

Ocean Cosmetics

INTRODUCTION

In the early 1970s, several Minnesota women who lived on farms close to each other began making a hand cream. The product eventually became known as Farm Hand Cream. It helped soothe and protect their husbands' and other farm workers' hands. Close friends asked for and were given the product. Other people also were interested in it and were able to purchase it for a nominal price. Farm Hand Cream was well received.

The process used to produce the cream was both time-consuming and smelly and, as the chemicals became more regulated, it became more difficult to obtain key ingredients. Because of these factors, the women quit making the cream in 1995.

In 2002 a daughter, Carol, of one of the women who made Farm Hand Cream discovered it was possible to use different ingredients and make a cream that was similar to the original one. A business idea was born!

IDEA FORMULATION

At first, Carol's thinking was "Let's make a hand cream and see who will buy it." She involved her husband and children, as well as her sister. Even her mother was involved (making it a three generation family venture) in the sense that Carol was able to use her mother's production equipment plus build on her past experiences. The needed equipment was minimal-a large pot to melt and combine all of the ingredients, and a blender to give the cream a thick and light consistency. Her sister helped refine the hand cream formula and identified a vendor who could provide containers for the finished product. Her two older children did much of the production work after school and on weekends in the basement of their home. Given family labor and equipment was used, start-up costs were about \$900. From the beginning Carol was concerned about her lack of business experience (she had none) and about what it would cost to get the business up and going. She and her husband did not have much in savings and she needed to keep start-up costs low, below \$1,000. She had a backup plan, however, if costs had exceeded \$1,000. Carol was quite sure her sister and two other friends would have been willing to contribute capital to the venture.

One topic that had come up at different times since Carol's first thought of her product idea was a name for her venture. She and her family discussed possible names with each other, off and on, but they could never agree. They finally decided to have a contest where each person could submit a name and then vote for the best name. The outcome was **Ocean Cosmetics**.

Carol had both her husband, John, and her sister, Sally, help identify who might need or be interested in the cream. John was a mechanic and used the cream on his hands with success. Further, he gave the cream, referred to now as Ocean Skin Cream, to other people who he thought might benefit from it (local mechanics and farmers) and asked them to take pictures of their hands before use, and after. The pictures showing hands before use, and after, were very positive for minimizing cracking, scaly and/or flaky skin plus removal of discoloration from working with oils and dirt. As such, Carol had established a need for her product among the same group/market that earlier had used Farm Hand Cream.

Sally was also helpful in suggesting market opportunities and even product extensions. One afternoon she said: "Carol, I have two possibilities for you to consider." Her first suggestion was to include scents in the cream and market these additional creams to groups such as women and teenagers. Carol thought it was worth a try

and added refreshing and fruity fragrances to her cream. She also tried scents with therapeutic traits, including essential oils like lavender (to remedy sleeplessness), peppermint and spearmint (for aches and pains). Early results were encouraging but Carol knew she would have more competition in these markets. Retailers who had helped in the earlier stages were able to talk to customers and find out their preferences. Those who bought the essential oils had asked for larger containers (initially, the only size offered was 4 oz.) to keep more of the cream on hand. Others thought that the fruity scents should be pocket sized so they could reapply at work or school. In response, Carol decided to package her creams in four sizes (½ oz., 2 oz., 4 oz., and 8 oz) and in three container shapes.

The other possibility suggested by Sally was a product opportunity, a lip balm, in different scents and flavors. One difficult obstacle that had to be overcome was to find a recipe that would not melt when carried in a customer's clothing pocket. After some experimentation that involved leaving lip balms in John's pockets, they found a recipe that stayed firm. This product, called Ocean Lip Balm, showed promise, too, but primarily for women.

One of the areas Carol knew the least about was marketing, including pricing. She pictured her products as selling at higher prices, given their characteristics. One key differentiation feature was that her creams/balms did not contain lanolin to which some people are allergic. An added distinguishing trait was their pleasant fragrances. Also, the ingredients in the creams were all safe and natural. This last trait, in particular, Carol thought was a real strength.

Another interesting start-up experience for Carol had to do with product testing. Carol knew from her mother's past experiences that her products needed to be tested for their capabilities of keeping bacteria from growing in them and, also, for the possibility of causing rashes for which she might be held liable (if a customer with a rash pursued litigation). She used a California firm for testing purposes and her creams were highly rated. Government regulations allow for approximately 10,000 living organisms in a lotion and her creams had ten. When Carol talked with one of the California testers he asked, "Given the highly positive results of your products, have you patented them?" Carol replied to him "No, but you have stimulated me to give it further thought."

