MSME DI

Leveraging the strengths of SMEs in Mumbai to take on the world

Opportunities for Cosmetics Cluster Mumbai west

A Concept paper

By

AIRA Consulting Private Limited

B- 405, Twin Arcade, Military Road

Marol, Mumbai – 400 059

July 2008

Contents

Acknowledgements

AIRA Consulting would like to express its grateful thanks to Mr. K. R. Sharma, Director MSME – DI Mumbai for his support and guidance, Mr. S. Vijay Kumar, Dy. Director MSME-DI, Mr. G.D. Ambhore, erstwhile Director MSME – DI for their encouragement and Mr.Sanatan Sahoo Asst.Director MSME DI, for the opportunity to work as a BDS provider for the cosmetics cluster development in Mumbai. We are thankful for his guidance and efforts in coordinating and leading the cluster member companies in coming together to articulate their vision.

We wish to express our thanks to the office bearers of AISSCMA, particularly Dr. Jain and Ms. Kajal Anand, for their candid discussion of issues and support for this research

We would also like to express our thanks to all cluster companies who provided their valuable time and cooperation in helping us develop this concept paper.

We sincerely hope that this effort of developing the concept paper will help provide a lead in realizing the immense potential that the herbal and aroma cosmetics segment has in this country.

1. Executive summary

The cluster development approach formalized and led by the Government of India has spurred growth of the SME sector.

MSME DI is charged with the objective of acting as a catalyst in the SME cluster development process.

In Mumbai, MSME DI is working actively on cosmetics as a category for cluster development.

Herbal and aroma cosmetics represent a phenomenal opportunity where the technical and product skills of SMEs can be strong leverages.

Sales, distribution, marketing and organization setup have been recognized as major challenges for SMEs not being able to fully leverage the opportunities.

A consortium approach to forming a company owning a brand under which a range of herbal, aroma products can be launched is recognized as the best approach to overcome current shortcomings.

The process of company formation, product range selection, brand creation, organization creation, talent development, sourcing, sales & distribution will require commitment from consortium participants. The commitment will be both in terms building common trust as well as financial.

This approach paper developed at the request of MSME – DI and AISSCMA provides a road map on organization building to leverage the opportunity that the product segments have in the country.

AIRA Consulting as a BDS provider with specialized capabilities in brand building, organization development, market development, sales and distribution coverage can partner with MSME DI and consortium participants in realizing their ambitions.

2. Background

Cluster development approach

The Indian government has identified and adopted the "Cluster development" approach for building, nurturing and growing small and medium businesses. The successes of early clusters like Tirupur for hosiery, Ludhiana for woolens and Bangalore for IT services has paved the way for adoption of this approach.

The government under the ministry of small scale industries has started a range of activities under the aegis of several developmental bodies. Primary among these is the MSME DI.

MSME DI is mandated with identifying and nurturing clusters under its jurisdiction.

In Maharashtra MSME DI is working on several clusters.

Within Mumbai MSME DI is working actively on Bulk drugs, Toys and Cosmetics.

Mumbai Cosmetics cluster

With growing affluence and change in consumer habits the usage of cosmetics has grown at a fast clip. This offers tremendous opportunity for growth of SMEs in cosmetic products. Cosmetics cluster therefore signifies a major opportunity for MSME DI in their developmental agenda.

Initial diagnostic studies conducted by MSME DI about the Mumbai cosmetics cluster have put forth the following data:

Type of cosmetics	Herbal, Aroma, Skin, Hair and Color
Number of units	90
Estimated turnover	175 crores
Number of employees	1500 direct, 5000 indirect

MSME DI is facilitating development of the cosmetics cluster through focus on hard and soft interventions.
In soft intervention MSME DI has conducted several training and orientation programs on management skills for entrepreneurs and their employees. In hard intervention MSME DI is working, among others, on creating centralized testing facility for quality control.

As a developmental agency MSME DI also facilitates engagement of BDS providers for specific competencies for cluster development objectives.

AIRA Consulting is associated with MSME DI and the participating cluster companies as a BDS provider.

During meetings between MSME DI, cluster companies and AIRA Consulting the following key issues have been identified.

Marketing:

- Lack of marketing inputs for cluster companies
- Weak branding and therefore less support from retail to stock and sell

Distribution:

- Scant distribution in retail
- Over dependence on institutional buyers
- Low price realization and thereby low profits

Organization

- No second line in management to support the entrepreneur
- No systems to run the business, over dependence on owner on day to day basis

Further during the meetings, it has been decided that MSME DI, cluster companies and AIRA will work jointly to create and implement a strategy to foster growth of the Mumbai cosmetics cluster.

