DRESS FOR SUCCESS

Establishing a winning proposition in the Chinese apparel market

OC&C
Strategy Consultants

China is now the world's largest apparel market. Despite the slowdown of the economy, apparel retail in China remains one of the fastest-growing markets in the world. Domestic players have traditionally dominated the market, however, the market is undergoing a transformation as the urban middle class grows to prominence. Foreign apparel brands may benefit from such transformation as Chinese consumers are becoming more sophisticated, starting to place more importance on quality and design, while price is no longer their top priority. Thanks to overseas travel and media exposure, consumer awareness of foreign apparel brands is now higher than ever. However, since a massive number of international brands have been flooding in, Chinese consumers are now facing many more options and becoming more selective. Moreover, rapid growth of online retailing (especially cross-border e-commerce) is changing how consumers shop and complicating the offline store economics. OC&C shares its insights into how an international apparel brand can succeed in China from its 2016 Apparel Proposition Index Survey.

MACRO LANDSCAPE

Fuelled by strong economic growth in the past and Chinese consumers' strong willingness to spend on apparel, the apparel market in China has been expanding rapidly in the past decade. Since 2015, it has surpassed the USA and become the largest apparel retail market in the world, valued at about USD 280 billion (Figure 1). Whilst market growth has damped down in recent years with the economic deceleration, China's apparel market remains one of the fastest-growing markets in the world, outpacing UK and USA in its growth trajectory.

OC&C APPAREL PROPOSITION INDEX SURVEY 2016

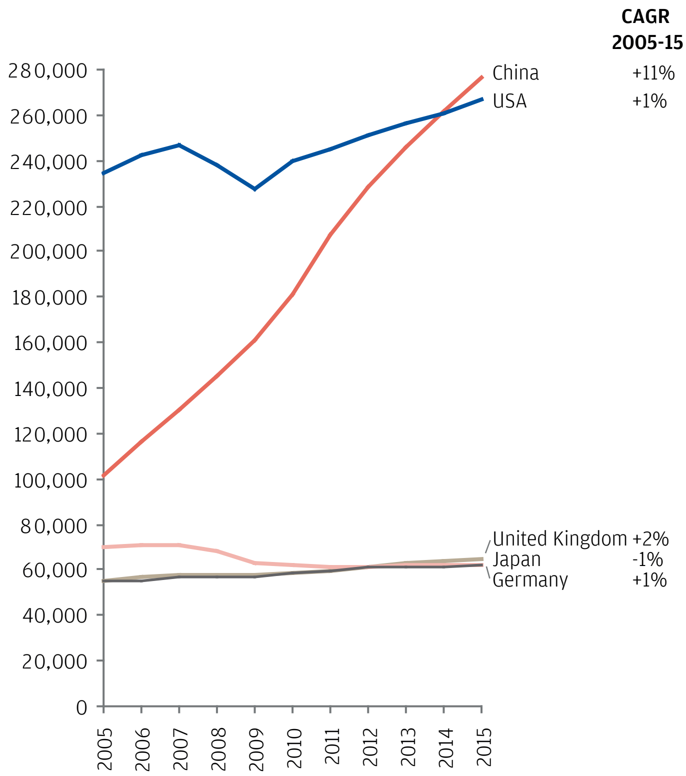
How do Chinese consumers make purchasing decisions on apparel? What do they value about foreign vs domestic brands? Which international players are most favourably perceived by Chinese consumers? Why?

To answer these questions and more, OC&C conducted an exclusive consumer survey, drawing on a sample of 2,600 respondents from 22 cities across various regions and tiers. The survey took place during March and April 2016 and canvassed the opinions of respondents over 16 years of age. In addition, we conducted qualitative consumer interviews in May to draw an in-depth understanding of how these consumers make their decisions.

FIGURE 1:

Top 5 Markets for Apparel, 2005-15

Retail Value, $m



Source: Euromonitor, OC&C analysis

With a population of almost 1.4 billion people, combined with explosive expansion of the middle class (annual household incomes of between US$9,000 and $34,000) and urbanisation, it is not a surprise that China is home to one of the most dynamic apparel markets in the world. On average, across 22 cities spanning different regions and tier groups, consumers purchase apparel almost once a month, spending around 6-7% of their disposable income on it. As apparel plays an important part in consumer identity, more than 70% of surveyed respondents claim that they are more willing to spend on clothing than before.

