The Growth Opportunity That Lies Next Door

How a Brazilian cosmetics giant saw the beauty in neighboring markets

by Geoffrey Jones

What will the continued stagnation of the United States and developed economies in Europe mean for aspiring multinationals based in booming emerging markets?

Traditionally, developed markets have helped these emerging giants learn to fight developed-nation multinationals on their home turf, tap into the growth potential promised by prosperous economies, gain access to the latest technologies, attract the best talent at home, and validate themselves as truly global players.

But how will the logic of globalization change for corporations from countries such as India, China, Indonesia, Brazil, and Turkey if the growth opportunities in emerging markets continue to far outpace those in developed economies?

One company that has considerable experience with that question is Natura Cosméticos, the Brazilian beauty giant that for some 30 years has been attempting to move, with decidedly mixed results, into developed markets even as the opportunities in its region have grown stronger and stronger. Along the way it has discovered just what a double-edged sword a robust regional base can be for an emerging-market multinational.

In successive attempts to move beyond its borders, Natura has found itself having

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A Regional Pattern of Expansion

As opportunities in Latin America continue to be more attractive for Natura than those in developed economies, the company has steadily expanded its distribution and production centers in its home region. The one departure from this regional focus is its store in Paris, the capital of the world's beauty market.

SOURCE NATURA COSMÉTICOS

to weigh the pressure to devote scarce managerial resources to challenging adventures abroad against the imperative of focusing on burgeoning opportunities close to home. Ultimately, it discovered, as its counterparts in Latin America and Asia may increasingly find, that the payoff from slow and patient investments in its neighbors was not a consolation prize for failing to reap sufficient returns in developed markets but was itself a successful globalization strategy. To realize that, Natura had to stop equating "the world" with "the developed world"—a fundamental change in mind-set that was decades in the making.

Growing Up in Brazil

Just 20 years ago, the U.S., Western Europe, and Japan accounted for two-thirds of the world's market for cosmetics, fragrances, and toiletries. Today Brazil is the third-largest segment of the $308 billion global beauty market, China is the fourth, Russia the eighth, and India the 14th. This growth has not, however, translated into success for most domestic firms. The Chinese, Russian, and Indian markets are dominated by Western and Japanese giants such as France's L'Oréal and LVMH; U.S. behemoths Procter & Gamble, Avon, and Estée Lauder; the Anglo-Dutch Unilever; and Japan's Shiseido, all of which are ever on the lookout to acquire emerging-market firms with attractive brands.

Against that background, Natura's success is exceptional. By any measure it is a giant in the industry: Its 2010 net revenues of R$5.1 billion ($2.8 billion) rank it among the world's top 20 beauty companies. Its R$1.2 billion ($660 million) in pretax profits, which represents a stunning margin of 24.5%, puts it among the most profitable (well above Avon's 12%, Estée Lauder's 18%, and L'Oréal's 19%).

Unusual among emerging-market multinationals, Natura sells not low-end but premium mass-market cosmetics and personal-care products to middle- and upper-class consumers. It does so through a direct-sales network of more than 1 million independent, mainly female sales consultants, about one-quarter of whom sell Avon and other competitors' products as well. Natura has been the market leader in Brazil since overtaking Unilever in 2004, holding fully 14% of the highly competitive market in 2010 (Unilever, at number two, held 9.7%, and Avon, number three, 9.1%).

Like so many emerging giants, Natura evolved in a way that took advantage of its home market's economic experience. In 1969, 27-year-old Antonio Luiz da Cunha Seabra founded Natura as a small lab and cosmetics shop in São Paulo. Five years later, after experimenting with various distribution models, he followed the example of Avon, which had been successfully operating in Brazil for nearly a decade through door-to-door sales. Such direct-selling networks are costly and time-consuming to establish because relationships have to be forged one by one. But once in place, these networks allow a company to expand at low marginal cost even in times of economic adversity.

Natura found itself at a distinct advantage, then, when most of the department stores and pharmacies where so many of its competitors' beauty products were sold succumbed to the rampant inflation of the 1980s. Rising prices and tight exchange controls prompted most international companies to leave Brazil or halt investments

during what many referred to as the "lost decade."

Yet Brazilian culture continued to place a premium on self-image. Rather than depress demand, the rising prices spurred large numbers of Brazilian women to enter the workforce, swelling Natura's ranks. With the stars aligned, Natura's revenues grew at a breathtaking 43% compound annual rate from 1979 to 1989. That year, Seabra and two Natura executives—Guilherme Leal and Pedro Passos—bought out the other shareholders to form Natura Cosméticos. The trio articulated a vision for the company that has informed its competitive advantage but has posed some fundamental challenges to its global ambitions.

