



By: Amit Sachdeva, Anurag Dayal and Rajesh Kumar

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SPOTLIGHT

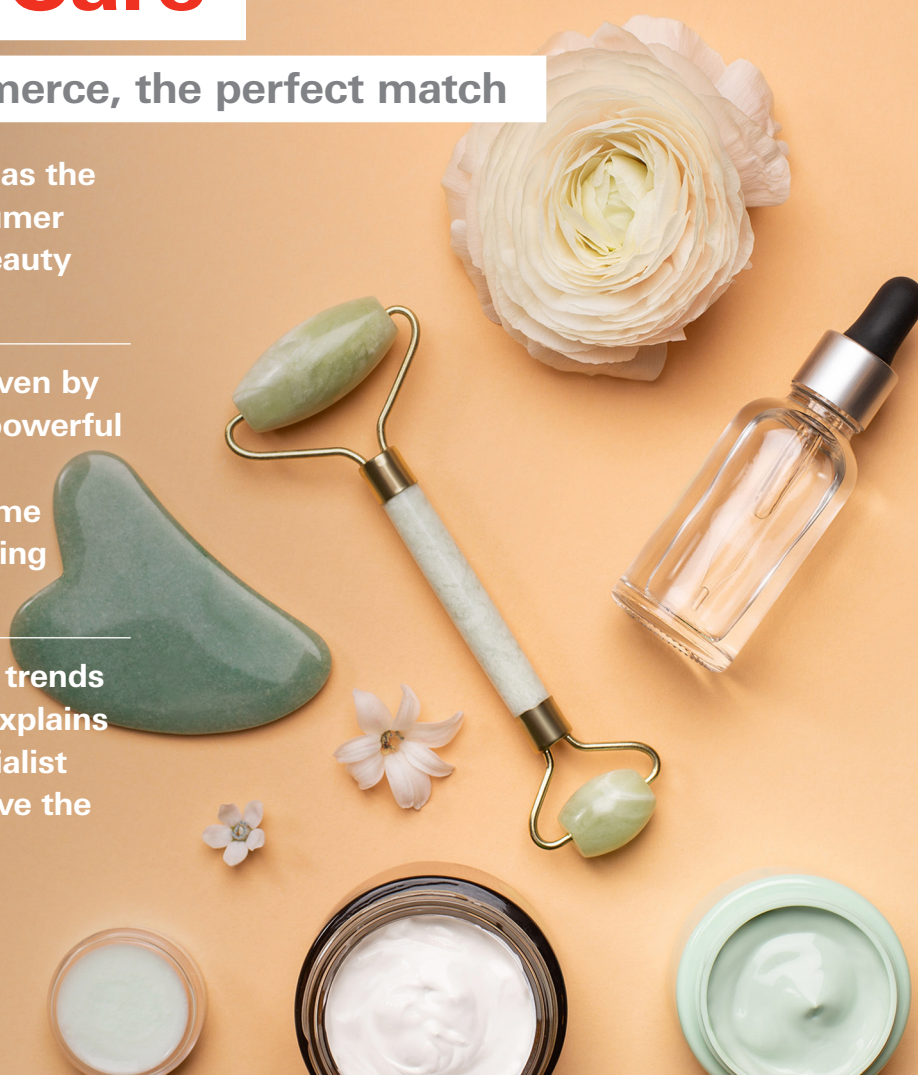
India Beauty and Personal Care

Beauty and e-commerce, the perfect match

We identify what we see as the next big, long-term consumer growth story in India – beauty and personal care

This narrative is being driven by the convergence of two powerful forces – rising consumer aspirations linked to income levels and the ever-widening reach of e-commerce

This report highlights the trends shaping the market and explains why we think large, specialist online beauty retailers have the winning formula



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The story in numbers

cUSD80bn

HSBC's estimated size of India's beauty and personal care (BPC) market by 2035e, 6x bigger than in 2020

