



# **Reviving Estée Lauder, the Beauty Queen**

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# I. Introduction

## Company / Brand Background

Estée Lauder is a retail brand of luxurious cosmetics, skincare and fragrance products, primarily targeting female consumers of age 30 and up. Sold in more than 120 countries and territories, Estée Lauder has a reputation for technologically advanced, high-performance products. Being the original label from which today's beauty industry giant, Estée Lauder Companies, has grown, it is justifiably the ultimate lifeline brand of the conglomerate company. The fact that the Estée Lauder brand carries the company's family name also inevitably makes it an immediate reflection of the business as a whole.

The original Estée Lauder label was launched by Estée and Joseph Lauder in New York City in 1946, and in a course of 60 years has expanded into a superpower owning 16 beauty product brands, among which are the 5 brands designed and launched by the group itself: the original Estée Lauder; Aramis Inc., a pioneer in prestige fragrances and grooming products for men; Clinique Laboratories, Inc., a specialist in allergy-tested, fragrance-free and dermatologist-approved cosmetics; Prescriptives, which emphasizes on personalized make-up; and Origins, an offering for those seeking natural ingredients. The company's other 11 brands were all results of strategic acquisitions and alliances. In sum, the portfolio of brands can be categorized into: the core labels for mature customers, including Estée Lauder, Clinique, Prescriptives, Aramis, and La Mer; eco-correct labels, namely Aveda and Origins; and hip labels, comprising M.A.C., Bobbi Brown, Tommy Hilfiger, Donna Karan, Stila, Jo Malone, Bumble and Bumble, Kate Spade, Jane, and Darphin<sup>1</sup>.

## Industry Overview

The beauty industry in the United States is dominated by a small number of multinationals that all originated in the early 20th century. Among the leading firms, the oldest and the largest is L'Oreal, founded by Eugene Shueller in 1909 as the French Harmless Hair Coloring Company. However, the true market developers were the American trio Elizabeth Arden, Helena Rubinstein and Max Factor in the early 1910s. These firms established the market and were augmented by Revlon just before World War II and Estée Lauder just after. Moreover, Procter & Gamble, giant of household items, now also claims a considerable share of the beauty product market with its ownership of Olay, Pantene, Clairol, Max Factor and a series of other make-up, skincare and hair

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<sup>1</sup> <http://www.elcompanies.com>

care products.

The market is extremely diverse: products are available in virtually every price range. The lower and mid section of the market are primarily dominated by drug store and super-market open-shelf brands: Olay, L'Oreal, Revlon, and Neutrogena to name a few. Although these brands may have specialty products (anti-wrinkle, line-reduction, etc.) that cost above \$15, their most popular sales are made on basic daily items, such as moisturizers and lotions that retail for less than \$10. The upper end of the market is controlled by more luxurious brands like Estée Lauder and Lancôme. These products depend more heavily on technological advancement, and benefit from added-value resulting from brand recognition and personalized brand images. Most of the up-market brands, including Estée Lauder, specifically target middle-aged female whose buying power is relatively secure and thus are less price-sensitive. Consequently, brands in this niche of the market are essentially only competing with similarly positioned brands – the worries that a customer may switch to another brand because of pricing considerations is minimal, if not non-existent.

## **Estée Lauder Today**

Fifteen years ago Estée Lauder was the absolute leader in the exclusive, high-priced segment of the cosmetic industry. Back then the Lauder companies account for 38% of this market, most of which was contributed by the Estée Lauder brand, while their nearest competitor, Cosmair Inc., the United States licensee of L'Oreal Worldwide and the maker of the L'Oreal and Lancôme lines of products, could claim only 14% altogether, according to Allan G. Mottus, a consultant to the cosmetics industry<sup>2</sup>.

However, Estée Lauder can no longer afford such an optimistic outlook now. The company keeps quantitative information on the performances of each subsidiary brand confidential. Nonetheless, there is evidence showing that Estée Lauder no longer enjoys the crowning position in upper-end skincare products. Estée Lauder's close sibling, Clinique, now has the highest sales volume nationwide, and although not supported by specific data, interviews with Lancôme and Clinique BA's (Beauty Assistants) have confirmed that Lancôme indeed is outperforming the aging Estée Lauder by making more sales and attracting a continuous stream of incoming customers. According to the Clinique BA, Estée Lauder now has most likely dropped out of the top-five list and merely takes a top ten position.

