



South Korea's high-end cosmetic brands such as Sulwhasoo are making a big impact in Chinese market.



# ASIAN BEAUTY SECRETS MEET HIGH-END COSMETICS

American and European brands may have been the traditional leaders in a majority of luxury goods sectors, but in high-end cosmetics, Asian brands, led by Japanese and South Korean companies, is making its presence known.

By Zhou Ying

When it comes to choosing cosmetics, the first decision most Chinese people face is deciding whether to go with American and European or Japanese and South Korean cosmetics.

Japan's Shiseido Group, led by its cosmetics brands Shiseido and Clé de Peau Beauté, has long held a place as one of the world's top 10 giants of the high-end cosmetics industry. During the 2014 fiscal year

(which ended in March of 2014), 50.5% of the group's \$5.53 billion in revenue came from foreign markets and by the middle of January of this year, the group's market value had reached \$5.5 billion. The quintessential example of a comprehensive cosmetics group, Shiseido's brand positioning covers the high, mid-range and mass consumer groups, while its range of products extends into a number of areas such as skin

and hair care, makeup, sunscreen, perfume and beauty supplements.

Quite a few Chinese consumers' first experiences with high-end cosmetics started with Shiseido. The flagship brand of the group's international business, Shiseido products are sold in 89 countries and regions around the globe. No matter if it's in the US, Europe or Asia, the Shiseido brand can be found in high-end retail stores such



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as Nordstrom, Harrods, Neiman Marcus and Lane Crawford right alongside Lancôme, Dior, Sisley and other big-name American and European brands—a testament to its influence in the industry. As for China, for the past seven years, Shiseido has continually won a place among the top-10 in New Fortune magazine’s Annual Survey of the Best Loved Luxury Products in Capital Circles.

Of course, it’s obvious that whether it’s the global stage or the Chinese market, European and American brands still possess overwhelming advantages over their Japanese and South Korean counterparts when it comes to aspects such as brand

awareness, business models, market share and profitability.

### South Korea Makes Waves

While the Shiseido brand has long been a familiar face at high-end retailers around the world, it has a new Asian neighbor and competitor in the form of South Korean brands. Represented by Sulwhasoo and Whoo, this South Korean wave is currently sweeping through the international high-end cosmetics market.

Sulwhasoo is one of AmorePacific’s top-tier products, whereas Whoo comes from South Korea’s LG Group. It’s said that LG designed Whoo specifically to compete with Sulwhasoo, while the name, which means “empress” in Korean, brings to mind images of regal beauty and the beauty secrets of empresses past.

It’s easy to see the impact this South Korean wave has had around the world. For instance, visiting Lane Crawford in Hong Kong’s Harbour City shopping mall and heading to the beauty section, one can find Shiseido brand products occupying six sections (three of which are specialty counters; the other three located at perfume counters), while three sections are the domain of South Korean products. Additionally, of the 10 makeover rooms at Lane Crawford, except for the one room that is open to all, three rooms are taken by Shiseido, Clé de Peau Beauté and Sulwhasoo, another three belong to Giorgio Armani, Sisley, Canelove and the last three are shared by Clarins/SK-II, Guerlain/Dior and Lancôme/Helena Rubinstein.

Even if this doesn’t explain why Sulwhasoo is able to encroach on the territory of cosmetic brands such as Shiseido and Lancôme, it clearly sends an important message to consumers: Sulwhasoo’s AmorePacific has the money and the ambition to try and stand eye to eye with traditional European and American brands.

In addition to Sulwhasoo and Whoo, other South Korean brands at Lane Crawford include Sulwhasoo’s sister brand



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AmorePacific, the group’s namesake brand. A new rising star, AmorePacific has yet to be listed among the other brands on the digital screens at Lane Crawford or on the map of stores at Harbour City.

The spot it currently takes at Lane Crawford originally belonged to Fresh—the American-born brand that made its name with brown sugar facial masks. Acquired by luxury giant LVMH in 2000, Fresh’s annual sales currently sit at more than \$20 million.

Looking at the 25-square-meter counter area where AmorePacific now stands, it’s easy to see why Fresh moved: It needed the space. Fresh now sits right across the walkway from its old location, probably giving AmorePacific the hope it can benefit from Fresh’s popularity to get a few extra customers, or maybe someday reach the point where it too will have customers that are willing to wait in line half an hour just to



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**With its 40% market share in the South Korean cosmetics market, the AmorePacific Group is the largest cosmetics group in South Korea.**

buy a stick of lip gloss like they do at Fresh.

