

THE COSMETICS INDUSTRY IN THE 2020S: A CASE STUDY

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CASE DESCRIPTION

Many brick-and-mortar stores are facing the repercussions of the retail apocalypse as consumers opt to shop online rather than visit physical stores. While retailers such as Sears, Forever 21, and Barney's have resorted to filing for bankruptcy, others are thriving. The \$25 billion specialty beauty industry has benefited from the changing retail landscape, as consumers have drifted away from department stores in favor of beauty, cosmetics, and fragrance stores to purchase their personal care products. Instructors will have plenty of opportunities to engage students and boost participation. This case is ideal for a junior or senior class on retailing, consumer behavior, marketing strategy, strategic management, or merchandising. It is designed to stimulate discussion about brick-and-mortar vs. online retailing, the future of retail, positioning, and psychographic segmentation.

This case is an excellent vehicle for demonstrating how retail strategies can be utilized by underdog and niche retailers to garner customer loyalty and growth. The case is designed to be taught in a 60-75 minute class, and is expected to require 3 hours of outside preparation by students.

CASE SYNOPSIS

Specialty beauty retailers, such as Ulta and Sephora, seem to be Amazon-resistant companies, immune to the downward spiral facing department stores. Millennials are increasingly electing to purchase products from beauty stores due to the stores' product expertise and incentivized loyalty programs. For instance, Ulta Beauty has continued to profit and grow due to the value and shopping experience it is able to offer its customers. The 1200-store chain has found a profitable niche in the intensely competitive beauty market, which was once dominated by department stores. Ulta offers a broad assortment of beauty products, cosmetics, and fragrances across the price spectrum in a low-pressure and relaxed fun environment. Thus, the specialty beauty retailer, that captures 26% of the market, caters to both casual customers looking for bargains and the sophisticated shoppers paying a premium for upscale brands; they then mix in salon services like hairstyling and brow tinting. Together, the mix makes Ulta Beauty a one-stop beauty shop—and one of the most amazing success stories in retail. Sales, profits, and stock price have tripled over the last six years. On the other hand, department stores are contending with powerful sources, like Amazon and trendy specialty stores and discount players such as Ulta and Sephora, chipping away at their business. In 2019, more than 9,300 stores of all kinds closed their doors, a 60% jump from the previous year. The retail apocalypse is real, but some retailers are flourishing nonetheless.

CASE BODY

THE U.S. COSMETICS INDUSTRY

This industry comprises stores that primarily retail cosmetics, perfumes, toiletries and personal grooming products. Operators in this industry include beauty supply stores, specialty cosmetics stores and fragrance stores. Women are the largest market for this industry, with 35- to 54-year-olds representing the most substantial industry customer base. Meanwhile, millennial women are growing at a considerable rate as a share of revenue. Expansive product selections and skilled staff have driven revenue growth for the cosmetics industry to \$26.8 billion in 2021. The growing economy has enabled consumers to leverage greater disposable incomes to buy high-end products, resulting in a decent margin for operators.

Table 1
Major Players (2021)

Company	Revenues	Market Share
Ulta Beauty	\$6.4 billion	26.1%
Sephora	\$4.4 billion	18.1%
Bath & Body Works	\$4.3 billion	17.5%
Sally Beauty	\$1.7 billion	6.9%
Others	\$7.7 billion	31.4%

Source: [IBISWorld](#) 2021

Beauty-specialist stores like Ulta and Sephora make up the second-fastest-growing U.S. retail category in the past five years, after off-price retailers (e.g. Marshall's and T.J. Max). Over the past decade, the industry has introduced a steady stream of new, improved, and reformulated products, resulting in revenue growth and increased demand for upscale products. An increase in Generation Z cosmetics, the growth of male-specific products, and the reformulation of antiaging staples have given specialty beauty stores an extensive assortment to offer customers. Increased consumer awareness and concerns of certain environmental and health issues has enthused demand for naturally derived and ecofriendly beauty products. Industry players have also amplified their focus on sun-care products, as consumers' growing concerns about skin health issues have stimulated demand for products that protect the skin from the sun. Meanwhile, stocking imports meant that consumers' options have increased due to an expanding supply of foreign-made cosmetics, beauty supplies, and fragrances (Ryan, 2019).

Table 2
Industry SWOT Analysis

Strengths <ul style="list-style-type: none"> - Low Imports - High Profit vs. Sector Average - Low Customer Class Concentration - Low Capital Requirements 	Weaknesses <ul style="list-style-type: none"> - Low & Steady Level of Assistance - High Competition - High Volatility - High Product/Service Concentration - Low Revenue per Employee
Opportunities <ul style="list-style-type: none"> - High Revenue Growth (2016-2021) - E-commerce sales - Struggling Department Stores 	Threats <ul style="list-style-type: none"> - Low Outlier Growth - Low Revenue Growth (2021-2026) - Low Performance Drivers - Per capita disposable income

ULTA BEAUTY INC.