Why is Estée Lauder suffering from this gradual decline of status? What has caused its underperformance compared with Clinique, Lancôme and other rapidly growing competitors? As a reaction to this decline, should it change its positioning strategy and brand image to one similar

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<sup>2</sup> Belkin, Lisa. "The Make-Over at Estée Lauder," *The New York Times Magazine*, 29 November 1987.

<<http://www.nytimes.com/1987/11/29/magazine/19871129lauder.html>>

to that of Lancôme, or should it give up the attempt to win back the younger market so that it will not hurt the success of Clinique?

## **II. High-end skincare market through Estée Lauder**

### **Five Forces Analysis**

Skincare products have been made appealing to everyone, regardless of age, sex, ethnicity or social status. Even though buyers can be thoroughly categorized by their skin type and income level, Estée Lauder is more interested in customers in the high-end market. Since affluent buyers are less price-sensitive, they have relatively less bargaining power compared to low-income buyers, who are more likely to switch to a similar product with a lower price. Therefore, even though there is effectively no switching cost in both markets, price competition is more intensive in the low-end market. On the other hand, the high-end market relies heavily on repeat customers<sup>3</sup>, and hence is mainly competing on product quality, brand recognition and differentiation.

Suppliers do not play a big roll and have little bargaining power in this market. Big brands like Estée Lauder develop essential ingredients in their own R&D department, and only outsource basic and non-value-adding chemicals and packaging.

Skincare products have very few substitutes. Once people start using skincare products, it can become a necessity. Unless there is new technology that promises permanent skin improvement, it is hard to replace skincare products by anything that is in the current market.

This is a market with many new entrants. A significant new entrant is likely to be a company with a new technology development or a well established foreign brand.

Complements to the skincare industry include the media, super models, makeup, stylish apparel and jewelry. All these items increase people's awareness of appearance. They also help define beauty for the general public. The recommendations of beauty salons also help promote skincare sales. The improvement in technology such as the rise in the internet has created a new channel for distribution.

### **Competitors Profile**

Although the diversity of possible distribution channels have accelerated the

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<sup>3</sup> In our interview with Lancôme's Beauty Assistant at a local Macy's, we were told that they have one to two new customers everyday, and the rest are all repeated customers.

fragmentation process of the market, Estée Lauder still primarily relies on traditional distribution methods, namely department stores and boutique shops. The following are the few brands that are present in almost every Macy's, Nordstrom and other similar department store, making them the most immediate competitors of Estée Lauder.

### **Clinique**

Launched by the Estée Lauder Group, Clinique features non-prescriptive dermatologist-recommended products that are mild, fragrance free, and hypoallergenic. It promotes a clean-cut, lab-like image, and is more affordable compared to other up-market brands. Although Clinique does carry anti-aging products, Advanced Stop Signs and Repairwear for example, its engine products are still unarguably the ones for younger skins which are oily and suffer from acne problems.

### **Lancôme**

Started in 1935 as a French perfumery, Lancôme now has a rather detailed yet still systematic products categorization. In its Spring-Summer 2005 brochure, 9 lines of skincare products were listed along an age spectrum from 20's to the 50's, each of which appears to have a specialty according to the description. A striking feature of Lancôme's brand image is that its advertisements almost always feature an enlarged face profile or portrait, peaceful but with a hint of sexiness – very often half-open lips. As a side note, Lancôme's makeup products use an even sexier image, one that is colorful and luscious.

### **Shiseido**

Founded in 1872 as the first western styled pharmacy in Japan, Shiseido entered the United States in 1965. After a few decades of rather unnoticed developing, in recent years Shiseido has been gaining market shares rapidly. Its current product profile consists of three lines, Pureness, The Skincare, and Benefiance, targeting young and oily skin, skin with early signs of aging, and more mature and dry skin respectively. Its price range, reportedly, lies between that of Clinique and Lancôme.