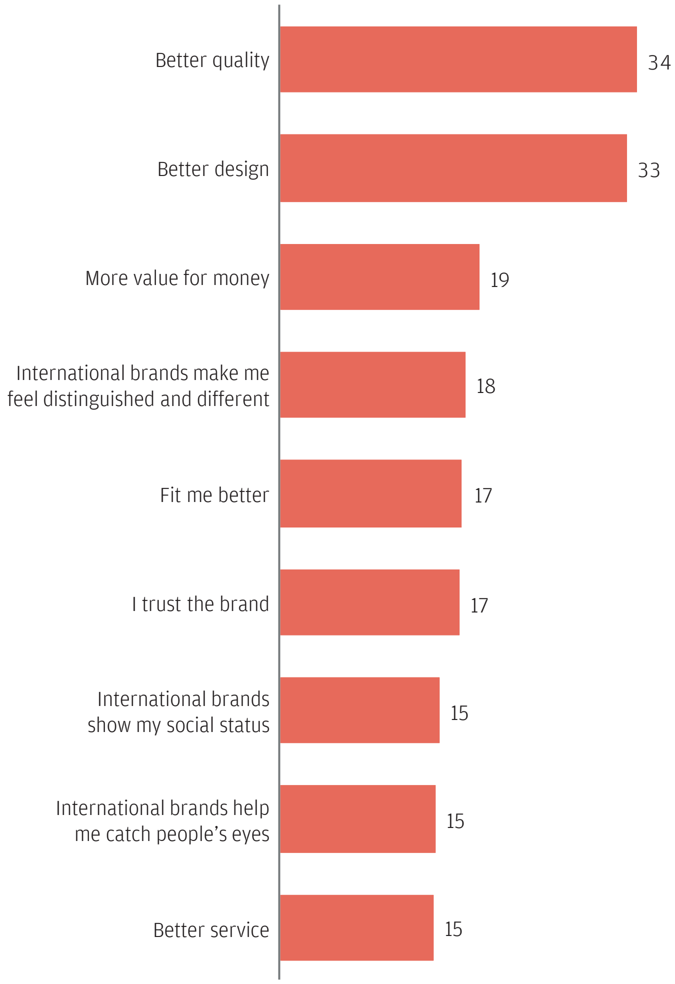
Increasing discretionary spending and consumer sophistication are giving international apparel brands significant new opportunities. Although domestic apparel brands have taken the lead in the past, especially in the non-sportswear segments, almost 50% of respondents now show preference for international apparel brands over domestic counterparts. Moreover, perceptions that their product are a status symbol are no longer a key driver for the pursuit of international brands. Instead, people are in favour of international apparel brands mainly because of the better quality and design (Figure 2).

However, there are still challenges for international brands. Exposure to a multitude of different brands, as well as the continuous inflow of new entrants has intensified competition in the market and Chinese consumers are now more selective. Domestic apparel brands such as La Chapelle continue to have an edge with their extensive store networks and low price options. Furthermore, online channels have changed consumer behaviour, complicating retail dynamics and pressuring offline store economics. In 2016, ASOS announced the closure of its Chinese business, while Marks & Spencer also closed five stores in Shanghai. These are stark reminders to players looking to enter the Chinese market that success is not guaranteed. What could have gone wrong for these international apparel brands? Is it more related to brand awareness, assortment, price, store operation, cost or something else?

FIGURE 2:

Top Reasons for Preferring International Brands

% Respondents



RETAILER RATINGS

As part of the survey, we asked Chinese consumers to rate the international apparel brands they purchased from in the past year on a 1-7 scoring system. The highest rated retailers for each price segment are showcased below.

FIGURE 3:

Top Apparel Brands by Price Positioning

Based on Respondents Who Have Purchased at Least Once in the Past Year

	Light Luxury	Mid End	Mass
1	J.CREW	oasis (OASIS-STORES.COM)	FOREVER 21
2	BOSS HUGO BOSS	AMERICAN EAGLE OUTFITTERS	GAP
3	TED BAKER LONDON	TOPSHOP	C&A

SUCCESS FACTORS

For an international brand to succeed in the Chinese apparel market, it should be heedful of the following four critical factors, which are brand building, product localisation, price equalisation and product quality.

