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L'Oréal in China:

Marketing Strategies for Turning Around Chinese Luxury Cosmetic Brand Yue Sai

Best Marketing Case
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This case was written by Haiyang Yang, Assistant Professor of Marketing at the Johns Hopkins University Carey Business School (INSEAD PhD 2013), and Pierre Chandon, the L'Oréal Chaired Professor of Marketing, Innovation and Creativity at INSEAD. It is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

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Maybe it was that eighth glass of *baijiu* that he had downed to show respect to the department store manager and her team, or their joke that they were honoured to see him but hoped that the head of Lancôme would join him at their next meeting, but all of a sudden doubts assailed Stéphane Wilmet, the new general manager of Yue Sai. Stéphane had always been passionate about China – teaching himself Chinese as a teenager – and had looked forward to coming back to China after an assignment with L'Oréal USA. But the challenge ahead was enormous. Yue Sai was one of the very few brands that had managed to lose volume and money in China's booming cosmetics market – a sore point for L'Oréal. While politely engaging in small talk with his hosts about the superiority of the local cuisine, Stéphane's mind kept returning to what was needed to turn around the situation and strengthen L'Oréal's reputation in China.

The Chinese Cosmetics Market

Brief Overview

China has one of the world's oldest civilizations with a history dating back 5,000 years, and is the most populous nation on the planet with over 1.3 billion people. Thanks to its consistently rapid economic development since the late 1970s, it is now the world's second largest economy in terms of GDP (see Exhibit 1). The World Bank has projected that it will surpass the United States as the world's largest economy in the coming decades. Given an enormous increase in disposable income, Chinese consumers increasingly desired more sophisticated, premium products in many categories, including beauty and skincare.

Procter & Gamble was the first multinational to enter mainland China's beauty and skincare market, with Olay in 1989. With the exception of Estée Lauder which waited until 2002, the other multinationals quickly followed: Shiseido in 1991 with Shiseido, L'Oréal in 1997 with L'Oréal Paris, and Unilever in 1998 with Hazeline. They introduced extensive portfolios of high-quality brands and products, and brought marketing expertise, financial resources and cutting-edge R&D (which were soon localized by establishing local research centres). Initially, they drove out weak local brands, replacing them in the most desirable department stores.

As of 2010, the top five companies in the beauty and skincare market (including personal care) were all multinationals: P&G, L'Oréal, Shiseido, Unilever and Amway. Yet they still only accounted for 40% of the €18 billion market, and now had strong local competition. Firms such as Shanghai Jahwa and Jala had experienced extremely strong growth and their brands were available everywhere, from high-end department stores to local cosmetic stores, presenting a formidable challenge.

Specificities of the Chinese Cosmetics Market

Distribution Channels

When multinationals first entered China, premium cosmetics were almost exclusively distributed via department stores (see Exhibit 2). As in department stores worldwide, brands rent floor space and sometimes pay a sales-based commission to the department store. They are then free to create a store-within-a-store (or counter), staffed with their own beauty assistants, with total control over sales and merchandising (but not, by law, on price). A legacy of the absence of other channels is that, even today, mass-market brands like L'Oréal Paris, Maybelline and Olay have counters in department stores in tier-2 and tier-3 cities (see Exhibit 3). In 2010, there were over 4,000 department stores in China, with a minimum of 6,000 m^2 of retail space. They were stratified into three classes: class-1 stores carrying brands like Lancôme, Chanel and Dior were only present in the largest cities. Hefei, the capital of Anhui Province, a city with 5.7 million people and the world's fastest growing metropolitan economy,[1] only had a class-2 department store.

The second distribution channel consisted of beauty store chains like Watsons and Manning (see Exhibit 4). These employed their own beauty assistants who could sell any brand, but they also had smaller spaces dedicated to mass-market brands like L'Oréal Paris, Olay and Vichy, with assistants employed by the brands in the largest stores. The positioning of the LVMH-owned Sephora chain is more upscale, allowing it to carry brands like Estée Lauder and Lancôme (and, of course, Dior). The third channel consisted of countless small local cosmetics stores selling exclusively beauty and personal care products without the help of beauty assistants (see Exhibit 5).

New channels of distribution, such as TV-based direct selling and ecommerce portals were rapidly emerging. Over half a billion Chinese consumers had access to the internet. Traditional media (e.g., TV, newspapers) were losing their appeal as the younger generation spent a significant portion of time texting, surfing the web, and using social media such as Weibo (a Chinese fusion of Twitter and Facebook). Internet-based retailing was thus likely to have a significant impact on existing channels in the near future.

Attitudes to and Usage of Cosmetic Products

For decades, cosmetics were seen as "counter-revolutionary" and were virtually non-existent in China. Generations of Chinese women grew up without ever learning about cosmetics from their mothers. This absence of inter-generational norms meant that cosmetic companies—starting with Yue Sai in 1992—had first to educate Chinese consumers about beauty products and routines. But it also created a market of open-minded consumers free of the preconceptions prevalent in many countries: for example, Chinese men were more open to skincare than their European and American counterparts.[2] China alone accounted for 70% of the worldwide sales of the Men Expert line of L'Oréal Paris. Chinese women were less interested in colour cosmetics than Europeans or Americans, not to mention Japanese and Korean women, who have the most sophisticated beauty routine in the world.