### **Clarins**

The French label Clarins was founded in 1954. Being a less recognized brand, Clarins surprisingly has an exceedingly extensive spectrum of products, which may sometimes be overlooked due to its less systematic product categorization. Oil-Control Care, Sensitive Skincare and Hydrating Care target general skin types; Line Preventing Care, Extra Firming Care, and Super Restorative Care target mature, aging skins; Brightening Care and Re-Energizing Care cater to special needs. Sun-care products are Clarin's engine products. They are the most heavily advertised, and also occupy most counter space in the Macy's where interviews were conducted.

### **Biotherm**

Founded in 1950 in France, Biotherm is characterized by its patented thermal spring water rich in proteins and minerals. On the official website, the skincare products are broken down by skin type, namely: normal to combination skin, dry skin, oily skin, sensitive skin, young skin and problem skin – acne in particular. Consistent with its spring water image, Biotherm’s advertisements have always featured young flawless skin and a watery feel. Its price is in general comparable to that of Clinique’s.

## **Marketing**

In the high-end cosmetics industry, brand loyalty and word of mouth, as opposed to price, play a major role in consumer purchases. Customers will generally trust the tried and true product, especially when it comes to skincare products. Those customers that have found a specific product or brand they like will also share their findings with friends. Thus, the marketing strategies are crucial in building brand loyalty among existing customers, attracting new customers and creating awareness of new products.

### **The Free Gift and Gift-With-Purchase**

The free gift and the gift-with-purchase techniques were pioneered by the company founder, Estée Lauder<sup>4</sup>. This technique works wonderfully by rewarding loyal customers for purchasing Estée Lauder products and by attracting new buyers who otherwise might not try Estée Lauder products.

### **Makeup Artist Events**

To further promote its products, Estée Lauder hosts Makeup Artist Events in select retail stores. These events provide an opportunity for women to receive a personal consultation from a top makeup artist. When giving professional advice, the makeup artists have a really good opportunity to promote Estée Lauder products. This is also a great way to attract new customers.

### **Models**

The models used in Estée Lauder advertisements represent the beauty that is possible through Estée Lauder products. The models also add a touch of romance, elegance and fantasies to the beauty industry. In addition to being beautiful, the models chosen to represent a cosmetic brand show the public what populations the brand is targeted towards.

### **Printed Ads in Magazines**

Printed advertisements in magazines are an effective way of reaching a large audience for any consumer industry. The Estée Lauder brand targets mature fashion magazines it expects its

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<sup>4</sup> “Estée Lauder,” *PBS*, <[http://www.pbs.org/wgbh/theymadeamerica/whomade/lauder\\_hi.html](http://www.pbs.org/wgbh/theymadeamerica/whomade/lauder_hi.html)>

consumer base to read; these include Bazaar, Cosmopolitan, Elle, Glamour, Marie Claire, In Style, Self and Vogue. In these magazines, Estée Lauder will generally feature at least two two-page advertisements: one for its skincare line and one for its fragrance line. In a few of these magazines, the Estée Lauder makeup line is also advertised. The skincare advertisement will generally be within the first twenty pages of the magazine while the fragrance ad will be somewhere in the middle of the magazine. Estée Lauder advertisements are not found in magazines targeted towards the younger generation such as Cosmo Girl, Elle Girl, Jane and Seventeen.

### **The Estée Lauder Spa**

The Estée Lauder Spa gives the Estée Lauder brand an opportunity to jump into the “well-being” market. This is a large market that has been ignored by most traditional beauty companies. However, whole treatment systems that cover beauty, exercise and diet which include spa visits is a growing market. The growing trend is to seek natural cures instead of chemicals and to place an emphasis on being fit instead of thin.

As marketing is crucial in the cosmetics industry, other high-end brands such as Lancôme and Clinique also follow the major marketing techniques used by the Estée Lauder brand. These brands recognize the importance of the free gift and gift-with-purchase technique as the techniques are employed not only in department store sales but also in online sales. High-end brands have also chosen to advertise in the same magazines. For example, in Glamour and Vogue the following brands are advertised: L’Oreal Paris, CoverGirl, American Beauty, Chanel, Maybelline, Avon, Clinique, MAC, Elizabeth Arden, Christian Dior, and Lancôme.

