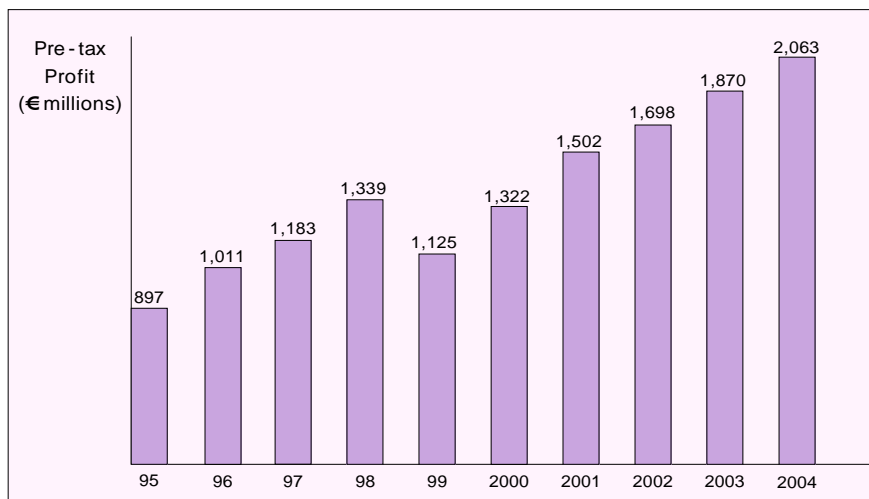


Exhibit 3: Pre-tax profit growth, 1995-2004



A survey by the Reputation Institute ranked L'Oréal first in the "reputation" quotient among French companies. L'Oréal received the top marks in 4 of the 6 selection criteria - - financial performance, appeal, vision and leadership, products and services. The Wall Street Journal Europe attributed L'Oréal's excellent reputation to "high-quality products, strong appeal, a true strategic vision, satisfactory financial results over the long-term" as well as "a diversified vision of beauty", with products adapted to local needs and the use of representatives from different ethnic communities.

This paper examines L'Oréal's innovation and growth strategy in order to identify its key success factors and learn best practices in strategic innovation, brand management and globalization strategies.

2. Company Background

L'Oréal was founded in 1907 by Eugene Schueller, a French chemist, who developed an innovative hair color formula which was sold to Parisian hairdressers. The first hair color dyes which was called "Aureale" had some unique properties in that it did not damage hair while coloring it, unlike other hair products that used relatively harsh chemicals.

From the very beginning, L'Oréal's policy has been one of constant innovation and research to develop new and better beauty care products. The fact that its founder was a chemist had a strong influence on the company's research orientation. By 1920, the company employed three in-house chemists and exported hair color products around the world. During the 1930s, L'Oréal extended its product portfolio to include skin care and suntanning products. Following World War II, L'Oréal diversified its products and brands to gradually include all types of cosmetics products.

L'Oréal used advertising in a major way to market its products. In the beginning, Schueller used promotional posters made by graphic artists to promote his company's products. In the 1930s, L'Oréal created and launched a beauty magazine for women named, *Votre Beauté*. During the 1950s, the company pioneered the concept of advertising products through film commercials screened at movie theaters.

In 1972, the company launched the legendary advertisement campaign “Because I’m worth it” to promote the Preference line of hair color. The slogan summed up the company’s philosophy of providing the most innovative, high-quality products at an affordable price which clearly differentiated L’Oréal’s products from others. The emotional pitch, “Because I’m worth it”, indirectly conveyed the message that “I am willing to pay more” which translated directly into profits for the company.

After Schueller’s death in 1957, L’Oréal became a publicly traded company. Under a complex deal to prevent government control of the company, a holding company called Gesparal was created. Lilian Bettencourt, Schueller’s daughter, held a 51% stake in the holding company and Nestle, the Swiss food giants, owned the remaining 49%. Gesparal in turn acquired just over half of L’Oréal’s stock, while the rest of the shares were traded on the Paris Stock Exchange.

Lindsay Owen-Jones, CEO of L’Oréal since 1988, has been the driving force behind the company’s rapid growth and globalization beyond France. When he joined L’Oréal in 1969, 90% of its sales came from Western Europe. Today, Western Europe accounts for 53% of total revenues, while 27% come from North America and 20% from the rest of the world including Asia, Latin America, and Eastern Europe. When Owen-Jones became CEO, one of the first things he did was prune the company’s brand portfolio to bring more focus. He identified five core business areas - - - hair color, hair hair, color cosmetics, skin care and fragrances - - - and 10 core brands and concentrated the company’s efforts into developing them into global brands.

