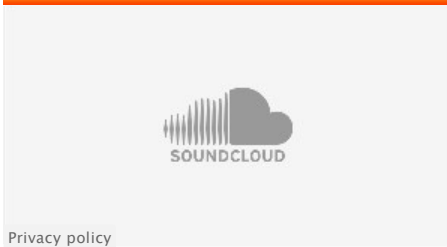


Cowen CEO Podcast Series - How to Catapult Customer Centricity at a Retail Haircare Leader Sally Beauty

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Insight by [Oliver Chen](#)



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On this episode, Denise Paulonis, CEO of [Sally Beauty](#), a global hair care [retail](#) leader with the #1 market share in color and professional hair care distribution, joins Oliver Chen, TD Cowen's Retail & Luxury Analyst. They discuss how Sally Beauty drives customer centricity and engagement across their brands and key initiatives such as Salon HQ, Virtual Color Experts, and Studio by Sally.

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Transcript

Speaker 1:

Welcome to Cowen Insights, a space that brings leading thinkers together to share insights and ideas shaping the world around us. Join us as we converse with the top minds who are influencing our global sectors.

Oliver Chen:

Catapulting customer centricity at a retail hair leader, Sally Beauty. This is a visionary podcast series about visionary ideas in people. My name is Oliver Chen. I'm Cowen's New Platform and Luxury Analyst. In this episode of our Retail and Luxury Visionary podcast series, we're excited to spend time with Denise Paulonis, the CEO of Sally Beauty. Sally Beauty is a global hair care retail leader with number one market chair in color and professional hair care distribution.

Denise has served on Sally Beauty's Board of Directors since May 2018. She's the President and CEO, a role she has held since October 2021. And prior to Sally Beauty, Denise served as CFO of Sprouts Farmers' Market, as well as the Michael's Companies.

Denise Paulonis:

Great to be here with you today, Oliver. Looking forward to it.

Oliver Chen:

Denise, so how are you defining and driving customer centricity and engagement at Sally Beauty?

Denise Paulonis:

Well it's really important, our DIY customers and our professional stylists, they come to us as a trusted source and resource for all things here. And so at Sally, customer centricity is about leveraging education and product knowledge to really help our customers get fantastic results with their color and care products. And with color in particular, creating confidence in the DIY execution or experience. At BSG, customer centricity is about being an ally to the professional stylist to really help them grow their business.

That usually begins with having the products they need to support their customers and being a core source of ongoing education. We're also extending it further into helping them in all aspects of their business. So a first step on that journey is making it easier for them to retail products to their clients with our stylist's platform that I look forward to talking about a bit more today.

Oliver Chen:

How are you driving innovation, what do younger customers care about?

Denise Paulonis:

Haircare is an amazing sector and it's undergoing a results-based evolution very similar to what happened to the skincare market a number of years ago. Products now go well beyond cleaning your hair to providing all types of more specific benefits that can be proven. Such as increasing strength, repairing damage, perfecting curls, to name just a few of those.

Additionally, we see customers increasing their interest in products that are free from certain ingredients that they associate as either less healthy or less environmentally friendly. Important to note they do want both the benefits and the clean attributes, not just the either/or. That's especially true of younger consumers. And in Sally, we drive this innovation in three ways.

First; through our own brands with products like Strawberry Leopard, which is vegan, cruelty-free, it's vivid color in a care line. And our Bondbar products, which is our new haircare brand, that's SLS/SLES, paraben, phthalate and cruelty-free and vegan.

Second; in partnership with our key vendors, we work closely with them to identify trends and bring new products to life. And finally; we love to help up and coming entrepreneurs and we do that in many ways, including those that we mentor as part of our cultivate program.

In BSG, our real focus is on close partnering with our key brands and our vendor partners to understand the current trends, really bring those innovations to life. Incredibly important in this effort is our ability to leverage our deep relationships with hundreds of thousands of stylists to effectively educate stylists on both the efficacy and the attributes of these new products and innovation items.

Oliver Chen:

Denise, for those who are less familiar, Sally Beauty has two divisions. Sally and Beauty Systems Groups or BSG. Could you give us a sense of each concept's key competitive strengths and marketing and what stage is each concept in as you think about key strategic initiatives?

