



Asia Case
Research Centre
THE UNIVERSITY OF HONG KONG

POON
Poon Kam Kai Series

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L'ORÉAL: EXPANSION IN CHINA

After acquiring Mininurse at the end of 2003, this new Chinese acquisition of Yue-Sai only serves to confirm our determination to step up the pace of growth in China.

- Lindsay Owen-Jones, CEO, L'Oréal¹

On January 26th 2004, French cosmetics giant L'Oréal signed an agreement to acquire a famous Chinese cosmetics brand Yue-Sai.² The acquisition came shortly after L'Oréal made another successful bid for Raystar Cosmetics (Shenzhen) Co. Ltd.'s skin-care brand, Mininurse, in December 2003.³ L'Oréal was already very successful in both China's high-end and middle-range cosmetic markets. The acquisitions of Mininurse and Yue-sai indicated that L'Oréal would focus more on the mass market and showed its determination to step up the pace of its growth in Chinese origin brands.

The mergers between L'Oréal and those two local companies seemed to be win-win deals, but there were still many challenges waiting ahead. Firstly, the merger triggered a wave of consolidation in the Chinese cosmetics industry, with more mergers waiting to take place between local cosmetics companies and their foreign counterparts. Facing such fierce competition, how could L'Oréal keep growing its business in China? Secondly, the tasks that follow integration were tough for a company. Would the two well-known acquired brands, Yue-Sai and Mininurse, perform as well as before? If not, would they erode the high-end brand image of L'Oréal? And finally, the most important issue was that given the many ways to differentiate oneself in a sub-market—such as direct acquisition, building one's own brand or alliance with the established brands—was the way adopted by L'Oréal, ie, acquisition, the optimal strategy to realize that objective?

¹ Rumsby, Mike, "Another Breakthrough for the Group in China: After Mininurse, L'Oréal Acquires Yue-Sai", [www document] www.Loreal.com (accessed August 16th 2005).

² Ibid.

³ Kressmann, Lorrain, "China: Acquisition of Mininurse Brand", [www document] www.loreal.com (accessed August 16th 2005).

Li Dongya prepared this case under the supervision of Dr. Zhigang Tao for class discussion. This case is not intended to show effective or ineffective handling of decision or business processes.

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L'Oréal Group

Head-quartered in Paris, the L'Oréal Group (the Group) was the largest cosmetics manufacturer in the world. The Group was also active in luxury goods and in the dermatological and pharmaceutical fields. L'Oréal was founded in 1907 (then named Société Française de Teintures Inoffensives pour Cheveux) by the French chemist Eugène Schueller in Paris to sell his innovation, the world's first hair color formula. L'Oréal enjoyed enormous success and quickly expanded into the field of shampoo and soaps. From the very beginning Schueller had made an effort to export his products to other countries, and they could be found in Holland, Italy and even Australia as early as 1912.⁴ L'Oréal began selling goods in the US market in 1953, and after Schueller's death in 1957, his successor, François Dalle, rapidly expanded L'Oréal further into other overseas markets.

With nearly a hundred years of experience in the beauty industry, in 2004 L'Oréal reported consolidated sales of US\$17,456 million⁵ (US\$17,079 million sales of cosmetics) with a net operational profit of US\$2032 million. In 2004, the Group had a global workforce of 52,000 employees and maintained a diverse, yet complementary, portfolio of 17 international brands sold in 130 countries. The majority of the Group's market in 2004 was still Western Europe, which accounted for 51.4% of the total cosmetics sales, while North America was next with 26.5% of total sales [see **Exhibit 1**]. The Western European markets were the most profitable, and had around 15% rates of sales in 2004 [see **Exhibit 2**]. Other regions across the world, however, exhibited a high potential for growth: eg, Eastern Europe, Asia and Latin America showed a 2004 growth rate of 29.3%, 17% and 16.2% respectively, although the markets in these regions were not as profitable as those in traditional Western European and North American markets [see **Exhibit 1** and **2**]. In terms of product division, consumer products dominated total sales, contributing 54.5% to sales in 2004 while the active cosmetics⁶ showed higher momentum to increase [see **Exhibit 3**].

Research and Development

The future belongs to modern, powerful businesses capable of facing up to the many technological, scientific and ecological challenges of the coming years. That is how we are getting ready for the future at L'Oréal.