Today, L’Oréal is organized into 4 product divisions and 17 brands with worldwide coverage.

The Professional Products Division offer hair care products sold to hair dressers and salons. L’Oréal is the world leader with 30% market share and has leading brands such as L’Oréal Professionnel, Kerastase, Redken and Matrix.

The Consumer Division offers hair care, skin care and color cosmetics distributed through mass-market channels. Leading brands include L’Oréal Paris, Garnier, Maybelline New York, Yue-Sai, Softsheen-Carson and Club des Createurs de Beaute. Overall, L’Oréal ranks #2 behind P&G in this mass market segment.

The Luxury Products Division offer prestige beauty products and fragrances sold in department stores, perfumeries, retail travel shops and company-owned boutiques. Major brands include Lancôme, Biotherm, Helena Rubinstein, Giorgio Armani, Ralph Lauren, Cacharel, Kiehl's and Shu Uemura. L'Oréal has 16% global share and is #2 behind Estee Lauder.

The Active Cosmetics Division offers cosmetics and skin care products sold in pharmacies. L'Oréal has the leading market position in Europe with brands like Vichy, La Roche-Posay and Inneov.

Exhibit 4 and 5 shows the breakdown of 2004 consolidated cosmetics sales by division and geographic regions

| Exhibit 4: Sales by division | € Millions | Exhibit 5: Sales by geographic regions | € Millions |
|------------------------------|------------|--|------------|
| ----- | | ----- | |
| Professional Products | 1,998 | Western Europe | 7,312 |
| Consumer Products | 7,754 | North America | 3,772 |
| Luxury Products | 3,520 | Asia-Pacific | 1,269 |
| Active Cosmetics | 852 | Latin America | 724 |
| ----- | | Eastern Europe | 524 |
| Total Sales | 14,220 | Other countries | 618 |
| | | ----- | |
| | | Total Sales | 14,220 |

3. Research and Development

Throughout the company's history, one of the guiding principle has been research and innovation in the interest of beauty. Each year the company devotes more than 3% of its revenue to R&D while the industry average is less than 2%. L'Oréal has three major scientific research centers in Paris, New York and Chicago, 10 applied research

operations and 12 evaluation centers where products are tested. Over 2,900 specialists from 30 different disciplines collaborate in various research activities from initial concept to final product development. In 2004, L'Oréal applied for 586 patents throughout the world and more than 3,000 new formulas emerge from labs every year.

L'Oréal define its research mission as follows:

- To gain an in-depth understanding of healthy skin and hair at cellular level
- To pinpoint the biological processes behind the skin aging process, sun damages, pigmentation as well as natural hair color, graying and loss
- To synthesize active molecules which protect, repair or color: over 110 original molecules have been produced by L'Oréal research
- To design and develop new products in all cosmetic fields, including skin care, hair care and make-up
- To evaluate product efficacy and safety using in vitro tests like skin models as well as sophisticated imaging techniques and sensory analysis.

The company's leadership eschews the widespread concept of the beauty business as selling hope in a jar and believes it is only genuine innovation and product quality that can sustain its leadership position. Due to its broad coverage of the cosmetics category, L'Oréal can leverage its R&D and product development programs over a large revenue base. For example, it can utilize technological breakthroughs in its professional hair care business in formulations for the consumer hair care division a few years later. Active ingredients in new products developed for the active cosmetics division can later be introduced in products for the luxury division and the consumer division.

According to Merrill Lynch, this ability to generate high returns on R&D will become increasingly important in the future. Personal care manufacturers have had to increase the number of new products they introduce into the marketplace each year, yet new product development is costly and risky. It is estimated that a new product costs about \$40 million to properly develop and market, but 80% of new product introduction fail

L'Oréal's research activities are focused on three subjects: skin, hair and color.

Lancôme's anti-aging cream Absolué was the result of systematic research conducted throughout the world on the skin's aging process. More than two thousand women from the USA, Japan, France, Korea, Taiwan, Germany and Italy participated in the study. Research indicated that these three causes - - - aging, hormonal deficiency and sun-induced aging - - - resulted in three different problems: dryness (for 71% of the subjects), loss of skin tone (skin was found to be three times less firm in 20% of the subjects) and a dull, lifeless complexion. Lancôme deployed all of its expertise to develop an effective, technologically advanced products that are enjoyable to use. To effectively combat the three consequences of aging, L'Oréal's research laboratories developed a unique formula based on natural ingredients such as extracts of wild yam, purified soya and brown algae to reconstruct aging skin. To complete the mixture, researchers added a capryloyl salicylic acid derivative that facilitates the elimination of dead cells as well as Mexoryl XL, a filter for UVA and UVB rays. The new formula is protected by seven international patents.