Denise Paulonis:

Sure. Let me start with BSG. As you know, BSG through our CosmoProf brand serves professional stylists. The key competitive strengths are really the breadth of the product assortment, the convenience to shop how you want through either stores, e-commerce or full service reps. And our commitment to help a stylists grow their businesses, which we refer to as being an ally. That can happen through education and new offerings such as our Stylists Platform with SalonHQ.

Our sweet spot here is the ever-growing independent stylist population and generally Premium Pro products, not necessarily Prestige products. And while we'll always have the opportunity with assortment and convenience, I think the work that we're doing around the stylist ecosystem is the concept that we're really ramping up and has the longest pathway to growth in the future as part of our customer centricity strategic initiative to increase both loyalty and gross share of wallet.

On the other side, for Sally, this is our retail business. We start this business with the spirit that everyone is welcome here and then we back that up with, what I believe to be the best customer service in the industry. Our associates, many of whom are trained stylists, they focus each day on providing education and advice to help our customers get their desired results across hair color, hair care, styling tools, nails, and a number of other smaller categories for us.

But behind that customer service, our Pro Quality products at affordable price points. Our customer centricity and our own brand strategic initiatives are really doubling down on these points and provide the growth pathways forward and are the newer initiatives that we're working on. To bring that to life a little bit, our Studio by Sally concept where a customer can get hands on education, so literally DIY coloring their hair with the guidance of a licensed stylist, will go live with its first store later this quarter.

And we plan to be testing the concept in an additional five stores, including some remodels of current stores by the end of the year. Our flagship own brand Ion is a 250 million plus brand, and we're building on that success with a plan to grow our own brands from 34% of the business today to 50% in four to five years, driving innovation with products like Bondbar and Strawberry Leopard.

Oliver Chen:

Denise, A hot topic is value in this inflationary environment. Everybody's looking for bargains. What happens in the hair care industry at large to retain loyalty and also, how are you thinking about promotions and price increases? And how much may the customer take in terms of price increases or not?

Denise Paulonis:

Yeah, it's certainly a very dynamic environment. We are incredibly conscious of the impact that inflation has had on our customers, and that's true on both the retail and pro resides. We particularly see that in our customers searching for value in whatever way they might define that. What we found is that in Sally, we're utilizing more product bundles to create additional value for the customer, while increasing units per transaction.

That customer feels a little better about getting that upfront value bundle price to not be afraid to use what's in their medicine cabinet when they want to color again, versus what could feel like an impediment to say, "I need to go put out and spend more money to go shop at the store again." So we love those product bundles and how they're working.

In both businesses we're doing a lot in leveraging the strength of our CRM and our performance media programs to communicate both value as well as innovation to drive our traffic. That innovation piece is still real. While some customers are certainly feeling a bit more of the inflationary pinch, new products still seem to come to market and perform quite well. Even if they might start with a little bit more premium price or maybe a more novel choice to risk a little bit of your money on and see how that will fare.

I think of note, with 17 million known customers at Sally, we're really able to leverage that combined with an award-winning loyalty program to keep that customer coming back. And then in both of our businesses, customer service is a strength and we like to tap into that, including our improved in-stock position and omnichannel offerings such as two hour delivery and BOPIS to increase conversion. So kind of working across that customer and the whole sales tree to make it work for them how they want to shop with us.

But you asked about pricing. On the pricing front this year we will realize the wraparound benefit of some pricing actions we took late last year and we'll continue to pass through any additional price increases that come from our vendors. I will say we certainly hope that those are slowing down. We do believe and we hope that there is an end to some of that climb. But I will say beyond that, we're also taking a really careful approach given the macro environment, so don't really have plans to lean into further pricing this year as we continue to read elasticities and understand how the next few quarters evolve.

Oliver Chen:

Denise, you do have a rich heritage of great loyalty program. What's ahead? Loyalty programs are changing rapidly and they can intersect with customer data platforms as well. What are some highlights regarding your program and the go forward strategy there?