All in all, the shops are located in a good area. Nearby is the main entry way that leads to Lane Crawford's beauty and cosmetics section and the main escalator that leads to the apparel department downstairs.

With its 40% market share in the South Korean cosmetics market, the AmorePacific Group is the largest cosmetics group in South Korea. Owners of a diversified brand portfolio, in addition to the group's 13 skincare brands that range from high-end to affordably priced, AmorePacific's reach also extends into daily-use products such as toothpaste, perfume and hair and body care, leading to a total of more than 30 brands under its purview.

Many of these products have been extremely successful. For instance, since hitting the market in 1997, cumulative sales of Sulwhasoo's First Care Activating Serum, one of the group's heavyweight products, has reached more than 1 trillion won (approximately \$930 million). With roots tracing back to 1932, over the years AmorePacific has become a global cosmetic powerhouse. Led by Sulwhasoo, Laneige, Mamonde, Innisfree and makeup brand Etude House, the group's sales for the 2013 fiscal year reached approximately \$359 million. Additionally, over the past five years, the group's stock prices have grown at a rate of more than 800%, far outpacing the Estée Lauder Group and the L'Oréal Group (Figure 1).

According to the AmorePacific Group

website, in October of 2010 it became the first South Korean cosmetics company to be admitted to the Dow Jones Sustainability World Index (DJSI World), an indication of the group's position in the global market. However, taking a closer look, of the group's five skincare brands that have already entered the global market place (according to the group's 2013 fiscal report, AmorePacific had yet to enter the Hong Kong market), only Laneige and Sulwhasoo have entered the American market (the former in 2004 and the latter in 2010), leaving the rest of the group's brands to focus mainly on Asian countries.

From an overall viewpoint, the AsiaPacific Group's annual sales volume is roughly one-third that of the Estée Lauder Group and it is still quite a ways from that of the L'Oréal Group. Additionally, the group's 12% operating margin is only higher than Shiseido's 6.5%. Compared to the more than 15% operating margins enjoyed by Estée Lauder and L'Oréal, the profitability of Japanese and South Korean cosmetics enterprises fall a bit short (Figure 2).

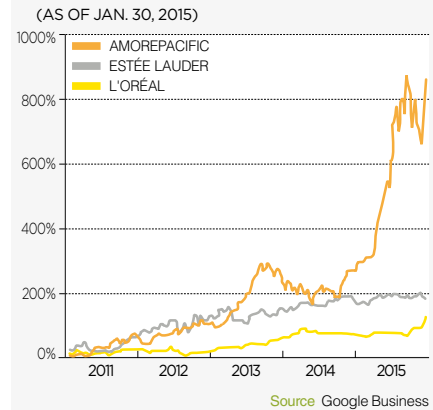
### The Strength of Chinese Money

Even though Shiseido and AmorePacific may still lag their contemporaries in the US and Europe, their rapid progress in the high-end cosmetics and even the entire cosmetics industry has been evident for all to see. This is no truer than in China, the world's second largest cosmetics market. To a certain extent, if it weren't for the enormous spending power of Chinese consumers, the

(Figure 1)

### GOING UP

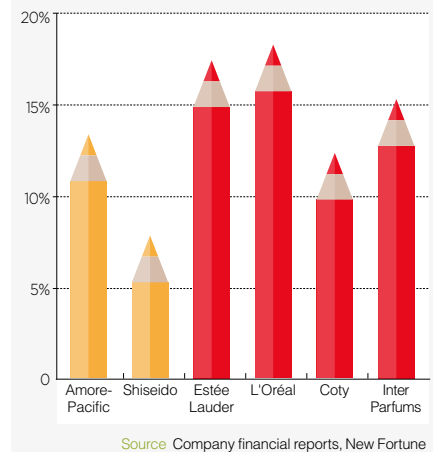
Over the past five years, AmorePacific stock prices have far outpaced the Estée Lauder Group and the L'Oréal Group



(Figure 2)

### LOW PROFITABILITY

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luxury market wouldn't be what it is today, nor would Shiseido and AmorePacific have achieved such growth and success.

Only reaching China in 2006, in less than 10 years, Whoo has established more than 100 stores throughout the country, reaching as far as Gansu, Qinghai and Xinjiang in the west. Currently, Jiangsu Province sits at the top with 18 stores.

