Country overview

# Growth prospects

*BW Confidential* analyzes how beauty companies are preparing for a return to growth in China, what that growth will look like and the changes they need to make following the closed Covid period
by Alex Wynne

Beauty companies are preparing for a rebound in China. While initial reports suggest that consumers have been slower to return to shopping than previously anticipated—after a negative 2022, the market has continued to be negative in the first months of the year. (For the total beauty and personal-care market, however, Euromonitor forecasts growth for 2022 will come in at +8.4%). But beauty players largely believe consumption will pick up from the second half. "Consumer income and confidence levels will increase, leading to more spending on beauty products," comments research company Circana China Beauty Industry Analyst Samuel Yan. "We believe in the rebound of the Chinese beauty market after Q1 and we are prepared for it," said L'Oréal CEO Nicolas Hieronimus during the company's most recent results conference.

For the moment, however, the rebound has been slow in coming. "While we expect growth year-on-year in all of the categories, it's not that explosive growth that we've seen in some of the other markets that have opened up," says distribution company Luxasia Group CEO Wolfgang Baier. "We expected stronger growth. However, there will be growth; it's a very large market and we're very positive it will come back."

### Premiumization priority

The premiumization of skincare and increased demand for clean and natural products in the category, as well as ongoing gains for high-end and niche fragrances, are likely to be the main contributors to the rebound.

In skincare, savvy consumers are looking for transparency, information on ingredients and efficacy, observers say. "In the skincare category, more consumers read product ingredients before purchasing, and choose the most suitable one for their skin condition," says Circana's Yan. "The popularity of functional skincare has helped local skincare brands rise; highlighting ingredients on packaging and offering lower prices have proven to be successful among Chinese consumers."

"Skincare is becoming even more focused on clinical, scientific claims," says Clean Beauty Asia Founder Allie Rooke. "That's a bit of a headache for some of the premium brands that don't naturally play to that position. That type of consumer is willing to spend, but they want to really see the efficacy part," she continues.

As such, international players are shifting upmarket, offering more premium products, with strong scientific credentials. Many of beauty's heavyweights are investing in this area, such as L'Oréal with Helena Rubinstein and the newly relaunched Carita, Coty with Lancaster's Ligne Princière and Clarins with the Precious range. Premium skincare is already estimated to account for around 40% of the category's sales in China.

### Fragrance forward

Growth in fragrance continues, driven notably by younger consumers—market sources cite forecasts of $5bn in sales in 2025, compared with $1.7bn in 2020—and beauty's players are also pulling out the stops here, notably in the artisanal segment. Between 2017 and 2021, the number of Chinese luxury consumers using fragrance every day went from 40% to 52%, according to L'Oréal.

The haircare category too is seeing strong growth. "Consumers' demands for haircare have evolved from just cleaning to more complex needs, such as repairing hair damage caused by perm and coloring, anti-hair loss, and promotion of hair growth," says Circana's Yan. In premium haircare, L'Oréal's Kérastase reportedly remains the market leader, but there have been new entrants in recent months, including Estée Lauder Companies' Aveda brand.

## Local brand builds

In all categories, competition from local brands continues to grow. Japanese company Kao was one player that cited the strength of local players as hampering its sales last year. China's homegrown players are also increasingly looking to tap into the premium space by launching more sophisticated products and formulas. That domestic brands are closer to consumers on the ground, with local supply chains means they can be fast in bringing new products to the market, giving them an advantage.

Chinese brands account for around 18% of the market in color cosmetics and about 28% in skincare, according to Daxue Consulting —compared with around 60% for both categories in Japan and South Korea.

International players are also looking at C-Beauty in a new light, despite some having burned their wings in the past. Both L'Oréal China and Shiseido recently launched investment vehicles targeting Chinese startups. L'Oréal's investment fund purchased a stake in local fragrance brand Documents in September last year, and Puig has invested in another local player, Scent Library.

It is becoming increasingly important for beauty players to exercise a long-term view when it comes to China, while monitoring the rapidly changing market as closely as possible. "One needs to be on-the-ball 24/7 to see where things are heading, and then adapt and make sure the brand's value proposition is in line with what you're doing," says Baier. "It's tempting to go quickly with each of the new trends that are emerging so fast. But it's important to keep that overall brand value proposition strategy in mind too."