Denise Paulonis:

To us, that loyalty program on the retail side, it has a lot of traditional components of a customer being able to earn points, earn special bonuses and rewards. But where we see people really engaging on our loyalty side, including signing up for SMS and text messaging, is the combination of the way to have this be their outreach and their ability to connect with us to understand new products and new innovation. As well as understand the value of what can be coming through.

So while the key points of the loyalty program, I think are pretty consistent with a lot of what others are doing, that stickiness of our customer, our really high NPS score, that flywheel really works for them in terms of the goodness that they can get. And on the pro side, we don't really need a loyalty program because at the end of the day, all of our customers have to be licensed stylists. So we really do know them all.

But there what we see in leaning into this point of value, is we offer a credit card that gives them cash back discount on their purchases, and we do see that having a nice uptick with a little under 10% of our BSG sales happening on that credit card. So people see that value and in our minds that really creates the stickiness and loyalty to our brand for them.

Oliver Chen:

You talked about this a few times, but innovation, Denise, what does innovation mean to Sally Beauty and any other highlights in terms of what you're seeing in fostering on the product brand and customer side?

Denise Paulonis:

Innovation is pretty broad based to us. I think, first and foremost, I've talked a little bit already about the product side of that business and bringing good opportunity to bear. We will continue to do that with things like our owned brands, but we will also do that with our vendors. For us, the focus for innovation that we're really going after right now is on how we're serving our customers and that notion of customer centricity.

When we think about it across different businesses, we have on our Pro side, our SalonHQ stylist platform offering, which I'd be happy to talk about some more color there to really help our stylist customers be able to retail more product. And then when we turn to the retail side, it really is about doubling down on that education and expertise, which is both our Virtual Color Expert program as well as Studio by Sally. So for us that innovation is really twisting it and saying, "How do we get the best to our customers? And how to feel really comfortable leveraging great product, great styling tools? But be able to do all that in the best way to either grow their business or get their at-home results?"

Oliver Chen:

Denise, what are the Virtual Color Experts and could you highlight features of SalonHQ and what this program is as well?

Denise Paulonis:

Yeah. So let me start with Virtual Color Experts, which is unique to our Sally retail side of the business. When you think about the business today, we have our in-store beauty advisors and they are the best in the business at service and education around hair care and color. Many of them generally are stylists who might do this as a part-time job. But even with all that expertise, sometimes someone just has a more complex question in terms of the problem they're trying to solve. Or in other cases they prefer to engage online rather than necessarily come in and visit with one of our beauty advisors in store.

So what our Virtual Color Expert program supports is by providing that customer video access to a licensed stylist who can coach the customer with whatever need they have. Think about this as if you're in a store, our associate in the store can pull up their iPad, they can connect live to a licensed stylist. The customer can provide more detail about what problem they're trying to solve, and literally the customer can move with that iPad up and down the aisles of the store to pick the right products to solve their problem and walk through what they need to do.

That same ability is what we're going to be launching later this year online. Where you'll be able to get that consultation live with a real human being and they'll actually be able to help you build your basket to have what you need to get the success that you want. We've only done the test in store so far in 75 stores, but what we're seeing is our NPS scores up about nine points off of an already really high base and we see average transaction value up 30 to 40%. So that idea of the quality of service, building the basket, building the loyalty of that customer, we're really excited about.

And as we watch the online launch happen later this year, we hope that we'll have great news to report there about that carrying over into the online way as well. So a pretty fun program to be able to bring that expertise to life to the customer and what still feels like a real human way, although in an online type of environment.

SalonHQ very similarly is a program for our BSG business that has that same digital connect point, digital and modern feel, but is really about helping our stylists be able to retail more product, in turn grow their business and make more money. So with SalonHQ, what we really think about is we know our stylists are eager to grow their businesses and most of them will currently retail product when a customer comes in for an appointment. But that said, the stylists talk to us about retailing product can be complicated, being able to stay in stock and having the right assortment in the right week when a customer comes in, it can be a little expensive because they have to purchase and hold the inventory.

And for some it's a little uncomfortable as they have to drive and try to make that sale at the same time the customer pays for a service. But yet we also hear, and we also know that when asked a salon customer will say their most trusted source of a recommendation is their stylists and they gladly have that stylist earn the money from the product sale as long as the products are competitively priced, rather than giving that incremental profit to perhaps a different retailer.