In an industry that has for decades been criticized for creating—and then preying on—women's insecurities, promoting racist stereotypes of beauty, instilling the fear of aging, and overselling the (sometimes entirely nonexistent) functional attributes of its products, Natura's founders wanted to foster a company ethos and operating model based on healthier relationships—between the company and its customers, its customers and its million-plus sales consultants, the company and its suppliers, and, more broadly, society and the environment.

Following this ethos, Natura became a pioneer in the natural cosmetics market, a determined opponent of animal testing, and the first Brazilian company to adopt the Global Reporting Initiative's sustainability reporting framework. In 2012 Natura ranked second (behind Novo Nordisk) on *Corporate Knights* magazine's annual list of the 100 most sustainable corporations in the world. The Ekos line of cosmetics Natura launched in 2000 is emblematic: The products are made from raw materials gathered through sustainable methods from the Brazilian rain forest. A decade before Unilever launched Dove's iconic Real Beauty campaign, Natura in its Truly Beautiful Woman campaign, which featured ordinary women over 30, had already moved to equate beauty not with the anxious pursuit of youth but with increasing self-esteem.

Beyond Soccer and Samba

Natura's first move outside Brazil, though, was not destined to fulfill or even advance any of its goals. Back in 1980, Seabra was already entertaining notions of global expansion. Walking down New York's Fifth Avenue that year, he was struck not only by the immense competition in the cosmetics market but also by the feeling that "there was a place for Natura in the world."

But where to start? Go after the riches of the U.S. market? Enter a wealthy market, such as Portugal, where consumers speak your language? Stay close to home?

Like many emerging-market powerhouses, Natura tried all three approaches. But having found success at home with a value proposition that was in many ways ahead of its time and a sales network that was very time-consuming to start up in new markets, Natura was at a disadvantage in moving beyond Brazil. With no compelling economic reason to venture abroad and limited managerial talent to spare as they were building the business at home, Seabra and his cofounders approached international markets halfheartedly, intent on protecting their core operations.

Natura entered Chile in 1982 by forming a partnership with a local distributor, which sold Natura's products less than enthusiastically through its own direct-selling network. A year later, the company allocated $100,000 to create Numina—a brand of cosmetics for export to Florida and Portugal—and hired people the company knew or who had previously worked for Natura to run the local operations.

In beauty, as in wine and cheese, country of origin matters. If Paris and New York were the globe's beauty capitals, Brazil was equated in much of the world not with rain forests and biodiversity but with hyperinflation, deforestation, soccer, and samba. This competitive handicap, combined with insufficient management attention, proved too great to overcome. The Florida and Portugal operations were entirely abandoned, while the Chilean business limped along unprofitably even as Natura attempted to start developing its own network in conjunction with a second Chilean partner.

Some five years later, as inflation abated, economies all over Latin America were beginning to grow. As they did so, many neighbors sought to scale up commercial ties with Brazil, which enjoyed a reputation in the region for being big, powerful, and innovative. Consumers in many parts of Latin America shared Brazilians' emphasis on beauty, and, propelled by mass advertising, they were becoming more sophisticated in their use of beauty products.

But with its home market heating up, Natura was loath to devote resources to establishing and building sales networks abroad, and so it moved into Bolivia, Peru, and Argentina with the same model it was using to ill effect in Chile—setting up networks through partnerships with local distributors.

It soon became apparent that Natura had underestimated the differences not only among Brazil's neighbors but also between Brazil and those countries—differences that went well beyond the fact that Spanish, not Portuguese, is the mother tongue of all other countries in the region. In Chile, for example, consumers were more inclined to use the country's strong retail channel than to shop through direct-sales representatives. Product formulas and labels needed to be adapted to local regulations and tastes in all four countries, and some entirely new product lines were launched. But without direct management, relationships between Natura and the sales reps remained too shallow for them to forge strong bonds with the brand or to allow enough information about local preferences to flow back to the production facilities in Brazil. The brand identity became diffuse. For a decade none of Natura's foreign operations turned a profit.

Finding Success in Latin America

Increasing revenues at home simultaneously made the prospect of investing in

other markets less attractive and allowed Natura to bear the cost of unprofitable operations for years. And so it was that the company did not devote serious management attention to its international operations until 1999- Alessandro Carlucci, then Nature's sales director and now its CEO, was sent to Argentina with the resources and authority to build a sales network that was truly committed to the brand and the company's values. To keep turnover low, the company built strong relationships with its sales consultants in Argentina. It also improved logistics by opening a distribution center there. Revenues from the Argentine business grew by about 30% a year from 1999 to 2001.

