



The Beauty Industry's Digital Transformation





Digital natives crave their own personal looks and fragrances and brands deliver

The days of the perfume and cosmetics industry being dominated by a few major players, putting forth one standard of beauty and evangelizing it through traditional print and T.V. ads are over.

Today new brands are being created at light speed, products are being re-engineered from the ground up, globalization and the growing diversity of the customer base are creating new demands, and, of course, technology is augmenting every trend.

At the center of the transformation, is the consumer — demanding that she be seen as an individual with a deep sense of herself and how she wants to look and feel.

In 2016, the worldwide cosmetics market was estimated at \$250 billion, with annual growth of 4 to 5 percent a year. As that growth plays out, a few categories in the vertical are performing ahead of the pack. “Clean beauty” or “natural beauty,” which comprises products made of “natural” ingredients, is growing in leaps and bounds, for instance.

Personalized fragrances and cosmetics are de rigueur. The internet has become a vital channel for the industry, with people, especially

those under 25, becoming increasingly more comfortable shopping for such products online.

The explosion of these trends has inspired executives at leading market intelligence agency Mintel to predict that the beauty and personal care market is experiencing a fundamental shift. And they’re not the only ones.

“I think the future of beauty will be more and more about technology, about quality, about formulation, about individualization, about digitalization, about responding to specific needs,” L’Oréal’s CEO and Chairman Jean-Paul Agon told CNBC recently. “We’re entering into a new world, and it’s going to be fascinating.”

In this report, you’ll learn about recent trends that are affecting sales in the new world of perfume and cosmetics and what it means for merchants in the evolving retail segment.

Beauty startups are proliferating at light speed

The growth in venture capital funding of beauty startups is enough to cause Silicon Valley to blush. Consider the surge: in 2016, \$608.9 million was invested across 150 deals, compared to just \$120.9 million over 86 transactions in 2012.

There are a number of reasons for the increase. The barriers to entry have lowered drastically. There are now labs throughout the United States, such as the Cosmetic Laboratories of America and Ariel Cosmetic Laboratories, which offer entrepreneurs the opportunity to work with chemists on a contract basis to develop new products.

Beauty retail stores such as Sephora and Ulta provide high-quality, smaller companies with opportunities to sell their products. Ecommerce sites are easier to set up than brick-and-mortar stores and social media has proven to be an extremely effective marketing channel for cosmetics (more on this below).

According to Forbes, there are at least 40 prominent beauty startups today founded by women, “making the \$445 billion (sales) industry one of the most prevalent places for women to self-start their way to big-time success.”

Indeed, 62 privately held beauty companies were acquired in 2016, 38 percent more than the previous year and a record since 2012, according to analytics firm CB Insights. Experts predict the momentum that carried through 2017 will continue in 2018.



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Segment growth in beauty is being accompanied by fraud growth

While the rapid growth in the perfume and cosmetics space might be cause for celebration, the most recent industry fraud statistics are reason to tamp down the excitement a bit.

Signifyd's Ecommerce Fraud Index found that the perfume and cosmetics sector was also a growth leader in the amount of fraud losses suffered during the two years covered in the report. Between 2016 and 2017, total fraud in the vertical increased by 103 percent.

That compares to a 7 percent increase in fraud losses across all eight verticals analyzed in the report.

“The beauty industry is facing an uphill battle with ecommerce fraud,” the report concluded.

Here are some examples of successful beauty start-ups:

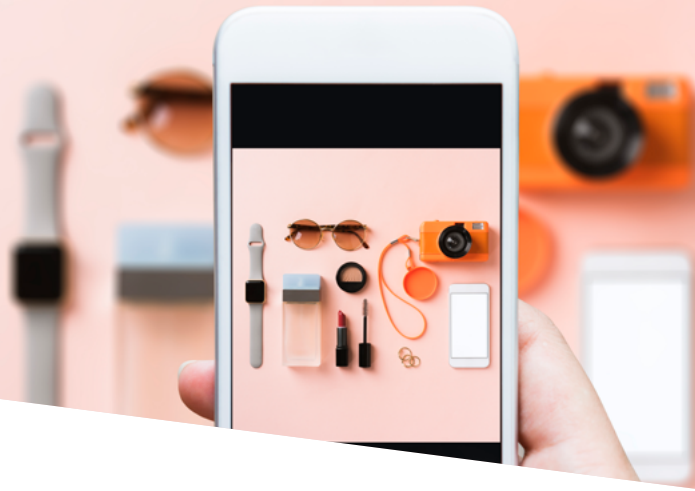
- Leading beauty company L'Oréal is launching an incubator program in Paris, in which 10 to 12 startups will collaborate with the company to develop innovative technology for beauty.
- In November 2016, Estée Lauder paid \$1.45 billion for Too Faced Cosmetics, a sassy cosmetics line with product names like Born This Way Foundation and Better Than Sex Waterproof Mascara. It was the company's largest purchase in its 70-year history. Earlier in 2016, it paid more than \$230 million for Becca Cosmetics.
- In the summer of 2016, L'Oréal paid \$1.2 billion in cash for IT Cosmetics, a luxury cosmetics line founded by former news anchor and reality TV star Jamie Kern Lima.
- In 2015, L'Oréal bought Toni Ko's NYX Cosmetics, which featured department store beauty at drugstore prices, for an estimated \$500 million. Ko is worth \$270 million and ranks No. 57 on Forbes' list of America's most successful self-made women.
- Organic perfumer Skylar Body, which features scents that use only natural ingredients, raised \$3 million last year in a venture capital round.

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High demand for “clean” beauty and all natural ingredients

The internet has made it incredibly easy for consumers to get information about the ingredients in their favorite cosmetics and perfumes. With the growth of the environmental movement and the proliferation of organizations and news focused on the hazards of chemicals in cosmetics and the treatment of animals used in cosmetics testing, more and more consumers are demanding “natural ingredients” in their beauty products.



The global beauty industry is growing at about 3.8 percent, but the natural segment is growing much faster — at about 10 percent. Mintel says 25 percent of U.S. consumers purchase natural deodorant, and about 56 percent of adults surveyed think that it's important for their personal-care products to be “natural or organic.”

Experts at online marketplace OnBuy.com analyzed market data and found that, in Britain alone, some 64 percent of fragrance consumers will be looking for vegan perfumes over the next 12 months. And Blair Lawson, head merchant at Goop, which now sells “clean beauty” products on its ecommerce platform, says vegan perfumes make up 35 to 40 percent of its business each month.

Even L'Oréal is launching new products that are, L'Oréal CEO Agon says, “almost 100 percent natural. Natural ingredients, natural formula, has biodegradability, recycling and recycled packaging.”

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At least fraud rates are headed in the right direction

Despite total fraud's dramatic increase in the cosmetics and perfume sector, there are signs that merchants might be turning things around. Signifyd's Ecommerce Fraud Index charted an up and down fraud pattern during the two years covered by the report.

Throughout 2016 and into early 2017, merchants in the vertical appeared to be effectively managing fraud, with the rate falling well below 2 percent in early 2016. But by mid-2017, the fraud rate was on the rise, hitting an all-time high of 7.48 percent by the third quarter of the year. The figure did settle down, falling to 5.34 percent by year's end.

The entry of new, small players into the sector and its innovative marketing might be partly to blame for the rise in fraud. Flash sales have become an important way for cosmetics company to stir excitement about their brands and their products. Such high-volume events bring their own set of fraud challenges.

And new, smaller players are sometimes ill-equipped to deal with well-established, sophisticated fraud rings that look for every opportunity to pounce.



But as popular as the niche is becoming, there's a lot of confusion as to the exact meaning of "natural ingredients" and "clean beauty." Traditionally, the terms have included products that are free from toxic ingredients, such as parabens, synthetic fragrances, carcinogens and endocrine disruptors.

For Goop, says Lawson, "clean means it does not contain ingredients that have been demonstrably linked to harmful health effects."