3. Objective

During the meetings between MSME DI, cluster companies and AIRA Consulting the following broad objectives have been identified and agreed to for the cluster:

- To develop a common brand(s) for cluster participant companies
- To develop a common marketing strategy for the brand(s)
- To develop a common distribution strategy for the brand(s)
- To develop a common set of business processes based on best practice sharing
- To develop a common raw material purchase process
- To develop a common talent sourcing and competence development process
- To develop a common testing process for quality control
- To develop a common financing process for the cluster companies

Within these broad areas, testing facility is under hard intervention and will be assisted by MSME DI. All other areas are under soft intervention and MSME DI will play primarily a facilitator role.

4. AIRA mandate for concept paper

AIRA Consulting is a go- to-market consulting company focused on assisting SMEs on business strategy, product and brand strategy, organization building and sales and distribution strategy. AIRA Consulting is not just a 'research and advice' company but works with the client in the implementation stage. AIRA Consulting therefore can play an active role in helping the cluster achieve several of the above enumerated objectives.

Some of the objectives where AIRA can play a significant role are:

- Developing brand, marketing strategy
- Developing distribution strategy
- Developing business processes and best practices
- Developing talent and competence management
- Hand holding on Implementation

As part of the discussions AIRA Consulting has been mandated to evolve a concept paper on "Cosmetic cluster development".

The scope of the concept paper is defined to present specific recommendations on "An action plan to implement the above objectives of the cosmetic cluster".

5. Methodology

As a precursor to the development of the concept paper AIRA Consulting has conducted several research and information collection exercises.

Some the research methodologies used are:

Detailed analysis of cluster companies.

AIRA has chosen a representative set of cluster companies and studied the internal operations of these companies.

The study includes:

Organization structure and key manpower

Product range and manufacturing practices

Supply chain and inventory

Marketing practices

This study has been done using one-on-one meetings with company proprietor and key officials.

Structured questionnaire

AIRA has used its proprietary structured questionnaire to capture the cluster company's perspective on the cosmetic market.

The questionnaire captures among other areas, the vision and ambition of the cluster company.

Market study

AIRA has invested considerable consultant time to conduct on ground retail market study covering all customer segments.

The focus of the market study has been:
Competitive scenario tracking

Sales and distribution

Distribution practices

Marketing inputs

Brand strengths and retail perception

Secondary research

AIRA has also conducted extensive secondary research and data through various published sources to help in cluster approaches and challenges, experience of cluster across the world, cosmetics market assessment and brand positioning assessment.

6. Research findings

Market structure

Product segments and key brands

The herbal cosmetics market is divided into two broad usage segments:

- Treatment products and
- Ready-to-use products

Treatment Products:

Treatment products are by definition used mainly by beauty parlors and trained beauticians. This is because, the usage of these products requires considerable knowledge of correct product selection based on customer's needs and also skill of application. Sometimes these products are also used by evolved individual customers but such volumes are much lesser in numbers.

Examples of treatment products are:

Facials

Massage creams

Face packs

Scrubs

Cold and hot waxes

Ready-to-use products are used directly by customers. These do not need any special knowledge of application or technique. These products are purchased based on customer's regular requirements.

Examples of ready to use products are:

Fairness cream

Shampoos

Face wash

Cleansing lotions

Mehandi Powder

Channel structure

Most players employ a combination of wholesale and retail distribution.

In wholesale, we have large outlets focused on beauty products like Beauty Center who cater to beauty parlors and beauticians.

In retail we have a range of store types from special cosmetic stores to novelty stores, departmental stores, chemists and also kirana stores. We also have large format modern stores like Shopper's stop and other malls with special beauty counters.

Promotional practices

While all players offer margins and discounts to both distributors, wholesalers and retailers, they also employ special promotional methods like setting up dedicated brand counters with inshop advisors who can offer professional help to customers while facilitating sales.

Marketing practices

Most players advertise in print media, focused on beauty parlor and beautician segment. Some large players like Ayur and Biotique also advertise in print media targeted directly to end consumers.

Advertising on TV or OOH is not prominent in the herbal cosmetic market.

Organization SWOT analysis

AIRA Consulting studied several cluster participant organizations as part of the research. Most organizations are small with owners playing a key role in managing all functions of the company.

The turnover ranges from Rs 50 lacs to Rs 4 crores.