Ulta Beauty Inc. (Ulta) is a chain of beauty stores in the United States, selling various cosmetics and fragrances, along with professionally licensed hair-care brands. Ulta started with five stores in Illinois in 1990, and has grown to almost 1,200 stores across 48 states in 2019. The company differentiates itself as a beauty superstore that provides salon services and mass-market merchandise to consumers, aestheticians, and salons. Product assortment revolves around five categories: cosmetics; skincare, bath and fragrance; haircare products and styling tools. In fiscal 2019ⁱ, Ulta reported \$6.7 billion in sales and \$658 million in profits.

Table 3
Number of stores and sales of Ulta Beauty (2012 - 2020)

Year	Stores	Revenue (USD Billion)	Profit (USD Million)
2012	449	1.78	120.3
2013	550	2.22	172.5
2014	675	2.67	202.8
2015	774	3.24	257.1
2016	874	3.92	320
2017	974	4.85	409.8
2018	1,074	5.88	555.2
2019	1,174	6.72	658.6
2020	1,254	7.38	705.9

Source: [Ulta Annual Report 2021](#)

According to the company's financial statements, Ulta's strategy is to expand its brick-and-mortar presence, increase upscale brand offerings, nurture its brand awareness and salon

services, and grow its e-commerce business. In recent years, Ulta has worked to launch partnerships with high-end and premium brands. In 2016 and 2017, for instance, the beauty giant announced partnerships with many fast-growing brands, including Julep, MAC, and Rituals Cosmetics. The company has also recently formed partnerships with celebrity-endorsed products, including Jessica Alba's "Honest Beauty" and Ariana Grande's fragrance "Sweet Like Candy" by Ariana Grande, which Ulta has the exclusive rights to sell in its stores and online (Acosta, 2017).

Thirty years ago, before Ulta was founded, female shoppers would go to different stores to buy prestige beauty products, get their hair styled, and pick up basics like lipstick. Its retail format, combining a one-stop shopping model with salon services, propelled it overtake Sephora in 2015 to become the largest beauty-specialist retailer in the U.S., with a 26 percent market share. Ulta has disrupted the status quo by offering unique product mixes, and featuring mass, prestige and professional brands under one roof. Besides, Ulta doesn't have commissioned salespeople. Shoppers can walk around the store and pick up nail polish or lipstick and put it on in a laid back environment. The company has grown rapidly due to its strong branding, competitive pricing and loyalty program. According to Ulta's financial statements, the company has about 32 million loyalty members, mostly millennials, who account for about 90% of total company revenues.

Mary Dillon, former CEO of McDonald's and U.S. Cellular, became Ulta's chief executive in July 2013. She unveiled a multiyear plan in 2014 and has delivered on her promises. Ulta's store fleet reached 1,200 locations in 2019. Dillon's vision included new brands and exclusive items that drive excitement among shoppers. The company added 30 new brands in 2014 alone to reach more than 500. Meanwhile, Ulta doubled down on its high-end segment, rolling out premium and pricey brands like Lancôme, Estee Lauder, and Clinique; making it a critical piece of its growth strategy. And Dillon got e-commerce up to 10% of sales by 2019, from 5% when she took office (Gharib, 2019). Her plans seem to have impressed Wall Street; and Ulta's market value has tripled since she became CEO. Stock price has risen from \$100 in July 2013 to \$300 in February 2020.

Because Ulta carries brands at all price points, it has the ability to seize market share from drug store chains like CVS and department stores like Macy's. In the Instagram era, where looking good on camera is a part of life for Generation Z and Millennials, Ulta found a way to capitalize on the selfie craze. Ulta's mobile app has a feature called "Glam Lab" that allows customers to take selfies and apply virtual makeup before they make a purchase. At its 1200 stores, shoppers can also visit a professional skin therapist for "face mapping," and get their eyebrows tweezed, trimmed, and tinted. Most of Ulta's stores are located in suburban strip malls. At 10,000 square feet, they're big enough to house a range of products, from Revlon Inc.'s \$8 Almay liquid eyeliner to Estee Lauder Cos.'s \$32 lipstick. Each Ulta store carries about 20,000 SKUs. The broad and deep assortment allows Ulta to cater to a wide range of shoppers. The company is also opening urban stores half the size of its typical space.