Only 10-15% of the beauty products sold in the Chinese market were makeup products. Many Chinese women viewed makeup as superficial, unnecessary and potentially harmful to skin, and heavy makeup as socially undesirable. The perfume market was tiny in China. Perfumes were more often bought as gifts than actually used. China was therefore primarily a skincare market (as can be seen by the relative space devoted to skincare and makeup at Sephora in Exhibit 4).

1 http://www.economist.com/node/21567579
2 http://www.businessweek.com/magazine/content/11_02/b4210022517035.htm

In China, the younger generation was significantly more receptive to cosmetics products than older consumers. The average cosmetics consumer was in her mid-20s (vs. early-50s in Europe). Most were raised as an only child (or "little emperor"), had significant disposable income, and liked novelty. For them, another "generation" meant people who did not overlap at university or were separated by a decade at most (not parents and children). Whereas European and American women associated a brand's longevity with heritage and prestige (particularly for luxury brands), 'old' had negative associations among Chinese consumers.

Paradoxically, in parallel with the Chinese focus on novelty, there was a renewed interest in China's ancient history, traditions and cultural heritage. Popular computer games and television shows were set in ancient China. Cultural beliefs pertaining to food, health and medicine had never been lost, and held true across all age groups.

Most Chinese have some knowledge of traditional Chinese medicine (TCM; 中医) and apply its basic principles, if only because they feel it could do no harm. TCM refers to a wide range of ancient medicinal practices, including herbs, acupuncture and massage, to prevent and treat ailments and enhance health. Common ingredients such as glycyrrhiza uralensis (甘草), lonicera japonica (金银花), "silver ear" mushrooms (银耳) and wolfberry (枸杞) can be purchased in most grocery stores and are cooked with food or made into tea. Other more specific and expensive ingredients (TCM has over 1,800 ingredients) like angelica (当归), cordyceps (冬虫夏草), ginseng (人参), and notoginseng (三七) are typically bought in special TCM pharmacies (see Exhibit 6).

However, China's economic development and rapid urbanization had come at a price. The country's environment had deteriorated significantly and a large number of Chinese cities suffered from smog and polluted air and water, prompting a growing number of consumers to use skincare products to protect their skin. The pitfalls of industrialization and some high-profile food safety scandals (e.g., melamine-adulterated milk) had also boosted demand for products made with natural ingredients.

Rising Chinese Confidence

Chinese consumers were irresistibly drawn to Western brands in the 1990s and 2000s. Even today, a significant number of Chinese and Asian cosmetic brands uses French-sounding names (like Franic, Kosé, Laneíge and Mamonde). Consumers began to take an interest in Japanese cosmetics from companies like Shiseido (and its China-only brands like Aupres and Urara), which were perceived to be more knowledgeable about Asian skin and beauty, although historical animosity toward Japan and recent geopolitical tensions were a risk for Japanese brands.

Achievements such as sending astronauts into space, hosting the Olympic Games (Beijing 2008) and the World Expo (Shanghai 2010), building bullet trains and advanced planes, and the global success of firms like Haier, Huawei and Lenovo had made Chinese consumers increasingly proud of their nation. This had kindled an interest in products with a local heritage as well as boosting preference for domestic brands. For example, the 2008 launch of Shang Xia (上下)[3], a Shanghai-based sub-brand of Hermès focused on furniture and

3 http://www.shang-xia.com

decorative objects showcasing Chinese heritage and craftsmanship, was seen as a milestone in the rise of Chinese luxury brands. More generally, the reputation for quality, safety and the perceived R&D capabilities of Chinese firms had improved. This was particularly true of cosmetics, because many (including the international brands) were manufactured in China. Still, since most Chinese continued to associate luxury with foreign brands, it was unclear how quickly they would accept Chinese luxury brands.

Overall, Chinese consumers, especially those in the tier 1 cities like Beijing and Shanghai, were increasingly sophisticated about brands and products in the beauty and skincare categories. With more opportunities to shop abroad and wider access to information on international fashion trends, they could distinguish true premium brands from those simply aspiring to be perceived as such. A seemingly Western name and image were no longer enough to attract discerning Chinese consumers.

L'Oréal China

The Group

L'Oréal is the world's largest cosmetics company, with worldwide sales of €19.5 billion in 2010. In that year, its sales in China exceeded €1 billion for the first time, an 11.1% increase over the previous year and a double-digit gain for the 10th consecutive year, making China the third-largest market for L'Oréal after the United States and France (vs. its seventh-largest in 2008). L'Oréal had vowed to acquire one billion new customers globally in the next decade, a significant portion of which will come from China.

L'Oréal is the second largest beauty and skincare player in China after P&G and No.1 in the luxury segment. It is present in China with almost all of its major brands, with the exception of Body Shop because Chinese regulations require cosmetics to be tested on animals. Five of its brands, including Lancôme and Maybelline New York, are No.1 in their respective categories.

The Luxury Product Division (LPD) manages premium brands such as Lancôme, Biotherm, Helena Rubinstein, Kiehl's, Shu Uemura and Giorgio Armani. The Consumer Product Division (CPD) oversees brands such as L'Oréal Paris, Maybelline New York and Garnier. Other divisions oversee dermo-cosmetic brands (e.g., Vichy) and brands tailored for professional hair salons (e.g., Matrix).

L'Oréal has established a Research and Innovation Centre in Shanghai, and has manufacturing centres in Suzhou and in Yichang, where it produces most of its mass and professional brands. Luxury brands, with the notable exception of Yue Sai, are still imported.