The characteristics of the organizations and their functioning show up in the following SWOT analysis:

Strengths:

- Intense participation and dedication of owners

All entrepreneurs are hands-on on all operations of the business from production to finance to organization to sales and marketing. Most entrepreneurs are also personally involved in the retail sales end of the business so much so that the retailer has direct access to the entrepreneur. This affords faster exchange of information and response to opportunities.

- Technical knowledge derived from past experience

Most of the entrepreneurs have a technical background coupled with work experience in well established organizations in technical roles. This gives them a unique opportunity to create new products. Further this helps them to maintain high standards of quality in their products

- Specialty products and quality

The cluster companies have focused on niche products that can be manufactured using special skills that the entrepreneurs possess and ingredients. Further the specialty products can be manufactured in small batches in line with the capacity of cluster companies.

- Flexible manufacturing with capability to produce small batches

The product focus and skills of the cluster companies afford them to scale manufacturing capabilities to available. In case of higher demand for a given products the cluster companies can expand production while in case of lesser demand they can divert production to other products ensuring high capacity utilization.

- Personal knowledge of key customers

The entrepreneurs are personally involved in the sales activity and are hence close to the market. This provides instant access to market information without getting lost in layers of organization. Further they are able to respond to customer requirements quickly due to knowledge of customer.

- CMU arrangements

Most of the entrepreneurs have CMU arrangements with institutions and also with other cosmetic companies that helps them offload a sizeable portion of the production and make business proposition more viable.

Weaknesses

- Owner responsible for all decisions-no delegation

Cluster companies are closely managed by the entrepreneurs with minimal or no organization. This leaves little scope for scaling the operations. Since the entrepreneur is involved in all aspects of operation, quite often decision making becomes a bottle neck.

- No effective second line of management

Cluster companies have not attracted talent from outside since professional do not find work atmosphere challenging for their competence. This is because the entrepreneurs are less willing to cede control of operations to professionals.

- Overdependence on few wholesale outlets catering to beauticians and parlor segment

In the absence brand building activities, the cluster companies are solely dependent on the large specialized outlet to sell their products. Further since these outlets preferentially deal with beauty parlors and beauty professionals, the terms of business are against the entrepreneurs.

Dependence on few wholesalers and retailers has led to competition between the cluster companies and price has been the only tool to combat it. This pushes entrepreneurs to compromise in the quality in order to sustain costs. Over the time the inconsistency in the quality damages the image of the product and pushes it to a price brand.

- Weak presence in ready to use range

Compared to ready-to-use range, the treatment products have limited market opportunity. The cluster companies are focused more on the treatment products and hence are limited in their potential.

- Low penetration in retail market like cosmetic, novelty and general stores

Little effort has gone into sales and distribution activity. Hence the cluster companies have limited market presence. This is a serious impediment to growth. Further since most cluster companies fight for the same shelf space, the channel dominates the terms of business rather than other way round

- Insignificant efforts on brand building

At the most brand building activities are restricted to sporadic advertising in trade magazines. There is no clear thinking on labeling, brand name choice, brand building creation, engagement of consumer and customer development initiatives. Consequently, the customer relies on the channel member's recommendation for the choice of a product. This while obliquely build a brand over a long time it is unsustainable as the channel will recommend products that are favorable to them.

- Low margins as channel takes up high discounts

From the above points it is clear that the channel member - cluster company relationship is tilted against the company. This provides tremendous bargaining power to the channel member who demands advantageous terms to stock and recommend cluster companies' products. Consequently while the products have high consumer end pricing which is a reflection of consumer perception of product quality, the channel member profits far more than the manufacturer by virtue of his recommendation power.

- Financially stretched especially on working capital

In a channel based business the collection of outstanding from the channel member is a critical component of working capital management. It is common knowledge that more SMEs go bankrupt because of failure to manage working capital than due to capital costs are any other reasons. Debtor control, inventory management and bad debt control are critical components of working capital management. Given the cluster companies' dependence on the channel members for their sales, the cluster companies have negatively skewed inventory and debtor list. In medium to long term this is a serious symptom and has the potential to adversely affect the cluster companies.

- Consumer awareness low

The direct communication with the end consumer is almost nil. Some feeble attempts of BTL advertising are made but they leave a lot to be desired both from the content and delivery point. This puts the burden (and opportunity) of brand building on the channel member.