30%+ CAGR

HSBC's estimated growth in India's online BPC market over the next decade

Only 8% of India's USD14bn BPC market is e-commerce; we expect this to increase to 35% in the next decade

52% CAGR

Average growth in online BPC business across Asia emerging markets between 2012 and 2020

38%

China's online BPC penetration in 2020

55%

Online sales of L'Oréal in China in 2020 (vs 27% overall)

4.2%

Share of premium BPC in India vs 35% in China and 25%+ worldwide in 2020

20-30%

EBITDA Margin for BPC (and double-digit EBITDA margin for scaled e-commerce players)

Emerging trends in BPC that will shape future growth: Digital transformation, premiumisation, personalisation, rise of naturals and clean beauty, beauty regimen, beauty devices

14%

Skin care's share of India's BPC market; in China, it is c50% in 2020

80+

Direct-to-consumer (D2C) BPC brands launched in India in the last five years

Executive summary

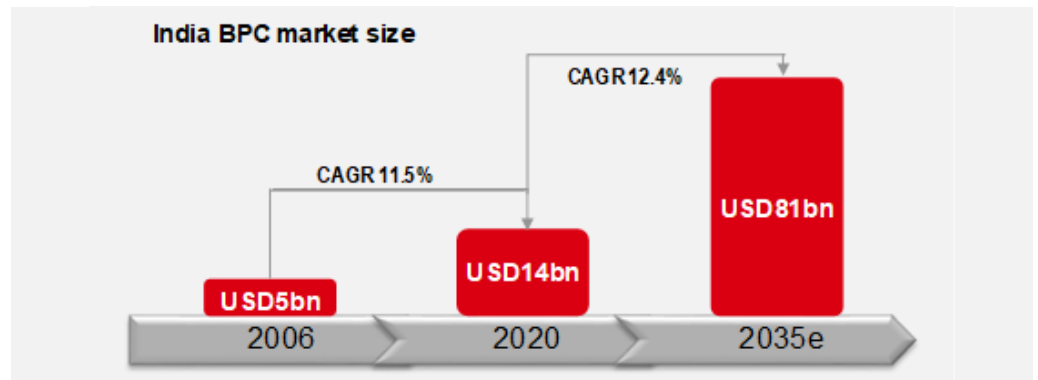
We think beauty and personal care (BPC) is the next big consumer growth story in India, driven by two powerful forces – rising aspirations linked to income levels, and the ever-widening reach of e-commerce. We expect the BPC market to grow 6x in the next 15 years and be worth cUSD80bn by 2035e. We also expect online sales to rise from 8% of the BPC market last year to 35% by 2030e, a CAGR of more than 30%. The winning formula is to build the scale needed to attract brands and consumers alike. Specialist online beauty retailers with an omni-channel presence look best placed to benefit from this structural growth opportunity.

The next big thing

We expect the beauty and personal care market to grow 6x in the next 15 years

1. **BPC is the next big consumer story in India:** We anticipate the market will grow 6x in the next 15 years, equivalent to at a 2020-35e CAGR of 12.4%, but for large sub-categories like skin care and colour cosmetics this could be as high as 20%.

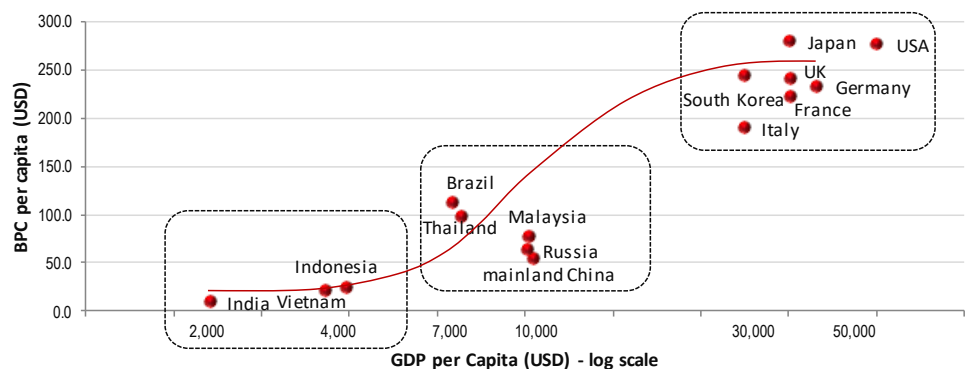
India BPC opportunity to grow to over USD80bn by 2035e