The Bolingbrook, Illinois-based company favors high-traffic strip center locations to spare its customers browsing a vast indoor mall to find the store, Ulta provides convenience for people with limited time to shop. They can traverse the stores for cosmetics, fragrance, and hair and skin products on 20 minutes or less. Ulta's in-house salons give it a unique advantage. Aside

from the convenience of enabling customers to get their hair done and shop for beauty products in the same trip, Ulta adds on more loyal customers. The result has been staggering growth, especially by the sluggish standards of brick-and-mortar retailing. Ulta's sales have tripled since fiscal 2012 (from \$2.2 billion to \$6.7 billion); and the future looks bold and beautiful.

SEPHORA

The second biggest player with about 18% of the market is Sephora. Owned by luxury holding company Louis Vuitton Moët Hennessy (LVMH), Sephora, which operates in the United States through Sephora USA Inc., is a beauty retailer that sells cosmetics, men's and women's fragrances and other beauty-related products in brick-and-mortar stores across 31 countries and online. Headquartered in Paris, Sephora first opened its doors in the United States in 1998 with a New York City store. To date, Sephora operates more than 2,700 freestanding stores around the world, with about 35.0% of its sales generated in the United States. The company also runs smaller Sephora stores within JC Penney Company Inc.'s and Kohl's Corporation stores. In 2020, Sephora generated \$4.4 billion in revenue.

Sephora has expanded its Beauty Insider program over the five years to 2021, which rewards loyal customers with special products and exclusive information. The new program offers a premium level of rewards for customers who spend more than a certain amount annually, ensuring customer loyalty from top spenders. In 2016, the company launched Play!, a subscription-based service through which customers receive a beauty box in the mail every month. The service has since been cancelled as of April 2020, however. The company has announced that they plan to replace the program with an improved subscription-based service.

Over the five years to 2021, Sephora's US industry-specific revenue is anticipated to decrease at an annualized rate of 2.2% to \$4.5 billion as e-commerce and international sales continue to make up a larger share of revenue. Overall, the company has achieved growth by offering a distinct in-store experience to its shoppers. At Sephora, customer service and a consistent image are paramount. The company's employees are referred to as "cast members" and the sales floor is the "stage," as workers are expected to provide customers with an entertaining experience. Due to the company's strong focus on customer service, high wage costs slightly eat into profitability, although profit still stands above the industry average. In 2021, the company's profit margin, measured as earnings before interest and taxes, is expected to reach \$298.5 million. Sephora's e-commerce sales increased strongly amid the coronavirus pandemic, but industry-relevant revenue is anticipated to decrease as a consumer foot traffic at brick-and-mortar locations declined. Industry-relevant revenue is likely to rebound in 2021, however, and is anticipated to grow by 40.2% as consumers return to shopping in-person.

BATH & BODY WORKS

Bath & Body Works LLC was founded in 1990 in New Albany, OH, and operates under the L Brands Inc. (L Brands)'s umbrella. Founded in 1963, L Brands operates brands including Victoria's Secret and Bath & Body Works. Bath & Body Works offers various personal care

products including body washes, lotions and fragrances, which are sold at their branded stores. The brand operates 1,633 stores in the United States, as well as others in Canada and 30 additional countries, adding up to a total of 2,024 stores. In fiscal 2021 (year-end January), Bath & Body Works generated \$4.3 billion in total company revenue.

The brand offers high-quality products and emphasizes innovation as part of its business strategy. Product development and a stimulating in-store experience, coupled with the knowledge of a well-trained management team, are central to Bath & Body Works' operations. Bath & Body Works invests significantly in their new concept stores, such as the White Barn design for their home fragrance assortment, which drives sales and attracts customers due to its innovative and compelling design. Between 2017 and 2018, Bath & Body Works focused in the remodeling of its stores in North America and increasing their square footage, while simultaneously expanding its domestic and international store count.

Over the five years to fiscal 2022, Bath & Body Works' industry-specific revenue is projected to increase at an annualized rate of 6.6% to reach \$4.1 billion. Furthermore, the Bath & Body Works' industry-relevant profit margin is also anticipated to increase, growing at an annualized rate of 18.7% to reach \$1.9 billion in fiscal 2022. Although sales are expected to have suffered amid the coronavirus pandemic in 2020, revenue is expected to recover in in fiscal 2022.

SALLY BEAUTY HOLDINGS

Founded in 1964 and headquartered in Denton, TX, Sally Beauty Holdings Inc. is a specialty retailer and distributor of professional beauty supplies. The company operates under two reportable segments: Sally Beauty Supply and Beauty Systems Group. The company's operations within the Sally Beauty Supply segment apply to the Beauty, Cosmetics and Fragrance Stores industry. This segment sells products for hair, nail and skin care to professional and retail customers. According to the company's most recent annual report, Sally Beauty Supply accounts for 3,644 company-operated retail stores with 2,753 located in the United States. In addition, the company's international stores are spread throughout Canada, Mexico, Chile, the United Kingdom, Ireland, Belgium, France, Germany, the Netherlands and Spain. In fiscal 2020 (latest data available; year-end September), Sally Beauty Holdings employed 30,000 people and reported \$1.7 billion in total company revenue.