L'Oréal has been the pioneer in the field of hair studies. Several generation of researchers have developed deep scientific knowledge on hair and haircare products. Insights into how the hair is constituted has resulted in the development of:

- long-lasting hair color
- biomimetic molecules such as certain ceramides which ensure hair surface cells cohesion
- softer cleansing agents in shampoos and conditioners in the form of lacquer or gel

In 2003, L'Oréal has opened a research center in Chicago to conduct and support basic research on ethnic hair and skin. The institutes's first major project is centered on characterizing the chemical and physical properties of African hair. The goal of this research is to better classify hair according to fiber structure so that the performance of hair relaxers currently on the market can be improved. Other projects will investigate skin care problems unique to people of color, such as pigment and scarring disorders. Chicago was chosen because it has historically been a center of Black American culture and learning, Softsheen/Carson - - - the world leading brand in skin and hair care for Black women - - - has long been headquartered in the city, and there are a number of renowned universities in the area that present opportunities for synergy with L'Oréal's new research institute.

In the field of hair color, L'Oréal is working at the cutting-edge of technology, investigating new make-up effects using an exclusive collection of 13,000 colorants. For the past ten years, the permanent hair color market has been regularly boosted by the technological innovations from L'Oréal's laboratories. Since 1990, 63% of European women color their hair, against 49% before. This strong increase was influenced by L'Oréal's launch of new technologies in hair color such as:

- 1980: L'Oréal laboratories developed temporary hair color formulas(Dedicace by L'Oréal Paris)
- 1990: L'Oréal Paris launches Casting, the first ammonia-free tone-on-tone hair color
- 1998: L'Oréal Paris launched Feria, the first permanent hair color for young people
- 2001: L'Oréal Paris and Garnier launched Open Color and Lumia respectively, the first low-ammonia hair color products.

In keeping with L'Oréal's geographic expansion, research is focused on:

- better integration of local issues
- better understanding of local habits to develop products for local markets
- capitalizing on ethnic hair and skin expertise

This worldwide approach has led scientists of many different nationalities and cultural backgrounds to collaborate for the mutual benefits of producing a melting pot of beauty and technological synergies.

4. Innovative Marketing and Brand Management

L'Oréal's rapid growth around the world can be attributed to its innovative marketing and brand management practices. According to Lindsay Owen-Jones, "good brand management is about hitting the right audience with the right products". The top 10 brands make up about 85% of revenues, each having over 300 million Euros in annual revenues (See Exhibit 6). Each brand has its own character and is positioned on a very precise market segments, which overlaps as little as possible with the others.

Exhibit 6: L'Oréal's Top 10 Brands

| Brand | Positioning | Sales(millions) | % of Total |
|-----------------------|----------------------------|-----------------|------------|
| L'Oréal Paris | Premium in mass market | 3,925 | 29% |
| Lancôme | Prestige segment | 1,675 | 12% |
| Garnier | Mid price mass market | 1,550 | 11% |
| Maybelline | Mid price mass market | 1,475 | 11% |
| L'Oréal Professionnel | Mid to upper end in salon | 1,075 | 8% |
| Vichy | Drugstore skin care brand | 525 | 4% |
| Giorgio Armani | Prestige segment | 375 | 3% |
| Ralph Lauren | American fragrance classic | 355 | 3% |
| Matrix | Mid price salon brand | 350 | 3% |
| Biotherm | Prestige skin care | 315 | 2% |

L'Oréal's branding strategy has two main approaches. The first approach is to retain the French persona of core brands like L'Oréal Paris and Lancôme, and promote them internationally with some local adaptation. The other more radical approach is to acquire potentially strong local brands, reposition them with a marketing makeover, and sell them globally. Maybelline, Softsheen/Carson, Helena Rubenstein are successful examples of the second approach.

The successful launch of Plénitude, a skin care product, exemplifies L'Oréal's classic brand management strategy. Plénitude was first introduced in 1982 under a "class of the mass" strategy with a single product specifically for the French market. L'Oréal positioned the brand as "high end, superior performance but accessible" and introduced a general purpose moisturizer at a 30% price premium over incumbents. Initially, print was the predominant advertising medium which emphasized the brand benefits "Delays Signs of Aging". In 1986, a cleanser product was added and advertising shifted more to television to reach the mass audience with a "modern woman" message. Supported by upscale packaging and merchandising, the product was a huge success achieving #1 market share of 19.6% in 1987 despite its price premium.