Source: Euromonitor, HSBC estimate. Note: growth numbers are in INR terms

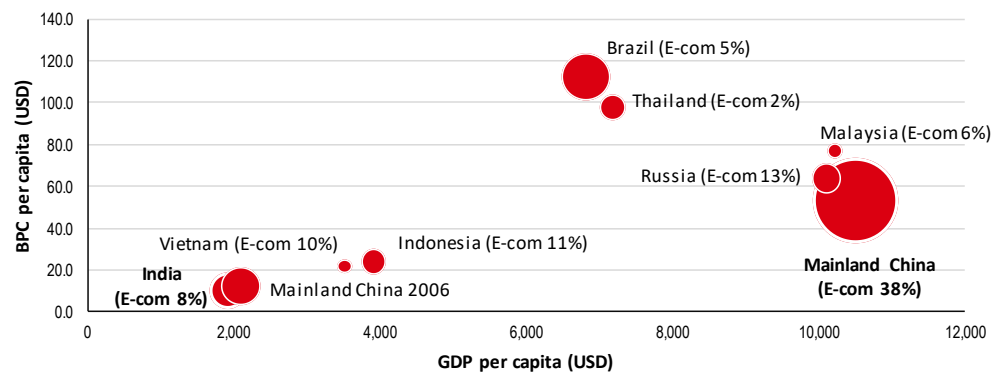
2. **Here for the long haul:** Our analysis of emerging markets, including China, suggests that the BPC market in India will follow an S-Curve growth trajectory as income levels rise. The growth story can span multiple decades.

BPC per capita spending follows a typical S-Curve, linked to the rise in income levels



Source: Euromonitor, HSBC

Today's India's BPC market is where China was in 2006



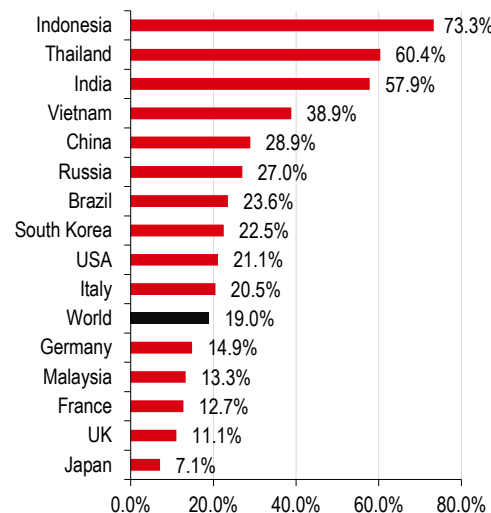
Source: Euromonitor, HSBC; Size of the circle indicates size of respective BPC markets

