



Analysis of Estée Lauder's Operations and Forecasts for the Future Based on Financial Statements

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Abstract. Estée Lauder (ESTÉE LAUDER) One of the world's largest skin care, cosmetics and fragrance companies. It was the forerunner of the Estée Lauder Companies, founded by Estée Lauder and Joseph Lauder, and has grown to become the world's largest skincare, cosmetics and fragrance company, and is still expanding its business. In these days of information explosion, the analysis of financial statements and industry markets is particularly important for the development of a business. In this article, we provide a industry, business and financial analysis of Estée Lauder. And make predictions about its future growth.

Keywords: Estée Lauder · industry · business · financial · analysis · prediction

1 Introduction

Founded in 1946 by Estée and Joseph Lauder, Estée Lauder is one of the world's leading manufacturers, marketers and sellers specialising in fine cosmetics, skin care, fragrances and hair care. Through the years, the Estée Lauder Group has built a family of brands with a unique balance. Estée Lauder was founded in 1946. The product range covers a wide range of make-up, fragrances and skincare products for women as well as fragrances and skincare products for men. The Estée Lauder brand has a reputation for technologically advanced, innovative and high quality products sold in more than 13,000 points of sale in over 130 countries and territories. The company's total net sales exceeded US\$16.22 billion. Retailer websites, third-party online shops, department stores, specialty multi-retailers, upscale perfumeries and pharmacies, as well as prestigious salons and spas are among its distribution channels. In December 2018, the 2018 World's Top 500 Brands, compiled by the World Brand Lab, was revealed and Estee Lauder ranked 227th.

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Adhering to its original mission of bringing beauty to every woman, its commitment to scientific breakthroughs and innovation, and These traditions of excellence continue and serve as a valuable foundation for future growth. The creative collaboration with fashion pioneers and the endorsement of a number of personalities who have distinguished themselves in their respective fields gives the brand a new glamour and substance, symbolising Estée Lauder's contemporary spirit and conveying the elegance and substance that the brand has long celebrated, together speaking to the return of feminine beauty - young, confident and extremely feminine.

2 Industry Analysis

The Porter's Five Forces model was developed by Michael Porter in the early 1980s. He argued that there are five forces in an industry that determine the size and degree of competition, and that these five forces combine to influence the attractiveness of the industry and the competitive strategy decisions of existing firms (Porter, M. E., 1998).

Estée Lauder belongs in the Global Beauty Market, also known as Cosmetics and Toiletries or Personal Care Products Industry. Especially, Estée Lauder focus on the middle and top grade products. So the following parts will analyse this industry and using the Porter's five force analysis.

2.1 Threat of New Entrants

Firstly, it is not easy for new entrants who want to enter the "prestige beauty" industry. Here are the reasons:

2.1.1 Economies of Scale

The larger the scale is, the more cost advantage company will have. In the high-end beauty industry, the famous incumbent companies have monopolized the market so it's difficult for new entrants to reach such scale and they have to accept a cost disadvantage.

2.1.2 Network Effects

For the enterprises, brand is the most important. The mature brands usually have stable customers and it is difficult for new entrants to establish brands acceptable to consumers in a short period of time. What is more, the customer will introduce the products they use to their family and friends, so it is difficult for new entrants to compete with the incumbent ones. Though the customers don't need to spend a lot of money on switching products, they need to spend time to find another safe, high quality and suitable product. That would stop them from changing to a new entrant.

2.1.3 Capital Requirements

To enter the "prestige beauty" industry, the entrants need to invest a lot in product development, service improvement and brand image building, that would cost a lot.

2.1.4 Government Policy and Other Incumbent Advantages

The government has no special policy for new entrants and it even introduce policies on the quality of cosmetics to limit new entrants. Besides, the incumbent enterprises have advantages in patents, purchase channels, customer groups, sales channels and other aspects, and it is difficult for new entrants to compete with them.

From the discussion above, the threat of new entrants of “prestige “beauty industry tends to be “weak”.

2.2 Bargaining Power of Suppliers

The direct suppliers of beauty industry includes manufacturers of packaging components, suppliers of raw material ingredients and third-party manufacturers. The indirect suppliers of this industry includes transportation, energy, print, visual merchandising, counter construction and other service providers.