- Jean-François Grollier, vice-president for research and development. L'Oréal⁷

L'Oréal operated on the principle of "research and innovation in the interest of beauty"; it believed that the ever-improving effectiveness and quality of its products was due to innovation, which had been nurtured since Schueller founded the Group in 1907. The company put a lot of emphasis on technological innovation as it was convinced that in the long term, quality and innovation were the only ways to satisfy an increasingly diverse and ever more demanding consumer base. Each year, L'Oréal spent 3% of its turnover on research and development⁸ [see **Exhibit 4**]. The company employed over 2,900 scientists and support staff from over 30 disciplines in its laboratories in France, the US and Japan; they worked in several research fields,

⁴ "The History of L'Oréal", [www document] www.loreal.com (accessed August 20th 2005).

⁵ €1 = US\$1.227 on January 25th, 2006.

⁶ Active cosmetics refer to those products only sold at the pharmaceutical counters.

⁷ Jean-François Grollier's speech made on July 4th 1997, [www document] www.loreal.com (accessed August 3rd 2005).

⁸ "L'Oréal Research", [www document] www.loreal.com (accessed August 3rd 2005).

such as chemistry, biology, medicine, physics, toxicology, etc. In 2004 alone, L'Oréal applied for 586 patents.⁹

Brand Management

Brand management in L'Oréal was quite complex as it had the most diversified brands under its umbrella. The brand portfolio grouped multiple L'Oréal brands under four divisions: consumer products division, luxury products division, professional products division and active cosmetics department [see **Exhibit 5**]. The consumer products division encompassed all the brands distributed through mass-market channels to reach as many consumers as possible. The luxury products division offered a range of prestigious international brands, selectively distributed through perfumeries, department stores and duty-free shops. The professional products division offered special haircare products for use by professional hairdressers and products sold exclusively through hair salons. The active cosmetics department created and marketed brands of cosmetics and dermatological products for selective distribution through chemists and specialist health and beauty outlets.

A Sustainable Growth Strategy

The company manufactured more than 94% of its products, which made the control over its processes an essential strategic issue. Meanwhile, the Group ensured healthy long-term geographic and sector-based balance for its brands. It looked to the growth of new markets, especially in developing regions such as South-East Asia, and increased the rate of its international expansion through a highly selective acquisition policy. As a result, L'Oréal had enjoyed double-digit growth in earnings for many years.¹⁰

China's Cosmetics Market

Given its population of around 1.3 billion, and nearly 502 million urban residents, China had the largest number of potential cosmetics customers in the world. Empowered by higher income levels and better living conditions, people were becoming fashion conscious. The government-backed Chinese Academy of Social Science claimed that a group of people among urban residents in China formed a new "middle class", defined as households with total assets of US\$18,000 to US\$36,000.¹¹

The production of cosmetics in China, in value terms, had increased at an average annual growth of more than 40% from 1990 to 2002, scaling a peak of 200% in 1993—at a much faster rate than the national economy.¹² Cosmetics sales in China had grown in the past 20 years from around US\$25 million in 1994 to US\$6 billion in 2004, an increase of more than 200 times¹³ [see **Exhibit 6**]. From 1982 to 1998, the total sales value of cosmetics in China had grown at an annual average of 23.8%, touching a high of 41% according to the report by the China Perfumes and Cosmetics Association. Growing at a considerable pace, the cosmetics industry claimed fourth spot in terms of consumption, after real estate, cars and tourism.¹⁴

⁹ Ibid.

¹⁰ "A Sustainable Growth Strategy", [www document] www.loreal.com (accessed August 9th 2005).

¹¹ "Coming of Age: Multinational Companies in China" (2004) *Economist Intelligence Unit*, p. 13.

¹² Dandan, Chen and Li, Xue (February 7th 2005) "Beauty Sector Benefits Chinese Economy", [www document] www.crienglish.com, DATE ACCESSED?.

¹³ Max Hare, "Chinese New Year", *Global Cosmetic Industry*, April 2004, Vol. 172, p. 24.

¹⁴ Dandan, Chen and Li, Xue (February 7th 2005) "Beauty Sector Benefits Chinese Economy", [www document] www.crienglish.com accessed February 20th 2005.

The market was still far from being saturated. Currently, China's per capita annual spending on cosmetics was only US\$4,¹⁵ which is far behind that of other major markets.¹⁶ Annual sales were expected to hit US\$10 billion by 2010, according to a China Association of Fragrance Flavor and Cosmetics Industry (CAFFCI) estimate.¹⁷ Meanwhile, China's commitment to opening its market in compliance with the WTO rules will further stimulate the market, with greater participation from international cosmetic companies.