1 BUILD YOUR BRAND, OFFLINE AND ONLINE

According to Chinese consumers, "brand" is still the most critical decision factor in their apparel purchase. Almost 60% of respondents only buy products from selected apparel brands they are familiar with, and 70% say they have higher brand loyalty than before.

Despite the flourishing online channels, physical presence in China is still the most important way for Chinese consumers to know about international apparel brands (Figure 4).

Many international apparel brands are still relatively unknown to Chinese consumers, driven partially by a limited store network in the country. However, it is not only about the number of stores you have, but whether you are getting into the right locations. As Chinese consumers have integrated their apparel shopping mission together with hanging out with friends / family or going out for fun, opening stores in popular locations where consumers visit most often has become even more important for brands. Forever21 for example, with stores either in prime retail locations or popular one-stop shopping malls, has achieved much higher awareness than brands with similar size of store networks (Figure 5).

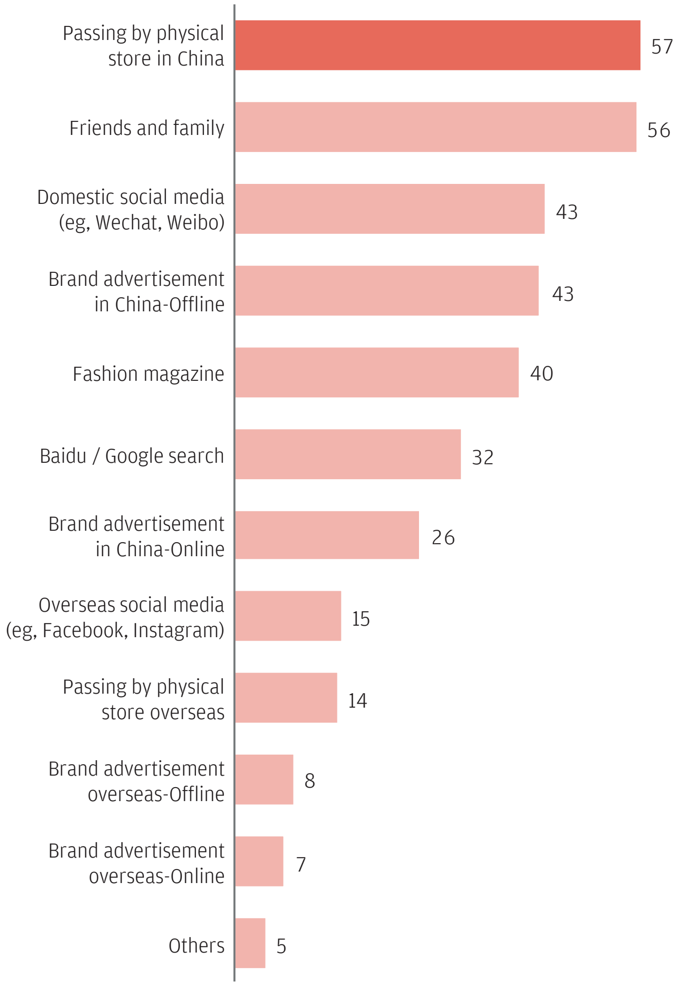
Whilst having a large scale physical presence appears to be the most effective way to build a brand in China, it is neither cheap nor easy. As internet penetration in China and its e-commerce market continue to grow, building brand online will become a critical complement to the offline presence. As a matter of fact, 65% of consumers research online before they make a purchase.

Apart from traditional e-commerce strategies such as selling on T-mall and brand own websites, the power of domestic social media such as WeChat and Weibo must not be underestimated. WeChat allows companies to create exclusive content and games. With WeChat's 697m (2015 Q4) monthly actively users, being able to leverage such channels will definitely determine a brand's success in China.

Many fashion players have already started to partner with WeChat to provide a unique and interactive experience to consumers. For example, H&M allowed in-store QR code scanning for WeChat Red Pocket (coupons), Burberry offered its account followers to view fashion week Autumn/Winter on the app, Kate Spade launched a flying-lantern game allowing followers to write wishes and greetings on it.

Apparel players should look to develop their brand and personal connection with consumers by setting up official brand accounts, developing exclusive content and partnering with key fashion individuals such as models, bloggers and celebrities to echo local voices in the market.