2.2.1 Concentration

Different suppliers have different concentration. Compared with the manufacturers of packaging components, the “prestige beauty” industry has only several big companies so the concentration of supplier is low. But for the suppliers of raw material and some high quality services, there are only a few big companies and they monopolize the market. So their concentration is low and the bargaining power is strong.

2.2.2 Customer Switching Costs

In this industry, the suppliers don’t offer a differentiated product. In fact all the beauty industry use similar basic materials. But the substitutes for supplier products are also little, all the beauty industry rely on several same materials. So compared with the suppliers, the beauty company, especially the “prestige beauty” industry rely more on the materials and the special design and service. So the big beauty industry tend to built good relationship with their suppliers.

In conclusion, the bargaining power of suppliers is “strong”.

2.3 Bargaining Power of Customers

2.3.1 Customer Concentration

There are a lot customers so the concentration is low and their bargaining power is weak.

2.3.2 Differentiated Products

Though there are lots of products and they tend to have similar categories, the industry try to provide really different brand design and patented “star products”. So in the “prestige beauty” industry, the products are different.

2.3.3 Consumer Sensitivity

The consumer of high-end products don't really care about the price because they are purchasing unique experience. So the customer is not sensitive.

In conclusion, the bargaining power of consumer is "weak".

2.4 Threat of Substitutes

There are not a lot substitute about the beauty industry. Compared with cosmetics, maybe there are just some health and beauty care products and the exercising.

2.4.1 Performance/Price Ratio of Substitute

Some health and beauty care products are not cheap and the performance is just like the cosmetics. Exercising is cheap but the effect is not so obvious and it is a long period. People who use the cosmetics usually don't want to exercise hard and they want quick and effective results.

In conclusion, the threat of substitutes is "weak".

2.5 Industry Rivalry

2.5.1 Competition

In beauty industry, the competition of general products is very intense. There are many competitors of roughly equal size and power so they have to compete on price and special design to attract people. Like Estée Lauder and L'ORÉAL, they compete for market share on a global scale. Because the famous luxury beauty brands don't have much difference on product nature, they need to compete intensely and have their own diversity of approaches on market segment.

2.5.2 Industry Growth

The industry grow slowly in America. And in Asian, it will not grow so fast in the future. That makes the competition intense.

In conclusion, the power of industry rivalry is "strong".

2.6 Industry

From the analyse above, for the incumbent companies like Estée Lauder, this industry is a competitive industry with so many competitors in the industry. However, it is also a profitable industry with low bargaining power of the customers. So Estée Lauder need to find their own advantages and keep a right strategy in the competition.

3 Business Analysis

3.1 Value Chain

The value chain describes the entire range of activities required to bring about value from the concept to the different stages of production of the product or service, delivery to the final consumer and final disposal after use (Kaplinsky, R., Morris, M., 2001).

Estée Lauder has its own factories in several countries around the world, such as the United States, Belgium, Switzerland, the United Kingdom, and Canada. It also established a comprehensive third-party manufacturing system. In fiscal 2021, they plan to begin construction of a new production facility near Tokyo. Production facilities distributed in different regions of the world and third-party manufacturing networks can highly reduce Estée Lauder's raw material transportation costs. For now, this also diversifies the risk due to the epidemic, as it ensures that there are still factories that can maintain the raw materials supply and production.

Estée Lauder has a strong business continuity strategy, sophisticated capacity planning tools and multiple sourcing solutions. Estée Lauder has sufficient supply resources, and their supplier portfolio has the resources and facilities to overcome most unexpected supply interruptions.

For operations, Estée Lauder Companies have simplified their production processes to improve efficiency, ensure adequate supply and reduce costs. Their factories are modern, and their production processes are largely automated.

Estée Lauder has high efficiency in outbound logistics. Estée Lauder's facilities, located in different regions of the world, allow them to better meet the demand of each region, increase speed to the local market and effectively reduce distribution costs. Estée Lauder have established a worldwide distribution network of flexible logistics providers and regional and local distribution centers around the world, including those operated by third parties, to promote the efficient delivery of their products to customers.