Yue Sai (羽西)

Madam Yue-Sai Kan and the Pre-L'Oréal Years (1992-2004)

The first modern cosmetics brand of China, Yue Sai, was founded in 1992 by Madam Yue-Sai Kan,[4] an Emmy-winning TV host, socialite and entrepreneur (see Exhibit 8), with the aim "to create, produce and sell the very best beauty and skincare products that we can offer to Asian women and to the world, and become the first global cosmetics brand from China." Her key insight was that the standards of beauty in China were different from those of other cultures; there was no reason why Chinese women had access only to foreign products that had not been designed for their specific type of skin and beauty.

To promote the brand, Madam Yue-Sai Kan wrote the first book about makeup ever published in modern China, which became a huge best-seller. Battling myriad obstacles and local regulations, she secured distribution in department stores nationwide, personally trained China's first beauty advisors, and developed a range of red lipstick and basic skincare products designed for Asian skin. The brand's red lipstick became an icon in China.

In 1996, Madam Yue-Sai Kan sold the company to Coty, the New York-based cosmetics firm and world's largest producer of fragrance, which outbid L'Oréal. Coty pushed the distribution of Yue Sai to reach more cities as well as less premium cosmetic stores. By 1998, Yue Sai had become the No.1 luxury cosmetic brand in China. Coty continued to focus on distribution rather than branding, and started focusing on its own brand, Lancaster. Yue Sai gradually lost relevance, straining the relationship between Coty and Madam Yue Sai.

L'Oréal acquired Yue Sai in 2004. L'Oréal CEO, Jean-Paul Agon, declared that adding an established Chinese brand like Yue Sai alongside European brands like L'Oréal Paris, American brands like Maybelline New York, and Japanese brands like Shu Uemura fitted perfectly with L'Oréal's "beauty for all" mission. That same year, L'Oréal also acquired Mininurse, a Chinese brand targeted at the mass market. Given the enormous potential of the Chinese market, coupled with L'Oréal's stellar track-record at integrating and developing brands (24 of its 27 major brands were obtained through acquisitions or licensing deals), the future looked bright for Yue Sai under L'Oréal management.

The Consumer Division Years (2004-2006)

The post-acquisition years were less smooth than anticipated. On the positive side, L'Oréal had acquired a brand with a wide distribution (more than 1,000 stores across different channels), strong sales (€39 million in 2006), historical strength in makeup, a few good skincare products and packaging, and a factory and R&D facility. On the other hand, the brand was associated with older consumers, sales were fading, it had lost its marketing and R&D innovative edge, and it was unclear how it fitted into L'Oréal's brand portfolio in China.

4 Madam Yue-Sai Kan (靳羽西) was born in Guilin, in China's southern province of Guangxi, in 1949. She grew up in Hong Kong and immigrated to the USA in her teens. The English transcription of her name is based on Cantonese pronunciation, which was typical of American Chinese during that period. In Mandarin, her first name, and hence the brand, is pronounced "Yu Xi".

Because Yue Sai had such a wide distribution and a moderate price, it was first assigned to the consumer-product division (CPD) of L'Oréal China. CPD tried to apply the marketing strategy that had proven so successful worldwide for L'Oréal Paris, a mix of scientific improvements, celebrity-driven glamour and wide accessibility. Yue Sai was priced slightly below L'Oréal Paris, new products were launched annually, and the brand continued to be distributed in a variety of channels. Communication focused on technology, featured beautiful Chinese actresses and models (see Exhibit 9), and was inspired by the L'Oréal Paris ads (see Exhibit 7).

The Luxury Division Years (2006-2010)

But the "Chinese L'Oréal Paris" strategy did not produce the intended results and the brand lost sales and awareness, while at the same time L'Oréal Paris was booming (see Exhibit 15). To provide the brand with a new strategy and new set of eyes, Yue Sai was transferred from the CPD division to the smaller Luxury Product Division (LPD) in 2006. LPD immediately promoted Yue Sai featuring a famous Taiwanese movie star, Shu Qi (舒淇), to re-establish the brand's luxury image (see Exhibit 10).

To deliver Yue Sai's longstanding brand promise that "Nobody knows Chinese skin better than Yue Sai," L'Oréal's Shanghai Research and Innovation Centre focused on creating products specifically designed for Chinese skin. For example, the Vital Essential line (生机之水) launched in 2007 incorporated extract of ganoderma mushroom (灵芝), a traditional Chinese medicine ingredient believed to foster internal balance and boost internal energy, with a fragrance evocative of the distinctive smell of traditional pharmacies. This product was the most-liked of the Yue Sai line-up, with above-average repeat purchase scores.

LPD then hired a reputable Paris-based branding agency and together they chose to reposition Yue Sai as "the first brand to stand for Chinese women's beauty". They built on the insight that modern Chinese women were radically changing, were proud and self-confident, and had a clear vision of their future and their new role in society. Although they treasured their families, they wanted to build for themselves a new professional, artistic and cultural environment.

To communicate the new "modern Chinese women" positioning, L'Oréal invested in a major television and print advertising campaign featuring Chinese supermodel Du Juan (杜鹃). These ads used such lifestyle taglines as "I hold my future in my hands" (未来掌握在我手中) and "I look forward to every day with confidence" (我期待,全心付出每一天) to bolster the image of Yue Sai as the brand for modern Chinese women (see Exhibit 11 and Exhibit 12). Consistent with the new positioning, Yue Sai's prices were notched higher than L'Oréal Paris.