Consumers

Urban Residents

In 2002, there were a total of 660 cities in China, of which 621 had a population exceeding 200,000 people.¹⁸ Although cosmetics were still treated as luxuries by rural residents, they were widely used in urban areas, particularly in large and medium-sized cities. Among these cities, Shanghai, Nanjing and Hangzhou in eastern China; Beijing, Tianjin and Dalian in northern and north-eastern China; Shenzhen and Guangzhou in southern China; and Chongqing, Chengdu and Xi'An in western China were generally considered to be the leading cities for China's cosmetics market.¹⁹ As the disposable income of urban residents continued to increase, they would continue to be a dynamic consumption force in China's cosmetics market for the foreseeable future.

Urban residents could be further segmented into two major groups. The first one had high-income earners in large and medium-sized cities. This group constituted the major consumers of well-known, up-market brands imported from Europe, the US and Japan. Most of them were young to middle-aged white-collared women. The second group contained medium-income, middle-aged to older women. This group indicated a marked preference for established domestic brands.

Potential Consumers in Underdeveloped Regions

Over the past two decades, cosmetics manufacturers had largely neglected the underdeveloped small cities and towns at or under county levels. However, this potential market was significant as China had 39,054 townships and town governments with over 780 million inhabitants in 2002.²⁰ In addition, during the past several years, the Chinese government had adopted a series of policies to develop the rural areas, eg, the policy to develop western China and the urbanisation policy. As a result, a large number of potential customers from small cities and towns in undeveloped regions would add their might to the group of cosmetics consumers. These women would primarily be from the many coastal towns that had already become relatively wealthy, and from an increasing number of towns in less developed regions that were starting to create wealth.

Many big and medium-sized cities in China also had a large number of migrant women laborers from the poorer provinces, a majority in the ages of 18 to 30 years. Although they remitted part of their income to their families, they still retained some disposable income. These women were generally naive about cosmetics, and buy on the basis of price rather than brand. Therefore they tend to prefer locally made Chinese products to international brands. This represents a large and as yet almost untapped customer base.

¹⁵ Shen, Yan (July 31st 2003) "Cosmetics and Toiletries Market Brief in China", [www document] www.strategis.gc.ca.

¹⁶ The average per capita yearly spending on cosmetics in developed countries is about US\$10.

¹⁷ "Fortune Telling", *Global Cosmetic Industry*, November 2003, Vol. 171, p. 45.

¹⁸ China Statistical Yearbook, 2003.

¹⁹ Li, Shuquan (May 6th 2003) "China Cosmetic Market", [www document] www.strategis.gc.ca.

²⁰ China Statistical Yearbook, 2003.

Competition: Domestic and Foreign Players

There were more than 4,000 Chinese cosmetics manufacturers producing 25,000 varieties of cosmetics. However, most of the companies were small and medium-sized, with annual revenue averaging less than US\$1.2 million.^{21, 22} Only a handful of them were relatively larger, such as Shanghai Jahwa, Beijing Dabao and Chongqing Olive, each ringing in annual sales of over US\$60.2 million. Moreover, local brands mostly target the low-end market. As a result, although local cosmetics brands had a market share of 60%, 80% of the profit is pocketed by the international brands.²³ This was best illustrated by the fact that the total sales revenue of all the domestic cosmetics companies was lesser than that of L'Oréal alone.

In contrast, foreign companies had been successful in establishing brand presences in China over the past two decades, thereby netting healthy profits. Some of the largest suppliers in the Chinese cosmetics market were American companies. However, now an even larger number of foreign companies were entering the market, mostly from France, Japan and Switzerland, such as L'Oréal Group, Shiseido Co. Ltd.²⁴ Armed with strong financial capabilities, extensive experience in brand management, strength in product research and development, advanced marketing strategies and long term commitment to the Chinese market, international brands such as Lancôme, SK-II etc. dominated the high-end segments of the cosmetics market in China [see **Exhibit 7**].

Aware of the significant potential and increasing demand in the high-end beauty segment, more and more Chinese chemical and pharmaceutical manufacturers were turning to the production of high-end beauty products. These developments altered the competitive landscape in the cosmetics industry, and made the competition fiercer for the future.