The power of mainland money is clear. One of the main reasons Whoo and



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Sulwhasoo chose Harbour City’s Lane Crawford for its Hong Kong location is because that’s where a majority of mainland tourists flock to when visiting the city. Appearing in the same space as Canelove, Estée Lauder and other major brands sends a clear message to Chinese consumers that these South Korean brands stand on the same level—a type of free advertising more valuable than many can imagine.

Over the past nearly 10 years, the AmorePacific Group’s sales in the China region have averaged annual growth of 47%, forming an important pillar for the group’s strong growth in overseas markets (Figure 3). During the first half of 2014, the group’s total sales in the Chinese market reached \$199.6 million, a year-on-year increase of 26.5%.

To meet the demands of this fast growing market, the group spent a total of \$120 million to open a production and R&D center in Shanghai. Opened in October 2014, the center is all part of the group’s plan to

increase the Chinese market’s contribution to the group’s global sales from 10% to 28% by 2020.

Compared to L’Oréal’s hefty 9.1% market share in China, AmorePacific trails no small distance behind with only a 1.2% share.

### ***Sales of the 11 brands that L’Oréal has introduced to China double every four years.***

Fighting its way into China’s high-end cosmetics market 20 years ago, L’Oréal long established itself in first- and second-tier cities, and has already started fixing its gaze on third- and fourth-tier cities. In 2012 and 2013, the group brought its ace-in-the-hole, Lancôme, to 70 new cities across the nation; of these 33 were third- and fourth-

tier cities. As it stands now, Lancôme can be found in 170 cities across China. As for growth, sales of the 11 brands that L’Oréal has introduced to China double every four years, and the group predicts that over the next two years Chinese consumers will become the largest supporting pillar of the group’s cosmetics business.

Also working on establishing channels in third-tier cities is Estée Lauder. Looking to make China its second biggest market after the US, in 2012 the group followed in the footsteps of Shiseido’s Aupres brand by establishing its own Osiao line of luxury skincare products specifically designed for the Chinese market. As it stands however, it’s difficult to predict the brand’s potential as the group has currently only established two specialty shops, both of which are located in Hong Kong, one in Lane Crawford in Harbour City and the other at the Elements shopping mall.

Although there is room for expansion, China remains an important market for

Estée Lauder is trying to make China its second biggest market after the US.





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### ***The Chinese-led Asian-Pacific market is fast becoming one of the world's most important markets for luxury cosmetics.***

overseas cosmetics companies. Currently, the Chinese market accounts for 5% of Estée Lauder's annual revenue and 7% of L'Oréal's. Worthy of note is that these numbers don't include sales outside the mainland in Taiwan, Hong Kong and Macau, nor do they factor in the multitude of mainland tourists that buy cosmetics in shopping centers and duty-free shops in Paris, New York or Dubai. If we were to include this into our calculations, Chinese money most likely accounts for as much as 15% of Estée Lauder's annual sales revenue.

According to Estée Lauder's estimates, for every dollar that the group earns in China, Chinese outside the mainland contribute twice as much. Even more important is that the Chinese-led Asian-Pacific market is fast becoming one of the world's most important markets for luxury cosmetics. The region's current 33.1% market share is nearly equal to that of Europe's.

#### **The Power of Packaging**

The rise of cosmetics in Asia is closely tied to the characteristics of the cosmetics industry. No matter if it is watches, jewelry or leather apparel, what the luxury industry values most is a brand's historical heritage, cultural tradition and the exquisiteness of its craftsmanship. However, when it comes to the cosmetics industry, these factors play a lesser role since cosmetics have a much shorter consumption cycle. Basically, when you come down to it, looking past the endless explanations about how a particular skin cream was developed or its effectiveness, what cosmetics are truly selling is a brand.

For luxury brands trying to get a piece of the cosmetics pie such as Burberry and Gucci, this is good news as they already have well-established reputations. When Burberry skin cream or Gucci foundation makes an appearance at the cosmetics counter, consumers' familiarity with these brand names automatically make them seem more valuable.

Looking at the money cosmetics groups spend on advertising can tell us a lot about how important branding is to these companies. Estée Lauder and Coty respectively spent \$2.84 billion and \$1.56 billion on marketing during the 2014 fiscal year. This includes different types of advertising, promotions and product samples given free or with purchase of other products. By comparison, the two only spent \$160 million and \$67 million on R&D during that same period, which means Estée Lauder spent 17.7 times the amount of money on marketing than it did on R&D, while Coty spent 23.3 times as much (Figure 4).