LPD tried to compensate for the volume decline brought by higher prices (see Exhibit 14) by entering new distribution channels such as Sephora (see Exhibit 16), while pushing for better deals with distributors in order to enter more cosmetic stores. Meanwhile, the increasing number of foreign premium brands entering the Chinese market led department stores to push Yue Sai's counters further back in the stores, reducing their visibility and exposure to traffic. Some department stores even delisted the brand.

Turning Around Yue Sai

Alexis Perakis-Valat, who became CEO of L'Oréal China in 2010 at the age of 39, had big ambitions. He wanted to make L'Oréal the No.1 cosmetics firm in China, and turn China into L'Oréal's No. 1 market by continuing to push into smaller cities and introducing L'Oréal's luxury brands, including Kiehl's and Yves Saint Laurent.

Yue Sai's lacklustre performance was spoiling the picture. Despite a booming market, it had never turned a substantial profit and sales had barely improved (€35 million in 2010 vs. €31 million in 2005). In Alexis' own words, it was "the pebble in L'Oréal's shoe". Internally, it was becoming difficult to motivate talent to work on the brand. Externally, it blemished L'Oréal's reputation as a masterful integrator of acquired brands and companies, which could hamper L'Oréal's future acquisition endeavours.

Alexis and Stéphane, with the help of Ronnie Liang, Yue Sai's new marketing director, needed to move fast and on all fronts.

Strategic Decisions

Choosing the Right Value Proposition

When it was launched, Yue Sai was the uncontested premium Chinese brand. But today's competitive landscape was very different. Yue Sai was not perceived as aspirational, unlike foreign brands such as Lancôme, Estée Lauder and Shiseido. It had an uncertain business model, an ageing consumer base, and an unclear positioning, the result of several years of trying various platforms. Yue Sai was not even the only Chinese brand owned by a large multinational company. Aupres (欧珀莱), a Shiseido brand launched in 1994, was developed specifically for and only available in Chinese department stores (see Exhibit 13), and had acquired a reputation for quality and a specific knowledge of Asian skin. The brand had been well managed and sales were around €100 million. There were indications that other multinationals would launch China-specific brands.

Chinese firms were catching up with the multinationals. Shanghai-based Jahwa group had recently launched Herborist (佰草集) which already had sales of €70 million (up from €45 million in 2008) and was available at Sephora in both China and Europe. Its positioning was "blending traditional Chinese herbal medicine with modern biotechnology". Herborist was unique in that it was distributed in department stores but also in small freestanding beauty stores which offered massage and spa treatments. Another Chinese mass-market brand, Chcédo[5] (自然堂, owned by the Jala group) reached €165 million in sales in 2010. Its positioning was "Chcédo makes women blossom with natural beauty and charm."

Given the situation facing Yue Sai and the current portfolio of brands of L'Oréal China, the critical issue is whether the brand should: 1) keep its new lifestyle positioning as the brand of "confident, modern Chinese women", 2) be positioned as a Chinese luxury icon symbolizing the nation's long history and rich heritage, 3) adopt a more affordable value proposition, or 4) try something totally different.

5 The spelling was later changed to Chando.

To choose the right positioning for Yue Sai, it is essential to decide which aspects of the brand should be retained and which should be discarded. For example, Yue Sai must decide whether to make its association with the L'Oréal group explicit to consumers by becoming a sub-brand (e.g., "Yue Sai by L'Oréal") or by acknowledging L'Oréal's ownership (e.g., by adding the tagline "Yue Sai, a Chinese brand of L'Oréal").

Finally, Stéphane and Ronnie need to decide if they should follow Aupres, which has entered the Malaysian market, and expand Yue Sai internationally (but where?) Alternatively, should they consider extending the brand into other product categories (which ones?) or target other consumer segments (which ones)?

Marketing Mix Decisions

Advertising and Promotion

An important decision is whether to continue with the current TV and press campaign or to change it, at a time when media costs are climbing steadily and deteriorating sales limit the advertising and promotion budget. As more and more Chinese brands are relying on celebrities (actresses/actors, singers, athletes), should Yue Sai replace Du Juan with a celebrity or should they stay with a model? At the moment, 80% of Yue Sai's communication budget is focused on skincare and 20% on makeup. Should this be changed? Further, should they change the current media plan or focus more on new media platforms like Weibo?

More generally, they need to determine what resources to allocate to brand communication vs. improving in-store presence, improving the product line-up, or changing distribution channels.

