

Which Fragrance Houses Will Still Be Standing in 2020?

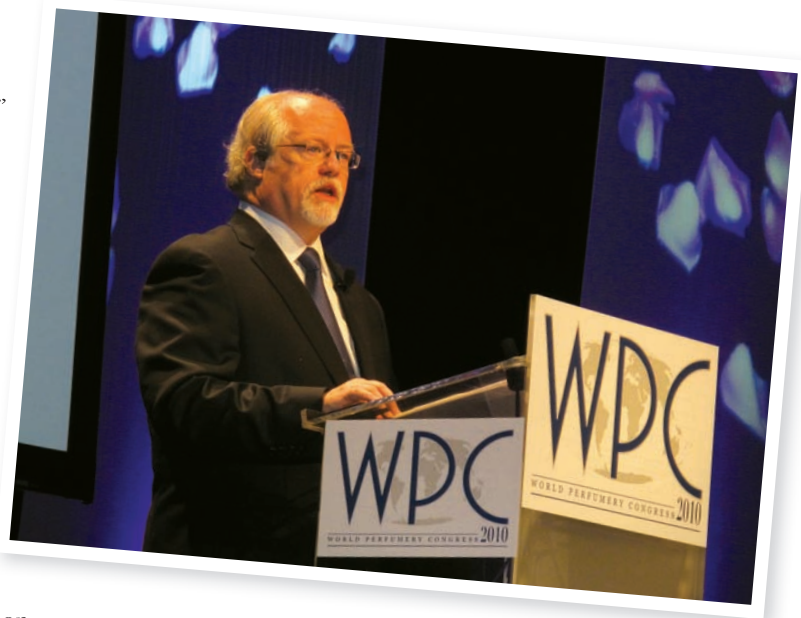
Stephen Hicks on the role of fragrance innovation and industry transparency in survival and success in the 21st century

“We are in control of our own destiny,” said Stephen Hicks, director of research and development, flavor and fragrance global capability, P&G, during a passionate, perhaps unsettling, and forward-looking presentation at the 2010 World Perfumery Congress. “However,” he continued, “we cannot pretend that we can make choices for our industry in the absence of the realities of the world around us. We have to better anticipate the rapidly changing needs of our consumers. We have to fully organize and positively influence the political landscapes in which we compete. We have to recognize what was proprietary and protected yesterday will be neither in tomorrow’s world. We must search for new and bigger sources of innovation to meet the needs of our customers and consumers of the 21st century. We have to face realities no matter how unpleasant they may be, because if we do not we are destined to become little more than victims of the changing world around us. This industry ... must look forward ... and make hard choices to survive and thrive in 2020.”

In mapping out strategies for the fragrance industry to survive and thrive over the next decade, Hicks outlined current challenges that have emerged since his last speech before the Congress in 2001. His conclusion: consumers and nongovernmental organizations (NGOs) have evolved more rapidly than the industry. “Looking back from 2010,” he said, “I today believe we underestimated the consumers of the world and overestimated the degree to which we would bring new olfactory innovation to meet their needs.”

Consumer Power

Of course, the rise of social media—Facebook, Twitter, etc.—wasn’t on Hicks’ radar nine years ago, yet it has rapidly emerged as a force in the world of consumer goods, boosting consumers’ ability to share feedback on products in real time to exponentially growing audiences around the world. “The public credibility of consumer experience shared through social media far exceeds that which manufacturers achieve through advertising,” Hicks said. “A single testimonial or rumor on Facebook about a brand can make it or break it in days through hundreds of



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thousands of online hits.” Effectively, this state of affairs circumvents traditional top-down models in which brands dominated the conversation on products.

While this loss of control can be unnerving for the industry, it does present some opportunities. As a result of complete interconnectedness via social media, said Hicks, “Our consumer is more global than she was [a decade ago]. Granted, her tastes and aspirations are still largely set in the context of the culture in which she was raised, but today she is touched by every other culture in the world. Her interest in experiencing the scent of brands marketed thousands of miles away is sparked through rapid word of mouth on social media.”