Over time, the success of Plénitude in France led L'Oréal executives to define its unique formula for success in mass market cosmetics products:

1. Have technologically superior products
2. Concentrate resources and support on newest “Star Product” to pull the entire line
3. Follow the “Golden Rules” of advertising
 - feature star products
 - provide technological superiority evidence
 - depict an executive woman who is up-to-date and assertive

L’Oréal has leveraged the equity of brands to migrate into new categories. For example, Garnier products had been marketed as “the marriage between science and nature” in hair care and colorants. The migration of the brand into skin care products has kept sales growing at double-digit rates. The success of Armani fragrances has allowed L’Oréal to use the brand to introduce a fashion-oriented color cosmetics line with competitive pricing that is comparable to MAC and Clinique. Biotherm and Vichy are extending its range of products for men.

L’Oréal has also been successful in broadening the appeal of its mass market and prestige brands to a younger consumer segments. For example, L’Oréal Feria hair colorants, launched in 1997 has been very successful in attracting younger consumers who are coloring hair as a fashion statement. L’Oréal Hydrafresh skin care products, launched in 2000, is aimed at 25-35 year olds concerned about effects of aging. Garnier Fructis styling products have consumers with a median age of 29 years old in Germany, compared to an average age for a styling product consumer of 47.

Strategic acquisitions and brand repositioning has been the second pillar of L’Oréal’s growth strategy. For example, in 1996, L’Oréal acquired Maybelline, a Memphis-based mass market brand with limited international presence. After the acquisition, L’Oréal shifted the brand’s headquarters to New York, introduced new colorful products like Miami Chill, changed its name to Maybelline New York, and launched an international rollout promoting Maybelline’s American image. Sensing and responding to local consumer trends and preferences, L’Oréal changed its Wondercurl mascara to suit Asian women’s short eyelashes, which became a huge hit with Japanese and Chinese consumers. By 2000, Maybelline had become one of the most successful brand in the medium-priced makeup segment, selling in more than 90 countries.

In an interview with Fortune, Lindsay Owen-Jones commented: “It took imagination to think that a nice, very basic, popular, and cheap but really not sophisticated make-up line called Maybelline made in Memphis could become the hottest thing for young women in Shanghai. That is why this business is always looking for candidates who not only have basic business disciplines but also an ability to dream”

L’Oréal applied the same success formula for other acquisitions like Helena Rubenstein. Considered a traditional luxury brand targeted at middle-aged women, Helena Rubenstein was suffering from years of stagnation. After the acquisition, L’Oréal revived the brand with bright colors, new packaging and trendy marketing campaigns targeted at younger women in the age group of 20-30 years. Despite the downturn in Japan and the slowdown in international travel, the brand sustained solid growth, attracting young, fashion-oriented consumers in Japan, Italy, Spain and Latin America.

To tap into the rapidly growing African-American hair care markets, L’Oréal acquired Softsheen in 1998 and Carson in 2000, and merged them into Softsheen/Carson. Both brands had very limited international presence, but L’Oréal saw a huge business opportunity in terms of people of African origin, wherever they were in the world. L’Oréal boosted awareness of the combined brand in Africa by educating hairdressers about the products and training them how to use them. Today, Softsheen/Carson generates about 30% of its revenues outside the U.S and controls about 40% of the South African hair care market. The goal is to capture half of the total African market within the next five to ten years, and penetrating the large black communities in such European cities as London and Paris.

“We must be careful not to give the impression that we are imposing one type of Western beauty on the world.....My ideal is to make L’Oréal the United Nations of beauty, in that we can offer something for people from us”. The CEO believed that there was a market for American brands that embodied American attitude, French brands that conveyed its chic, and Italian brands that represented its fashion. He wanted L’Oréal to have brands that delivered each one of them. Furthermore, at L’Oréal brands don’t stay at home serving the same old clientele. “They get spruced up, put in a new set of traveling clothes, and sent abroad to meet new customers”.

L’Oréal often made use of dramatic advertisements to promote its brands. Creating surprise, arousing emotion, getting closer to women’s hearts- - -such are the

themes of the new Lancôme advertising campaign that was launched in 2004. This change was part of a radical transformation in the brand as a whole. According to an executive of Lancôme International, “We know that brands have to renew and nurture their advertising identity. Luxury brands in particular have to renew their identity even more frequently. What people are looking for, above all, is for these brands to be bold, to be different. With this new identity, we have moved away from merely representing beauty to actually feeling it, feeling the emotion it inspires, which enables us to show the woman and the product simultaneously.”