Estée Lauder owns various well-known brands and designs different advertising plans according to each brand's style, target customers, and main production region. This sort of targeted advertising strategy for different types of users allows Estée Lauder to attract potential customers and develop loyalty more efficiently. They have taken a "high-touch" approach to provide consumers with a unique and truly personalized experience through product expertise and technology, which includes personal consultations with beauty consultants in person or online. Furthermore, Estée Lauder has a diversified, large-scale and mature online and offline distribution channel.

3.2 SWOT

SWOT is actually an acronym that stands for Strengths, Weaknesses, Opportunities and Threats. It is a common framework used in business. It is used to analyse the competitive position affecting a company in the marketplace (Rizzo, A., Kim, G. A., 2005).

Estée Lauder has a large number of brand-loyal customers by years of its sales and advertising. It has also invested a lot of research and development funds, which makes Estée Lauder have many star products that other companies do not have. In addition, the

global distribution of facilities and sales channels is also an important strength of Estée Lauder.

However, compared with similar competitors in the industry, Estee Lauder's stores are mostly located in the big cities where the economy is more developed. The market share is not very high. The excessively concentrated distribution of stores makes Estée Lauder's sales risky. For illustration, in 2022, Shanghai imposed strict controls due to the epidemic, which led to a huge impact on Estée Lauder's sales in China. Most customers would not choose to purchase Estee Lauder's products because of their high price. These are two weaknesses of Estée Lauder.

Estée Lauder had a high sales growth rate in Asia/Pacific region in recent years. With the increase in Internet commerce, many traditional sales methods will change significantly. The development of e-commerce will provide many new sales platforms. These two elements represent critical opportunities for Estée Lauder to increase its market share.

Estée Lauder's threats are mainly from other industry competitors. Such as L'Oréal, P&G, and Unilever. They also have a clear brand positioning and a huge loyal customer base. The market is saturated, and the competition will be fiercer. Estee Lauder's makeup sales have been declining for several years.

3.3 Differentiation Strategy

Estée Lauder has primarily been high-end makeup products and skin care products and occupies a high share of the global high-end makeup and skin care market. Therefore, Estée Lauder mainly focuses on providing unique products and services to enhance its competitive advantage rather than lowering product prices. Estée Lauder's research and development costs for fiscal years 2021, 2020 and 2019 are \$243 million, \$228 million and \$202 million, respectively, according to Estée Lauder's annual report. In the meantime, Estée Lauder has built up a good brand image and brand loyalty through its advertising and sales. The company also gradually acquired a great number of well-known brands with a similar style to Estée Lauder's brand.

4 Financial Analysis

4.1 Profitability

What is profitability? It is the ability of a company to earn profits from its main business. To analyze an Estee Lauder's profitability, you need to calculate its yield, profit margin, etc. Here are the results of our calculations and analysis of Estee Lauder's various metrics (Tulsian, D. M., 2014).

As seen in Table 1, Estee Lauder's profit margin decreases by 7% in 2019–2020, but recovers to 18% in 2021. Estee Lauder's asset turnover is above 0.80 in 2019–2021, indicating that Estee Lauder's asset utilization is very efficient (Yohn, F., 2001). Estee Lauder's capital structure leverage is unchanged in 2019–2021. Estee Lauder's ROCE is 37% in 2019, but only 14% in 2020. And the ROCE has risen to 60% in 2021. However, the ROCE is higher than 10% for all 3 years. This indicates that Estee Lauder is doing better.

Table 1. ROCE

ROCE		2021	2020	2019
profit margin for ROCE	net income to commen/sales	18%	5%	12%
× assets turnover	sales/average total assets	0.92	0.81	0.84
× capital structure leverage	average total assets/ (average commen equity -noncontrolling interests)	3.68	3.68	3.68
= ROCE	net income to commen/ average commen equity	60%	14%	37%

Table 2. Net days of working capital financing needs

net days of woking capital financing needed		2021	2020	2019
accounts receivable turnover	sales/average accounts receivable	10.3	9.1	9.4
inventory turnover	cost of goods sold/average inventories	1.7	1.6	1.5
accounts payable turnover	purchase/average accounts payable	3.4	3.5	2.1
days accounts receivable outsdanding		35.5	40.2	38.7
days inventory held		208.6	225.1	236.1
days accounts payable outsdanding		107.0	105.6	177.6
net days of working capital financing needed		137.1	159.8	97.3

4.2 Liquidity

Liquidity is used to reflect the efficiency of an enterprise's use of capital. From a narrow perspective, the liquidity of a firm's assets refers to the ability to realize and service its debts without loss of value. Liquidity is the ability of an enterprise to generate cash, which is determined by how many liquid assets can be converted into cash in the near future, while debt service capability reflects the ability of an enterprise to repay its debts in a timely manner as agreed (Amihud, Y., Mendelson, H., Pedersen, L. H., 2006).