According to Miriam Bray, CEO of Chrysalis Beauty, the Chinese licensee of Joyce Beauty, international brands still have the edge when it comes to premium categories, especially skincare. "This is where the Chinese brands probably lag a little bit, especially in skincare or in product categories that require sophisticated R&D," she says. "You have not seen a skincare brand from China that really stands out in the premium and luxury sector, and I think that's the reason."

Japanese and South Korean brands offer an advantage because they are perceived as being culturally closer to China, Bray says. But South Korea's players in particular are not perceived as offering premium products and experience and have seen their share of challenges over the past couple of years due to trade tensions.

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> Luxasia Group CEO Wolfgang Baier

## Regulatory wrangles

While the lifting of animal testing regulations has led to an increased number of international brands being able to enter the Chinese domestic market, registering products remains complex and fewer brands have benefitted than anticipated.

Regulations from China's CFDA are also continuously changing, making the market difficult to navigate. "You need people on the ground constantly working on product licenses," says Ioma Founder and President Jean-Michel Karam. "Many brands are finding ways around some of the issues, for example with ingredients that were not on the safe list, by reformulating," says Rooke.

For brands that have been able to enter the market over the past few years, they are now looking forward to an acceleration. "The consumer has not been able to travel in two-and-a-half to three years," observers Elemis Co-founder and Global President Noella Gabriel. "We have expanded dramatically, so now we have the brand awareness. When that consumer starts to travel again, they will recognize the brand."

But the challenges of the past year have also incited a number of brands to exit the market, largely in the make-up space, among them Huda Beauty, Estée Lauder's Too Faced ■■■

### China's top-10 premium beauty & personal-care brands in China (2021)

| Brand | Company | Market share % |
|---|---|---|
| Lancôme | L'Oréal | 8.3 |
| Estée Lauder | Estée Lauder Companies | 7.4 |
| Christian Dior | LVMH | 4.3 |
| SK-II | Procter & Gamble | 3.3 |
| La Mer | Estée Lauder Companies | 3.1 |
| Adolph | Guangzhou Adolph Personal Care Co. Ltd. | 2.7 |
| Chanel | Chanel SA | 2.6 |
| Winona | Kunming Botanee Bio Tech Co. Ltd. | 2.6 |
| Shiseido | Shiseido Co. Ltd | 2.5 |
| The History of Whoo | LG House-hold & Health Care | 2.3 |

*Source: Euromonitor International*

# Country overview

■■■and LG Household & Health Care's The Face Shop.

In terms of market share, L'Oréal appears to be on a winning streak. L'Oréal Luxe was the only major player to grow in a difficult market context affected by several lockdowns in the fourth quarter of last year, according to L'Oréal Luxe President Cyril Chapuy. With a 30% market share at the end of last year, the company claims, L'Oréal Luxe is the leader by a long distance in China.

Estée Lauder Companies, despite the Shanghai lockdown weighing heavily on results, also claims to have been gaining share in all of its categories. "Our brands are really working," said company CEO Fabrizio Freda. "The aspirational value of our brands remains very, very strong, which in the moment of reopening is a very good position to be in." The company cited market-share gains from La Mer in skincare, Tom Ford Beauty in make-up and Jo Malone in fragrance in the three months to December.

## The impact of promotions

Signs suggest that brands are seeking to move beyond the promotional frenzy of China's shopping festivals, but this remains challenging, given that consumers have become accustomed to waiting for heavy discounts to buy, impacting margins significantly. "That did not go well for the bottom line of a lot of the larger brands who went on that hunt for sales," says Baier.

Certain companies, like LVMH say they have refused to participate in discounting campaigns, and while this has hurt sales in the short-term, the longer-term impact on brand equity may be beneficial. But they are in the minority.

"The big groups are still playing very hard for 11.11, because they can afford to discount and they're in this cycle," says Rooke. "With brands that can step away from it, they're starting to, but it is difficult, because consumers are programmed to wait for it."

Looking ahead, more players are likely to seek to engage consumers with added value that goes beyond deep discounts. "We are expecting a bit of peddling back and looking more of where to invest where we can really create value for the consumers and for the brand itself," Baier says.

