Analysis: Trends in Global Diversification

2012 Marcum/Cornell study points to growth opportunities for fragrance manufacturers

Kevin McGann, Marcum LLC; and Emerson Wen and Mingxi Wu, Samuel Johnson School of Business, Cornell University

This year marks the second collaboration between Marcum, a national public accounting and advisory services firm, and the Samuel Curtis Johnson School of Management at Cornell University on a comprehensive survey of the fragrance manufacturing industry in the United States. The results and analysis of the collected data have been presented, in summary, during the 2012 World Perfumery Congress (*wpc.perfumerflavorist.com*). In this, the first of a two-part article, the authors will present the results in greater detail and offer analysis.

This year's survey benefits from both a comparative year-over-year perspective and a higher response rate than the prior year, yielding a more data rich response set. The survey was conducted independently by Emerson Wen and Mingxi Wu, participants in the entrepreneurship program at the Samuel Johnson School of Business. The subsequent analysis is the product of their collaboration with Kevin McGann, a partner at Marcum LLP and its fragrance industry practice leader.

In the 2011 survey, the Marcum survey results were processed into data sets sorted by size of company (by revenue) and rate of growth[a]. For the 2012 survey, the authors preserved these categorizations of companies but overlay them in the context of globalization. This first article will examine trends in global diversification (from where does their revenue come). We seek to answer the following industry-specific questions:

- How does global diversification play into growth?
- What are the challenges for large, medium and small fragrance manufacturers when entering the global markets?

Survey Methodology

The survey followed standard protocols of objectivity and independence to ensure the delivery of clean qualitative research from industry experts. The data discussed in these articles comprises information from 110 respondent companies. This is the net amount of completed surveys remaining after the elimination of bad data or insufficient responses within surveys. For example, participants who took fewer than 15 minutes to complete the survey were eliminated. Those who omitted critical responses such as revenue were likewise eliminated. The number of respondents varied greatly among the subsets of large, medium and small companies. This disparity is proportionate with the actual number of companies in the United States of those revenue categories, extant. For example, as there is a multitude of small companies in the United States, the authors received nearly 70 responses that would fall in that group. Likewise, existing large companies (as defined by the survey) number closer to 10 in the United States—so the six of whom that are present in the analysis make up a quality representative sample.

Size Segmentation Methodology

For the purposes of this series, participating companies with revenue in excess of \$80 million are designated as large, companies of \$79 million to \$11 million are designated as medium, and small companies are those with \$10 million or less in revenue. This year's survey analysis offers benchmarking data from the personnel ranks among these companies, offering average numbers of certain key positions (**F-1**).

Growth Segmentation Methodology

Among the response set, approximately one quarter of companies reported 6% or greater revenue growth over the past three years; this group will hereafter be referred to as high growth. Meanwhile, 75% of the respondents showed less than 6% growth and are therefore referred to in this article as low-growth companies. Neither of these terms is intended to be qualitative and, on the whole, better represent a moment in time along the lifespan of a company. Subsequent articles will examine what companies within those subsets have in common for both high and low growth.

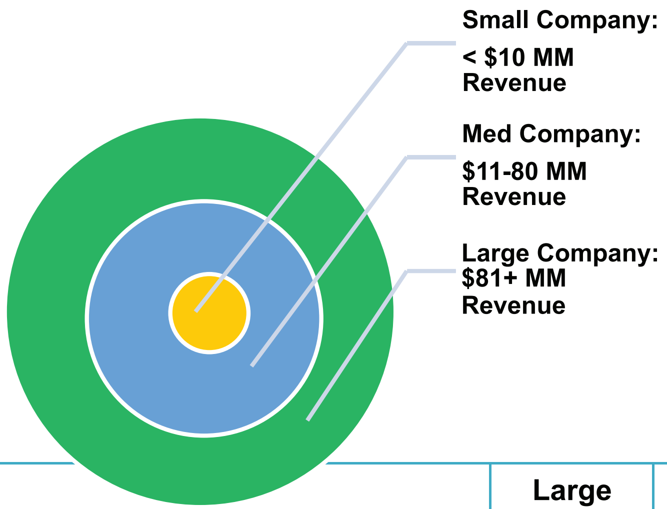
Revenue Generation and the Global Markets

The survey asked respondents, "Please indicate the percentage of your revenue from each of the following regions: North America; South America; Europe; Asia (excluding China); China; India; Other."