But there's no FDA oversight of natural products, so any company can claim its products are "natural." [Tata Harper](#), the founder of the self-titled skincare line, credited as the "queen of the green skincare movement," says she remembers finding out some of the most common ingredients in "natural" skincare products included antifreeze, tire lubricants, and simethicone — all products used in the auto industry.

In the future, companies should expect consumers to become more demanding about transparency around products labeled "natural."

Also in the future, [Mintel](#) says biotechnology and the locally-sourced trend could soon play a larger role in the beauty industry: "In the coming year, the possibilities for creating safe, allergen-free, pure, and efficacious ingredients through science could replace the harvesting of natural ingredients. Local sourcing and production of ingredients will become essential in the years ahead, strengthening the idea of local pride — not just with brands and manufacturers, but with consumers too."

Local ingredients like what? Well, In July 2017, The Journal of the American Academy of Dermatology published a report that showed that cannabis plant extracts THC and CBD prove to have anti-inflammatory effects and reduce itching in cases like psoriasis, eczema and allergic dermatitis when topically applied.

With laws in 29 states that currently legalize marijuana in some form, [Forbes](#) is predicting that, yes, cannabis will "lose its stoner reputation" and become a key skincare ingredient in 2018.

All of "which means you may be seeing weed-centric skincare in your local Sephora soon," says San Francisco-based writer Janna Mandell.

Social media will continue its populist influence on the beauty industry

The effect of social media on the beauty industry cannot be overstated. Beauty vloggers have done the job of marketing for companies by showcasing their favorite products in videos and photos for their millions of subscribers. In 2008, beauty-related content generated about one billion views on YouTube; in 2017, that number went up to 88 billion. Yes, an increase of 88 times. The most popular beauty channel hosts have more than 10 million subscribers. Among the most popular are British vlogger [Zoella](#), and Americans [Bethany Mota](#) and [Michelle Phan](#).

According to [Statistica](#), "the cosmetic industry has benefited from the increasing popularity of social media channels such as Instagram and YouTube. These platforms are not only highly influential amongst certain groups, but (also) create a demand for beauty products and help fill the gap between cosmetics brands and consumers."

Facebook has also become an influential part of the online beauty world. Twenty percent of all time spent on the internet is spent on Facebook's platforms, including Facebook, Whatsapp, Instagram, and Facebook Messenger. Every day there are 526 million posts that relate to the beauty industry.

At 2017's WWD Beauty Summit 2017, Jo Malone, founder and namesake of the popular fragrance line, said social media influencers, "take it all up and spread the word for you. You think they're not taking it in, but they are. They don't want to be just your consumer or be entertained by you – they want to create with you, they want to touch the heartbeat and be part of the creative process... they want to be part of it."

Also at the summit, Fabrizio Freda, President and CEO of Estée Lauder, said younger generations are defining the culture with images of self-expression. "They take more pictures in a day, on average, than their parents took in a year. Sixty-five percent of teens rely on social media to discover and select beauty products. By lowering the barrier to entry, we are encouraging an entrepreneurial fire."

Social media has also helped to make the beauty industry more diverse and inclusive, with the popularity of minority hosts and vloggers who take on the industry's products from their own perspective. Examples include Nyma Tang and Farah Dhukai.

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Account takeover is plaguing providers of the makeover

Fraudsters are constantly turning to new tools and tactics. Perfume and cosmetics merchants saw a dramatic spike in account takeover fraud — attacks in which fraudsters log in as an established user and access existing payment options to make purchases.

The sector saw account takeover fraud skyrocket by 271 percent between 2016 and 2017, according to Signifyd's Ecommerce Fraud Index. The fraud rate in the account takeover category ultimately reached 1.48 percent, thereby accounting for 27.7 percent of total fraud losses in the cosmetic and perfume category, the index found.

The shift toward account takeover reflected a bigger trend in online retail. Looking at data across all eight verticals studied in the Signifyd Ecommerce Fraud Index, researchers found that account takeover fraud increased 80 percent between 2016 and 2017.