To put it a bit more bluntly, cosmetics is an industry that relies heavily on packaging ideas and selling consumers a dream of beauty. This is even truer when it comes to the luxury cosmetics industry, which is far more demanding than other luxury industries when it comes to building an image and telling a story. No matter if we're talking about handbags or watches, creating the type of brand recognition that Whoo did in just 12 years (Whoo was first introduced in 2003) is practically impossible outside the cosmetics industry.

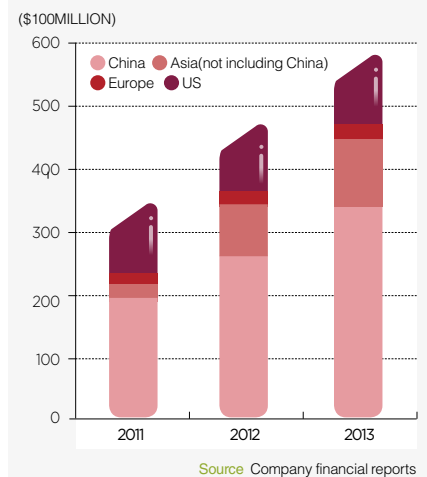
In other words, even if luxury handbag maker Hermès or Swiss ultra-luxury watch maker Patek Philippe had never sold themselves as luxury brands, since the quality of their products would be tested and recognized by the market, they would still have become luxury items. However, when it comes to cosmetics, it really doesn't matter how effective your product may be. So long as you tell a good story and set your prices high, you're already well on your way to becoming a luxury brand. The difference

between other luxury items and cosmetics is a bit like the difference in reputations between families from "old money" and those with "new money."

With this in mind, it's easy to see how Japanese and South Korean cosmetics have earned their position in the luxury cosmetics arena. For instance, in 2013, the extremely popular South Korean soap opera "My Love from the Star" could be seen on TV screens throughout Asia. In the

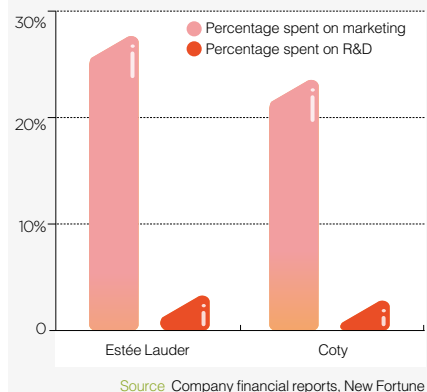
(Figure 3)  
**DEPENDING ON CHINA**

China is an extremely important overseas market for AmorePacific



(Figure 4)  
**MARKETING IS IMPORTANT**

Marketing expenditures of cosmetics enterprises far surpass that spent on product R&D





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show, South Korean actress and Hanyul brand cosmetics spokeswoman Jun Ji-hyun's character Cheon Song-yi could often be seen using Hanyul and other AmorePacific brands cosmetics in scene after scene.

Statistics show that sales of Hanyul brand Gogyol Rich Effect Hydration Essence Water and Ja Woon Dan Moisturizing Cure Balm increased by 75% after appearing on the show. In February 2014, daily sales of the latter at cosmetics stores in Myeong-dong and Insa-dong, Seoul—two areas that are often visited by overseas tourists—were five times higher than January, with Chinese tourists accounting for a majority of pur-

chases. Additionally, in 2013, single-product sales of the IOPE Air Cushion XP that Jun Ji-hyun used on the show broke past the \$90.4 million mark to reach cumulative sales of 10 million units.

Currently, neither Hanyul nor IOPE have been introduced to markets outside of South Korea. Selling for the equivalent of more than \$160, IOPE skin care products fall at the high end of the luxury cosmetics spectrum, with Hanyul just slightly behind.

### Where Are the Chinese Brands

No matter if it's long-established Shiseido or the more recent rising star that is AmorePacific, Asian cosmetics have also

benefited from a concept that has been becoming increasingly popular over the past few years: Masstige. A portmanteau of the words "mass" and "prestige," it is a marketing term describing the process by which high-end brands are extended down to the masses and mid-market brands are given a boost. Both Shiseido and AmorePacific have these types of skincare brands that fill the gap between mid-market and super premium brands, becoming a force to reckon with through sheer numbers.