L'Oréal in China

L'Oréal was a late entrant in the Chinese market and it opened counters in Shanghai, Beijing and Guangzhou in 1990, and a joint venture plant in Suzhou in 1996. Despite ceding a head start to its competitors, L'Oréal blazed a fast and steady growth path in China. Its sales rose from US\$22 million in 1997 to US\$107 million in 2002 and further to US\$181 million in 2003.²⁵ In 2004, it reported a 99% surge in sales to US\$385 million, and expected another 50% rise in sales in 2005.²⁶

Since its entry into the Chinese market in 1996, L'Oréal had invested US\$120 million to garner market share, and had also rolled out 10 brands. To manage the multiple brands, L'Oréal adopted a differential and comprehensive products and brands strategy, or the "Pyramid Brand Structure" as Paolo Gasparrini, the president of L'Oréal China, called it.²⁷

The high-end products, including Lancôme, Biotherm and Helena Rubinstein (HR), lay at the top of the pyramid. They were mainly distributed through the specialty counters in top-notch department stores. Through distribution centres like department stores, specialised boutiques and

²¹ Exchange rate: US\$1=Rmb8.3

²² Dandan, Chen and Li, Xue (February 7th 2005) "Brand Analysis for China's Cosmetics Industry", [www document] www.crienglish.com, accessed February 20th 2005

²³ Ibid.

²⁴ Li, Shuquan (May 6th 2003) "China Cosmetics Market", [www document] www.strategis.gc.ca DATE ACCESSED?.

²⁵ O'Neill, Mark, "Giving Face to China's Beauty Quest", *South China Morning Post*, November 22nd 2004.

²⁶ "L'Oréal Sales Surge", *Shanghai Daily*, February 25th 2005.

²⁷ Yuanyuan, Liu and Bo, Deng, "Restructuring Brands, Restructuring Industry?", *Sino Foreign Management*, Vol. 4, 2004.

travel retail outlets, the company could give customers access to personalised advice and premium service. Until 2004, Lancôme owned 45 counters in over 22 cities, and held the top slot in China's high-end cosmetics market.

Mid-way through the pyramid were two kinds of products, the professional hair colour products and healthy skin care products. The professional hair colour products included Kérastase and L'Oréal Professionnel, which were sold through professional hair salons. Hairdressing, a founding pillar of L'Oréal's business, called for a combination of artistic flair, fashion sense and scientific know-how. The skin care products included Vichy and La Roche-Posay, which were sold over the counter at chemist shops. The company's research teams enhanced their own expertise in the skin care products through partnerships with dermatologists and pharmacologists who provided advanced know-how in specialized fields.

At the base of the "Pyramid Brand Structure" were L'Oréal Paris, Maybelline and Garnier. These brands targeted the mass market, and were sold under the "convenience to buy" policy²⁸ which made the technology available to as many people as possible. Customers had access to their full range of expertise in hair colors, styling, hair care, skin care, body care and make-up.

Recognizing the huge potential and rapid growth of the cosmetics industry in China, L'Oréal announced its new strategies and invested further in the Chinese market. In September 2005, a new research facility was opened in Pudong, on the outskirts of Shanghai. This was the first facility of its kind to be operated by a cosmetics company, and equipped with a world-class team of chemists and physicists. The main mission of the Pudong L'Oréal Research Centre would be to conduct and support basic scientific research to vastly improve present understanding of the unique properties of the hair and skin of the people of Chinese descent.

The opening of this Research Centre represents an important turning point for our company and for people of Asian descent around the world. The knowledge and insights that we gain through research conducted at the Pudong Research Centre will ultimately allow us to develop innovative new products that better service the beauty care needs of the global Asian market.

- Lindsay Owen-Jones, CEO, L'Oréal²⁹

The decision to invest in China was part of a long term global strategy and commitment to formulating cosmetics that met consumer needs the world over, whilst continuing to respect cultural diversity. It would also support L'Oréal's brand internationalization strategy—adapting brands originating from other parts of the world to the Chinese and Asian consumers' needs. This would also support the internationalization of Chinese origin brands, such as Yue-Sai.³⁰

The company would also move the first Asia-Pacific management and training development centre from Singapore to China to set up a global brand research and marketing unit in China.³¹

²⁸ Liu, Botao (February 13th 2003) "Chinese Strategies by L'Oréal, Yue-Sai and Nature Beauty", [www document] www.emkt.com.cn, DATE ACCESSED?

²⁹ Rumsby, Mike, "L'Oréal Makes Further Investment in China with Opening of its First Research Centre in the Country", [www document] www.loreal.com (accessed Jan 25th 2006).

³⁰ Ibid.

³¹ "Cosmetics Giants Combat for Chinese Market", SinoCast, *China Business Daily News*, London, UK, March 2nd 2005.