As seen in Table 2, Estee Lauder's accounts receivable turnover days are relatively stable at around 35–40 days in 2019–2021. Estee Lauder's inventory held days are also relatively stable at around 200–240 days in 2019–2021. Estee Lauder's accounts payable days change from 2019 to 2021, with accounts payable days in 2019 is 177.6 days and relatively stable at 105.6 days and 107.0 days in 2020 and 2021. Estee Lauder's net working capital days range from a low of 97.3 days in 2019 to a high of 159.8 days in 2020, falling back to 137.1 days in 2021.

Estee Lauder's current ratio is stable and appropriate in the range of 1.5–2.0 for 2019–2021. The quick ratio also remains around 1, but the quick ratio increases year by year from 2019–2021, indicating Estee Lauder's deteriorating short-term solvency (Ulu, S. M., Dogan, M., Ahsen, A. et al., 2013). The lower operating cash flow to current liability ratio in 2020–2021 indicates Estee Lauder's lower solvency and improved profitability.

Table 3. Risk ratio

risk ratio		2021	2020	2019
current ratio	current assets/current liabilities	1.8	1.7	1.6
quick ratio	(cash + short-term investments + accounts receivable)/current liabilities	1.3	1.2	1.0
operating cash flow to current liabilities ratio	cash from operations/average current liabilities	0.436	0.700	-
days accounts receivable outstanding		35.5	40.2	38.7
days inventory held		208.6	225.1	236.1
days accounts payable outstanding		107.0	105.6	177.6
net days of working capital financing needed		137.1	159.8	97.3
liabilities to assets ratio	total liabilities/total assets	0.7	0.8	0.7
interest coverage ratio	(net income + interest expense + income tax expense + net income attributable to noncontrolling interest)/interest expense	20.2	7.4	18.3

Estee Lauder's liabilities to asset ratio fluctuates around 0.7–0.8, which is at a high risk level. Estee Lauder's interest coverage ratio is very high, a positive number greater than one, indicating that the company's funding sources are fully sufficient to service its current debt (Library, W. E., 2006).

Overall, Estee Lauder has a good profit outlook and high asset utilization. Estee Lauder has good economic pride and less risk for investors. Liquidity performance has been relatively stable. However, there is a trend towards increasingly poor short-term solvency in 2019–2021, but it is currently fully sufficient to repay current debt.

5 Discussion

After knowing the key features of Estee Lauder, it is important to discuss some situations that Estee Lauder is facing and what actions it can do.

Before discussing its development direction, it is meaningful to analysis its opportunities and risks. For a company or a group, the length of its history is one of the indicators that can best prove its ability. There is no doubt that Estee Lauder is still a highly influential group in cosmetics market. A 76 years history let it accumulate a lot of resources. One of the important resource is its popularity. Estee Lauder used a lot of time to strengthen its authority and visibility in the cosmetics market. In the eyes of consumers, a company which has longer history is more believable. At the same time, Estee Lauder has its advanced R & D teams in some important locations in the world. They can let its productions keep the leading position. That is why it has a large number of stable and increasing customer sources. However, Estee Lauder also face some risks in this process. First and foremost, its production quality is a key problem needing attention,

such as strong alcohol smell and water emulsion separation of facial cleanser. There were also big problems in marketing. For example, Estee Lauder unilaterally referred to the overall concept of “Youth” by the recovery of the number of skin metabolites. Another one is that “Estee Lauder was fined 400000 yuan by Chinese government” (Sohu, 2021) because of false propaganda.

Based on the upon analysis, Estee Lauder will continue to strengthen its advantages in product development. Its acquisition plans will be executed to expand R & D team and update product categories. The quality inspection standard need to be increase and thoroughly implemented. This part has significant connection with the product experience of consumers. In order to minimize the negative impacts, it will make greater contributions to society to ensure its group image. At the same time, it still needs to have a more thorough understanding of the laws of major countries, especially the laws of China. This will play an important role in Estee Lauder’s consolidation of the Asia Pacific market.