Revenue data was collected for 2009, 2010 and 2011 and, as illustrated in **F-2**, the average percentages of distribution vary significantly among the large, medium and small companies. Interestingly, among the geographies, only South America and Europe make up nearly identical percentages of overall revenue. That consistency does not connote stagnation, however, only that each sized company would appear to be addressing those markets in similar fashions.

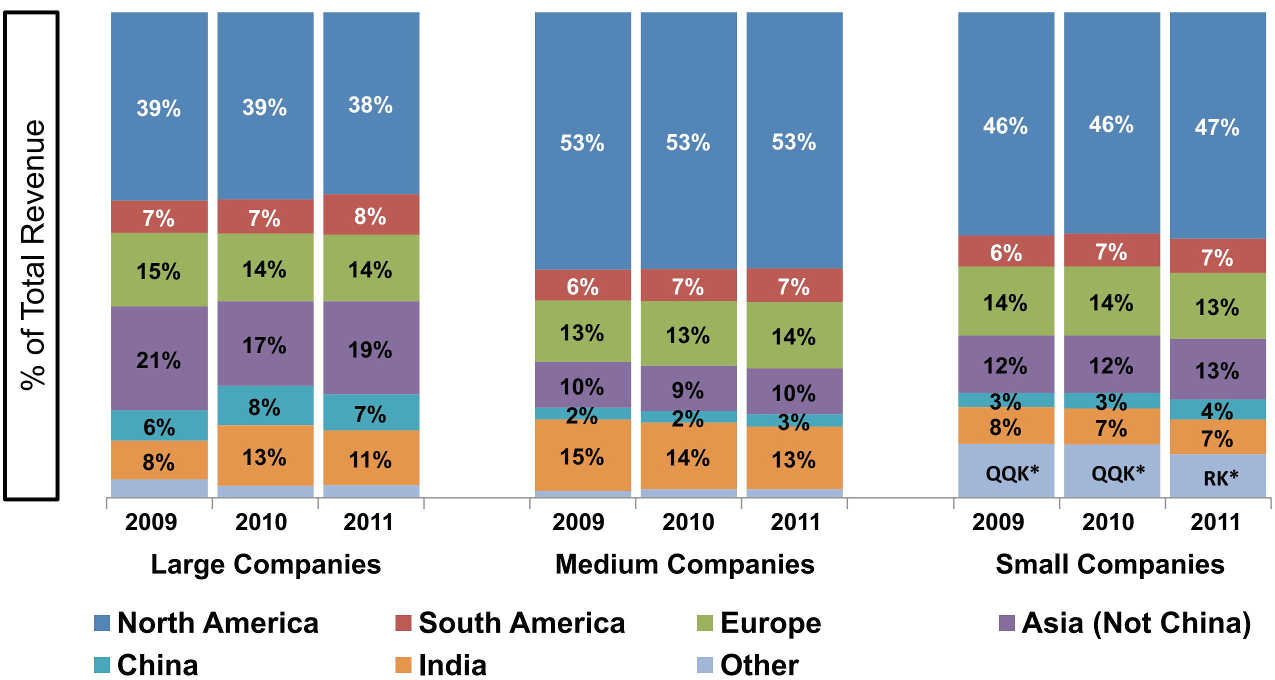
[a] Previously: K McGann, S Chen, EY Wong, L Shufelt and A Burke, Action Items: Keys to Success and Competitive Challenges for Fragrance Manufacturers of All Sizes, *Perfum Flavor* 37(1), p 42 (2012); K McGann, S Chen, EY Wong, L Shufelt and A Burke, Overachievers and Underachievers: What it Takes to Beat the Industry Average, *Perfum Flavor* 36(10), p 58