3. Six major consumer trends that are shaping the BPC market:

- ◆ **Digital transformation:** Nearly 800m potential customers have smartphones, raising their awareness and range of choices. This creates a BPC network effect.
 - ◆ **Premiumisation:** Evidence from developing and developed markets suggests that the premium segment is growing fastest and consumers are willing to pay for better quality products, brands and experience. This means premium and “masstige” products – 2x to 5x more expensive than the mass market segment – are a sweet spot.
 - ◆ **Rise of naturals/clean beauty:** Increasing consumer preference has opened the door for many new entrants. Naturals has emerged as the anchor for innovation and direct to consumer (D2C) brands.
 - ◆ **Marketing is changing:** Consumers increasingly prefer content and education-led personal and beauty care regimes to standalone products. This is disrupting the old models of brand building, such as traditional media advertising, leading to the rise of influencers and content-led digital marketing.
 - ◆ **Personalisation:** Beauty and personal care needs are complex and individual. The huge scale and mass market approach of fast-moving consumer goods (FMCG) companies has left room for niche rivals, such as online rivals.
 - ◆ **Active vs emotive:** There is also a rising awareness and consumer willingness to pay a high premium for products with proven efficacy.
4. **Wide appeal:** To us, the BPC market has wide appeal, including: 1) very high gross margins, unmatched by any other consumer category; 2) consumers are consistently seeking premiumisation across price points; and 3) scale is a determinant of value due to branding, the sunk costs involved, and spending on advertising and promotions.
5. **E-commerce is the key growth driver:** We believe e-commerce/omni-channel is the way forward for the BPC industry. This approach should help brands: 1) penetrate deeper into smaller cities and towns; 2) display a large range of products across all price points in India; 3) personalize offerings; and 4) offer competitive pricing. We estimate that the online BPC market will become a USD37bn opportunity by 2035e, up from USD800m in 2020, with a 45% penetration rate; this implies a channel revenue CAGR of c26%. For reference, China's BPC penetration rate is already in excess of 38%.

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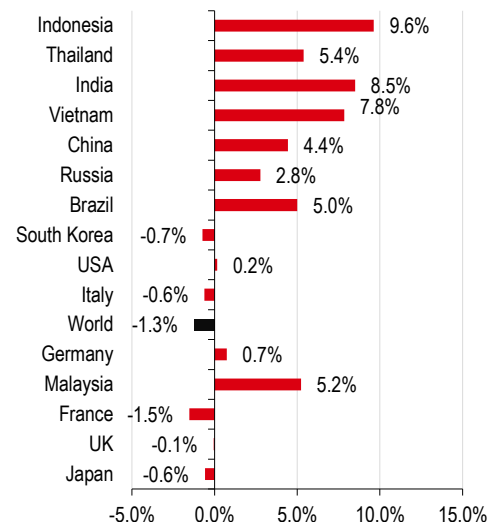
E-commerce sales have grown rapidly since 2012 ...



E-com channel sales (2012-20 CAGR)

Source: Euromonitor, HSBC

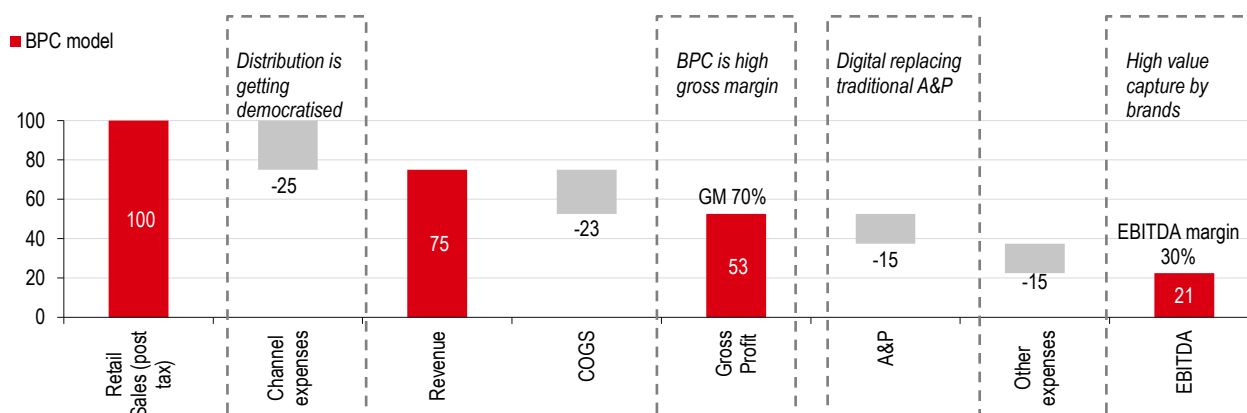
... outpacing sales from traditional channels



Traditional channel sales (2012-20 CAGR)