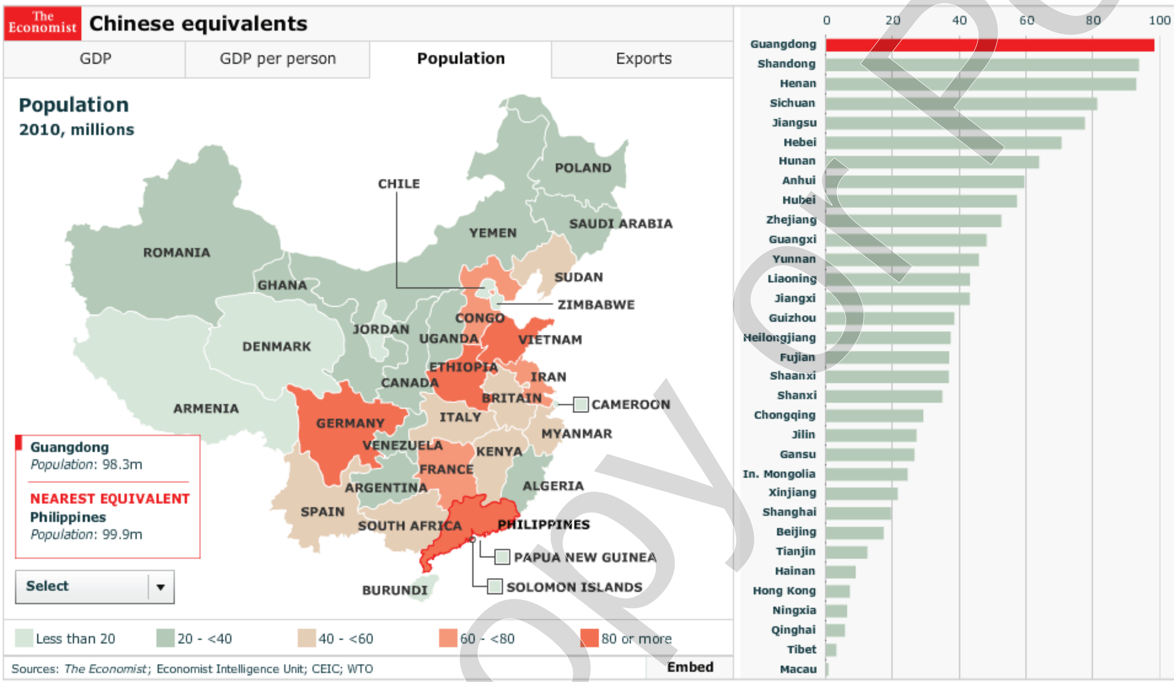
Pricing and Distribution

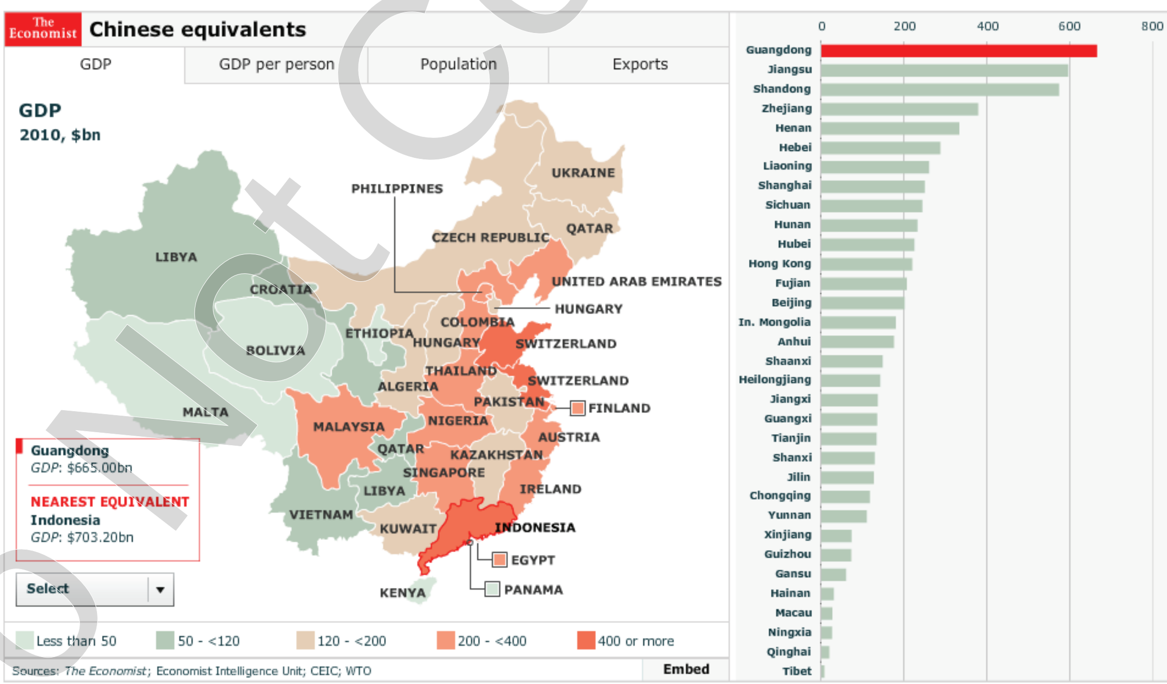
Stéphane and Ronnie must decide how Yue Sai should be priced within L'Oréal's brand portfolio in China (especially in comparison with L'Oréal Paris). And whether all of Yue Sai's products (see Exhibit 17) should be priced similarly, or should they charge more for some lines (which ones?)

One of the most important decisions will be to select the right channels of distribution based on the market tier(s) Yue Sai should pursue and the consumers it should target. How should Yue Sai deal with new distribution channels such as ecommerce portals? Should it engage in franchising to create its own stand-alone stores like Herborist?

