CONSUMER AND RETAIL GROUP

Beauty in the Next Normal

How consumer behavior shifted during the pandemic and what we predict won't shift back

The beauty industry has enjoyed steady growth in the U.S. over the last 10 years, driven largely by the strong performance of prestige beauty sales, the growth of specialty retailers, and bolstered, in more recent years, by a new crop of celebrity-backed and direct-to-consumer brands.

When the COVID-19 pandemic hit, consumers' routines were instantly disrupted across all areas of life; working remotely became the norm for large portions of the population, non-essential retail outlets were closed for extended portions of 2020, social gatherings were discouraged, and face masks (not the ones we would traditionally think of in the skincare world) became a necessary accessory.

As we kick off 2021, the A&M Consumer and Retail Group has set out to understand how customer beauty preferences and behaviors have changed, and which of these changes may be here to stay.

Unsurprisingly, in the A&M Consumer and Retail Group Beauty Survey issued in December 2020 to ~1,000 female beauty consumers in the U.S., the majority of respondents indicated that, since COVID, they have either completely stopped or purchased fewer beauty products including skincare and makeup.

- 70% of respondents shopped for less makeup this year
- 18% stopped buying makeup altogether
- In skincare, where we anticipated a less significant impact, 40% of respondents bought less
- Only two out of every ten consumers in the U.S. said their beauty routines remained unchanged

As we begin to emerge from the pandemic sometime this year, many will return to work in-person, social gatherings will ramp up again and some usage occasions will return. But will consumer routines and behavior return to pre-COVID days or continue on their current trajectory?

- Four in ten respondents do not expect to return to pre-COVID makeup purchase levels
- 20% of respondents who stopped buying makeup do not plan to start again after the pandemic
- While the trend is not as dramatic in skincare, almost three in ten respondents indicated that their plan is to shop less

The beauty industry underwent rapid and profound changes during 2020. As customers' lives and behaviors shifted, so did some of the major paradigms in the beauty industry.

- Ingredients became increasingly important as brand loyalty continued to erode
- Discovery and brand experiences went digital
- Shared testers could no longer anchor product discovery
- The newness drumbeat slowed down

> *70% of customers bought less makeup in 2020, and 18% stopped buying it altogether"*

How can beauty brands and retailers think about operating in this next normal and what will be critical in driving growth? We have outlined some key focus areas brands and retailers need to consider as they navigate the next normal.

Ingredients Enter the Battle for Brand Loyalty

If the battle for loyalty wasn't already tough enough, it's about to get harder

Brand loyalty had been under pressure even before COVID. Although half of respondents say their brand loyalty in beauty did not change during the pandemic, many of them were never brand loyal to begin with.

Before the pandemic:

- 33% of respondents did not have a go-to brand in makeup
- 25% did not have a go-to brand in skincare
- The younger the consumer, the less loyal, as 47% of the 18-29 age range did not have a go-to brand in makeup or skincare

Most respondents indicated that during COVID, Instagram and Facebook were their preferred channels to discover new beauty products. Social media has armed customers with product knowledge, acquired from beauty gurus and influencers vying for their attention. This trend ramped up comparison shopping and the shift towards ingredients-first product discovery, a departure from the brand-first approach that led for decades.

- Searches for "Hyaluronic Acid Skincare" and "Vitamin C Skincare" increased 5x and 3x in the last 12 months
- "Better ingredients" was the top reason respondents switched skincare brands in 2020
- Brands like CeraVe, The Ordinary and The Inkey List benefitted from this trend due to the clear messaging around ingredients

The Long-Term Impact of the Digital Explosion

Discovery and brand experience must be digital, now more than ever

Like most retail categories in the U.S., beauty saw a massive shift to online shopping in both makeup and skincare. That e-commerce growth is (mostly) here to stay. Our survey respondents indicated similar trends.

In makeup	In skincare
Pre-COVID, 34% of their shopping was done online	Pre-COVID, 32% of their shopping was done online
During COVID, this number increased to 47%	During COVID, this number increased to 46%
Post-COVID, they anticipate 42% of shopping to remain online	Post-COVID, they anticipate 42% of shopping to remain online

Shopping for beauty products online has its own set of unique challenges. The traditional "test before you buy" model is difficult to replicate online. Brands and retailers have been grappling with these issues long before the pandemic. But when COVID hit, they rushed to accelerate their digital capabilities across key areas: virtual try-on, augmented reality, online consultations, new social media platforms and content development. Examples include:

- **Rolling out online consultation capabilities through one-on-one live video chats.** For Clinique, capability updates resulted in a higher frequency of purchase, time spent on site and conversion.[1]
- **Launching virtual-only makeup looks.** L'Oreal's "Signature Faces" features 10 different makeup looks compatible with Snapchat, Instagram, Google Duo, Skype, Zoom and Google Hangouts.
- **Harnessing the power of TikTok.** In September 2019, only 8% of the world's top beauty brands were on the platform but as of September 2020, 41% were utilizing it.
- **Moving in-person events online.** From virtual concerts as stand-ins for Coachella, to masterclasses and a house party with Rihanna, brands sought to create unique brand-building experiences online.

Content is currency in this environment. Delivering a differentiated digital experience is critical, especially as multi-brand marketplaces like Instagram Shopping gain traction due to their frictionless purchase experience. Standout content can set brands apart in these digital, brand-agnostic environments.