FIGURE 4:
Top Channels For Brand Awareness
% Respondents



"H&M HAVE STORES IN ALMOST EVERY POPULAR MALL / LOCATION – IT'S HARD NOT TO SEE THEM, AND I ALWAYS DROP BY TO LOOK FOR NEW STYLES OR IDEAS TO MATCH MY OUTFITS"

– 27 YEAR OLD

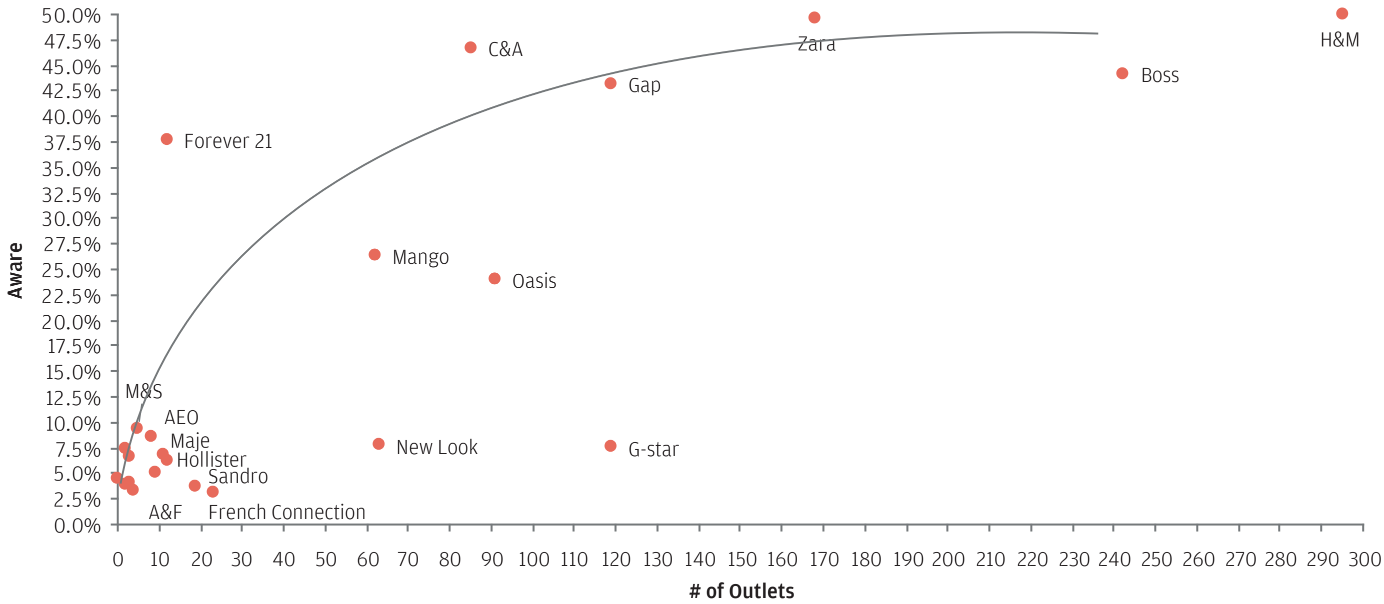
> **"I TRAVEL OVERSEAS A LOT AND HAVE FRIENDS WHO STUDIED ABROAD – THAT'S WHERE WE GAINED KNOWLEDGE OF INTERNATIONAL BRANDS"**
>
> **– 35 YEAR OLD**

> **"I HAD NEVER HEARD ABOUT FOREVER21 BEFORE, UNTIL THEY OPENED THAT HUGE FLAGSHIP IN EAST NANJING ROAD"**
>
> **– 34 YEAR OLD**

FIGURE 5:

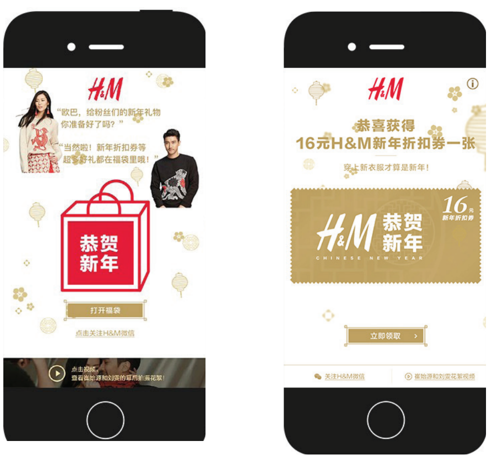
Brand Awareness vs Portfolio Scale by Brands

% Respondents



CASE STUDY

H&M integrates store promotion with its WeChat account, where consumers can scan QR codes either in-store or online to get red pocket (coupons) to be used for H&M purchases. The partnership with a top-tier model and her reality-show "boyfriend" further attracts attention to the brand and its WeChat account. To maintain those followers, H&M then provides daily fashion & style match news push and constant promotion, which provides links to its online store with in-WeChat purchase and payment.