With this, the French cosmetics giant aimed to develop Chinese cosmetics to cater to the domestic market first, and subsequently built an export market for beauty products designed and manufactured in China.³²

Shenzhen Raystar Cosmetics Company

Shenzhen Raystar Cosmetics Company (SRCC) was a fully owned Hong Kong investing company, headquartered in Shenzhen Shekou Industrial Zone. It was set up by a Chinese entrepreneur, Li Zhida. Since its establishment in 1989, it followed the brand-building strategy. A series of brands were launched in the market, the most famous one being Mininurse.

Mininurse

The Mininurse brand was introduced to the Chinese cosmetics market in 1992, and its sales value reached US\$47 million in 2003. After many years of development, Mininurse was listed in the top three domestic skin care brands in China.³³ Below were listed the leading reasons behind its success:

- **Full range of product series:** Mininurse had a complete product line with different functions for all kinds of skin types, such as hydro-series, cleansings, sun-protection (the most well-known series), anti-ageing, etc.
- **One of the top three domestic skin care product brands in China:** Mininurse's market share reached 6.8% in China in 2001 and 5.9% in 2002 [see **Exhibit 8**].
- **Extensive distribution channels:** Customers could buy Mininurse Products from 280,000 sales counters throughout the country. It had the most extensive distribution channels for skin care products in the Chinese market.
- **High brand recognition rate among young customers:** According to an ACNielsen poll, the brand recognition rate for Mininurse was as high as 90% among customers, especially among those below 20 years, for whom the rate reached 96%.³⁴
- **Affordable Chinese products:** As a mass market brand, Mininurse's products were priced between US\$1.20 and US\$3.60. Customers considered Mininurse to be one of the best domestic products with reasonable price, and which most of them could afford. Its target customers were those young women with natural style.

Yue-Sai Kan (Shenzhen) Cosmetics Ltd.

Yue-Sai Kan Cosmetics Ltd. was founded in 1992 by Yue-Sai Kan, a Chinese-born international celebrity who was formerly a famous television program producer.

In the early 1990s Yue-Sai noticed that Chinese women rarely wore makeup, and named China "the world of no colour". In view of this situation, Yue-Sai was all set to start her own cosmetics business. She spent two years on creating the line, carefully studying the colours best-suited for Asian faces and which most enhanced their skin. With experience in the media industry to back her, Yue-Sai was gradually able to build her brand, Yue-Sai Cosmetics, which was exclusively

³² O'Neill, Mark, "L'Oréal to Make up the World with Mainland Cosmetics", *South China Morning Post*, November 19th 2004.

³³ Kressmann, Lorrain (December 11th 2003) "China: Acquisition of Mininurse Brand", [www document] www.loreal.com, (accessed August 9th 2005).

³⁴ "Beautiful Deal for Cosmetics Firm", *China Daily Business News*, December 12th 2003.

meant for the Chinese woman. To support the brand, she also wrote a book to instruct Chinese women about how to dress and use make-up. She also produced a television series introducing Chinese culture to Westerners. Both the book and the TV series were very successful and popular. Her savvy management style paved the way for her products to become the top cosmetics line in 1996, after spending only US\$3 million in advertising since the launch in 1992.³⁵

As demand grew, Yue-Sai realised that there was a need to expand her company, and in order to do so she would need a global partner. Thus in 1996, she formed a strategic joint venture with Coty Inc., an international cosmetics company valued at US\$1.7 billion. The alliance allowed Yue-Sai Kan Cosmetics to continue its rapid expansion, to extend its cosmetics product lines and to enhance its manufacturing capabilities by opening a factory in Pudong, Shanghai in 1997 worth US\$20 million.³⁶

From the outset, Yue-Sai's product lines were created exclusively for Chinese women. Yue-Sai was a major brand with a strong market position, and was sold at more than 900 stores in 240 of China's largest cities.³⁷ Yue-Sai was now a leading cosmetics brand, ranking third in a list of China's top 10 cosmetics brands in 2002, with 11% of the country's total market share. In 2003, Yue-Sai reported sales of almost US\$47 million.³⁸

The Acquisitions

This acquisition is an outstanding opportunity to speed up our growth in the Chinese market. It is a major step forward in L'Oréal's development in a market which is strategically important for the group.