## **III. Estée Lauder’s problem**

### **Why is Estée Lauder declining?**

#### **More Competitive Market**

When Estée Lauder introduced her all purpose cream in 1946, it was one of the few choices in the market. For years, the high-end skincare market was only for big players. Small brands had difficulty establishing their credentials, and the market demand was not good enough to keep them alive. As a result, Estée Lauder was able to enjoy a substantial profit margin without much competition for many years, along with a handful of other brands such as Elizabeth Arden and Helena Rubinstein. However, those good days are now gone. The global beauty industry has grown to consist of a \$24 billion skincare market with an annual growth rate of up to seven

percent<sup>5</sup>. These juicy returns have attracted many new entrants. On Nordstrom's website, there are over 60 skincare brands with prices ranging from \$50 to \$100<sup>6</sup>. This also does not include many prestigious brands which are distributed through other channels. Modern technology and marketing/distribution methods have made it easier to establish a big name in the market. Neither the learning curves nor brand names are as significant barriers to entry as they were 60 years ago. The traditional prestigious brands are not only facing domestic new entrants, but the threats from international brands are also increasing with globalization. For instance, Shiseido, the number one brand in Japan, has presently made its appearance in almost every Macy's store.

### **More Segmented Market**

The time when an all purpose cream could win the market is gone. Today, sophisticated customers demand different types of beauty products. The skincare market is becoming more and more fragmented. In addition to price, products are differentiated in various ways. An 18-year old teen with an acne problem will not want to use the same cream as a 40-year old woman with a wrinkle problem. A natural product lover will not go after a brand that focuses mainly on technology. Even though any brand would love to include product lines for every type of customer, it is dangerous to do so. A diluted brand image could only hurt sales. Most top brands have successfully focused on a segment of the market. Clinique, the number one brand in the U.S., has positioned itself clearly to capture a young group with oily skin problems. Its advertisements are consistent with building such a brand image by emphasizing laboratory development and the product itself. Its products are also priced affordably for young people. Lancôme has attracted many 30 to 50 year olds, advertising itself as a sexy and romantic leading brand. Biotherm stands out from the rest for their natural ingredients. Different ethnic groups are also targeted. Shiseido has its advantage in attracting Asian customers, and Fashion Fair is well known among black customers.

### **Problem with Estée Lauder's current market position**

For years, Estée Lauder had successfully positioned itself for 30 year-old and older, high-end customers. With increasing competition and specialization in the market, is this still the right position to take?

### **Sciency or trendy**

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<sup>5</sup> "Pots of Promise," *The Economist*, 22 May 2003.<[http://economist.com/displaystory.cfm?story\\_id=1795852](http://economist.com/displaystory.cfm?story_id=1795852)>

<sup>6</sup> <http://nordstrom.com>



Figure 1. DermSolution: with test tubes and beakers, Estée Lauder is trying to look scientific

A clear brand image is very important in the beauty industry. A brand cannot cater to totally different market segments. In a highly fragmented market, it is not even a plausible strategy to cover too broad a range of the spectrum. Successful brands are very carefully establishing and protecting a clear image. They make sure every detail is consistent with their image. For example, Clinique sales representatives wear lab coats and Biotherm sales girls are required to wear white uniforms to keep the “clean” image. Estée Lauder, on the other hand, is losing its identity bit by bit. In response to increasing competition and segmentation, it has emphasized more on its leading technology. At the same time, it has been marketing itself as a chic brand with famous models to pose exclusively as a “face” for the brand. In fact, in most of its magazine advertisement, Estée Lauder put so much emphasis on its models that the product itself sometimes gets lost. A recent move to hire Tom Ford, a former Gucci fashion designer, is clearly an effort to achieve a trendy status. Science and fashion could go together with care, but equally stressing on both might dilute the brand image and end up losing customers.

### The wrong slice of the pie

The high-end market used to be the best part of the cosmetic pie. That is where the best and most customers used to be. For long, beauty products were a symbol of luxury. The majority of buyers were the rich women who were able and willing to shell out additional dollars for a bigger name with better credentials. With full-service and a touch of prestige, department store skincare counters used to sell the most. That was good news for Estée Lauder, which relies largely on department store sales. However, while more American women are taking better care of their skin, seeking out sophisticated serums and lotions, they are also looking for alternative retail channels in place of expensive department stores. Chain drug stores and mass retailers are ramping up their efforts to attract these department store ex-pats to their beauty departments. The market that was once reserved for luxurious brands is now taking the mass market by storm, with brands that promise to be just as effective and a price tag that is much more appealing to the average consumer. Marketing efforts by leaders such as Neutrogena and Olay have educated women that, given all the advancements in skincare technology, they can find quality products rivaling department store quality in the mass market. In 2004, supermarkets, chain drug stores and mass merchandisers accounted for 61% of retail dollar sales, and the growth is mainly coming through huge grocery