Much of the online shopping trends will stick post-pandemic, and we predict that a battle for share of online purchasing could ensue. The results will largely come down to the retailer or brand's ability to leverage technology and content to maximize the digital customer experience. This will require both technology upgrades as well as operating model changes.

But digital alone will not be enough, and omni-channel experiences and capabilities will be more critical than ever post-pandemic. While more people will shop for beauty online, only 6-9% expect to shop beauty exclusively online after COVID. This means that more customers than ever will be exposed to brands across multiple online and in-person channels.

Re-imagining the Store Experience

Accessible product testers once revolutionized the in-store experience. What will replace them in a post-pandemic world?

The explosive growth of beauty specialty retailers (like Sephora for instance) has been due, in part, to their innovative store experience. They did away with traditional beauty counters and instead put testers out in the open for customers to use, while sales associates offered a very hands-on interaction, often helping customers apply makeup. Their stores became a playground where customers could discover new favorites in a high-touch environment. What happens now to this successful model?

When asked how they feel about shared beauty testers:

- Only 15% of respondents feel comfortable using shared beauty testers now and ~25% would be willing to use them again once a vaccine is widely available
- For 42% of respondents using a shared tester is something they do not foresee ever being comfortable with again

The outlook is only slightly better for services like makeovers:

- Almost 20% feel comfortable with having a makeover now
- 30% indicate they do not foresee ever engaging in that type of interaction again

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[1] Estee Lauder Companies Earnings Call – Q4 2020

> *Only 10% of customers are actively looking for what's new in makeup and skincare."*

As we continue to operate in the new normal, brands and retailers will need to pivot and evolve their product testing experience both in-store and online. The future of in-store testers is uncertain in a post-pandemic world hyper-focused on safety and hygiene, and some categories like fragrance do not lend themselves to augmented reality. Single-use samples, increasing gift-with-purchase programs, for-sale minis and perhaps a resurgence of subscription boxes are likely candidates to tackle the sampling problem. But what about the artistry of a professional makeup application? It's hard to imagine technology replacing that, but enhanced hygiene protocols will pose logistical, operational and cost hurdles that must be addressed.

Less is More and the Role of Newness

What is the role of newness in the next normal?

Newness lost some of its shine in 2020. While recent years in beauty had been a race towards ever-shrinking product development cycles, creating an endless stream of newness during the pandemic became, understandably, less relevant.

- Currently, only ~10% of respondents actively look for what's new in makeup and skincare
- After COVID, almost 40% of respondents expect to care even less about newness in makeup
- In skincare ~20% of respondents expect to care more about newness than they did pre-COVID

Despite the current environment, brands have not completely shied away from launching new products, but instead slowed the rate of new launches. In all likelihood the slowdown in 2020 launches reflects a shift of calendars into 2021 rather than the cancellation of product launches, especially in skincare. Skincare product development is oftentimes a years-long process requiring heavy investment, which brands are unlikely to walk away from. However, as customer needs changed during the pandemic, brands likely had to go back to the drawing board and re-imagine what a successful product launch would look like – from new marketing campaigns to updated launch dates and potential reformulations, launches will need to look different in order to hit the right note with an audience whose day-to-day needs have changed significantly.

The endless churning out of newness may have slowed down this year as consumers focused on ingredients and buying products that were reliably available. However, the jury is still out on whether newness will be a critical factor in getting people to buy again in the near future. For brands and retailers, this means becoming more consumer-centric than ever and creating agile supply chains that enable them to make demand-led decisions to manage inventory risk in a volatile environment. Beauty's flavor of the month (or week) may have paused during 2020, but consumers may crave newness again as the new normal settles in.

In Summary

While it is hard to truly grasp what the "new normal" will look like for beauty in a post-pandemic world, brands must embrace that things will continue to change. How they reach and interact with customers, how and where customers discover their products, and how they communicate their products' benefits will not be what it was before. Evolving to meet the changing customer is table-stakes in this new world.

With brick-and-mortar and brand loyalty under growing pressure, coupled with 90% of customers indicating that they plan to shop across multiple channels online, creating a seamless and meaningful brand experience across all channels will be critical. Companies that understand this and can re-imagine their operations will succeed. New store formats that embrace safe interactions, life-like virtual try-ons and consultations, leading with quality ingredients, and creating demand-based planning that moves away from a traditional launch calendar are just a few things brands and retailers have to rethink if they want to win in beauty in the next normal.

- **Develop (and follow) a technology and digital roadmap:** Robust digital offerings and technologies are no longer just "nice to have". Brands that can service customers online in unique ways stand to win the beauty battle as more customers than ever shop online.
- **Reinforce omni-channel strategy:** E-commerce used to be complementary to main flagship stores but now, omni-channel capabilities in all retail stores are imperative. 90% of customers expect to shop across multiple channels online and in-store, so the need for a seamless and meaningful brand and fulfillment experience across channels will be a must.
- **Refocus new product development:** in the short term, sharpen assortments and rationalize SKU mix, while strengthening customer insights capabilities and shortening lead times even further to gain flexibility in the medium term.
- **Leverage demand-based planning:** Move away from a traditional launch calendar and create an agile supply chain that can respond to shifts in demand in a volatile environment.
- **Evaluate co-investments and partnerships with suppliers:** Now more than ever, the ability to create end-to-end flexibility in the supply chain can help brands and retailers mitigate risk.

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