- Lindsay Owen-Jones, CEO, L'Oréal³⁹

On December 11th 2003, the L'Oréal Group signed an agreement with Raystar Cosmetics (Shenzhen) Co. Ltd., with a view to acquiring its skin care brand Mininurse.⁴⁰ The purchase included a manufacturing facility at Yichang in Hubei province, through which L'Oréal planned to increase its production capacity to meet the rapid growth in China. As part of the agreement however, Li Zhida, the founder and president of Shenzhen Raystar, had to quit the cosmetics field.

The acquisition could be a win-win game. The acquisition could enhance L'Oréal's portfolio and enable the group to move quickly into the Chinese skin care market. Moreover, L'Oréal would be able to reach the mass market by selling its products, such as Maybelline and Garnier, through the 280,000 sales outlets owned by Mininurse across the country. Also, since Mininurse already enjoyed a high profile and a good reputation among Chinese women, L'Oréal's strong technological force and experience could only help the brand go further. L'Oréal would re-package the Mininurse image and its products by improving its formula, using technology from Garnier, its strongest mass-market product.⁴¹

³⁵ Barnet, Kim, "Yue Sai Kan: The Face of Modern China", [www document] www.brandchannel.com (accessed August 16th 2005).

³⁶ "Yue-Sai Kan", *Asian Women in Business*, [www document] www.awib.org (accessed August 15th 2005).

³⁷ Rumsby, Mike, "Another Breakthrough for the Group in China: After Mininurse, L'Oréal Acquires Yue-Sai", [www document] www.loreal.com (accessed August 16th 2005).

³⁸ "L'Oréal Snaps up Women's Brand Yue-Sai", *China Daily*, January 28th 2004.

³⁹ "L'Oréal Continues Chinese Pursuit", [www document] www.cosmeticsdesign.com (accessed August 20th 2005).

⁴⁰ Kressmann, Lorrain, "China: Acquisition of Mininurse Brand", [www document] www.loreal.com (accessed December 11th 2005).

⁴¹ "Cosmetics Firm Plans Shanghai Base", [www document] www.chinadaily.com, March 3rd 2005.

A month after the Mininurse acquisition on January 26th 2004, the L'Oréal Group signed an agreement to acquire another local make-up and skin care brand, Yue-Sai Kan Cosmetics.⁴² The purchase further confirmed the Group's determination to step up the pace of growth in this increasingly important market. Also included in the acquisition was a manufacturing plant in Shanghai, which would further increase the Group's production capacities. And akin to the Mininurse acquisition, the founder and president of Yue-Sai, Yue-Sai Kan, was required to never enter the cosmetics market.

Acquiring Mininurse and Yue-Sai gave the Group two additional factories in China. After two acquisitions, 160 million units of annual capacity were added to L'Oréal's existing manufacturing base of 100 million units. In 2004, L'Oréal had three production bases in China located in Suzhou in the Jiangsu province, Yichang in the Hubei province, and in the Shanghai Pudong area. They would be used to produce skin care products for the L'Oréal Paris, Mininurse and Yue-Sai brands. More importantly, the two acquired brands also enabled L'Oréal to expand into the mass cosmetics market and gain more market share before competitors take action. The L'Oréal Group owned 14 different brands in China in 2004.

The Future

The future of Mininurse is hard to predict. It depends on the business strategy of L'Oréal. In the past, some brands such as Hai Er Mian, a cream for children that was taken over by Henkel KGaA, have continued to develop. Others like MAXAM have been totally ruined.

- Zhang Dianyi, chairman, CAFFCI⁴³

Although the current expansion seemed benefit the Group tremendously, there were many issues left to be solved.

Li Zhida and Yue-Sai Kan, the presidents of the acquired companies, had played an important role in the past successes of their companies, and on whom the companies were largely dependent. The future performance of the two brands would therefore be uncertain, although they had been injected with L'Oréal's technology, capital and management. Would the two brands be able to maintain their performance without the insights of their sagacious founders?

On the other hand, although the new brands enriched the product portfolios, they inevitably increased L'Oréal's tasks of brand management, especially when the company already had products similar to those in the Mininurse range. Would L'Oréal just want to kill a competitor through acquisition?