chains such as Wal-Mart<sup>7</sup>. This is good news for P&G and L’Oreal which already gain two-thirds of their revenue from mass retailers, but bad news for Estée Lauder which is dependent on unfashionable department stores where sales are declining and selling costs are high. A move downscale to grocery stores like Wal-Mart is not appealing, given Estée Lauder’s upscale price and existing high-end customers.

### **An aging brand**

What’s more, baby boomers are no longer the only ones willing to pay extra for skincare products that promise to stave off the signs of aging. Women in their late 20s and 30s, who are taking a proactive approach to long-term skin health, are gravitating increasingly towards products with advanced anti-aging ingredients. To these women, Estée Lauder is too old. It has achieved “classic” status, industry code for not relevant to anyone under 40 years of age. At the same time, Estée Lauder hasn’t been very successful in attracting new 30-40 years old either. There is a newly-launched anti-wrinkle line for the 30-40 age group, but it hasn’t stopped the Estée Lauder label from aging with its customers. What can Estée Lauder do after its 70 year-old loyal customers pass away? Compared with Clinique’s dermatologist-recommended and slightly lower-priced products, Estée Lauder intrinsically lacks what makes the former easily appealing to younger customers: a clear focus on problem skin based on a scientific yet simple formula of ingredients. While Clinique’s best-selling “engine product”, the 3-step solution helps to further establish the image of the brand, Estée Lauder still does not have such a benchmark product with which the brand image can be readily associated. It’s true that Clinique appears to primarily (and implicitly) target young women, the brand still benefits substantially from a widened customer age group, since when these customers get older many still choose to stick with the brand because of the already established confidence of the brand’s quality. On the other hand, Estée Lauder is also unable to match Lancôme’s advantages of being colorfully luscious and romantic yet still sensually mature. For Lancôme, its ripe (but not overly mature) and romantic image successfully appeals to young women in their early 20’s as well as women in their 50’s. In contrast, Estée Lauder’s current image of maturity, often illustrated or implied by its models and advertisement (mature, almost expressionless) and its product design (the three lines that are currently most heavily promoted, Idealist, Perfectionist, and Advanced Night Repair are all for mature skin with aging problems), unavoidably keeps young customers away. In other words, Estée Lauder’s brand image, if it has one at all, has effectively excluded itself from the young buyers, and increasingly catered to an older customers group.

### **Too big to focus?**

Compared to many new entrants in this market, Estée Lauder seems to have too many

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<sup>7</sup> Antoinette Alexander, “Mass Invades High-end Skincare Market,” *DSN Retailing Today*, 28 March, 2005: 23-24 [magazine]

products at hand, and most of its primary lines are traditional skincare products. For instance, although Clarins cannot compete with Estée Lauder in many ways, it dominates the high-end sun-care market which is a rising branch of skincare products. New entrants, such as many doctors' brands, can focus on the currently most profitable products. This not only reduces inventory cost for unpopular lines, but also helps establish authority and expertise in a particular market sector. Estée Lauder, on the other hand, must stock certain items, and must present a complete portfolio of items to consumers. There is also increasing attention to environment and animal testing. Many newer brands are well recognized for their natural and environmentally friendly approach. With the rapid rise of ethnic diversity in the United States, many brands focusing on needs of minority skins are gaining their popularity. For instance, compared to the majority of the white customers, demand for brightening and whitening products is huge among Asian customers. Estée Lauder is now increasingly challenged by the growth of several well-established Asian brands that have focused Asian skin type for years, Shiseido, Kose, and SK-II to name a few.

## **Repositioning Strategies for Estée Lauder**

To regain its position as a premium product, Estée Lauder must reposition itself. A successful repositioning would require the Estée Lauder brand to develop a clear brand image and provide its customers with something that is unique. There are a few possibilities that Estée Lauder could take; Estée Lauder could emphasize the natural ingredients in a product, the romance and sexiness, or the technology involved in a product. Another possibility for Estée Lauder would be to create a new brand image through the release of a sub-brand. In considering each of these strategies, it is also important to take into account how Estée Lauder's competitors will react.

