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**UNDERGRADUATE RESEARCH FELLOWSHIP  
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***Effects of Market Failures  
on the Skincare Industry***

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## **Effects of Market Failures on the Skincare Industry**

### **Introduction**

Recently, social media channels like Instagram, YouTube, and TikTok have become powerful sources for information, where influencers show their morning and nightly routines. This has spread more awareness about taking care of one's skin and beauty, and massively boosted the skincare industry. This rise in interest has led to new consumers eager to spend a little bit more, investing in treating their skin right. However, with a rise in interest comes an increase in already existing economic problems like information asymmetry and negative externalities. Acknowledging these challenges is important to help the skincare industry grow even more and effectively serve consumers. The general objective of this research paper is to identify and analyze the types of market failures in America's skincare industry. In addition, this paper will also explore the negative impact of these market failures on the customers of skincare brands and identify ways to minimize these negative impacts.

Market failures arise when the social surplus at the free-market outcome is smaller than the maximum possible social surplus in the market. This is a problem because when the system of the free market "fails" to work efficiently, it can negatively impact and harm businesses, their customers, and even the broader society. Although the skincare industry has been booming, it also experiences some market failures like quality control issues, information asymmetry, negative externalities, and regulatory failures. The effect of these market failures can break the relationship between skincare-related businesses and their customers, which, over time, can cause a negative stigmatism against these businesses.

## Information Asymmetry

With the rise of social media, it has become extremely easy to access information and connect with people from around the world. Anyone can now type in their symptoms of any skincare concern, whether it is dry skin, acne, rosacea, and more, and someone will have an answer for how they tackled their problem. Floods of recommendations for products to buy and natural remedies to make are just a tap or swipe away. Looking at this at face value, it seems great! Instead of spending massive amounts of money going to a dermatologist and all the time going to the checkup visits, the internet seems to have an answer to all the problems a medical professional knows. But what most social media influencers do not inform their followers of is that everyone's skin is different, which means what might work for one person might not work for or could even harm someone else.

There is a ton of good information and education on the internet about how to take care of skin care concerns, but it is drowned out by the thousands of product promotions to buy other products and quick schemes to get rid of acne fast. As a consumer, it is hard to pick out the gold within the pile of rubble. Within the skincare industry, there seems to be a lack of transparency about what consumers really need for the health of their skin. According to Maupin, "Less than 10% of US consumers have seen a dermatologist to help diagnose their skin and educate them about how to solve their skin concerns". This means that 90% of US consumers of skincare products are buying what they assume they need or are being told to buy the products from an outside source.

Lack of transparency can also come from the companies themselves by claiming that they are an all-natural brand. In the past couple of years, there has been a huge surge of interest in clean skincare, and companies seem to have jumped to make the most profit from it. Some companies market these products to be organic when, in reality, there are many chemicals going into these

products before they hit the shelves. Some of these chemicals are not necessarily bad; most of them are preservatives to keep the product from molding or chemicals used in the process of making the product itself. But deeming these products organic would be misleading and wrong. According to Maupin, “Skincare companies can loosely claim 'organic' for the process of extracting ingredients from organic produce- sometimes the 'organic' extraction is done using chemical methods”. By claiming that these products are organic, it provides a disconnect with the users of these products because when they are choosing which products to buy, if their core value is finding something that is truly organic, then they are not understanding what they are purchasing. This presents a problem when the information disconnect ends up hurting the consumers when they are allergic to certain ingredients.

### **Effects and Solutions of Information Asymmetry**

When consumers are not informed about their own skincare concerns or possible ingredients in skincare products, it can affect their decision-making skills and potentially expose them to harmful ingredients. It can also affect the image of firms and cause a loss of revenue. An example of this would be the reputation of St. Ives. St Ives has an apricot facial scrub, which is considered abrasive and irritating; because of this, their reputation has been “maligned after receiving years of negative media attention” (Sweeney 2024). To solve this problem, there needs to be more honesty in the skincare industry. Companies should be more direct about which ingredients go into their products and help customers understand that synthetic skincare is not all bad and all-natural skincare is not all good. Skincare companies should also be more educational with their advertising and express which ingredients would help certain problems, not some broad category like “Helps Acne”.

## **Information Asymmetry: Quality Control Issues**

When it comes to the skincare industry in the United States, managing the quality of ingredients in skincare products is under regulated which presents significant challenges. To start with, The FDA does not have a strict testing process of product quality in the skincare industry, so companies are able to rush production without properly going through all the necessary safety tests. These safety tests need to be done to manage the number of harmful substances being put in skincare products. This creates an issue because the customers are virtually unaware of the potentially harmful substances they are being exposed to, they buy the product because they have trust in the firm. According to Maupin, “Because of the lack of required safety testing in the US skincare industry, many smaller beauty brands do not have extensive testing protocol in place. These companies can sell skincare products directly to consumers without completing rigorous testing, such as toxicology profile or patch testing for cosmetic allergens.” By excluding these protocols, these smaller companies are putting themselves and their customers at risk. Without knowing it, consumers are at risk for allergic reactions, potential skin damage, exposure to cancer-causing or other harmful ingredients, and more.