So with the Stylists Platform with SalonHQ, we really address a lot of those pain points to allow a stylist really a way to compete in a digital world that they wouldn't be able to do on their own. So as maybe as many words as that was, ultimately what this does is it says with the platform, a stylists can set up their own online storefront in just minutes with the assortment that they want.

So it can be as tailored as five or 10 products or as broad as almost all of the CosmoProf BSG care and styling assortment. And they can set up that assortment and set up that online store without needing to buy and hold inventory. The stylist will then be able to offer suggestions or products to the customer while the customer's in their chair, they'll have a QR code that could direct the customer to how to get to the online storefront or they can tell them directly how to get there.

And then the customer can choose to order when they're ready, which might be at the time of service, it could be days or weeks later, and the product just get delivered straight to the end customer's home and the stylist is paid a commission immediately on the sale of when the product is purchased.

So the stylist can earn as much money as they were earning in inventorying and holding that product in their salon. But what they're able to do is not have to put out that cash up front and the customer, the end customer can have it be their choice when they purchase product rather than doing it immediately at the time of their service.

So we see it as an opportunity to drive sales near term and more importantly, increase the loyalty of stylists to BSG with this service to drive sales and share of wallet over the longer term. So both of these are ways of maybe a bit more sophisticated business opportunity build on the Sally side with better education with the Stylists Platform about making it easier for stylists to live a little bit more in that online environment as well.

Oliver Chen:

Sounds like a win-win in terms of inventory management and also customer centricity. Denise-

Denise Paulonis:

That's what we're hearing.

Oliver Chen:

... there's so many good initiatives here. How would you rank them in terms of how they may impact the younger customer or how material they'll be as we think about our financial models as well?

Denise Paulonis:

Yeah. They're really all starting to ramp up. So own brands is the nearest and closest in opportunity in terms of what we think will impact the P&L, both with top line sales and with margin. Own brands is really on the retail side of the business, but with about 34% of the business there today and really stretching that to 50 in the future, we see that not as a trade-off with Pro Brands. We see it as both businesses growing together.

So winning with our vendor partners and being able to have own brands push into additional categories just beyond hair care and color, things like essential oils and that type of space. We have the talent inside to drive this portion of the business. It'll come at a higher margin and it's offerings where we can really tailor it to the customer base. So both Strawberry Leopard and Bondbar are great examples of things that are ripe for today's customer.

Strawberry Leopard for the younger side is really about vivid's and bringing that to life with both color and care products. And then the Bondbar product itself is around a repair from any of that coloring activity you've done, but it's also for any and all hair types, including curly and coily hair, which not every product can cross into all different hair types. So we're excited about that. Probably the closest in, in terms of impact.

And then you start building these other programs, so Virtual Color Expert and SalonHQ and our Stylists Platform come shortly after that. So they're really all in test mode right now. We hope that with successful tests we'll start ramping both of those businesses towards the end of 2023 and into 2024. And then we'll see how big they can be based upon ramping them up a little bit more than where we are today.

If you look a little further out, the next nearest in on our trajectory is our Studio by Sally store on the Sally side. So that's really a little further out. We're going to open one store here this quarter. So in fairly short order in the Dallas area, we'll get five more stores in test. And many of these are retrofits of existing stores versus necessarily being a new store, but a very different concept and a concept that we think that can take that education piece to the next level and take it off of the Virtual Color Expert, do it on a screen to actually make it a hands-on fun experience.

And so for that one, we'll be pushing just the beginnings of that pilot activity, as I said, later this quarter and later this year. But as you look to the end of 2024 and beyond, we think that there could be great potential here. And if I just tell you a little bit about what this really is. So it's a store with a DIY salon studio area. So in addition to shopping the store, the stores are laid out with a dedicated studio space.

A customer can book an appointment with a licensed stylist, and that appointment is to learn how to achieve a desired result like all over color, highlights, root touch-ups, just to name a few of the types of things. The stylist will consult with them, they'll help them pick the right products from the Sally assortment for the appointment. They'll actually provide hands-on coaching while the customer DIYs and the stylist will also help video the session if desired, using the customer's phone, so the customer can keep it as reference.