### **Natural Ingredients?**

Currently, Estée Lauder's customers are not interested in the naturalness of the ingredients used in Estée Lauder skincare products. This is evidenced by the fact that Estée Lauder does not promote the natural ingredients and yet they still have customers. To redefine the brand as one that emphasizes natural products might ostracize the current Estée Lauder customers. In addition to this, the natural ingredient skincare market is not high-end. The main competitors in that market are Biotherm and Clarins. These brands are well recognized by those customers that place natural ingredients above technology; however, they cannot demand as high a price as Estée Lauder for their skincare products. This would not be a wise move for Estée Lauder.

### **Romance?**

Another option for Estée Lauder would be to position the brand so that it is appealing for those women who desire the romance and sexiness that is associated with cosmetics. This positioning strategy would place Estée Lauder in direct competition with Lancôme. As Lancôme is a French brand, it already has an advantage over Estée Lauder as France is widely associated with



Figure 2. Carolyn Murphy (left) and Liya Kebede (right) from Estée Lauder advertisements taken from BWGreyscale.com

romance. The Estée Lauder brand would have to work very hard to overcome Lancôme's natural advantage. A first glance comparison of an Estée Lauder and a Lancôme booth at Macy's will show that Estée Lauder's image is lacking the luscious, red lips of Lancôme. Instead, Estée Lauder's image is of the elegant Carolyn Murphy and Liya Kebede. Their images are beautiful but distant and lacking passion. To rework this image would be extremely difficult. Direct competition with Lancôme would also be unfavorable.

### **Technology?**

The Estée Lauder brand is already known for being technologically advanced with high-performance products. Unlike Clinique, which is also known for its technologically advanced products approved by dermatologists, Estée Lauder does not emphasize its use of technology enough. The magazine advertisements used by Estée Lauder focus on the image of its beautiful models with a very small section dedicated towards promoting the technology involved. In addition to this, it is often difficult to see exactly what product is being promoted. In this way, Estée Lauder is missing an opportunity to promote one of its biggest selling points. Clinique magazine advertisements are very clean and simple. They display the products with no models. In department stores, Clinique booths feature scientific pamphlets on skincare. Even the sales representatives wear lab coats to further this image. Estée Lauder does not take advantage of this

way of attracting new customers. To reposition as a technologically-advanced brand, Estée Lauder will need to develop advertisements that more heavily emphasize its technology. These advertisements will also have to maintain the elegant image that Estée Lauder has developed. The brand has already begun this repositioning through the “test-tube” packaging of some of their new products (see Fig.1). Even some of the brand’s pamphlets feature its products in test-tube-like jars. Estée Lauder should also consider marketing its products through dermatologists as Clinique does. In addition to validating the technological claims made by the products, dermatologists’ recommendations would provide another channel for the distribution of Estée Lauder skincare products.

In the department store setting, Clinique is the main brand that is heavily emphasizing its technology. In the market for high-end skincare for more mature skin, technology is emphasized by very few brands. If Estée Lauder were to take a more aggressive approach to emphasizing its technology, the only competitor that would be worried is Clinique. However, Clinique is a slightly lower-end and younger-aged brand than Estée Lauder. Clinique also promotes simple formulas while the formulas of Estée Lauder are more complicated. For example, when comparing the three-step system of Clinique and the advanced night repair system of Estée Lauder, one will find that the ingredient list for the Clinique product is much simpler. This repositioning would most likely not alarm Clinique which is good for Estée Lauder. In addition to this, Clinique lacks the elegance for which Estée Lauder customers pay a premium. As a result, the Estée Lauder brand would maintain its high-end status.

By more heavily emphasizing its technology, Estée Lauder also has the opportunity to occupy the trendy end of the technology market as opposed to being a complete dermatologist-brand. This is due to the elegance and fashion that is associated with Estée Lauder. Presently, the bestsellers in the skincare market in general are anti-aging formulas. In the growing Asian skincare market, the bestsellers are anti-aging and whitening formulas. Both these formulas rely heavily on technology, so it is a good time for dermatologist-brands to enter the market. By occupying the trendy end of the technology market, Estée Lauder will have a good position against these strong new entrants.