Personalization and inclusion are the new buzzwords

In 2018 and beyond, Minted predicts that “beauty consumers will demand that their individual needs are answered with options or customizable beauty.” This involves creating customized, on-demand products that allow consumers to define beauty on their own terms – regardless of their demographic.

“In the past, brands had sole control over what defines beauty; however, perceptions of beauty based on age, gender, skin, hair, and body type are changing as today’s consumers take control of how beauty is defined,” Minted says.

The major beauty launch of 2017 followed this trend of personalization and inclusivity. Rihanna’s Fenty Beauty makeup line featured a foundation that comes in 40 skin tone shades. The brand generated \$72 million in media value in its first month alone. The UK’s Evening Standard predicts that “the resulting pressure will see major cosmetics retailers step up their offerings in 2018.”

Now, consumers can buy kits that enable them to make everything from their own signature scents to specialized serums for their particular type of skin. This trend is similar to what people expect from their technology:

personalization and customization. Call it the era of iMakeup.

Digital technology enhances beauty options

New technologies are continually changing the beauty industry. For example, when the selfie was invented, it wasn’t too long before entrepreneurs realized they could use that technology to offer personalized cosmetic suggestions to consumers. For example, Modiface is an app that lets you see yourself in different lighting conditions, with different makeup and different hair colors. Seventy-five of the top 100 beauty brands are using Modiface.

According to Mintel, “digital technology will follow consumers everywhere, influencing their product purchases and helping them to navigate the complexities of the beauty aisle.... Digital technology will make shopping more personal in 2018.” Eventually, new technology will be able to “interpret consumers’ facial expressions and eye movements to determine their product preferences and offer help, both in-store and online.”

Luxury beauty, active cosmetics, and the rise of J-beauty

The luxury or prestige beauty segment

is outpacing growth in the mass beauty segment. The U.S. prestige beauty industry reached \$17 billion in 2016, growing 6 percent, compared to 2015, according to the global information company The NPD Group. At 12 percent, the makeup segment experienced the healthiest growth, while skincare increased by 2 percent, and fragrance grew 1 percent.

Active cosmetics, which are skincare and beauty brands pertaining to sensitive skin or dermatological conditions and are often sold in pharmacies, are another growing trend. According to a report by Research and Markets, the global cosmeceutical market is expected to grow at a compounded annual growth rate of nearly 6 percent between 2017 and 2021.

L'Oréal is one of the leading names in the active cosmetics market, with its recent acquisitions of the skincare brands CeraVe, AcneFree, and Ambi from Valeant Pharmaceuticals for \$1.3 billion.

Finally, industry experts are predicting that following the recent popularity of Korean beauty products, Japanese beauty products will see a surge, accelerated by the 2020 Summer Olympics in Tokyo.

“Japanese cosmetics companies are developing innovative products inspired by traditional Japanese aesthetic principles of kanso, shibui and seijaku (simplicity, understated beauty and energised calm),” according to the Evening Standard. “Shiseido’s new skincare line Waso is, for example, inspired by the tradition of washoku (traditional Japanese food), and comprises a series of holistic and natural products.”

Embrace the future – and the complexity

Leading cosmetics companies recognize that the only way to stay competitive in this changing landscape is to embrace change. Young upstarts are proving to be serious competition, and it seems that so far, for larger corporations, the attitude is, “if you can’t beat ‘em, join ‘em – or have them join you.”

We are likely to continue seeing acquisitions of innovative startups by industry leaders such as L'Oréal, Estée Lauder and Procter & Gamble. At the same time, getting ahead of new market demands, as well as leveraging social media and new technologies, are key to maintaining a competitive edge.

“The beauty industry is becoming increasingly complex,” said Camillo Pane, the CEO of Coty, at the WWD Beauty Summit in 2017. “Our instinct is to dislike complexity. But we either embrace it, or we’re not going to be around.”

For a deeper dive into the fraud statistics in the perfume and cosmetics industry, download Signifyd’s Ecommerce Fraud Index.