In another sign that traditional models have been upended, Hicks noted, “At the special interest sites, consumers are designing the brands and benefits they want. They no longer wait for [consumer goods companies] to think of them. She is designing ideas and sharing them with thousands of others. She wants better brand

experiences and better brand performance unforeseen a decade ago.” Among these benefits are sustainability parameters such as environmental conservancy, social justice and energy conservation.

“Today, the consumer’s voice is much louder, clearer and far more influential than it was in 2001,” said Hicks. “She knows what she wants and she certainly knows what she does not want, and she’s willing to educate millions of her peers on both in social media. She has earned the means to take back control of the products she chooses in her life.”

Fragrance Variety: Better, or Just More?

Even as consumers have become more empowered through technology, Hicks wondered if the fragrances offered to them have notably improved or differentiated. Even as the industry has brought to market hundreds of new fine fragrances each year, he asked, “Has the proliferation of new brand launches brought the consumer the innovation she desires? Or have we just confused her and polluted the equity of individual brands?” In short, are the fragrances of 2010 significantly superior to those of a decade ago, or are they mere variations on the same old themes?

“In the personal care and laundry business we, too, have exploded the market with scent line extensions around the world on many brands,” said Hicks. “This has certainly provided the consumer with many more choices and variety than we gave her a decade ago. But are we giving her vastly better fragrance experiences today or just more of them?”

“There have been profound advances in delivery technologies that enable us to give consumers scent experiences at times and conditions that were nearly impossible 10 years ago. Today, we can give consumers fine fragrancelike top notes that last hours on skin. We can make washed fabrics smell fresh for weeks. We can eliminate malodors in the air and on surfaces with unique technologies that capture or react with the offending molecules. We can make the personal bathing experience

explode with blooming fragrances based on low-odor detection phase chemistry know-how. We provide consumers with detectable scents to overcome acclimation in home air freshening devices and antiperspirants.”

Yet even as technologies improve and expand the ways in which consumers can experience fragrance, Hicks lamented the lack of truly new, differentiating fragrance molecule launches: “When was the last time we [the industry] invented a blockbuster like the musks or the Hediones that completely transformed the industry?”

Transparency, Commoditization and Emerging Markets: Significant Challenges for the Future

Among the unpleasant realities that the fragrance industry must face, said Hicks, are the political and regulatory threats to ingredients and proprietary formulas and the looming threat of commoditization. How the industry responds to these issues will determine which companies remain over the next 10 years.

Here, Hicks presented two possible futures for the industry—one positive, the other disastrous. In the latter scenario, he imagined a time, following successful anti-fragrance campaigns by NGOs, in which California passes legislation requiring the listing of all fragrance ingredients on consumer product labels—fine fragrance, detergents, personal care products, etc. This legislation, the NGOs would argue, provides more and thus better information for consumers in making wise purchases. The industry’s secrecy, after all, will be viewed as a tool for boosting profits to the detriment of human and environmental health and safety. As a result of the new labeling guidelines, manufacturers will likely need to raise prices on products to accommodate larger packages necessitated by the requirements. Meanwhile, NGOs and the public will raise concerns on select “dangerous” ingredients due to concerns over matters such as endocrine disruption. As a result, Hicks can imagine a scenario in which the US Food and Drug Administration

is given oversight of fragranced products under a system similar to Europe's REACH. As a result, fragrance ingredients lacking complete safety dossiers will eventually be removed from the market.

In a more positive future scenario, Hicks posited that consumer product companies and the fragrance industry could work more diligently to publicize adherence to International Fragrance Association (IFRA) safety standards, going so far as to require that all consumer products in the United States be required to meet minimum safety standards. Simultaneously, these industry interests would embark on a multi-year safety and environmental program to assure the public of the safety of all fragrance ingredients. During this process, the industry would "aggressively" remove suspect ingredients. IFRA would then publicize its safety program as a superior alternative to full ingredient disclosure as the latter would merely confuse consumers. As part of this program, the organization would leverage social media to launch a campaign highlighting this commitment to human health and safety and sustainability. Taking this path, Hicks argued, would help the industry win the war of public opinion, sway legislators to an industry-friendly stance and marginalize NGOs.