So you end up with a customer who will leave the studio with their desired result, so their hair done in whatever way that they're trying to get their help and the know-how to do it again at home. We're also going to have small group classes, watch and learn opportunities and have all these be at a great value. So this is another one we're on that longer trajectory of customer-centricity. It's an offering to gain new customers, those who might not have ever been willing to try this, which we also think is really appealing to younger customers who might be coming into the category for the first time.

But also deepen our relationship with existing customers as they just might love to try the concept, see what other ideas they have all while making it a fun and inviting experience. So from a growth standpoint, early on owned brands, then pushing into some of these new initiatives we talked about. And then very similarly in driving our P&L, we're focused on expenses and cost control as well. So we recently completed a piece of store optimization work as well as some DC consolidations.

We've pulled about 350 stores out of the Sally chain and closed two of our BSG distribution centers that were smaller, really enabled by a lot of the supply chain improvements we've made over the last few years. As we also look to the end of '24 and into 2025, we're taking that same spirit of efficiency and channeling it into more ideas in terms of cost savings.

Whether that be how we can think about programs and offerings like our loyalty program to be more efficient, whether it can be automation and outsourcing, whether there's more network optimization. All things so that while we're growing the top line, we're also going to become more efficient, a little further down the P&L. And we think that that's a great marriage to get a long-term algorithm of low to medium single digit sales growth and then low double-digit operating margins, which is what we're striving to do in the coming years.

Oliver Chen:

That's very helpful, and it sounds quite experiential as well. You touched upon this, but what's ahead on terms of the store base and what you're doing there? And then on closing remarks, as we think about the next three to five years, where do you see Sally Beauty? What are you most excited about?

Denise Paulonis:

So the store strategy, a really great question, and we've gotten a lot of questions about this. And I think one of the most important starting points to understand is that as we started into the store optimization program, a key fact is that materially all of our stores are four wall EBITDA positive. So to embark upon store optimization, it wasn't really about just closing unprofitable stores because we didn't really have many of those. But rather it was about responding to the shift in sales to omnichannel and addressing growing labor and real estate costs.

So with the help of analytics, we profiled all of our stores and accessed the likely sales recapture and then the expense savings we'd also see from a closure. We started with approximately 100 stores that we tested as a pilot to prove out the model on the sales transfer and then after about a year of study and positive profitability results, we refined that model, which led to the 350 stores we closed in December.

And at a 40% recapture rate, we anticipate the cost reduction from those closures to be about 50 million in fiscal '23, that is partially offset by about \$40 million from lost sales, but that nets us 10 million in profitability and increased operating income benefit. We think that this was the right tranche of stores to do right now according to the model. So we don't expect that we'll see a large scale set of closures in the near future, but we'll continue to update the analysis annually and then we'll act on any additional opportunity that we see. Whether that could be through further e-commerce trends and growth in that area, the business or other cost opportunities that might become available. But feel pretty good that we're at the right place for the next couple of years.

And then for us, I think in terms of closing thoughts that you suggested. What really excites me most about the company is the culture that we're building. The culture of our organization is really grounded in our purpose statement, which is to inspire a more colorful, confident, and welcoming world. That certainly leaves plenty of room for growth. Our near term path is to leverage the strategic initiatives that we've been talking about today, so customer centricity, own brands and innovation.

And then our fuel for growth efficiency, cost savings effort to really make Sally the undisputed expert and leader in professional color and care for both the DIY consumer and the professional. I think behind that, what's fantastic to me is that we've got a consumer tailwind of individual self-expression, we've got our focus on the customer, including digital investments we've made to be able to meet the customer where they want. We've got a very clear vision for how we will win. And I think we have the agility and the talent of the organization that all combined give me a great confidence in where we're heading and in our future.

Oliver Chen:

Well, Denise, it's been great to learn more about how you're catapulting customer centricity through virtual engagement, virtual stores, do-it-yourself and new programming. As well as lots of product and brand innovation. Great spending time with you.

Denise Paulonis:

Great to spend time with you too, Oliver. Thanks very much.

Speaker 1:

Thanks for joining us. Stay tuned for the next episode of Cowan Insights.