### **Estée Lauder-Jade**

Regardless of its declining market share, Estée Lauder has carried the name of the Beauty Queen for 59 years. This golden name, with the credibility and reputation associated with it, has given Estée Lauder substantial advantages over many competitors. To adapt to the current market while still maintaining such advantage, Estée Lauder could introduce sub-brands customized for different markets, which provide the flexibility to enjoy multiple brand images without diluting each other. For instance, with the thriving new economy, China has become a huge market for foreign luxurious brands. This is a market that could potentially surpass the U.S. market in the long run. Competing with big Asian brands like Shiseido, Estée Lauder needs a more specific representation than just a few whitening lines to win over Chinese customers. Introducing a

sub-brand, such as Estée Lauder-Jade, could serve well for this purpose. EL-Jade would have a clean-cut image featuring products for Asian skin types only, focusing on their specific needs. It could start with the existing whitening products, and then extend to include different lines, for example, a line featuring Chinese herbs as ingredients. EL-Jade leverages Estée Lauder's prestigious brand name without alienating the existing majority of Caucasian customers. Starting with the Asian market, Estée Lauder-Jade could then be reintroduced to the U.S. market if it succeeds. By the same token, a sub-brand targeting at younger customers could improve the aging-brand problem and capture the growing young market. Of course, Estée Lauder has to make sure no sub-brand like Estée Lauder-WalMart should be introduced. Sub-brands should also be well differentiated from each other and establish a clear image of their own.

## **IV. Conclusion**

The current skincare industry's transforming into a highly competitive and fragmented dynamism has taken away Estée Lauder's privilege of having too optimistic an outlook. In sum, Estée Lauder's inherent lack, or at least the ambiguity, of a clearly defined, widely recognized brand image, combined with the declining dependability and popularity of the brand's primary distribution channels, i.e. department stores, have both substantially contributed to the brand's vulnerability when competing with the rivalry brands. In addition, the absence of a clearly established brand image has also cost Estée Lauder a portion of the market of young buyers, the effect of which is even further intensified by possibly inappropriate design of the products themselves. Also, not only does Estée Lauder lack an engine product which appeals to a specific group and as a result arouses loyalty, it also potentially suffers from a diluted focus due to the current strategy of developing and maintaining an extremely extensive and thorough product – but not necessarily beneficial – portfolio.

In fact, as a response to the problem of department stores losing popularity, Estée Lauder has already begun to take actions to horizontally diversify its distribution channels. As today's information explosion has made beauty products' description, users' comments and reviews readily accessible by virtually everyone, the need of individual assistance, which is typical of department stores, has become less necessary. Currently Estée Lauder has reduced its dependence on department stores sales from 80% to 65% and has shifted more focus towards boutique sales and is opening free standing cosmetics stores, which are considerably more cost efficient in terms of number of staffs per unit. Moreover, the brand is also reportedly considering possibilities of promoting their future products through dermatologists, physicians, and other health professionals.

However, there are still optimistic aspects in the overall scenario. The beauty industry as a whole has increasing awareness of beauty in the society. The market is growing at up to seven

percent a year<sup>8</sup>. Analysts also estimated an average annual growth of at least five percent in the coming years. The growing market represents big opportunity for Estée Lauder, and the crucial issue remains is whether Estée Lauder is able to adaptively capture the opportunity and increase its share of the growing market, potentially by re-establishing a clear image, re-designing its products portfolio, adjusting its existing distribution networks, and introducing new lines or sub-brands that strategically take geographical diversification into account.

Some other threats Estée Lauder that are not discussed at lengths here but nonetheless highly possible concerns marketing. The industry is now becoming hugely expensive, putting pressure on margins. Estée Lauder spends around 25% of its sale on advertising and promotion. Advertising wars with rivals will end up undermining everyone's profitability. Truth in advertising laws will also catch up with the extravagant market claims made by most cosmetic companies. Big brands like Estée Lauder will be the first to be exposed to potentially ruinous litigation. What's more, critics have raised questions about the morality of changing someone's looks in order to confer social and economic advantages. Products like Estée Lauder's age-reduction cream may find itself roundly condemned and subject to legislation. How Estée Lauder minimizes the harm of these issues is indeed an urgent topic in the near future.