"We have to be very proactive to manage the public image of our industry," Hicks concluded. "These battles will not be won or lost in the courtroom of NGO opinion. They'll be won and lost in the courtrooms of public opinion. We have to be willing to publicly commit ourselves to new programs and transparency of activity in order to avoid legislation that will expose the intellectual property of formulas. We will not win with the ways of the past."

In another negative future scenario, Hicks warned that REACH could ultimately eliminate several key fragrance ingredients, leading to the loss of fragrance performance and differentiation—particularly as adequate backups for these chemicals may not be available. Meanwhile, prices could climb as a result of regulatory burdens, prices that will ultimately be borne by consumers. At the same time, patents on many key chemicals will expire, giving rise to cheap generics. As a result, profit margins at top houses could fall, leading to a loss of R&D funding—a situation similar to what happened with many major commodity chemicals in the 1990s. The overall outcome is a diminished level of olfactive innovation and higher costs for all. Perfumes, then, lacking excitement or differentiation, could become mere commodities. Those fragrance companies not investing in fragrance innovation, said Hicks, could largely be pushed out of the market by lowering prices. "Those that successfully anticipate this and innovate cost-effective, high-performance, alternative chemistries stand to make a fortune in this decade," Hicks concluded.

Hicks also pointed to the threat of analytical advances that increasingly render fragrance cloning quick, easy and cheap. "Formulas as trade secrets in this industry will not be secret much longer," he said. "Reliance on just a secret formula to protect a given perfume will become weaker and weaker. I believe over the long term the only basis

for profitability in this industry is based on proprietary, patented new aroma chemicals that allow for entirely new levels of product performance and cost efficiency. By 2020, most fragrance companies that are not part of innovation will [lose ground]—that's because they're playing in the same sandbox as everyone else."

Putting further pressure on cost controls and ingredient innovation is the rise of a new middle class in countries such as India, China and Brazil. Hicks noted that consumer product companies will struggle to provide product innovation for these markets, which will inevitably have a lower price point threshold. The relatively high cost of fragrance, Hicks noted, will lead the list of problems. "Most of our fragrances today are designed and costed out for the needs of brands sold in the developed world. Fragrances ranging from \$10/kg to \$100/kg are used for laundry products, fine fragrances and the like in North America, Japan and Europe. Growth in the future is not going to come from these developed markets. It's going to come from an emergence of a new middle class in those countries anxious to buy consumer goods that were never available to them before." However, Hicks noted that these consumers may live in households with annual incomes of just €2,000 a year. The goods sold to these consumers will have to range far below western cost thresholds, and so, he argued, the costs of fragrances must be modified.

"The answer is not selecting cheap existing aroma chemicals and doing the best you can," Hicks warned. "The answer is to innovate with new materials that enable outstanding fragrance experiences at a cost that enables us, the consumer product companies, to be able to affordably sell them to the new emerging middle class. Lots of new technologies need to be invented by this industry to enable that to happen."

Innovation = the Future

Hicks closed his talk by underscoring the benefits proprietary chemicals could have in driving profit growth for fragrance houses by improving biodegradability and sustainability standards, driving uniqueness in sensory experience, and allowing cost innovations that allow a point of entry for a growing consumer base in emerging markets. "We must innovate more," he said. "We must manage our public image and practices much better. We must not let our science become commoditized. Art alone will no longer carry us into this profitable sunset. We must do so much more.

"I'm sometimes asked if consolidation in the industry will continue, who will still be here in 2020, and do small and medium-sized companies have the ability to compete in the future? What I do know is companies that are still here and thriving in 2020 will pay close attention to the headlines of today and will innovate their way to success tomorrow."