In addition, the United States has taken a remedial approach to testing skincare products. They allow products on the market and “only ban substances that have been proven to be harmful” (“Plus Chem 2023”). The problem with adopting this method is that the product has already been on the market for an extensive period of time and therefore could have harmed an unknown number of consumers without their knowledge of the possible harmful ingredients. As of today, the United States has only banned 11 substances. Compared to the regulation system that the United States uses, other jurisdictions like the European Union focus more on a preventative approach so that there are fewer negative effects of quality control issues. The European Union requires a safety inspection for each product before it can appear on the market. This inspection focuses more on

the safety of the ingredients being used in each product rather than the overall product itself. By focusing on the ingredients, the European Union can build a database of safe ingredients that are most typically used in skincare products. According to the European Union website “many thousands of different cosmetic products on the European Union market are all derived from a limited number of substances”. Through the inspection of the ingredients the European Union can also ban ingredients it deems “of potential concern for human health” (Scientific Committee on Consumer Safety 8). The European Union has currently banned 1,300 ingredients. Whilst the European Union regulation system is extensive and can be considered costly the United States is heavily under regulated so adapting some of the qualities from the European Union's system can help cut out the severity of this problem on the United States' skincare industry.

### **Effects and Solutions of Information Asymmetry: Quality Control Issues**

When a factor like quality control falls short, it can have effects on both consumers and firms. This can lead to safety hazards for the consumers, of which they are unaware they are being exposed to. It can also lead to distrust in the firm, loss of revenue, and potential legal action. To prevent consequences like these, the United States should create a more of regulatory system that the FDA should uphold for the skincare industry. The FDA should regulate the skincare industry similar to how it regulates the food industry. Right now, the FDA's goal for food is to “transform the nation's food safety system by shifting the focus from responding to foodborne illness to preventing it” (“Food Safety Modernization Act” 2024). By applying this goal to the skincare industry, it builds overall trust in consumers' minds because preventative methods make sure that the quality is up to par before any consumer touches it.

## Externalities

From packaging to transporting to consuming, there are unintended consequences which can affect anyone. The skincare industry is not immune to negative externalities. Some examples would be the extraction process of ingredients and plastic packaging.

There are two types of skincare products, natural and synthetic. Synthetic skincare products are made by natural resources that are then chemically processed. Extraction of synthetic materials, which are generally derived from petroleum (for example, mineral oil, paraffin wax, sodium lauryl sulfate, and diethanolamine) is extracted by using carbon-intensive and refining processes. By using carbon-intensive processes it generates high levels of carbon dioxide gas emissions which play a part in increasing global warming. According to (Herring and Lindsey 2020) some examples of public health risks from climate change include: “extreme heat and poor air quality increase complications from the underlying heart and respiratory conditions like asthma, renal failure and pre-term birth, and as temperatures rise, there will be more heart-related illnesses and deaths in both urban and rural areas” and, additionally “human-caused climate change also threatens food safety in multiple ways including lowering the nutritional quality of staples like wheat and rice, causing greater accumulation of mercury and other toxins in seafood, and increasing the chance for food-borne pathogens to enter the food supply”.

Packaging in the skincare industry is mainly dominated by plastic. Plastic packaging is favored by others because of the cheap cost and durability but it also has an effect on the environment. Plastic does not decompose which means that as people use more of it, it accumulates in our environment. “The organization Ocean Conservancy estimates that 11 million metric tons of plastics are dumped into our oceans every year on top of the estimated 200 million metric tons already circulating in them” (Goldberg 2023). Plastic does not only harm ocean

ecosystems but human health as well. Toxic materials including manufacturing chemicals which have been embedded in plastic “get into people, mainly by eating contaminated seafood” (Hayward 2020). Exposure to chemicals in plastics can impact human health since they “accumulate in the body, can mimic, block or alter the actions of hormones, reduce fertility, damage the nervous system and/or cause cancer” (“Chemicals in plastics” 2023).

### **Effects and Solutions of Negative Externalities**

The effects of negative externalities could potentially harm an abundance of people, whether they buy the firm's products or not. This could potentially affect revenue when negative externalities like releasing carbon emissions are taxed by the U.S. Environmental Protection Agency. Some solutions to help cut back on the number of negative externalities occurring would be research on how the process of development may be affecting others. Plastic usage can be cut back by banning single-use containers and focusing on packaging that reuses old containers.

### **Conclusion**

In conclusion, the United States' skincare industry is riddled with market failures that can have long-term effects on the relationship between consumers and firms. Dealing with these problems can benefit the consumer by making them more knowledgeable about what they are buying, and can benefit the business by providing them with a quality product, which they know is going to sell because of the trust still built and kept by their customers.

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