F-1. Size segmentation methodology

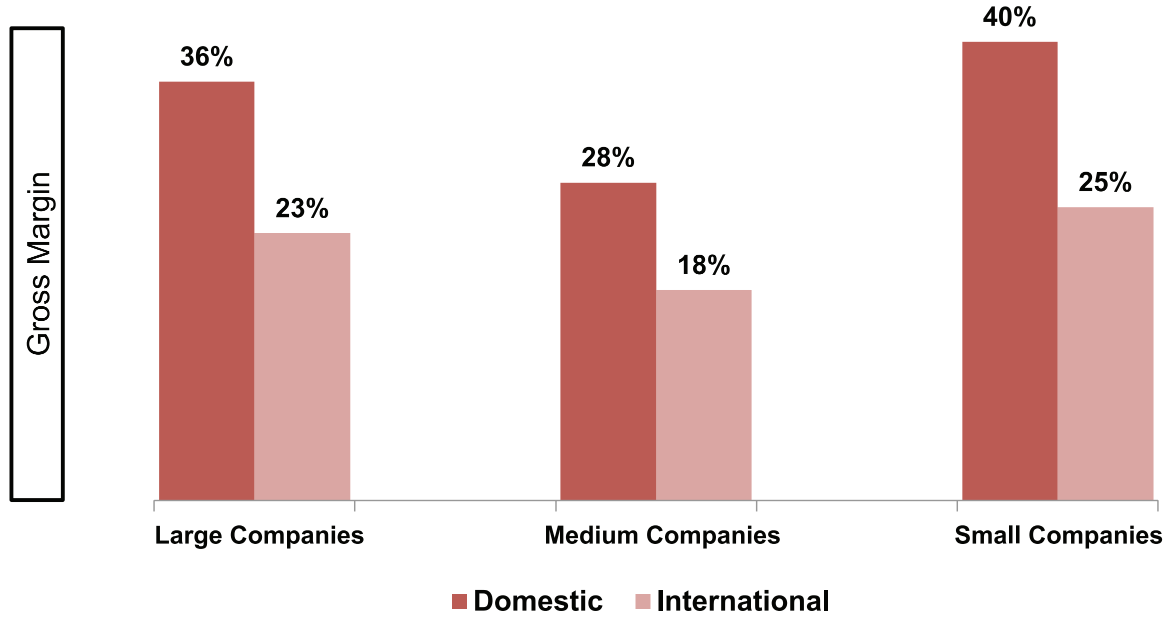


	Large	Medium	Small
Amount of Revenue Coming from Compounded Fragrance	$81MM+	$11-80MM	<$10MM
Average # of Employees in Fragrance Division	225	132	10
Average # of Outside Sales People	51	18	4
Average # of Inside Sales People	30	11	4
Average # of Senior Perfumers on Staff	6	2	1
Average # of Total Perfumers on Staff	19	6	3

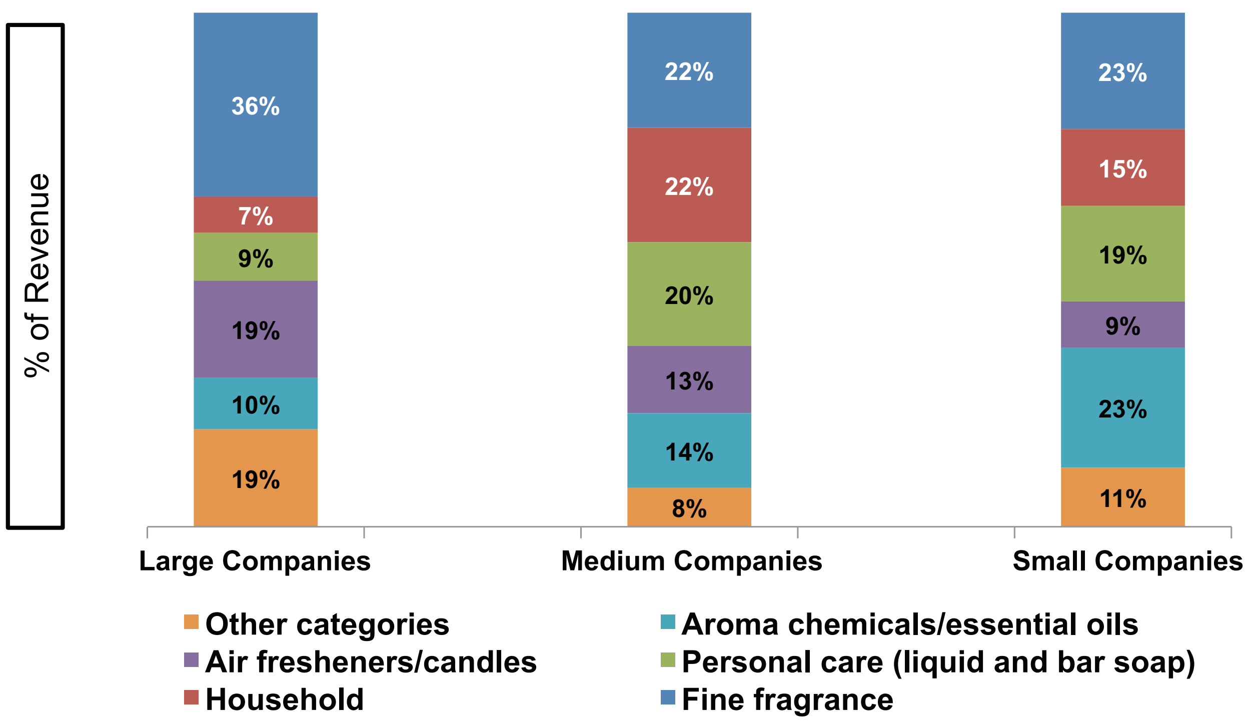
F-2. Companies surveyed continue to derive most sales from the North America region, irrespective of size