Exhibit 1

Chinese Provinces as Countries: Population (top) and GDP Equivalents (bottom)[6]





6 Source: http://www.economist.com/content/all_parities_china

Exhibit 2

Cosmetic Counters in Department Stores in Shanghai (top) and Hefei (bottom)

Exhibit 3

L'Oréal Paris Counter in a Department Store (top) and in a Watsons Store (bottom)

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Exhibit 4

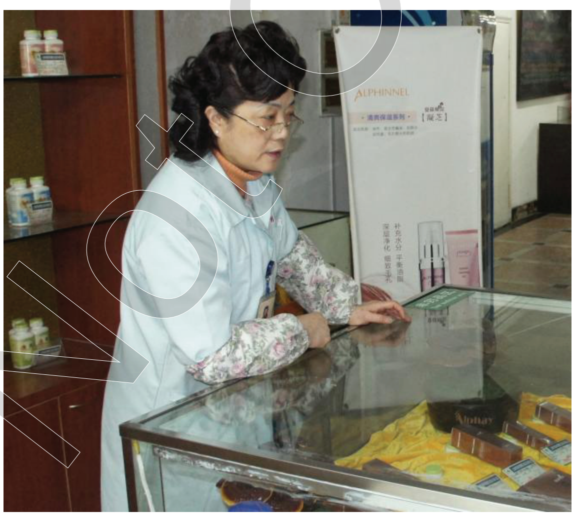
Beauty Chains: Watsons (top) and Sephora (bottom)

Exhibit 5

Cosmetic Store: Overview (top) and Close-Up of "Homemade" Displays (bottom)

Exhibit 6

Traditional Chinese Medicine[7]: Store, Pharmacist, and €2,900 Cordyceps box



7 Traditional Chinese medicine practices are rooted in theories documented in ancient texts such as the Inner Canon of the Yellow Emperor (黄帝内经). The human body is viewed as a coherent system in which organs serve distinct functions but are interconnected and interdependent. Health is maintained and ailments eliminated when the different functions are balanced within in this system. An important notion is Qi (气) — a vital energy or life force that circulates throughout the human body continuously. Health requires maintaining harmonious circulation of Qi. Some rare TCM ingredients, like cordyceps (a fungus that infects caterpillars and mummifies them) are more expensive than gold.

Exhibit 7
L'Oréal Paris Ads in China

Exhibit 8

Madam Yue Sai Kan for the Launch of Yue Sai (left)[8] and Crowning Miss China 2011 (right)

8 “Yue Sai, changing the face of the Middle Kingdom, one lipstick at a time” —— Forbes.

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Exhibit 9

Yue Sai: Advertising History (1992-2005)[9]

[9] Left: The Mrs Yue Sai Kan years (1992-1997); middle: The Coty years (1992-2002); right: The L'Oréal Consumer Product Division years (2004-2005)

Exhibit 10

Yue Sai: Advertising History (2006-2007)

Exhibit 11

Yue Sai: Current Print Advertising

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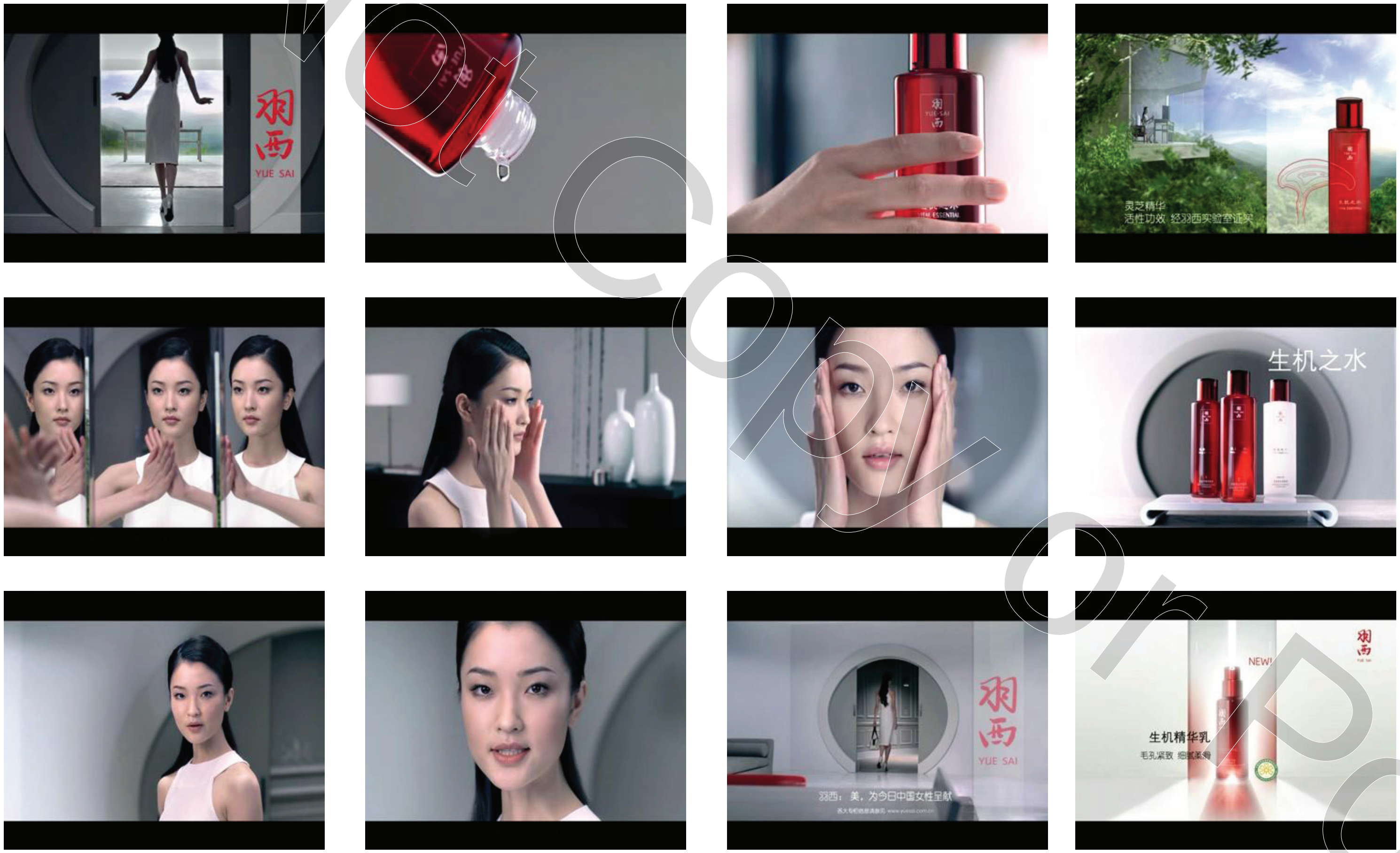
Exhibit 12