Source: Euromonitor, HSBC

Higher margins make BPC e-commerce a viable and profitable business model at scale



Source: HSBC

Notes: Channel expenses assumption include 15% retailer margin, 5% distributor margin and 5% onsite promotion

- There are several ways to capture the value of this growth:** 1) Significant value will be captured by large specialist e-commerce channels; 2) FMCG sales will accelerate, led by iconic brands; and 3) few of the direct to consumer (D2C) brands will also gain scale.
- Many new entrants over the coming years:** Given the fall in barriers to entry in terms of distribution and consumer engagement, we expect to see many new entrants over the coming years, including many international luxury brands.
- M&A is likely to rise** as players aim to bridge portfolio gaps and gain scale.

The largest value should converge to large-scale online beauty retailers, which we believe have found a winning formula. Their traffic, scale and assortments act like a magnet for both brands and consumers alike, creating a virtuous network effect, while their digital capabilities and consumer education-led approach to selling should become a formidable competitive advantage. We expect this all to result in business models which will not only offer exponential growth but also sustainably high returns on capital.

Industry overview

- ◆ Although India's BPC market is relatively small (USD14-15bn), it is among the fastest-growing in the world
- ◆ The market should expand rapidly as income levels rise
- ◆ A comparison with other developing and developed markets suggests that this is the start of a long-term growth story

Why this is a big long-term growth opportunity

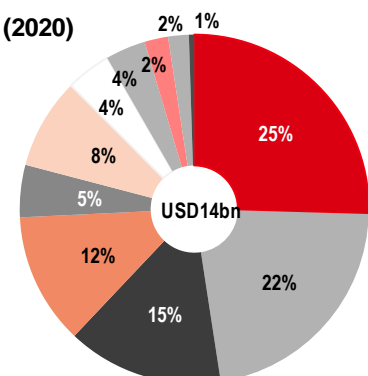
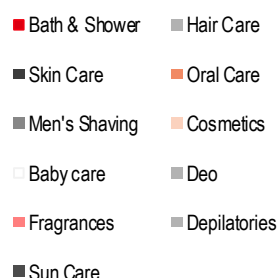
How long will the period of high growth last?

The biggest question being asked about how to value the opportunities in India's beauty and personal care market (BPC) is how long the period of high growth will last for? In this section, we analyse its current structure and seek pointers about its future direction by making comparisons with other markets. Key points:

- ◆ **One of the fastest-growing markets:** At USD14-15bn in 2020, India is only the eighth largest BPC market in the world, but it is among the fastest-growing in the past 15 years.
- ◆ **Still at an early stage:** Despite this structural growth, the market is still at an early stage of development. More than 50% of the market is dominated by mass market products (bar soaps, hair care and oral care) and essentials. Discretionary consumer categories such as skin and beauty care are relatively new concepts in India.
- ◆ **Income level and BPC consumption follow an S-Curve:** Evidence from other markets suggests that BPC is linked to income growth and follows a S-Curve consumption trajectory. India is at the lower end of S-Curve and per capital consumption is the lowest in the peer group, suggesting that a period of rapid growth lies ahead.
- ◆ **The China benchmark:** China in 2006 was almost the mirror image of India today, both in terms of the size of the BPC market and GDP per capita. After 15 years of rapid expansion, China's market is now 6x larger than India's. E-commerce in China has risen at a CAGR of 30% in the past eight years and is still growing strongly.
- ◆ **High growth expected in new categories:** The evidence suggests that as income levels grow, discretionary categories such as skin care and beauty care should grow at a faster rate than the overall BPC market.
- ◆ **E-commerce is the major enabler.** E-commerce is growing exponentially in almost all Asian emerging markets. Even in rich, mature markets where category growth is almost zero, e-commerce is still growing in double digits. In India, all the ingredients are in place for e-commerce to drive rapid growth in the BPC market in the coming decades.

Bath and hair care dominate India's BPC market...

India BPC composition (2020)



Source: Euromonitor, HSBC.