INDUSTRY ANALYSIS

The industry that Ocean Cosmetics belongs to is the skin care industry, specifically the hand creams and lip balms product areas. Six key areas or forces to consider in an industry analysis are: barriers to entry, rivalry among existing competitors, substitute products, complementors, supplier power, and buyer power. The reason it is important to analyze these forces is that they influence a firm's ability to achieve a profit.

The skin care industry is relatively easy to enter-i.e., it has few barriers to entry. One obstacle is that a product needs to meet government regulations around bacteria level and rash minimization. Compliance tests for these regulations are simple to obtain for a fee less than \$500. Other start-up costs include equipment for making the product and marketing (including distribution) costs. These costs are fairly low if a venture starts small. This is the approach Carol took-i.e., she used family labor plus equipment from her mother. If Carol were to increase the size of production runs, additional equipment and production space would be needed. Hiring people to do the extra work would not be difficult since the community she lives in has a labor surplus. Another possibility would be to outsource production to another firm. In either situation, the benefits of larger production runs would be greater economies of scale. Although low barriers to entry benefit Carol's venture, it also benefits others who have an interest in entering this industry.

Currently many companies are capitalizing on the skin care industry. Some of the firms employ the cost leadership (or cost superiority) strategy, others the differentiation strategy and even others the focus/niche differentiation strategy. Table 1 contains information on Ocean Cosmetics' likely competitors.

Firms position themselves based on their strengths and often it is either ingredients or price. Burt's Bees is a strong competitor since its creams are developed from natural ingredients. Further, the firm claims that the ingredients have healing capabilities. Ocean Cosmetics uses natural ingredients, too, and some people use it as a substitute for eczema medications that are typically more expensive. Camille Beckman, with her glycerin-based lotions, is also a potent rival. Both firms tend to be marketed in the same stores as Ocean Cosmetics, and their displays are frequently nearby each other. Crabtree & Evelyn markets many of its items via upper class boutiques. They carry not only lotions but gourmet snacks, candles, and relaxation tools. Mostly, they emphasize a higher quality of life. The Original Udder Balm is more often found in farming supply stores. Because of Ocean Cosmetics's link with Farm Hand Cream, people tend to confuse Ocean Cosmetics with the Original Udder Balm.

Substitutes for skin care creams include: natural oils, homeopathic medicine, and spa treatments. Natural oils moisturize and soften the skin. Homeopathic medicine, although expensive, can produce good results. Spa treatments can also generate positive outcomes. But not all communities have a spa. For example, the closest spa for Carol is about an hour and a half away. Spas are also expensive, ranging anywhere from \$100 to \$1000 per treatment, depending on the type of service rendered. Although these products/services are substitutes for skin care creams, they also can be used in combination with creams.

Another area to consider in an industry analysis is complementors. For the skin care industry, complementors are firms that offer products that can influence the sales of skin care products. One example is stores selling soap. In some situations-e.g., gift baskets-soaps and skin care creams are sold together. Other examples are auto parts and gardening supply stores. These businesses can sell hand cream products to people who are looking for gifts for either auto workers or gardeners.

Numerous vendors or raw material suppliers exist for firms producing skin care products. Whenever a large number of suppliers are available, no one supplier can usually exert a high degree of power over a firm that purchases its products. That is, in this situation a supplier can't usually raise its prices because the purchasing firm can easily switch suppliers. Sage Shipping is one of the many raw material suppliers. Sage has had financial leadership problems in the past but its current owner appears to have the firm back on track. In fact, Sage Shipping has been growing rapidly in recent years. Early on in Ocean Skin Cosmetics' life it became a customer of this vendor. Sally recommended Sage Shipping to Carol at that time because it had just started selling scents and it was interested in developing further this aspect of skin care. To simplify her relationships with vendors (i.e., minimize the number), over time Carol has been purchasing more and more supplies from Sage Shipping. In turn, Sage has given Ocean discounts and customized services. Currently, Sage Shipping provides not only Ocean's hand cream and lip balm ingredients, but also its containers, and its container labels.