Yue Sai: Current TV Advertising[10]



10 Watch the television commercial and the making of on the case website: http://cases.insead.edu/loreal-china.

Exhibit 13

Print Ads of Key Competitors: Aupres (top) and Herborist (bottom)

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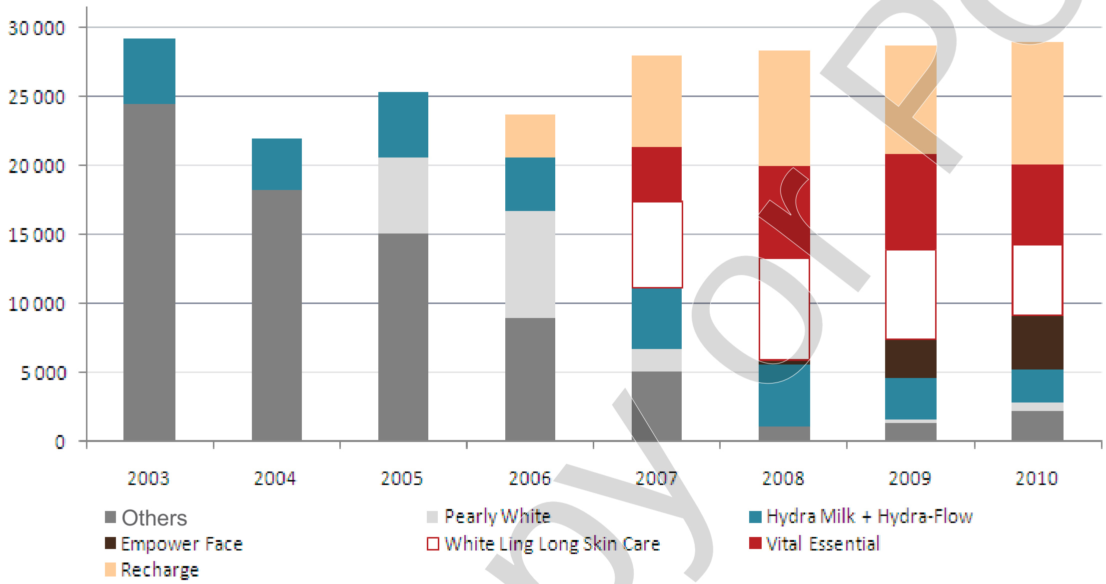
Exhibit 14

Yue Sai: Skincare Sales (€m, top) and Volume ('000 units, bottom)