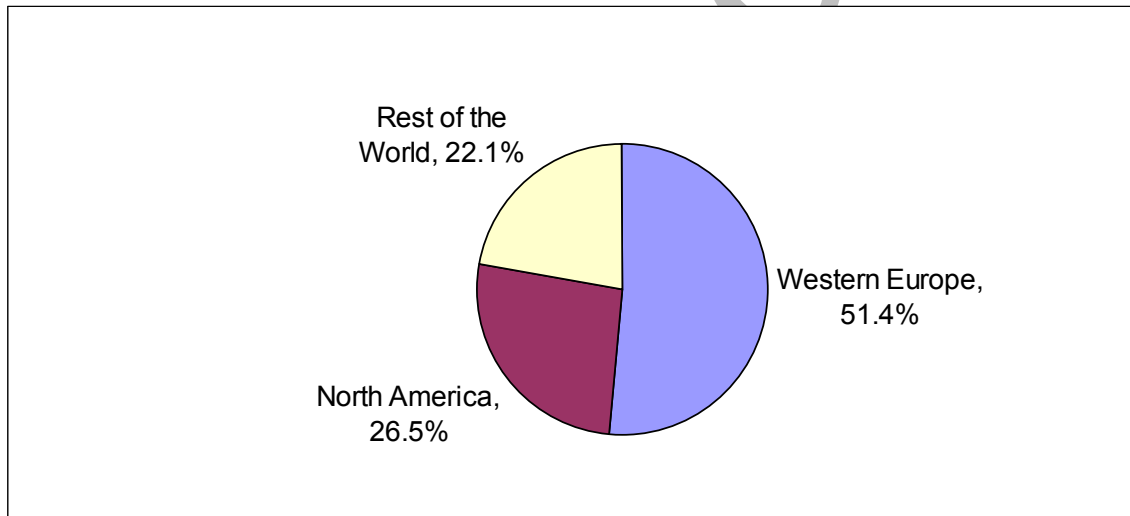
Moreover, the merger triggered a wave of consolidation in the Chinese cosmetics industry, with more mergers waiting to take place between local cosmetics companies and their foreign counterparts. Facing fierce competition, how could L'Oréal's management team keep growing the business in China?

⁴² Rumsby, Mike, "Another Breakthrough for the Group in China: After Mininurse, L'Oréal Acquires Yue-Sai", [www.document] www.loreal.com (accessed August 16th 2005).

⁴³ "L'Oréal Buys into China", [www.document] www.eastday.com (accessed May 5th 2005).

EXHIBIT 1: DIVISION OF CONSOLIDATED COSMETICS SALES BY GEOGRAPHIC ZONE OF L'ORÉAL GROUP IN 2004

Zone	US dollar millions	Growth based on published figures	Like-for-like growth
Western Europe	8,972	1.3%	1.1%
North America	4,628	-0.3%	8.1%
Rest of the World:	3,847	16.2%	18.1%
Asia	1,557	19.3%	17.0%
Latin America	888	7.0%	16.2%
Eastern Europe	643	27.3%	29.3%
Other countries	758	13.2%	13.9%
Total Cosmetics Sales	17,448	3.8%	6.3%



Source: L'Oréal Group Annual Report, 2004.

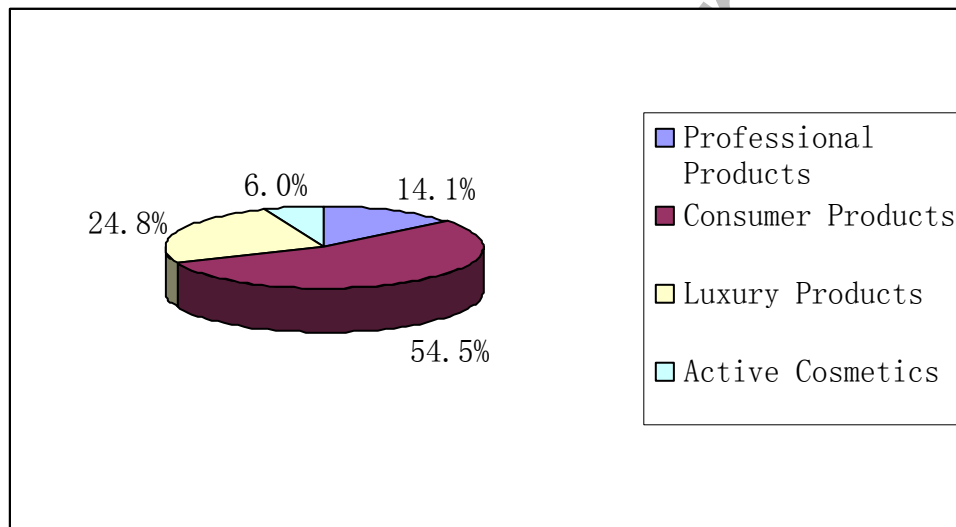
**EXHIBIT 2: ADJUSTED OPERATING PROFIT OF COSMETICS BRANCH BY
GEOGRAPHIC ZONE OF L'ORÉAL GROUP IN 2004**