L'Oréal frequently used celebrities from various fields of life to promote its brands. Some of the well-known personalities featured in L'Oréal's promotional campaigns included Claudia Schiffer, Kate Moss, Jennifer Aniston, Andie MacDowell, Catherine Deneuve and Natalie Imbruglia. L'Oréal has been the official sponsor of the Cannes Film Festival in which international personalities and actresses represented its brands as L'Oréal beauty ambassadors. L'Oréal also maintained close links with the world of fashion by sponsoring design awards and fashion shows in association with prominent design schools.

Given the high frequency of purchasing decisions made at the point of sale, merchandising has become a key element in the development of a brand or product. For L'Oréal, merchandising expresses the marketing strategy of its brands in retail outlets. It is estimated that a new merchandising concept can generate an increase in revenues of between 15 and 35% on a given distribution circuit and with an equal share of shelves. The new trend, as exemplified by L'Oréal Paris Store in Bucharest or the new Lancôme concept store in Hong Kong, is to create areas, not only to sell products, but also to communicate about the brand. The goal is to develop the product's image, to enable the consumer to feel the atmosphere the product creates, and to experiment with it before buying it.

Street marketing is also used to reach the young consumers, outside of stores, in a fun atmosphere. Garnier's Fructis brand launched the first European street marketing campaign in 1998 with buses decorated with Fructis shampoo colors. Designed to be traveling hair salons, they visited the major cities of France, Belgium and the UK in order to develop a personal relationship between the brand and its young consumers. Sample distribution, hair styling advice and makeovers in very unusual surroundings were among the events held as part of this campaign.

In Thailand, street marketing was used to promote skin care products in the streets and on university campuses. Fun activities, visual aids, talk shows on beauty and skincare featuring local personalities and a bus full of hair dressers and skin care professionals who offer personalized advice introduced consumers to the world of Garnier. Street marketing establishes contact with consumers in their own surroundings, in places where they feel more relaxed and receptive. Whereas mass media often sends young people a one-sided message, street marketing can create a dialogue. The high visibility of the marketing campaign can also make each product launch a real media event.

5. Future Challenges

L'Oréal has been successful in sustaining growth and leadership in the world cosmetics industry through continuous innovation, brand revitalization, and international expansion. Its brand portfolio is strong in all the major categories and channels, and its size has allowed it to forge closer relationships with trade partners so its brands get favorable shelf space placement in mass market and prestige outlets. However, the company faces a number of challenges in the future.

Growth in its core market is slowing down. In 2004, cosmetics market growth in Western Europe was 1.8%, North America grew by 2.5%, while Japan experienced a negative growth of 1.1%. Future growth is expected to come from the emerging markets, especially China, Russia and Brazil, but L'Oréal's position in those markets has significant room for improvement. One problem the company has had in those markets was that its brands were too high end for the majority of middle class consumers. In China, L'Oréal had only 2.6% of the \$5.5 billion Chinese market in 2002. To overcome this problem, L'Oréal acquired two Chinese brands, Mininurse and Yue-Sai in 2004, but the success of these moves is yet to be seen.

Competition is stiff. L'Oréal faces threats from P&G, Unilever, Avon, Henkel, Beiersdorf and a host of local players in the mass market segment. Beiersdorf's Nivea skin care brands sell larger volumes than L'Oréal's Plénitude, and P&G's recent

acquisition of Wella poses threats in the hair care segment. In the prestige segment, L'Oréal faces competition from Estee Lauder, LVMH and a host of luxury and fashion goods providers. Trade consolidation in both the mass market and prestige segment could put pressure on L'Oréal as retailers gain clout over manufacturers.

After 17 years as CEO and Chairman, Owen-Jones announced that he will relinquish his post as CEO to Mr. Jean-Paul Agon (currently head of L'Oréal USA) from 2006. Owen-Jones has been a key factor to L'Oréal's impressive growth and profit performance, and the longevity at the top has been a source of stability and strategic consistency for the company. Mr. Agon has an impressive track record building the Asian and North American business, and Mr. Owen-Jones will maintain the non-executive chairmanship, which will ensure a smooth transition and maintain L'Oréal's traditional management longevity.

The biggest risk facing L'Oréal is becoming complacent and arrogant. In this rapidly changing industry characterized by the sheer unpredictability of consumer, competitor and channel trends, being number one cannot always be guaranteed. L'Oréal has to continually re-invent itself through technological innovation and brand renewal, balancing creativity and imagination with operational excellence and business disciplines.

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