"The deals culture is kind of slowing down," says Miriam Bray, Co-founder and CEO of Chrysalis Beauty, the Chinese licensee for Joyce Beauty. "People are talking much more about content-driven selling. [...] That is also reflected in the fact that people are paying more attention to offline now."

## Young consumers

Another aspect of the Chinese beauty market that brands need to be watchful of is that consumers, even for premium brands, are significantly younger than their counterparts in the rest of the world, with major implications for marketing. "With Joyce Beauty, in Hong Kong, we typically target people from their mid-thirties to late forties," says Bray. "In China, my target group is 25 to 32, and the core is 25-28—that's a lot younger than you would imagine in the Western part of the world." For example, brands are increasingly targeting even teenage consumers with anti-aging products, a strategy that has been successful for ELC's La Mer.

From a brand standpoint, Bray points out, with younger generations accessing the market, the notion that international brands offer superior products will become a thing of the past. "Give it another five years, it will become very vague; in their minds it's just who understands me better and which product suits me better," says Bray. "From that view, I see that there is a bright future for Chinese brands." Equally well, the bigger international players with major resources on the ground in China are likely to find this situation easier to navigate than smaller players.

Looking ahead, observers suggest that with Chinese consumers expected to start traveling again in the second half, business is likely to start to pick up. "I think there's a good scenario for normalization and footfall coming back in the second half and towards the festive season and the end of the year," says Baier.

While expectations are high, there is an elephant in the room, in the name of geopolitical tensions between the US and China, which could seriously affect trade in the longer term. This could see beauty players be forced to change how they operate in the market and come up with new models for China. It may also see some look to lessen their dependence on China. In the meantime, however, the current focus remains preparing for a return to growth. ■

### China prestige beauty e-commerce sales 2022

| Category | 2022 sales |
|---|---|
| Skincare | $12.48bn |
| Make-up | $3.43bn |
| Fragrance | $1.18bn |
| Haircare | $491.41m |

*Source: Circana (previously NPD and IRI)*

### China beauty & personal-care sales*

| Category | 2022 sales forecast $bn | % change 2022/2021 |
|---|---|---|
| Skincare | 49.15 | +7.9 |
| Color cosmetics | 11.10 | +9.1 |
| Haircare | 10.78 | +6.9 |
| Fragrance | 2.7 | +23.7 |
| **Premium beauty and personal care** | **38.63** | **+16.3** |
| **Mass beauty and personal care** | **47.85** | **+3.1** |
| **Total beauty and personal care** | **95.59** | **+8.4** |

*Source: Euromonitor International, Retail sales in dollars at current exchange rates.*
**Forecast, final data was not available at press time*

Covid aftermath

# Beyond Covid

An analysis of the long-term impact of three years of harsh restrictions on China's beauty market by Alex Wynne

The effects of the pandemic on China's beauty market have been wide-ranging, with major ramifications for the supply chain, operations and how brands interact with consumers. Now as China has opened up, the impact of three years of on-off and often severe lockdowns is likely to be long-lasting.

According to the IMF's most recent estimate, China's GDP is expected to increase 5.2% this year, compared with just 3% last year. For the beauty market, industry observers had anticipated a rebound, but this has been slower to come than many expected, and there are no signs as yet of the "revenge spending" reported in other markets once lockdowns were lifted. "The bounce-back will be progressive, as consumers need to regain trust," L'Oréal CEO Nicolas Hieronimus commented during the company's year-end conference call. In the first few months of the year, the beauty market in China has still been negative, according to industry sources.

### Nervous consumers

"From the consumer's perspective, there is a latent nervousness about the economy," says Clean Beauty Asia Founder Allie Rooke. "The economy hasn't been going as well as expected. Things are going to rebound, but it's just going to take a little bit longer."

"The full confidence of the consumer about going out, going to the malls, is not yet back," observes distribution company Luxasia Group CEO Wolfgang Baier.

Consumer confidence in China was at 91.2 in January this year, according to Trading Economics, which cited data from China's National Bureau of Statistics. This was its highest level since March 2022, but well below the January 2022 level of 120.5.

"[There is a] feeling of being careful about how people spend their money, so savings rates are up," says Rooke. "I think this year people are looking to spend initially on travel, either internally or abroad."

Although consumers have tightened their spending and are looking for discounts—although this is reportedly changing—the premium end of the market is expected to recover faster than lower-priced products, according to sources, benefitting international players.