	2003		2004	
	US dollar millions	% of sales	US dollar millions	% of sales
Zone				
Western Europe	1,308	14.8%	1,371	15.3%
North America	601	12.9%	625	13.5%
Rest of the world	337	10.2%	401	10.4%
total for zones	2,247	13.4%	2,396	13.7%
Non allocated	85	0.5%	179	1.0%
Cosmetics total	2,331	13.9%	2,576	14.8%

Source: L'Oréal Group Annual Report 2004

**EXHIBIT 3: BREAKDOWN OF 2004 CONSOLIDATED COSMETICS SALES BY
DIVISION OF L'ORÉAL GROUP IN 2004**

Divisions	Euro millions	Growth based on published figures	Like-for-like growth
Professional Products	1,998	5.2%	7.6%
Consumer Products	7,754	3.3%	5.8%
Luxury Products	3,520	2.3%	5.2%
Active Cosmetics	852	13.8%	15.0%
Total Cosmetics Sales	14,220	3.8%	6.3%



Source: L'Oréal Group Annual Report 2004

EXHIBIT 4: L'ORÉAL GROUP R&D EXPENDITURE (IN MILLIONS OF US\$)

Year	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
R&D expenditure	180	200	220	255	287	325	383	432	468	480	507
Increase Year-to-Year	11.3%	10.3%	10.3%	15.9%	12.6%	13.3%	17.8%	12.8%	8.3%	2.6%	5.6%

Source: www.lorealchina.com (accessed August 5th 2005).

EXHIBIT 5: L'ORÉAL'S BUSINESS CATEGORIES AND BRANDS

Division	Brands	Mission
Luxury Products	Lancôme Biotherm Helena Rubinstein Kiehl's Shu Uemura Giorgio Armani Cacharel Ralph Lauren Viktor & Rolf	Develop prestigious global brands sold through a selective distribution network designed to add value to the products; offering service based on personalized advice and relationship with the customer.
Consumer Products	L'Oréal Paris Garnier Maybelline New York Yue-Sai Softsheen Carson CCB Paris	Develop beauty products for the widest possible range of customers, offering the most innovative products at affordable prices through the broadest distribution channels.
Professional Products	L'Oréal Professionnel Kerastase Redken 5 th Avenue Mizani Matrix	Portfolio of brands that meet the requirements of hair salons and provide customers with a wide range of innovative products.
Active Cosmetics	Vichy La Roche-Posay Inneov SkinCeuticals	Develop dermo-cosmetic brands that meet the highest standards of skin care safety and effectiveness (proven by clinical tests) and are backed up by pharmaceutical advice.

Source: www.loreal.com (accessed January 24th 2006).

EXHIBIT 6: ANNUAL SALES OF CHINA'S COSMETICS INDUSTRY

Year	1998	1999	2000	2001	2002	2003
Annual Sales (US\$ billion)	3.3	3.6	4.2	4.8	5.5	6.0

Source: www.strategis.gc.ca (accessed August 11th 2004).

EXHIBIT 7: THE TOP SEVEN COSMETICS BRANDS MOST OFTEN USED BY THE 25,000 CONSUMERS SURVEYED IN MAINLAND CHINA

Maybelline	51.88%
Avon	37.32%
L'Oréal	27.99%
Yue-Sai	21.73%
Red Earth	14.79%
Revlon	13.31%
ZA	8.65%

Source: "Fortune Telling", *Global Cosmetics Industry*, November 2003, Vol. 171, p. 45.

EXHIBIT 8: MARKET SHARE OF SKINCARE PRODUCTS IN CHINA (%)

Rank	Brand	Producer	2003 Sep/Oct	2002 Sep/Oct	2001 Sep/Oct
1	Olay	P&G (China)	27.2	18	13.9
2	Dabao	Beijing Dabao	9.5	10.1	10.1
3	Avon	Avon (China)	6.8	1.9	-
4	Mininurse	L'Oréal Group	4.4	5.9	6.8
5	Longliqi	Longliqi Group	3.5	2.6	3.1
6	Pond's	Unilever	3.4	2.1	2.9
7	MAXAM	Shanghai Jahwa	2.2	2.8	2.2
8	L'Oréal	L'Oréal Group	2.1	2.5	0.2
9	Yumeijing	Yumeijing	1.9	2.1	-
10	Tjoy	Beinong	1.7	1.9	-

Source: ACNielsen report, 2004.