The last industry analysis force to be considered is buyer or customer power. Carol's current customers are retailers who, in turn, sell to end users. She started selling her products in two locations in her hometown, a hardware store and a drug store. Sally, with the help of a friend, identified another customer during Ocean's first year, a drug store with three outlets in neighboring towns. Sales revenue from these five stores in 2002 was \$6,240, but the business didn't start selling until June. In 2003, one of Sage Shipping's employees found two leads for Carol. The first lead was a building supply firm with ten stores located in Idaho, Montana and Washington. This chain is currently her biggest customer. Ocean's total revenue for all locations in 2003 was \$25,550.

The second lead from the Sage Shipping employee was that he told his wife about Carol's products. His wife works for a wholesale firm that distributes cosmetic products to drug stores in the region. Although Carol has talked with her twice and the wholesale firm is interested in distributing her products, she is uncertain what to do.

FUTURE DIRECTION

Two factors contribute to Carol's indecision about what should happen to Ocean Cosmetics. The first factor centers on the price the wholesaler is willing to pay. Currently her production costs are very low, about 20% of sales. Plus, she ships her products to the retail stores at little cost. Regarding advertising, displays are used in drug stores and the owners/pharmacists are educated on the benefits of the cream so that customers searching for an over the counter skin cream can be referred to Ocean Cosmetics. In the other stores in which her products are sold, only displays are used. Overall, her costs are about 25% of the retail selling prices. The wholesale firm has told her they would purchase her products for 50% of the current selling prices.

A second factor leading to her uncertainty is growth. Carol keeps asking herself: "Should growth be Ocean's goal?" If she decides to make growth a key goal then she recognizes that, in addition to the wholesaler's offer, she needs to consider the possibility of licensing the entire operation (production and marketing) to another firm in exchange for a royalty. She has heard of firms getting between a 10% to 20% royalty on sales. This would mean shutting down the family business. This might be for the best, because she reminds herself that a few family fights have occurred! On the positive side, the business has been both a challenge and a learning opportunity for her family. Of course, a third growth option she would need to think about is to grow **Ocean Cosmetics** by expanding the firm's current operations. Here, she would hire additional people and acquire the necessary assets to perform the expanded production and marketing activities. Carol would not, in this case, contract with a wholesaler or license her products to another firm. Lately, when she wakes up at night, she finds her mind contemplating these three options.

Discussion Questions

1. You need to do a SWOT analysis of Ocean Cosmetics. You need to make sure to explain the points of your SWOT.
2. What do you think is the competitive advantage that the company has? Do you think that this is a sustainable competitive advantage?
3. Carol has reduced the number of vendors with which she does business and is using primarily Sage Shipping. Discuss the positives and negatives of this approach. Is it smart to have just one vendor or it makes more sense to have multiple vendors?
4. Discuss the positives and negatives of each of Carol's three growth strategies (expanding the firm's current production and marketing operations, employing a wholesaler, and licensing both production and marketing to another firm). Which one is the best?

Table 1: Comparison of Competition I

Name of Company	Product	Strengths	Hand Cream Price and Sales Channels	Weaknesses
Burt's Bees	Full line of body care, including make-up and hair care. Also, candles.	Products made of beeswax and other natural ingredients.	Depends on what you buy. Hand cream around \$3.50/oz. Sold in drug stores, specialty body care stores and some grocery stores.	If the customer does not care about the environment, this could seem like a steep price to pay for beauty products.
Camille Beckman	Hand creams, lip balms.	Uses Wood Mallow, Ivy, Pellitory, Cucumber, Elder and Arnica herbs, glycerin, Sweet Almond Oil and Vitamin E.	Ranges from \$1 to \$4/oz. depending on quantity purchased. Sold in drug stores, specialty body care stores and some grocery stores.	Some customers find the lotion "sticky" because of the high amount of glycerin.
The Original Udder Balm	Udder Balm	Been around since 1800's (recently patented, though). A modified version of the product that soothes cow's dry, irritated teats. Claim that all other lotions copy them.	Approximately \$0.37oz. Sold in farm supply stores, some drug stores.	Some customers think it smells funny.
Crabtree & Evelyn	Soaps, Creams, hair care, body care. Also, home décor, gourmet kitchen.	Promotes living well, and having a balanced lifestyle—stress reducing products. Certain gourmet chefs endorse some of their products.	Depends on what line of products you purchase. (Around \$3.60/oz.) Sold in specialty stores and department stores.	Considered to be upscale, some people may never consider it...too luxurious for them.