With borders now open, beauty players anticipate that Chinese consumers will begin traveling once more, shopping both abroad and in domestic travel retail, which has seen a gold rush of retail development in the Chinese island of Hainan since the start of the pandemic, meaning new retail opportunities for brands. Beauty's majors are ■■■

# Covid aftermath

■■■ downplaying any risk of cannibalization both for Hainan and for the domestic market.

"Travel retail in general, whether it's in Hainan, in Hong Kong, in Macau or even in Paris is never a cannibalization," Hieronimus said. "It's a fantastic exposure of our brands. [...] Our Mainland China share is continuously growing, which tends to indicate that we must have struck the right balance between travel retail and the domestic market."

Market observers are quick to point out that the number of Chinese consumers traveling abroad, as a proportion of the population, is tiny, and that there is still plenty of white space on the domestic market. "Today we have approximately 100 million customers that buy our brands in China and we have to double that," said Hieronimus. "We have potential in tier-three and tier-four cities where our penetration is half of [that] in tier-one and tier-two cities. So this is more my focus on the Chinese growth markets, rather than knowing whether they're going to go to Thailand or to Paris."

## Challenged

However, China's zero-Covid policy brought to light a number of challenges. On the supply chain and logistics front, many companies were penalized, and the impact of this is ongoing. Stock levels remain high, meaning retailers have reined in inventory, and footfall and spending, have as yet to catch up.

During the Shanghai lockdown, L'Oréal benefited from its broader distribution footprint, and claims to have gained market share, while other players were disadvantaged by blockages in and around Shanghai, through which around half of imported beauty products transit, according to estimates. Estée Lauder Companies opened a new distribution center in Guangzhou in August to mitigate future supply-chain difficulties.

Signs suggest that among local players too, those based in and around Shanghai suffered more than elsewhere in the country. Among the public local players, Shanghai Jahwa reported an annual sales decline of 7.1%, while Chicmax's sales fell 28.8% in the first 10 months of the year. Proya, based in Hangzhou, saw its sales in the first nine months of the year gain 31.5%, meanwhile, and Marubi, from Guangdong, reported flat revenues for the first nine months of the year.

Consumer frustration with delivery delays or out-of-stocks was a major issue for certain brands last year, penalizing international players reliant on cross-border sales in particular, and favoring the domestic market.

## Caution and visibility

Unable to travel to China, meanwhile, beauty's players without a footprint on the ground have become more reliant on trade partners to operate and navigate the market, exacerbating the sense of uncertainty. "We're seeing a lot of people feeling the frustrations of the past couple of years," says Digital Luxury Group Head of International Client Development Iris Chan. "If you're on the outside, it's not as easy to get through."

> "[Companies] are being very careful about their portfolios. The big groups are looking at whether a brand is actually suitable for the market and rationalizing their portfolio. They want to double down on the brands that are winning"
>
> Clean Beauty Asia Founder Allie Rooke

But knowing who to work with is a challenge —such businesses are constantly evolving, and many brands have been burnt, sometimes with partner companies almost seeming to disappear overnight.

"You have companies that are there one day and then are not there the next day," says Luxasia's Baier. "A lot is about trust and hedging your bets and not necessarily putting all your eggs in one basket," he believes.

This has made many on the market more cautious, given the lack of visibility. "I would say [companies] are more sophisticated now when they think about investment," says Baier. "When you look at the first part of the pandemic, China was one of the few markets that was still open, and because of its size, it was very tempting for a lot of brands to say, okay, we stopped all investments in the markets [...] and put that money into China."

Fast forward two years, and some companies have been reviewing operations and pulling out brands that have been underperforming. "They are being very careful about their portfolios," says Rooke. "The big groups are looking at whether a brand is actually suitable for the market and rationalizing their portfolio. They want to double down on the brands that are winning."

But investment—of a more measured kind — in an increasingly sophisticated market is exactly what's needed, according to some. "China's been doing a really good job for many years for a lot of brands, so it's never been a priority to think about operational excellence," says Chan. This, she says, needs to change if brands are to harness future growth. "China is not just printing free money anymore."