Sally Beauty Supply's mission is to empower their customers by offering in-store knowledgeable professionals and strategic product assortment. The company flourishes from partnering with specific brands and influencers and providing salon-quality products at attractive prices. The company invests in their compelling shopping environment to help drive customer traffic to their stores and increase their sales. Furthermore, the company always keeps up with the latest fashion and industry trends to cater to changing customer preferences and demand. In 2021, the company's profit margin, measured as earnings before interest and taxes, is expected to comprise 15.9% of overall revenue. Although revenue fell in 2020 as a result of the coronavirus pandemic, the company is expected to recover in 2021 as consumers spending increases.

WINNERS AND LOSERS

The department store was the typical go-to place for cosmetics a decade or so ago. However, the challenge in the cosmetic department in department stores has been twofold. First, traffic continued to decline due to the competition in the mall from Amazon. And second, the cost of doing business for a cosmetic brand continued to rise, as beauty advisor salaries and overheads continue to go up. Because of the department stores' challenges, a new face in cosmetic retail evolved: the specialty open-sell cosmetic store. The most famous of these are Ulta and Sephora. The two beauty retailers were not successful, initially, because the big brands were still committed to the department stores and feared that they would be dropped if they expanded outside the traditional store channel. Over time, however, it became clear that Ulta and Sephora are the go-to retailer for any new prestige brand because its traffic amongst the younger female population far exceeds that of department stores. Ulta has completely discredited the old notion that you were either prestige or mass. One of Ulta's advantages is that 90 percent of its stores are located in outdoor shopping centers, rather than enclosed malls, whose department-store anchors are struggling with slow traffic and competition from Amazon. Ulta's success comes as U.S retailers are reeling from a disastrous decade. Some of the industry's biggest names, including Sears and Barney's have filed for bankruptcy. Others like Macy's and J.C. Penny are experiencing stagnant revenues and declining profits and shutting weak locations (Warfield, 2019). Table 5 shows how Ulta has had a thriving 2019, while major department stores struggled. Ulta's market valuation (\$20.7 billion) was almost equivalent to the major 4 department stores combined (\$21 billion).

Table 4
Major Department Stores Vs. Ulta Beauty (2020)

	Revenues (\$Million)	Revenue % Change	Profits (\$Million)	Profit % Change	Assets (\$Million)	Valuation (\$Million)	Employees
Ulta Beauty	\$6,716	14.3%	\$658.6	18.6%	\$3,191	\$20,683	30,000
Macy's	\$25,739	3.6%	\$1,108	-28.4%	\$19,194	\$7,388	130,000
Kohl's	\$20,229	5.9%	\$801	-6.8%	\$12,469	\$11,220	81,500
J.C. Penny	\$12,019	-3.9%	-\$255	-	\$7,721	\$471	95,000
Dillard's	\$6,503	1.3%	\$170.3	-23.1%	\$3,431	\$1,897	31,000

Source: Fortune 500 (2020)

There are reasons why Ulta hasn't succumbed to the Amazon Effect. Like off-price stores, beauty retailers frequently get a call-out for being resistant to Amazon's offensive tactics in today's evolving retail world. The unique in-store experience, the test-and-trial nature of beauty products, and vigorous loyalty programs are the major factors behind this success. These retail tactics appeal greatly to millennials, who tend to exhibit little brand loyalty (Eldor, 2017). By visiting a Sephora or Ulta, they can tinker with various options, without having to visit

separate stores or counters. They also enjoy putting the product on with no or minimal human interaction. The “treasure hunt” atmosphere created by these stores allows young beauty shoppers to have fun in the process. Most of them have watched celebrities and bloggers apply various make-up styles or researched reviews of different products online, so they feel confident enough to search and try the cosmetics on their own. Consequently, Sephora is looking at opening an additional 100 stores in 2020, and Ulta is doing the same (Valinsky, 2020). The future looks bright for the specialty beauty stores. We cannot say the same about department stores. The novel Corona pandemic will have implications on the retail sector, particularly for department store chains which have little margin for financial downturns. The specialty beauty industry, nevertheless, is anticipated to recover partially from the adverse effects of the COVID-19 pandemic, with industry revenue expected to expand 22.5% in 2021 after falling 18.1% in 2020.

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