The company quickly transferred the lessons learned in Argentina to other markets in the region and took steps to ensure that its sales networks became fully committed to the brand and the company's values. Investments in marketing shored up brand awareness in Peru. Seasoned managers from Brazil replaced local managers in Chile. Nature's executives closely monitored the distribution network in Bolivia. Logistics were improved and local warehouses established. Revenues increased 30% in Chile from 2001 to 2003 and 85% in Peru in the same period.

With its confidence growing and its coffers brimming from an oversubscribed IPO on Brazil's Novo Mercado in 2004, Natura followed the path of other successful Brazilian firms in setting its sights once again on developed markets. In 2005—which happened to be a year of celebration of Brazilian culture in Paris—Natura opened a two-story flagship store in the elegant neighborhood of Saint-Germain-des-Pres. Although France was not as open to direct selling as neighboring Great Britain and Germany, Natura had long-standing ties with France as a source of packaging, some raw materials, and knowledge. Moreover, Paris was the capital of the beauty world.

The Paris store offered only the Ekos line and was viewed as a chance to test different sales models. The second floor functioned as a space where customers could sample Natura's products and learn about Brazilian culture, and Natura in turn could learn from highly sophisticated consumers. No one at Natura, for example, had been aware of the controversy surrounding the use of parabens in cosmetics until a visitor to the Paris shop asked about them. The company subsequently removed the preservatives from its products. It also began to consider internet sales.

Bolstered by their forays into foreign markets, Natura's leaders felt they had developed sufficient managerial expertise to enter Mexico, a country they had long recognized as a more natural fit with the company's business model. Mexico shared Brazil's passion for cosmetics and strong direct-sales tradition, and it had a similar economy and demographic structure. But Natura was a latecomer: Avon had been operating there since 1956. In fact, Avon's largest market outside the U.S. was Mexico, where it sold not just beauty products but also jewelry, toys, and cooking utensils.

Drawing on its experience in Paris, Natura not only began establishing a direct-selling network but also opened a store it dubbed Casa Natura in the upscale Polanco neighborhood of Mexico City. Unlike the Paris shop, though, the store sold no goods. It was less a shop than a clubhouse—a place for sales representatives to meet one another and exchange experiences, test products, and receive training. Natura saw this as a hybrid of the direct-selling and retail models, which could be replicated at a fraction of the cost of building a comprehensive retail-store channel. This hybrid model—which the company began to use in Brazil in 2007—helped Mexico become the company's biggest international market (by 2012 Natura had opened five Casa Natures there). Its success in Mexico seemed to pave the way to the U.S. market.

The Decline of the West?

Now, five years later, Natura has not gone to the U.S. or, in fact, to any other new market outside Latin America. The French business remains small, unprofitable, and the only one in the developed world (see the exhibit "Beyond Brazil: A Regional Pattern of Expansion"). Finding markets elsewhere that are compatible with the company's direct-selling system, its community values, and its focus on sustainability has proved tricky.

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Then, at the end of 2001, Argentina plunged into recession after devaluing its currency by 40%, and Natura learned a vivid lesson about the wisdom of sticking to its values and vision. In response to the devaluation, most competitors raised prices. But Natura chose to keep its prices steady and forgo short-term profits, focusing instead on reducing costs through efficiencies gained from the $110 million state-of-the-art integrated logistics, production, and R&D facility it had built on the outskirts of São Paulo the previous year. "The idea," Carlucci says, "was to create a social pact among suppliers, employees, and customers, showing the Argentine market that we were there for good and we expected profits [only] in the long run."

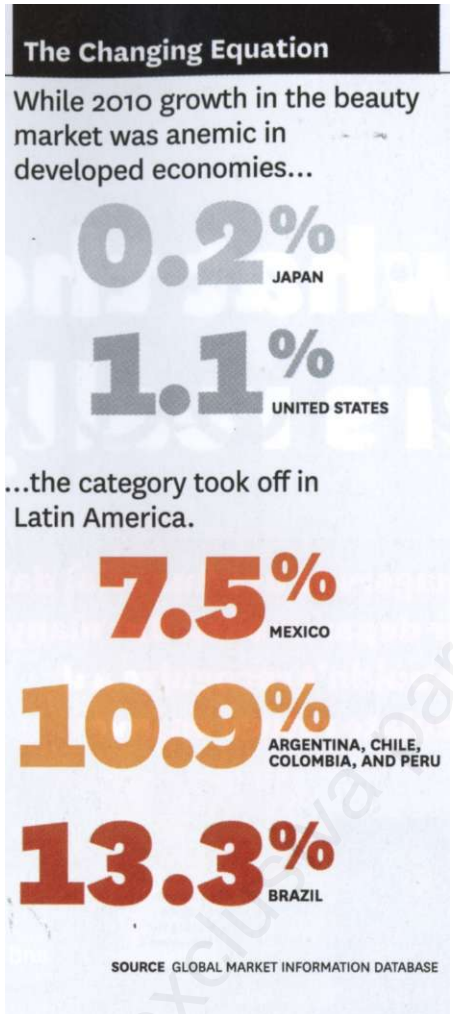
The strategy paid off. From 2002 to 2005, revenues increased sixfold, and the number of sales consultants grew from 7,000 to 20,000.