<u>Opportunities</u>

- Growing knowledge of herbal treatments and acceptance by consumers

It is commonplace today to use traditional treatment products both as 'therapy' and as adjuvant among beauty professionals. Increasingly beauty professionals are updating their knowledge on traditional therapies and actively recommend to their customers. The obvious advantage is minimal adverse reaction of the body to such products. Beauty professionals confirm that their consumers report higher satisfaction from natural products and consequently enhance their pricing opportunity for such services. The cluster companies bring in many years of experience in these traditional products and are in a good position to enhance their presence.

- Growing usage of herbal ready to use products

The Indian consumer has come a full circle in her/his quest for beauty products that work. Traditional products went out of her/his favor with the onslaught of MNCs with synthetic combinations, product claims endorsed by celebrities, high decibel advertising and trade power. Increasingly, the Indian consumer is turning towards products that contain traditional ingredients containing Indian herbs. In fact it is fashionable to flaunt 'herbal' in product packs to denote purity and safety. Cluster companies are almost totally focused on herbal and natural products. This is an opportunity waiting to be tapped.

- Increasing affluence and spending by middleclass

Interestingly most consumers attribute herbal and traditional products to 'high price'. They believe acquisition, purification, extraction and manufacturing of herbal products is a higher order capability and are willing to spend more for such products. On the other side, the need to look beautiful and willingness to spend on it is becoming increasingly acceptable. The growing disposable income of the middleclass that is 300 million strong in India is a huge opportunity.

- Willingness of retail to sell herbal products

In response to the consumer demand, the retailers have also increasingly willing to stock herbal and traditional products. As an illustration, It is commonplace to find 'mehendi' or'multani mitti' in grocery outlets. Retailers believe that the distinct bend of the Indian consumer towards herbal and traditional products is a business opportunity and have shed their inhibition of stocking low consumer awareness brand.

- Vast distribution network for cosmetics products

Our market research shows there is a vast distribution network for cosmetic products. While traditional outlets are cosmetic outlets and novelty stores, increasingly, chemists and groceries have hiked their stocking cosmetics. Further Modern trade is a huge opportunity for high value, high margin herbal cosmetic products.

- High margin opportunity especially in ready to use products

Given the consumer perception of 'high value', there is a pricing opportunity in the herbal products. Consumers intuitively believe that herbal product for the same application is expected to be 'higher priced' than synthetic products. This is an important leverage in pricing and branding exercise for cluster companies.

Threats

- Well entrenched existing players

Large cosmetic companies are well concentrated and entrenched in the herbal markets. Brands like Ayur or Himalaya have strong quality associations through their branding activities and retail presence. To make a headway in this market is to take them head on. Strategies need to be designed to account for this threat and flank them.

- Entry of MNCs into herbal and Aroma segments

Large Cosmetic MNCs are eyeing this market. While this increases the overall decibel level in favour of herbal products, their marketing muscle is a cause of threat. Their deep pockets to sustain consumer engagement and widespread distribution are serious threats to cluster companies' efforts to create a market for themselves.

- Bargaining power of large wholesale outlets

Since the cluster companies are almost totally focused on large outlets, they have willy nilly handed over their bargaining power to these outlets. With increasing competition within and outside the cluster companies, the wholesaler with direct access to consumer and recommendation power enjoys serious clout to dictate commercial terms.

Based on the SWOT analysis we have identified the following high level gaps:

- Branding and marketing

Creating a brand that is recognized as a ‘quality’ and ‘world class’ by consumers. Quite often products from small companies tend to suffer from a negative image despite their quality. Branding and marketing exercise is aimed at neutralizing this initial consumer apprehension and create a positive image for the cluster brand.

- Width of distribution and range selling

To enhance the brand visibility there is a need to rethink sales and distribution strategy and on ground implementation. This is also to ensure that the cluster company has a pricing power commensurate with its brand power and not dictated by trade.

- Talent and competence

To create a lasting organization that is motivated and empowered to work in line with the overall vision of the cluster companies. This would require acquiring and nurturing top talent and providing them with the environment where their creativity is unleashed and potential realized to achieve the cluster objective of 300% growth in three years.

- Business processes
  Any organization that has desires to scale must operate on the basis of sound processes and not individual premises. An organization that has clear cut laid down processes in areas of authority, accountability and relationships is a must for sustained growth. An interwoven organization of top talent and sound process is recipe for success.

7. Opportunity

The research and analysis clearly indicates that although the cluster participant companies may be disadvantaged in several ways, but there exists tremendous market opportunity in herbal and aroma segments which the companies can leverage.