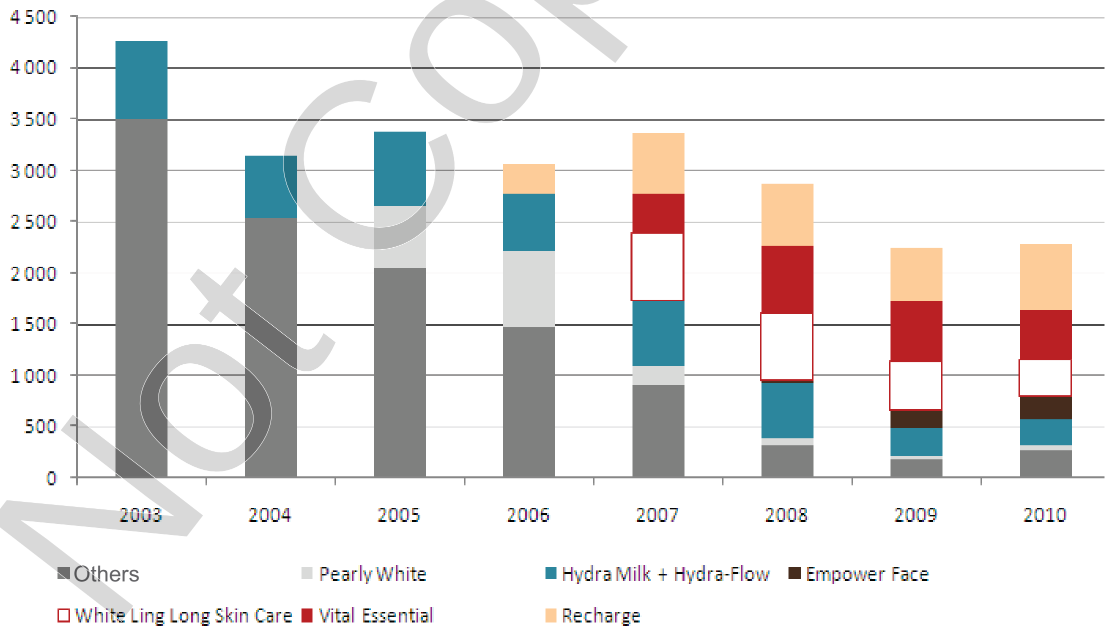


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Exhibit 15

Yue Sai vs. Competitors: Spontaneous Brand Awareness

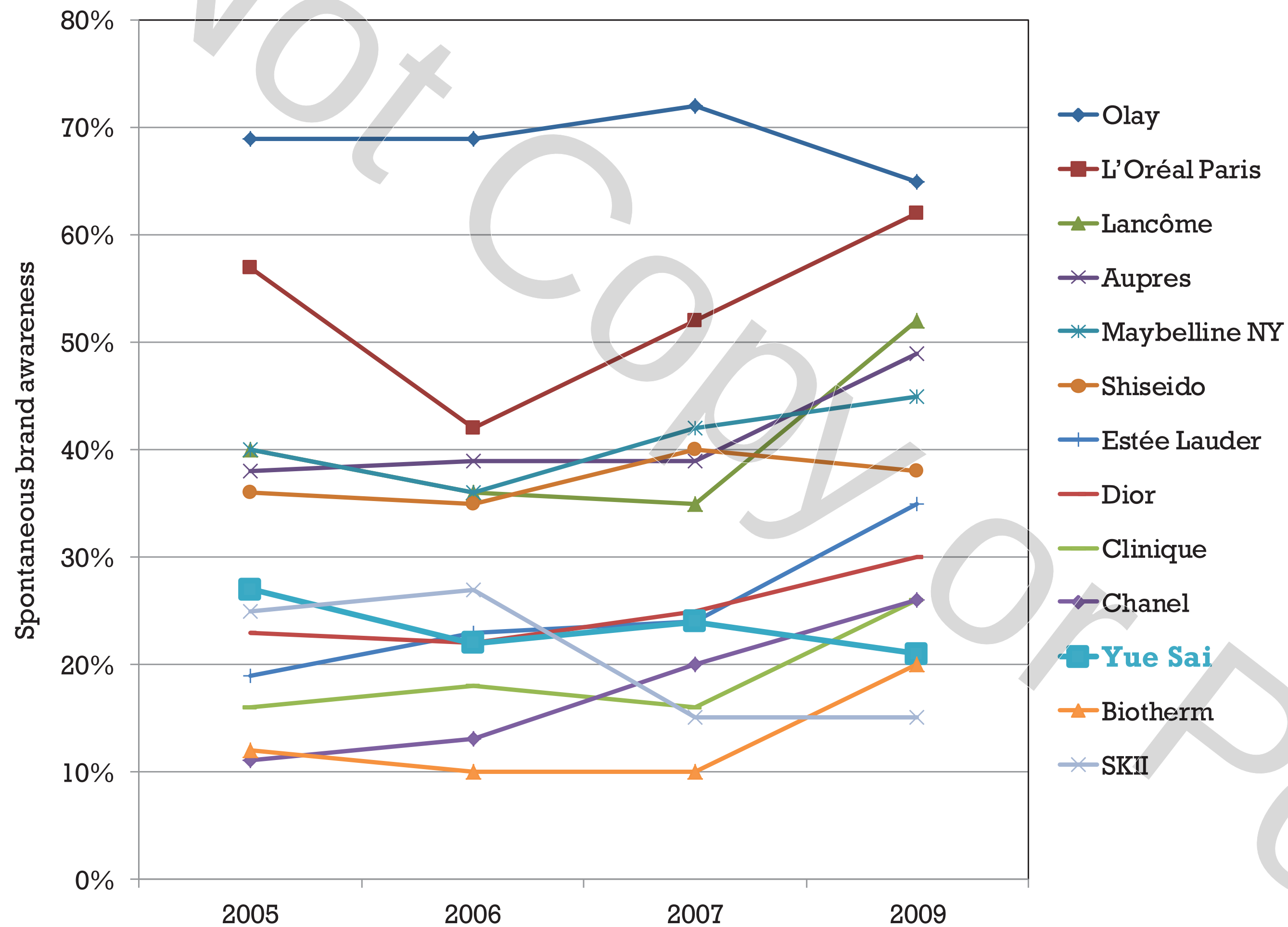

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Exhibit 16

Comparison of Yue Sai's Business Model vs. Competitors'

	Market	Yue Sai (羽西)	Lancôme (兰蔻)	L'Oréal Paris (巴黎欧莱雅)	Aupres (欧珀莱)	Herborist (佰草集)
Distribution (total doors)	280,202	1,078	203	3,000	689	1,000
Department stores	2,572	550	105	1,000	689	500
Cosmetics stores	4,980	430	-	2,000	-	-
Watsons + Manning	934	-	-	-	-	-
Sephora	98	98	98	-	-	-
Self-standing stores	N/A	-	-	-	-	500
Net sales (€m)	**N/A**	**35**	**120**	**334**	**100**	**70**
Net sales per door (€k)	N/A	32	591	115	145	70
Total Media spend (€m)	**2,038**	**18.1**	**120.2**	**606**	**8.2**	**4.4**
TV (€m)	1,746	16.5	9.4	579	-	-
Press (€m)	210	1.5	17	17	5.1	2.3
Internet (online buzz vol. '000)	N/A	0.7	N/A	4	1.4	1.0

Exhibit 17
Yue Sai's Product Range in 2010

Makeup

Skincare

Whitening

Anti-aging