In 2005, for instance, the founders traveled to Russia, where the fast-growing market for cosmetics and toiletries had topped $6 billion. Direct sellers Avon and Oriflame were thriving, as the market share of direct-sales beauty companies there soared from 5% in 1999 to 19% in 2004. But as the three founders watched focus groups of Russian consumers from behind one-way mirrors, it qtiickly became apparent that these people not only knew virtually nothing about Natura, or even Brazil, but also were not much concerned about environmental sustainability. A poor fit, the founders concluded, and they pursued the opportunity no further.

The firm's commitment to environmental sustainability also played into the decision not to enter China, where regulations required cosmetics to be tested on animals. Nature's commitment to sustainability and the highest ethical standards also figured into its walking away—sometimes after months of negotiations—from acquisitions that might have greatly extended its reach in developed markets. At the same time, mainstream beauty companies were energetically acquiring leading natural cosmetics businesses around the world: L'Oreal bought Britain's Body Shop in 2006, Colgate acquired Tom's of Maine in 2009, and the Japanese direct seller Pola Orbis purchased Australia's Jurlique in 2011.

Did Natura's decisions limit its growth? A case can be made either way, though Avon's recent problems in China—where allegations of bribery of local officials have tarnished its brand, damaged relations with sales representatives, and made possible a takeover bid by Coty—lend some weight to the founders' insistence that the company's values remain a fundamental source of competitive advantage.

Meanwhile, recognizing that Natura's lack of management expertise has been a continuing impediment to regional expansion, the company steadily worked to build up its international management ranks in Latin America. It established the Natura Management System to capture and disseminate lessons learned. It began recruiting Brazilians and other Latin Americans from top MBA programs in the U.S. And it worked to balance its predominantly Brazilian management with executives from other countries in the region. Even so, the company's 2007 annual report announced its intentions of entering the U.S. market—a testament to the hold developed markets have on the aspirations of emerging-market multinationals.



In 2008 the financial meltdown conspired to make developed markets far less alluring and Natura's home market and region even more lucrative. Since then, the company has stopped talking about U.S. markets in its annual reports. Instead it has focused squarely on Latin America, entering Colombia in 2007, increasing the efficiency of its logistics, and tailoring its products and communications to local conditions. (Perfumes evaporate more quickly in the higher altitudes of Chile, for example, and Mexican consumers prefer drier products than their Brazilian counterparts.) In 2010 Natura engaged in manufacturing outside its home country for the first time, through a partnership in Argentina, and in 2011 it entered into manufacturing agreements with partners in Colombia and Mexico.

These investments are a reflection of the slowly changing economic equation of globalization. Even as the U.S. beauty market grew by an anemic 1.1% in 2010 and Japanese demand by a microscopic 0.2%, demand in Mexico grew by a healthy 7.5%; in Argentina, Chile, Colombia, and Peru by 10.9%; and in Brazil by 13.3%. Natura's net revenues from its operations in Argentina, Chile, and Peru, while small compared with those from Brazil, grew a hefty 27.7% to R$256 million ($139 million) from 2009 to 2010, as EBITA ballooned 44% to R$13 million ($7.1 million). Although Colombia and Mexico, where the sales networks have had less time to develop, are not yet profitable, 2010 revenues from the two countries jumped 69.9% to R$98 million ($53 million).

As Natura negotiates a world in which the economic importance of the West may have reached a plateau while the commitment to environmental and ethical issues is rising, it is finding itself in a position that Seabra never envisioned as he walked down Fifth Avenue 30 years ago. In the long run, Carlucci says, although the company has not abandoned plans to enter the U.S. or expand in Europe, the goal isn't to go to any particular place but to have a global portfolio that can be constantly adjusted to reflect the knowledge acquired in different markets. Just as its customers are moving beyond stereotypes of youth, straight hair, and light skin, Natura is moving beyond stereotypes of globalization, recognizing that winning in Chile, Argentina, and Mexico can be an entry onto the world stage every bit as effective as conquering Paris or New York.

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