While the focus on treatment products channelized through beauticians and parlors will continue to provide bulk business the true opportunity lies in building a product portfolio and brands in the ready to use segment.

Our study indicates the following areas where gaps exist in the current market and can be effectively filled by the cluster companies.

Some of these product segments are :

Shampoos
Value added oils
Face wash
Moisturizing lotions/creams
Bleach creams
Under eye creams
Fairness creams
Cleansing lotions
Rose water
Scrubs
Sunscreens
Facial packs
Mehendi

The above shortlisted products represent a market opportunity of over Rs hundred crores in the western states of Maharashtra, Gujarat and MP, CG.

Over time as the brand builds strength and volume we can consider rollout into other states as well.

8. Approaches to leverage opportunity

We have considered two primary approaches to leverage the opportunity in the herbal cosmetics market and with the above shortlisted product range.

Broadly these two approaches are as follows :

Approach 1

Form a consortium of cluster companies into a separate legal entity which will own the brand under which the product range will be launched.
The manufacture of the products can be from the participating consortium companies and the brand company can source the products based on transfer pricing.
The consortium companies will have to participate in the share capital of the brand holding company, and also contribute towards the organization setup and marketing costs.

The brand company will perform all activities of sales and marketing, except production which will be sourced from the consortium companies.

The brand company can be led by one of the consortium company heads or ideally by an external CEO.

Approach 2

Form a consortium of cluster companies into a legal entity which is a distribution company.

The brand ownership remains with the participating cluster companies. The distribution company only handles the sales and distribution of the products in the shortlisted range.

9. Recommendations

Of the two approaches discussed in point 8 above, we recommend that the consortium adopt approach 1, i.e. form a separate legal entity, a private limited company which will own the brand under which the product range will be launched.

The participating cluster companies in the consortium can then act as CMUs(contract manufacturing units) to the brand owning company.

Details of the recommendations are given below.

a. <u>Product, brand, marketing, geography</u>

The market opportunity suggests that of the above mentioned product range we initially target to launch the following products :

Facial packs
Fairness creams
Scrubs
Moisturizing lotions
Bleach creams
Mehendi
Rose water

The key USP will be about the quality, range and purity of ingredients.

We also recommend that the entire range be launched under a common umbrella brand name, which connotes the purity, quality context.

We also recommend that the product range be initially launched only in western India and in key towns above 4 lacs population, which will have a significant clientele for herbal cosmetics.

The target consumer is the middle class, age 18 to 40.

We recommend BTL activities with emphasis on promoters ensuring direct contact with consumers at retail outlets. This will build word of mouth awareness for the brand.

b. Distribution and channels

We recommend having superstockists in major cities who in turn will distribute stocks to sub stockists under their reach and also feed local retail market.

This will reduce number of direct contact points for the company, as also ensure lower working capital requirements.

c. Organization setup

Of the two approaches detailed earlier we recommend that approach 1 of forming a brand holding company is formed.

10. Impact of recommendations

The implementation of the above recommendations will have the following imperatives.

Legal and statutory

The participating group of cluster companies or the consortium will need to form a separate company, a private limited company under incorporated under Section

The company will need to comply with all necessary statutory and legal requirements.

Financial

The new company will need to have share capital contributed by each of the participating cluster consortium companies. The exact contribution can be arrived at after appropriate discussions.

Further the new company will need to allocate financial resources towards two major cost heads.

1 Organization: including recruitment of personnel for sales, marketing and for training.

2 Marketing: including brand building activity starting from brand name development, packaging design, brand communication, point of sale activities, media and inshop promotions.

The participating consortium companies will need to contribute towards the financial requirements of the new company.

11. Projected results

<u>Top lines:</u>

Revenue targeted to grow from Rs 2.85 cr in year 1 to Rs 13.56 cr in year 2
Cost commitment of Rs 2 cr in year 1 to Rs 6 cr in year 2
Distribution spread of 3800 outlets in year 1 to grow to 8000 outlets in year 2
The cost commitment is excluding product and production costs.

The net profit before tax is projected at Rs 25 lacs loss in year 1 and at Rs 2 cr profit in year 2

Overall, in addition to the revenue and distribution the key success will be the creation of a strong brand owned by the consortium companies.

The brand can then be used to leverage launch of additional products in the herbal and aroma categories.

12. Role of participating companies

The role of the consortium participant companies can be summarized under the following heads:

Firm commitment to the cause of building a brand in the herbal and aroma segment
Financial commitment towards organization creation and brand building
Acting as CMUs towards the production requirements of the products launched under the brand