F-3. Domestic margins are higher than international margins



F-4. Distribution of sales by product type differs among large, medium and small companies



As would be expected, the large companies have the furthest reach globally when it comes to their revenue with meaningful access to every marketplace. Worth noting is the three-year stability in the Americas, Europe and Asia and the proportionally significant growth in India. From 2009 to 2010, India-originated revenue increased by more than 50% among these companies; 2011 shows a slight contraction, but the three years, overall, still show nearly 30% growth in proportionate revenue.

There would appear to be a global continuum among the different-sized companies. Almost counterintuitively, there is no gradual decline in international diversification as companies get smaller. It is in the center of this continuum, among the medium-sized companies (between $11 million and $80 million in revenue), where the greatest percentage of domestic revenue is based (53%). One could deduce that when a company is large enough to market internationally, or small and niche enough to target specific markets, greater global diversity abounds. The scale of the medium-sized companies provides enough critical mass to market well in the United States, but neither enough resources to reach into other regions nor the luxury of hyper focusing in geographic niches. Those challenges likely represent one of the factors behind the trend toward the consolidation of medium-sized companies in the industry.

Barriers to Expansion

When the respondents were asked, "What are the key barriers to international expansion?" the overwhelming majority (47%) responded with "regulations." This contrasts with 22% who noted "culture," and 10% each for "relationships," "cost" and "logistics." Companies considering expanding abroad, or merging or selling into a larger firm to increase their reach, should allocate resources accordingly. These companies may be better off, or worse, than they think. Additionally, the industry and its trade groups may want to consider expanded coordinated action to mitigate this obvious impediment to global growth.

As exciting and profitable as it may seem to reach new markets in new geographies, a set of responses to the survey question about gross margins suggests, at a minimum, something to consider (**F-3**). Across all three size groups, domestic gross margins are meaningfully higher than international gross margins—to the tune of about 160% higher in the States. This notwithstanding, the niche products offered among small companies present the highest margins among the three size categories, both domestically and internationally. The medium-size firms find themselves stretched in between the two business models, the small niche players and the large companies with vast resources. The smaller companies are nimble enough to penetrate opportunities that the medium-size companies need to pass up due to their costly infrastructure. At the same time the medium companies need to sacrifice margins when competing against the large companies "just to get in the door." Also, as highlighted in **F-4**, the product mix among the three different company sizes contributes to reduced margins by medium-size firms.

It is worth exploring how differently sized companies create their product mixes and diversify their product offerings. Large companies derive the majority of their revenue from fine fragrance, followed by air fresheners, candles and products from other categories (other than household, personal care, aroma chemicals/essential oils). Medium companies tend to diversify their product marketing more evenly across product categories with the top three concentrations in fine fragrance, household and personal care categories. Small companies focus on earning revenues from aroma chemicals and essential oils, fine fragrance and personal care categories. While all company sizes earn similar ratios of domestic margins vs. international margins (**F-3**), small companies are able to earn significant margins by utilizing a different portfolio diversification strategy.

Conclusion

Whether it is in pursuit of new markets, expanding market share or simply generating more profit, the global marketplace is a complex and nuanced arena for the fragrance industry. For the largest and smallest of companies, opportunities seem to abound. For the middle tier, there are serious questions whose answers will change the course of companies' futures and those of its leadership.

The next article in this series will shift focus and compare how large companies and small companies stack up on the subjects of growth philosophies, costs, labor and overhead, and other vital factors to success. These companies will be placed in a larger context of growth across the industry as well as the context of current events.

Address correspondence to Kevin McGann; kevin.mcgann@marcumllp.com.