Another thing that shouldn't be overlooked is the geographical advantage that comes from Shiseido and AmorePacific's location in Asia—a natural advantage that sets them apart from their US and European counterparts. Research indicates that women in Asia use an average of eight different skincare products each day, while in France they only use three. This fact provides Japanese and South Korean enterprises the impetus to introduce a more varied line of products. The fact that the skin tone and complexions of Asian consumers in the three countries are very similar, as are ideas about beauty, is also helpful when it comes to managing products for the region.

The question seems to be: Where are Chinese enterprises in all this? While maybe it's understandable why Chinese enterprises can't rival luxury consumer goods makers such as Louis Vuitton and Cartier, it doesn't stand to reason that Japanese and South Korean cosmetics enterprises can take on their American and European counterparts and yet China can't, since China possesses many of the same natural advantages. South Korean cosmetic brands go on about beauty secrets passed down through the ages; China has those as well, in addition to traditional Chinese medicine. With the world's second largest cosmetics market as a local market, why do Chinese cosmetics seem to be missing from the picture?

China is also weak when it comes to the global cosmetics market. While there have been a few Chinese contenders, from Yue



China's local brands are limited to mid- and low-end markets.



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Sai and Mininurse to the more recent TJoy and Mg Masks, these were soon bought up by American and European cosmetic giants. This has been good for some brands, but not so great for others. Yue Sai and Mininurse were both purchased by L'Oréal, but while the former has managed to survive at its new home, the latter has completely disappeared. Meanwhile, after losing money after being purchased by Coty, TJoy encountered a similar fate as Mininurse and was eventually abandoned.

The number of local cosmetics brands recognizable to a majority of consumers can practically be counted on two hands and are pretty much limited to mid- and



***With the world's second largest cosmetics market as a local market, why do Chinese cosmetics seem to be missing from the picture?***

low-end markets. Inoherb, Natural Beauty, Chando and the Shanghai Jahwa Group's Herborist can be considered as some of the China's better-known brands.

A new player in the Chinese and even Japanese cosmetics industry, Shanghai Jahwa has nine major brands which include the GF brand specifically for men. However, when one-third of the market is dominated by L'Oréal, Proctor & Gamble and Shiseido, and another third by other Western brands, this makes it extremely difficult for Chinese brands to find a place in the market, leaving one to wonder just how long it will take for China to come up with a standout international brand of its own.

### NEW TREND

## The Continued Rise of Male Cosmetics

Three years ago, metrosexual, a portmanteau derived from metropolitan and heterosexual, was still very popular in the common vocabulary. However, while metrosexual men have already made way for China's so-called sunshine boys—men who are considerate, positive and show respect towards women—cosmetics aimed at fashionable men willing to spend money to look good are becoming increasingly popular. When it comes right down to it, women don't have a patent on beauty and no matter if you're a metrosexual man or a sunshine boy, wanting to look good is part of everyone's nature.

Changes in social attitudes, increases in living standards and the influence of celebrity idols have all increased male demand for aftershave, moisturizer, anti-aging products and even concealer. This market's huge potential for growth has inspired numerous brands aimed at men. For instance, Clinique, Biotherm, Sisley,

Kiehl's, Ralph Lauren and Clarins have all introduced men's skincare products. In 2012, SK-II also entered this growing market, while Tom Ford Beauty began introducing men's skincare and shaving products just three months after beginning to work with Estée Lauder in 2013.

In South Korea—the world's largest consumer market for men's cosmetics—lotions, oils, eye cream, foundation and concealer are basic necessities that every fashionable man needs, while some will even use eyeliner and lipstick.

For this reason, it's easy to understand why BB (blemish balm) cream has become the leading force for a majority of men's cosmetics brands in South Korea. Even Biotherm has introduced men's BB cream, in addition to its more than 70 other men's cosmetics brands.

In order to better serve this male market, in 2011, the AmorePacific Group established a one-stop beauty shop just



for men known as Manstudio, which not only sells Laneige and Hera brand men's products, but also has beauty consultants on standby to help men find what's right for them.

Also in Asia, Lab Series, Estée Lauder's Aramis brand men's care cosmetics line, chose a high-end mall in Singapore as the location of its first flagship store. L'Oréal's Biotherm followed close behind, establishing its first stand-alone specialty store at the same mall in 2013. Seeing the potential of this growing market, Estée Lauder has even established a men's cosmetics department.

It seems that the day that men become just as important to cosmetics enterprises as female consumers may not be that far off.