H&M CNY red pocket

Celebrity style and match guide

H&M online store directed from WeChat

"I LEARNED ABOUT J.CREW WHEN I WAS STUDYING IN THE US"

– 26 YEAR OLD

2 UPHOLD YOUR BRAND HERITAGE WITH A LOCAL TWIST

Chinese consumers, especially the middle class, show high preference for international over local apparel brands (Figure 6). Despite the premium they may have to pay, almost 50% of respondents favour international brands for various reasons, e.g. better quality, design and brand image.

One of the key questions international apparel brands should consider in their China entry strategy is, what products they should bring to China market? Should it be exactly the same as in home market? Or should it be China / Asia-specific? What should be kept identical worldwide? What should be adjusted for local market?

From our survey, it is obvious that Chinese consumers want a tailored assortment. More than 90% of respondents expressed their desire for Asia / China-specific assortment from international brands, such as design / styles, cutting, colour / pattern and size. Brands that have managed to adapt their products to the Asian market have had proven success. For example, Burberry launched Blue Label in Japan, with product options tailored for Asian skin tone and stature. Gap also broadened its size range by introducing smaller options (e.g. XXS) when entering China.

The importance of localising assortment and fitting is unquestionable. When first entering China, ASOS faced massive complaints from Chinese consumers for providing limited assortment with styles not suiting Asian preferences, e.g. deep V dresses, see-through tops and mini-skirts. For styles that are welcomed by Chinese, fitting turned out to be another issue, with consumers finding dresses with the right waist size are too long and pants with the right hip size too tight in legs. ASOS eventually failed to win customers from domestic online apparel giants such as Taobao and T-mall and exited the market when their revenue failed to justify the high costs.

However, localising assortment doesn't mean you lose brand essence or heritage. With the rapidly-growing number of Chinese travellers and overseas students (Figure 7), more and more Chinese consumers are learning about and becoming fans of the brands in their home markets. When these consumers come back to China, they are more likely to be core customers and advocates of these brands, seeking designs which represent the brand heritage.

In summary, localisation strategy requires striking the balance between adhering to brand heritage and employing local customisation. Insufficient localisation may alienate consumers with unsuitable assortment and fitting. Over-localisation may eventually lead to the loss of a foreign brand's distinctive edge and put it at risk of being considered a local brand.

FIGURE 6:
Acceptance of International Brands
% Respondents

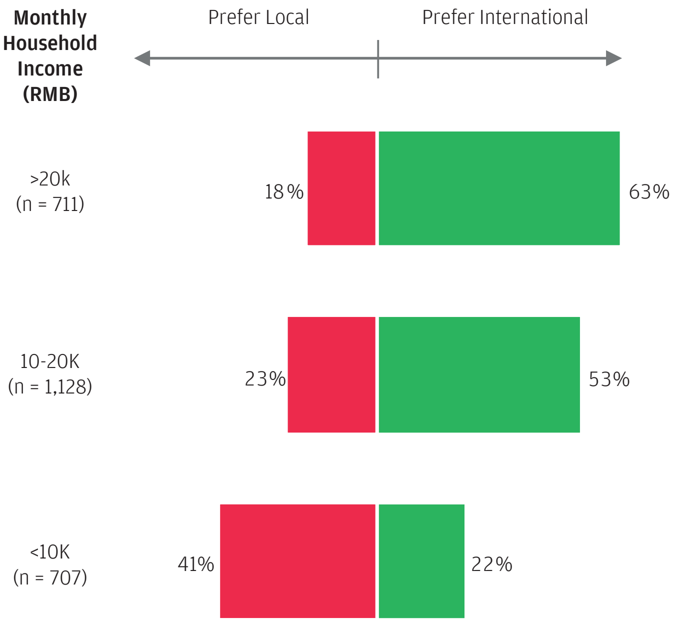
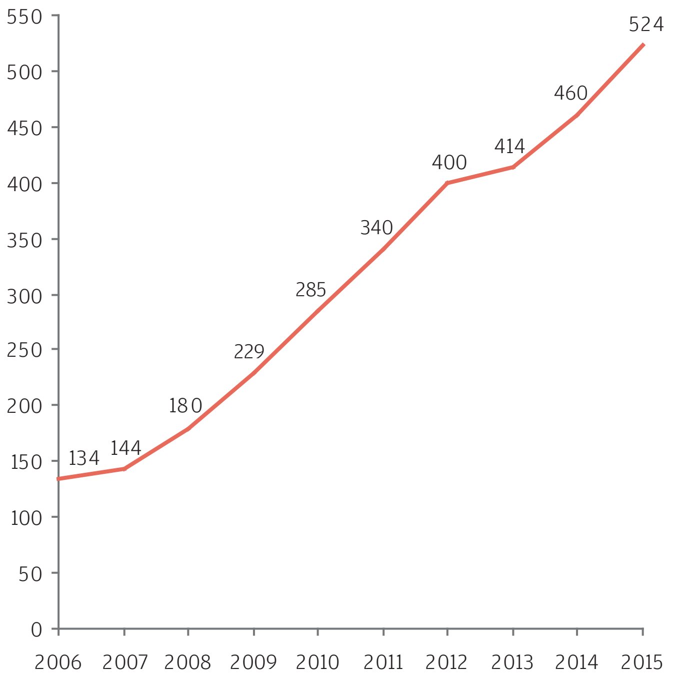