At the same time, certain players are doubling down on investments, with international companies ramping up R&D capacity in China to offer more locally relevant products. Estée Lauder Companies' new R&D facility in Shanghai, which opened last December, will help it to strengthen local market innovation starting from the next fiscal year, it said. Shiseido also opened a new R&D facility, in the region's Oriental Beauty Valley, in late 2021, and is looking to partner with C-Beauty startups.

Despite a more careful approach and potentially more measured growth, China, still offers opportunities. "Even with the uncertainty, you've got volume; there's a huge population you can crack into," Chan sums up. Beauty players have learned that growth in China can no longer be taken for granted. Companies now need to be more nimble to navigate what is a more complex market, even in spite of the large population that continues to buy into beauty. ■

# Douyin sales drive

How social-media platform Douyin is evolving as a sales platform

by Alex Wynne


▲ Korean skincare brand History of Whoo has seen strong business on Douyin

Douyin, known in the West as the Chinese version of TikTok, is on the rise as a beauty sales platform, taking share away from heavyweights Alibaba and JD.com. The platform has consistently been the biggest driver of online sales growth over the past year, according to sources, who suggest that both of the larger players have seen their beauty sales decline.

Traditionally associated with low prices

> “Thanks to its 800 million users and high daily active users, [Douyin] quickly became an important channel for beauty retail”
>
> Circana China Beauty Industry Analyst Samuel Yan

and lower-tier cities, Douyin’s positioning is changing, and brands are paying attention. According to data from Circana (formerly NPD and IRI), emerging online channels including Douyin and online travel retail represented more than 20% of total online beauty sales last year. “Thanks to its 800 million users and high daily active users, [Douyin] quickly became an important channel for beauty retail,” comments Circana China Beauty Industry Analyst SamuelYan.

### Sales driver

Douyin’s GMV last year was Rmb1.5 trillion ($217bn), according to industry sources. For the all-important 11.11 festival, facial skincare and perfumes and cosmetics were the top-selling categories on the platform, with skincare representing 34.4% of revenues and 19.4% of skus sold, and fragrance accounting for around 7.7% of revenues and 8.8% of skus sold, according to information from CBN Data cited by Gentlemen Marketing Agency in a recent report.

“It’s been doing very well for some brands, both big and smaller brands,” says Allie Rooke Founder of Clean Beauty Asia. “If you get the right mix and you’re really doing the right livestreaming, you have the right content from your brand and the right KOLs and influencers, it’s a very powerful sales channel. It’s very threatening ■■■

# Douyin


■■■to Tmall because it's an entertainment channel. It was, at the beginning, really only very low price point stuff, but consumers are getting much more used to buying expensive things on there. If it's from someone they trust in terms of the KOL, they'll buy expensive premium skincare."

"There are a number of brands that are anecdotally reporting that they are doing a lot more [on Douyin] than they are even doing on Tmall," says Digital Luxury Group Partner and Head of International Client Development Iris Chan. "Especially for higher end brands, a couple of years ago, Douyin was an experimental space. That's been experimented on, learned from, and you're starting to see multiple stores."

Some recent success stories include Shanghai Jahwa's Herborist, which multiplied its Douyin sales tenfold in the third quarter of last year, and Yatsen-owned Galénic, whose Secret D'Excellence was reportedly the top-selling serum on the platform in the second and third quarters. For another local company, Proya, Douyin now represents around 10% of its sales—the same proportion as JD.com.

Korea's LG Household & Healthcare has seen success on Douyin with its History of Whoo brand. "[For Single's Day] based on strong brand awareness, Whoo entered and topped the rankings on new fast-growing e-commerce platforms, such as TikTok and Kuaishou," the company wrote in its most recent earnings report.

"Brands doing well on Douyin include some of the big players like Estée Lauder, La Mer and SKII; but also local brands like Winona, Chando, Florasis," says Chan. "South Korean skincare brand History of Whoo has done a significant turnaround on their business with their activity on Douyin."

## The entertainment element

When it comes to success on Douyin, entertainment is key—particularly during lockdowns when consumers, stuck at home, had time to spare. Brands winning on the channel have been quick to capture this. According to Rooke, the key is fun, engaging content, being open to localize content and not being too precious about the brand. "If you're a high-end brand and you're very worried about the way you're presented, it's very difficult on a platform like Douyin. But I think most brands are feeling more comfortable because of TikTok in the West. They have to embrace that more, not from a sales perspective, but from a marketing perspective, so those barriers are much lower than they were before."