BPC consumer trends

- ◆ We forecast that India's BPC market will expand at a CAGR of 12.4% over 2020-35e, to reach cUSD80bn
- ◆ We identify seven themes that should support long-term growth
- ◆ High gross margins, unmatched by any other consumer category, to boost profits

A sector with wide appeal

India's BPC market registered a CAGR of 11.5% in the past 15 years in local currency terms. We expect this growth to accelerate in the range of 12-13% in the next decade, reaching cUSD80bn in the next 15 years. Key consumer trends include:

- ◆ **Digital transformation:** Nearly 800m potential customers have smartphones, raising their awareness and range of choices. This is creating a network effect for the BPC market.
- ◆ **Premium and "masstige":** Evidence from developing and developed markets suggests that the premium segment is growing fastest and consumers are willing to pay a premium for better quality products, brands and experience. This means premium and "masstige" products – 2x to 5x more expensive than the mass market segment – are a sweet spot.
- ◆ **Rise of naturals/clean beauty:** Increasing consumer preference has opened the door for many new entrants. Naturals has emerged as the anchor for innovation and direct to consumer (D2C) brands.
- ◆ **Marketing is changing:** Consumers increasingly prefer content and education-led personal and beauty care regimes to standalone products. This is disrupting the old models of brand building, leading to the rise of influencers and content-led digital marketing.
- ◆ **Personalisation:** Beauty and personal needs are complex and individual. The huge scale and mass market approach of FMCG companies has left room for niche rivals, such as online rivals such as Nykaa.
- ◆ **Active vs emotive:** There is also a rising awareness and consumer willingness to pay a high premium for products with proven efficacy.

To us, the BPC market has wide appeal, including: 1) very high gross margins, unmatched by any other consumer category; 2) consumers are consistently seeking premiumisation across price points; and 3) scale is a determinant of value due to branding, the sunk costs involved, and spending on advertising and promotions.

The rise of BPC e-commerce

- ◆ E-commerce in India grew at a CAGR of 58% over 2012-20
- ◆ We estimate the online BPC channel will be worth USD37bn by 2035e; key drivers are reach, product range, and experience
- ◆ Sustainable value will be captured by large-scale specialist players with competitive advantages

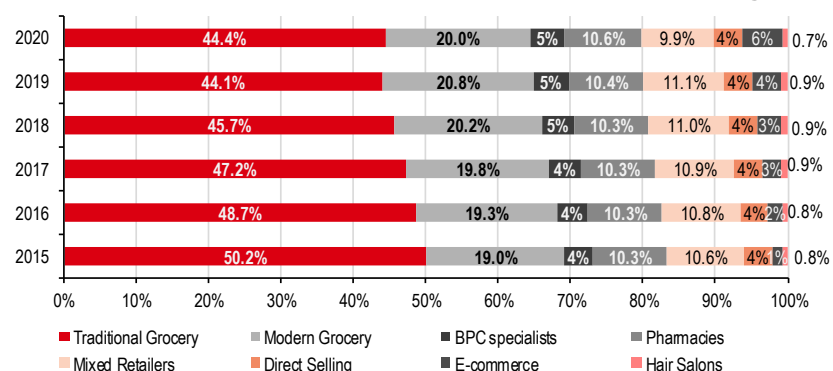
The online experience is hard to beat

We believe e-commerce represents the future of the beauty and personal care (BPC) products in India, accounting for 35% sales in a decade, up from 8% today. This should be driven by:

- ◆ **Evidence from global markets:** Online BPC sales are driving growth globally. In India, the market has grown at a CAGR of 58% in the past eight years (albeit from low base). We expect this trend to continue.
- ◆ **The only channel that can meet demand in smaller cities:** In India, traditional channels struggle to offer customers in tier 2-4 cities a wide range of products. E-commerce can – this is a large structural tailwind.
- ◆ **High margins (60-80%):** The e-commerce channel for BPC companies offers much higher margins than other areas of the consumer market. These allow for favourable economics of ecommerce channel.
- ◆ **A wider product range:** Along with competitive pricing, this is a big draw. Specialist channels also guarantee that the products it sells are authentic.
- ◆ **Digital engagement:** Consumer education is a key part of the BPC sales process, with influencers and key opinion leaders (KOLs) playing a big role. This is a huge enabler of e-commerce, giving specialist players with scale a big advantage.
- ◆ **Data collection, customer insights:** Predictive data analytics is instrumental in capturing consumer insights at a granular level – buying behaviour, willingness to pay a premium, category and brand preferences – giving e-commerce leaders a competitive advantage over traditional channels.

India's e-commerce penetration has risen from less than 1% in 2015 to c6% in 2020

Traditional channels still dominate in India, but e-commerce sales are rising fast



Source: Euromonitor, HSBC;

D2C brands: A tailwind for e-commerce growth

- ◆ E-commerce has spurred the growth of D2C beauty brands
- ◆ Some brands have scaled up, focusing on the mid-premium segment, often filling gaps left by FMCG companies
- ◆ Traditional FMCG players are also launching online D2C brands, but we expect them to converge over time. E-commerce is the future

BPC brands and the D2C market

A number of direct-to-consumer (D2C) FMCG brands have flourished over the last few years in India, benefitting from the rapid adoption of e-commerce and limited innovation among market leaders. In the BPC segment, at least 80 new D2C brands have been launched over the last 5-6 years and many have gained significant traction with consumers.

Key drivers for D2C in BPC

- ◆ **Gaps in the market.** Established FMCG players primarily target mass market products, leaving gaps in the market in terms of products categories (naturals, science-backed, clean beauty), as well as price points. New D2C brands are exploiting these gaps to address customer needs with innovative product launches.
- ◆ **E-commerce has reduced barriers to entry:** The traditional barriers to entry – high upfront costs to gain scale, setting up distribution networks, and promoting products – have become less daunting due to the rapid advance of online channels and digital marketing.
- ◆ **Cost economics:** The BPC segment's high gross margins (60-80%) make it ideally suited for e-commerce cost economics. High margins ensure that D2C brands can focus on customer acquisition and build their own platforms, while still being profitable.
- ◆ **Personalisation:** Customer awareness of the latest global BPC trends has increased significantly. D2C brands have the technology to offer niche, targeted offerings, cater to specific consumer needs, and gain a loyal customer base.
- ◆ **Increasing confidence in online purchases:** The sharp rise in number of people engaged in online shopping – expected to reach 420m in 2025e from 175m in 2020 as per RedSeer estimates – is a result of improvements in digital infrastructure and the online shopping experience (e.g. fast, free delivery, no-questions-asked returns, and hassle-free refunds).
- ◆ **Higher female participation:** The rising adoption of mobile Internet among Indian women – up from 19% in 2017 to 50% in 2019 – has become a key enabler for online shopping.

Conclusions

- ◆ We believe that the rising consumer preference for naturals and sustainable products will result in a plethora of new brands. But only a few will gain scale and be available across channels. Subscale brands should struggle.
- ◆ Some brands with good products but scalability issues will become the ideal acquisition targets by big D2Cs and the larger FMCG companies. As mentioned above, consolidation has already started.
- ◆ We believe large global and iconic brands will eventually dominate, especially in the fast-growing premium and mass-market segments.
- ◆ We also expect many more overseas entrants to enter India, given the lucrative growth opportunity as the pace of premiumisation accelerates.

The dominant specialist e-commerce channels should capture a large part of the value in the BPC value chain, driven by assortments, brands, their access to consumers across India, data-driven insights, and consumer trust and engagement built over the years. They will act as magnet to brands and consumers alike and should offer not only exponential growth but also sustainably high returns on capital.

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Registered Office
52/60 Mahatma Gandhi Road
Fort, Mumbai 400 001, India
Telephone: +91 22 2267 4921
Fax: +91 22 2263 1983
Website: www.research.hsbc.com
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