FIGURE 7:
Number of New Overseas Students Per Year, 2006-15
k Students



3 RETHINK PRICING

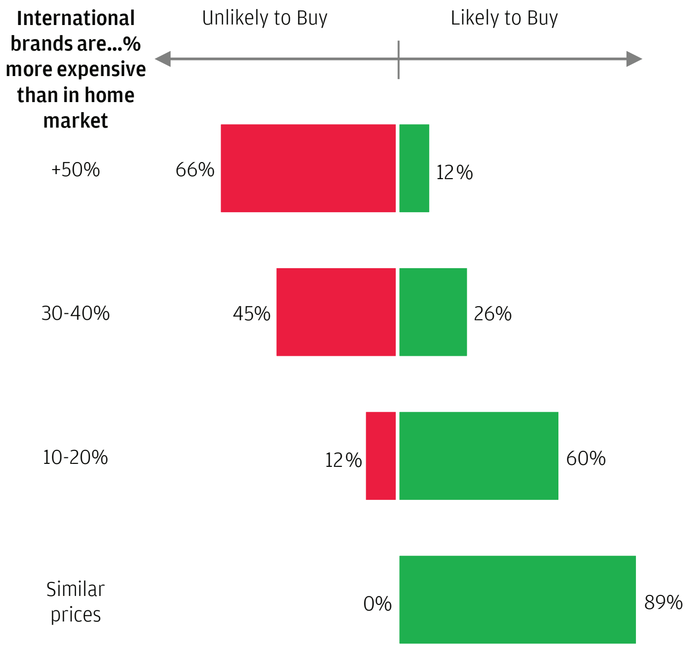
Whilst price is no longer the top concern for Chinese consumers in apparel shopping, 60% still actively compare prices and seek promotions. The internet has made pricing transparent to Chinese consumers, making it easier to compare a brand's home market prices to prices in China. Furthermore, Chinese consumers also have access to the prices of products when travelling abroad. When facing significant price gaps in comparison to a brand's home market, Chinese consumers find it easier to buy goods from overseas, either through travel, parallel importers, or cross-border e-commerce. Chinese consumers are willing to pay a certain premium when purchasing international apparel, but the willingness plummets quickly when the premium approaches 30% over home market prices (Figure 8).

With the impact of media, unequalised pricing may even hurt brand image: Starbucks, for example, experienced rounds of criticism for pricing its coffee at higher prices in China than in London and Chicago, and had to resort to PR to ease the tension. Tesla, on the other hand, is regarded as one of the most conscientious international brands, charging the same price as in US and only adding logistics costs, customs duties and VAT.

Chanel was one of the first luxury apparel players to rationalise the price gap between China and Europe, followed by other brands such as Dior, Gucci and Valentino. In April 2015, Chanel reduced the retail price of handbags, leather goods and dresses in China, while increasing European prices. For example, after price equalisation, bestselling handbag "Le Boy" is now selling at 26,000 RMB (~€3,750) in China and €3,720 in Europe, compared to 32,700 RMB (~€4,720) in China and €3,100 in Europe before the change. As a result, Chanel saw healthy double-digit growth in China in the same year, while most of its counterparts were struggling and closing down stores.