Capturing consumers on Douyin is a fickle game, however. "The feature of livestream purchasing is competitive price and extremely short consideration time," says Circana's Yan. "Well-known beauty influencers usually offer very competitive pricing, but are only valid for a short time, which means consumers need to make immediate decisions. This also echoes our sentiment study finding that over 75% of consumers watched beauty livestreaming every week, and half of them purchased during livestreaming."

As such, for brands, one of the most

important elements of success on Douyin is working with the right influencers. "Finding the right celebrities, KOLs, partners to help you is very important," says distribution company Luxasia CEO Wolfgang Baier. "Is it only one or is it a bunch of them, that is something for the strategy in the future to think through."

Increasingly for brands, hedging their bets and working with a number of smaller influencers instead of one or a couple of the top KOLs is essentially—as witnessed by the many brands penalized when Austin Li was taken off air last year.

Equally well, having a granular strategy is particularly important for brands present across a number of categories, as on Douyin, a single store can only sell products in a maximum of three product categories, with a business license needed for each. "Some brands have up to eight stores," observes Chan.

### Fragmented, complex and costly

The fragmented nature of doing business on Douyin makes it particularly complex to navigate for brands—and winning on the platform can be costly. A multitude of trade partners are battling to offer brands advisory services, promising to help drive explosive sales on the platform. But while the promise of fast growth is alluring, Douyin necessitates a tailored strategy beyond the short term.

Brand awareness is key. "The problem is about brand awareness in the first place; these small brands come in and they're still struggling to get on the ladder of consumer consideration, because there's so much competition and expense in just getting eyeballs," observes Rooke. "If you can create interesting content or do some fun collaborations, you can skip a few rungs on the ladder."

But Douyin also offers distinct advantages for brands that go far beyond its own eco-system, observers note. "Because Douyin has created entire logistics, brands are exploring that all the way through, from having the marketplace to payments that are integrated, the logistics, the CRM side of things," says Chan.

> "There are a number of brands that are anecdotally reporting that they are doing a lot more [on Douyin] than they are even doing on Tmall. Especially for higher end brands, a couple of years ago, Douyin was an experimental space. That's been experimented on, learned from, and you're starting to see multiple stores"

Digital Luxury Group Partner and Head of International Client Development
Iris Chan

One distinct advantage, she notes, is that Douyin, unlike other platforms, allows brands, for a fee, to divert traffic to external e-commerce platforms. "When you have the ad come in through Douyin, you can drop them anywhere, and that facilitates your whole experience, depending on where you know your consumers are going. If you're a higher end brand, where a Douyin store is not going to be where you need to be because that's not where you're going to sell, you can drive them to where it makes sense based on the targeting of your ads," she says. This means that Douyin's impact, for brands, can reach far beyond actual sales numbers on the platform itself.

But while Douyin is being touted as an Eldorado for brands, the complexity, and expense, of doing business there mean challenges—and potential pitfalls—abound. Seeing beyond immediate results is key, according to observers. "You need patience, you need a long-term vision to drive it, because it's very volatile. It's quite expensive, and if you're not one of the top-10 brands, it needs a nimble approach and a very analytical approach to step-by-step growth. I think that's an important message for everyone," says Baier. "You can't win overnight—you could, but it's going to cost you significant amounts of investment." Spreading out investments, he warns, is key in a Chinese market that is increasingly fragmented—especially if the industry is to shift away from the prominent discounting of the past few years, which has been an essential selling point on Douyin, as well as other platforms, hurting brands' bottom lines.

In the meantime, other e-commerce platforms have not rested on their laurels. Alibaba's Tmall, notably, has not said its last words, and has been upping its game in the short-video space, offering support and free traffic to brands to compete with its fast-growing rival. In China's e-commerce landscape with its dizzying pace of change, there is no such thing as a given. ■


▲ Florasis opened a megastore in Hangzhou

Brick-and-mortar retail

# Retail renewal

Despite the pandemic, there has been new interest in brick-and-mortar stores and a wave of innovative concepts have hit the market
by Alex Wynne

The pendulum is swinging back slightly to brick-and-mortar retail as China opens up. But the market has changed, and retailers need to do more to lure consumers back.