As the financial information of Estee Lauder, its inventory turnover was a bit low. Meanwhile, it has higher capitalization ratio, which means that its capital structure is higher, especially under the background of global economic depression. These problems are the challenges that Estee Lauder has to face in the future. In order to increase the inventory turnover, Estee Lauder need to change product structure and strengthen marketing efforts to let its productions are easily sold. For example, Estee Lauder can increase the sales proportion of middle and low-end products. At the same time, it must keep sufficient profitability to deal with large amount of long-term liabilities, especially before the plan to expand the Asia Pacific market is completed. During this time, it is difficult to reduce the capitalization ratio of group. Enhancing its profitability can also increase the stocks’ price of the group. This can improve the stability of the group’s capital structure to some extent and balance debt asset ratio.

COVID-19 has had a great impact on the world economy. “In 2020, the COVID-19 spread all over the world, which has a general impact on the production and life of all countries and regions” (Dianting, W., 2021). One of the most obvious sign is that the cost of everything increases in varying degrees. Estee Lauder must undertake multiple negative impacts, such as raw material, producing, transportation and other scarce resources. The impact of rising production costs will be transmitted to product prices and weaken the competitive power of productions. It is also difficult to sale products in times of economic downturn. When consumers worry about their life, they seldom have the mind to buy beauty products. Many offline stores are closed to response the epidemic prevention policies. This time can also test the ability of industry practitioners, some peers may suffer huge losses. It is significant for Estee Lauder to through this difficult time. In the item of producing, Estee Lauder has to minimize production costs. For example, it can reduce raw material costs through commercial cooperation. Meanwhile, it is necessary to reserve enough raw materials for future trouble. For human resources, Estee Lauder can cut executive pay appropriately or make appropriate layoffs. There is an important point is that these actions must be finished without disharmony within the group. If the human resource problem is not handled properly, it will cause adverse social impact and difficult legal problems. Based on this point, this kind of actions can be secondary methods. In terms of sale, Estee Lauder need to further expand online sales channels.

In terms of promotion, the strategy can be improved according to the actual situation. For example, it can launch portfolio package to let consumers feel they get benefits. For regular consumers, they need to launch corresponding marketing plan to make sure customer sources maintenance. At the same time, Estee Lauder can also make some substantial contributions to epidemic prevention and control. "Anti-epidemic culture" can have a bonus on its sales. At last, the most important is that all the actions must strictly abide by the regulations on epidemic prevention and control, especially in China.

6 Conclusion

As one of the leaders of the cosmetics industry, Estee Lauder has a mature business model and obvious group advantages. However, it is not enough to deal with other powerful opponents. In some ways, they have many similarities. These similar factors will let Estee Lauder loses its unique competitiveness. Then, it is easy to fall into the price war. The profit margins of all parties will be compressed. It is clear that innovation is the most important factor besides market development. "The American Marketing Association defines a brand as a design, a symbol or a service that distinguishes an enterprise from its competitors" (Siyang, J., 2019). In terms of brand image, the one of Estee Lauder must be unique. It will not only contain the beauty and makeup, but also other cultures, such as public welfare charity, humanistic concern and environmental protection. Especially during the epidemic situation, Estee Lauder must let itself have intimate connections with epidemic prevention and control. These kind of methods are very useful in some countries with strict prevention and control policies. For example, Chinese consumers prefer enterprises that can give back to the society. At the same time, Estee Lauder must dig deeper into its own corporate culture, such as its history and service idea. These innovations can let consumers think that they are not only buying productions or services, but also something deeper without nature of business. This soft power is higher than the hard power of the product to some extent. For productions, functional innovation is indispensable. It needs to enrich product functions while ensuring quality. The innovations also need to be used on product design and use, such as more distinctive outer packaging and more convenient usage. For the business management, it can be more open in management mode, everyone can put forward their own useful suggestions to promote the innovation and reform of the company's operation. As a cosmetology and beauty makeup group, the most important point is keeping up with and leading the time. For now, Estee Lauder is doing this and there is still a lot of room to innovate.

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