Price gaps between Asian and European markets are not only common in luxury brands. A €199 Massimo Dutti brown leather jacket on a Spanish site, is listed at RMB 2,290 (~€310) on the Chinese site. Given the trend towards price transparency, cross-border e-commerce and international travel, price equalisation will be expected by Chinese consumers across a wide brand spectrum. However, it might have significant impact on corporate profit if the brands are heavily reliant on mark-up from Chinese market. Therefore, companies should be wary of imposing exorbitant premiums, while taking careful consideration of factors such as the global economy, exchange rate and customs tax etc.

FIGURE 8:
Price Sensitivity of International Brands
% Respondents



4 QUALITY MATTERS

When asked about the key purchase factors that influence consumers' brand selection in apparel shopping, brand image / trust and product quality came top. In particular, the 25-44 age group, who are core customers for fashion, rated product quality as their first priority. This is a critical change, as quality was previously not listed as the most important criteria for Chinese consumers in the past five years.

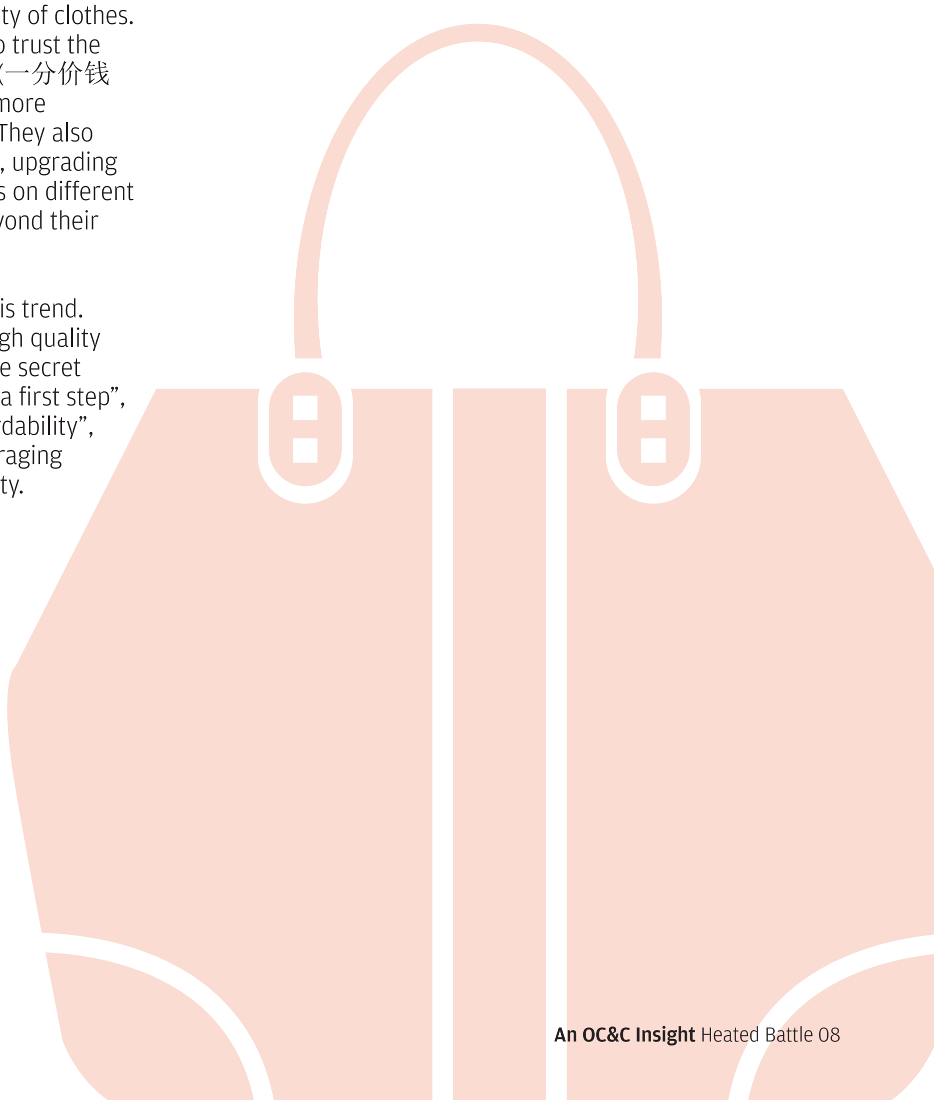
This is likely driven by the booming middle class and rapid urbanisation. Middle and working class consumers are actively upgrading their wardrobes and seeking higher quality fashion and professional apparel. Fast fashion players who typically focus on price rather than quality will not be able to meet the emerging demand from this group of consumers. Upper-mid / light luxury players such as Furla, Sandro, etc., have enjoyed growth recently in China, while several major fast fashion brands have reported a decline in growth, partially driven by the quality problems they have.