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<sup>8</sup> "Pots of Promise," *The Economist*, 22 May 2003.

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## VI. Appendix

**Exhibit 1** Consolidated Statements of Earnings for Estee Lauder Companies Inc.

YEAR ENDED JUNE 30	2004	2003	2002
(In millions, except per share data)			
<b>Net Sales</b>	<b>\$5,790.4</b>	\$5,096.0	\$4,711.5
Cost of sales	1,476.3	1,324.4	1,260.5
<b>Gross Profit</b>	<b>4,314.1</b>	3,771.6	3,451.0
Operating expenses:			
Selling, general and administrative	3,651.3	3,225.6	2,982.8
Restructuring	—	—	109.6
Special charges	—	22.0	—
Related party royalties	18.8	20.3	16.5
<b>Operating income</b>	<b>664.0</b>	503.7	3,108.9
Interest expense, net	27.1	8.1	9.8
<b>Earnings before Income Taxes, Minority Interest and Discontinued Operations</b>	<b>616.9</b>	495.6	332.3
Provision for income taxes	232.6	163.3	114.7
Minority interest, net of tax	(8.9)	(6.7)	(4.7)
<b>Net earnings from Continuing Operations</b>	<b>375.4</b>	325.6	212.9
Discontinued operations, net of tax	(33.3)	(5.8)	(21.0)
<b>Net Earning</b>	<b>342.1</b>	319.8	191.9
Preferred stock dividends	—	23.4	23.4
<b>Net Earnings Attributable to Common Stock</b>	<b>\$342.1</b>	\$296.4	\$168.5
Basic net earnings per common share			
Net earnings attributable to common stock from continuing operations	\$1.65	\$1.30	\$0.80
Discontinued operations, net of tax	(0.15)	(0.03)	(0.09)
Net earnings attributable to common stock	\$1.50	\$1.27	\$0.71
Diluted net earnings per common share:			
Net earnings attributable to common stock from continuing operations	\$1.62	\$1.29	\$0.79
Discontinued operations, net of tax	(0.14)	(0.03)	(0.09)
Net earnings attributable to common stock	\$1.48	\$1.26	\$0.70
Weighted average common shares outstanding:			
Basic	228.2	232.6	238.2
Diluted	231.6	234.7	241.1

**Exhibit 2** Results of Operations for Estee Lauder Companies Inc.

YEAR ENDED JUNE 30	2004	2003	2002
(In millions)			
<b>NET SALES</b>			
<b>By Region:</b>			
The Americas	\$3,148.8	\$2,931.8	\$2,846.0
Europe, the Middle East & Africa	1,870.2	1,506.4	1,261.1
Asia/Pacific	771.4	657.8	610.6
	5,790.4	5,096.0	4,717.7
Restructuring*	—	—	(6.2)
	\$5,790.4	\$5,096.0	\$4,711.5
<b>By Product Category:</b>			
Skin Care	\$2,140.1	\$1,893.7	\$1,703.3
Makeup	2,148.3	1,887.8	1,758.3
Fragrance	1,221.1	1,059.6	1,017.3
Hair Care	249.4	228.9	215.8
Other	31.5	26.0	23.0
	\$5,790.4	\$5,096.0	\$4,717.7
Restructuring*	—	—	(6.2)
	\$5,790.4	\$5,096.0	\$4,711.5
<b>OPERATING INCOME</b>			
<b>By Region:</b>			
The Americas	\$319.2	\$255.3	\$222.8
Europe, the Middle East & Africa	274.4	227.7	179.9
Asia/Pacific	50.4	42.7	56.0
	644.0	525.7	458.7
Restructuring and Special Charges*	—	(22.0)	(116.6)
	\$664.0	\$503.7	\$342.1
<b>By Product Category:</b>			
Skin Care	\$336.3	\$273.2	\$248.4
Makeup	257.7	206.6	183.1
Fragrance	24.8	32.1	13.4
Hair Care	23.6	14.8	13.7
Other	1.6	(1.0)	0.1
	\$664.0	\$525.7	\$458.7
Restructuring and Special Charges*	—	(22.0)	(116.6)
	\$664.0	\$503.7	\$342.1