This is corroborated by our in-depth discussion with consumers, where most expressed their concerns about the quality of clothes. After multiple trial and error, they have now grown to trust the traditional Chinese saying "you get what you pay for (一分价钱一分货)". Savvier and richer, they would buy fewer, more expensive pieces, rather than more, cheaper pieces. They also hold true to the idiom "you are what you wear / buy", upgrading outfits with proper quality to match their social status on different occasions, sometimes even venturing into brands beyond their affordability to realise their aspirational self.

Meanwhile, social media has been further pushing this trend. Articles like "Why women should have at least one high quality winter coat and how to pick up one for yourself", "The secret behind the label – gauge quality by reading labels as a first step", "Every guy needs a high-end suit at his greatest affordability", can be seen on popular WeChat subscriptions, encouraging consumers to upgrade their wardrobe and seek quality.

"HIGH QUALITY CLOTHES LOOK AND FEEL BETTER THAN THE CHEAP ONES. I BELIEVE HIGH PRICES STAND FOR GOOD QUALITY, AND I AM WILLING TO SPEND MORE FOR BETTER QUALITY."

– 28 YEAR OLD



TO WIN IN CHINA, FOCUS ON THE FOUR E'S

There are still plenty of latent unexploited opportunities for brands that are not in China yet. Our survey disclosed the most wish-for brands for Chinese consumers (Figure 9), most of which already have an established position within their home country.

The future of the Chinese apparel market will continue to evolve into a more sophisticated and complicated landscape, driven by shifting consumer behaviour, increasing competition and macroeconomic change. Tackling this challenging yet lucrative market requires international apparel players to take action on the following Four E's:

1. Effective brand building both online and offline: open stores where your target consumers frequently visit, actively engage with them on their day-to-day APPs / online platforms
2. Exquisite balance between brand heritage and local twist: stay true to your brand image and heritage, carefully select assortment for local taste and adjust the fit
3. Equalised price: rethink the pricing strategy in China, set the optimal premium that consumers are willing to accept without hurting your brand image
4. Emphasis on quality: offer better quality to meet growing consumer demand and premiumisation

FIGURE 9:
Most Wished For Brands in China

OC&C SURVEY RANKING OF WESTERN APPAREL BRANDS 2016

Overall ranking based on 12 core elements: product suitability; product quality; brand image; fashionability (design/style); value for money; low prices; service; wide choices of products; store ambience; convenience of shopping; selection for special occasions; online proposition.

Brand	Number Of Stores In China	Year of Entry	Ranking Within the Price Segment	Price Positioning
JCrew	3	2014	1	Premium
Boss	242	1994	2	Premium
French Connection	23	2003	3	Premium
Ted Baker	9	2012	4	Premium
Brooks Brothers	100	2003	5	Premium
Maje	11	2013	6	Premium
Tommy Hilfiger	330	1997	7	Premium
The Kooples	2	2013	8	Premium
Sandro	19	2013	9	Premium
Oasis	91	2004	1	Mid End
Abercrombie & Fitch	4	2014	2	Mid End
American Eagle Outfitters	8	2011	3	Mid End
Topshop	2	2012	4	Mid End
G-Star	119	1998	5	Mid End
Zara	168	2007	6	Mid End
Hollister	12	2012	7	Mid End
Esprit	641	1992	8	Mid End
M&S	5	2008	9	Mid End
Tom Tailor	3	2012	10	Mid End
Forever 21	12	2012	1	Mass
Gap	119	2010	2	Mass
C&A	85	2007	3	Mass
H&M	295	2007	4	Mass
New Look	63	2013	5	Mass
Mango	62	2002	6	Mass
Etam	991	1994	7	Mass
Vero Moda	1773	2001	8	Mass

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