The term "experiential retail" is taking on a new meaning in China, with the traditional concept of sales-per-square foot turned on its head as newer players combine sophisticated and increasingly blurred online and offline capabilities with a real focus on entertainment and services. "People in first-tier cities are looking beyond shopping malls for places that are more creative and interesting, fueled by social-media culture," says Miriam Bray, Co-founder and CEO of Chrysalis Beauty, the Chinese licensee for Joyce Beauty.

New retail concepts are among some of the most sophisticated in the world—from Aesop's two-floor store in Shanghai, which opened in the fourth quarter, to local brand Florasis' new megastore in its home city of Hangzhou mirroring a traditional Chinese garden design, and Armani's Armonia concept in Shenzhen.

### New retail concepts

Chinese company S'Young International, which runs its own brands, as well as partnering with international brands in China including Kiko, Jo Loves and Neutrogena, last October launched its first physical store, Shuiyangtang, in Changsha's International Finance Square, which has a daily average customer flow of 1.2 million, according to the company. It is linked online to Tmall Global, Douyin and WeChat. "[This] not only reinforces their omnichannel credentials, but supports customers in their new retail store with QR codes appropriate for multiple online channels that allow for the convenience of online shopping, while testing products in person—creating a truly interactive retail ecosystem," said S'Young.

With "beauty butlers," different experiential areas and a focus on artwork and interactive installations, the store is a prime example of how retailers in China are working to go beyond traditional boundaries.

Among other new concepts, Shanghai-based The Beast, originally a high-end florist, has developed Little B, a cross between a convenience store and a concept store showcasing high-end brands with a curated selection. It currently has three such outlets, and recent initiatives include a pop-up with Maison Margiela's Replica fragrances.

Such concepts are putting existing retailers through their paces. A few years prior to the pandemic saw a wave of investment, with local players emerging, with chains like The Colorist, Harmay and Wow Color opening many stores. According to observers, this was largely a move from cash-rich investors keen to seize a gap in the market when investment in other parts of the world had largely stalled. "There was a lot of hot money trapped in China, private equity and venture capital that would typically have gone outside China to look for opportunities, that was impossible. They had to complete their KPIs and invest money somewhere," says Bray. "That fueled a lot of new retail concepts and also the birth of many Chinese brands."

### Under pressure

But the lockdowns and supply-chain woes of the past year have put retailers under extreme pressure, as witnessed by The Colorist owner KK Group's IPO prospectus, where it said the retail chain had seen its operating margin sink to a negative 1.3% in the 10 months to October, compared with a margin of 4.7% in the prior-year period."That fever is no longer there," says Clean Beauty Asia founder Allie Rooke."

Bray adds: "In terms of retail footprint expansion, talking about new projects was definitely halted from the second quarter of last year, all the way to the end of the year. Now everyone's going into this very optimistic hopeful period again, but I definitely sense a layer of caution."

Nevertheless, observers highlight that the chain-store concepts offer opportunities for brands to expand into new cities beyond the traditional department-store model, which continues to struggle.

With footfall remaining below forecasts as the market emerges from ■■■

## China's key retailers

**Watsons**
**Stores:** 4,836
Sales at A.S. Watson's Health & Beauty business in China fell 22.8% to HK$17.58bn (US$2.24bn) in 2022, and in local currencies dropped 20%. Its EBIT margin shrank to 1%, from 8% a year earlier. Comparable store sales declined 18.3%, and Watsons closed 343 stores during the year. The retailer is implementing various initiatives both in-store and online to engage consumers following the reopening of the economy. Two further crossover Marionnaud x Watsons stores for premium beauty opened in the second half of last year, bringing their total number to five.

**Sephora**
**Stores:** 315
LVMH-owned Sephora has been ramping up omnichannel services, bringing in one-hour delivery, and has been praised by industry observers for its omnichannel activation, with localized WeChat programs for each store. It is enhancing its C-Beauty offer, and has introduced new Chinese brands. But the retailer is reportedly struggling to differentiate itself from nimbler competitors, especially in tier-one cities.

**The Colorist**
**Stores:** 210
Run by KK Group, The Colorist launched in 2019 and expanded rapidly over the subsequent two years, with stores in 108 cities in 28 provinces. The Colorist saw its sales drop 29.8% in the 10 months to October 2022, to Rmb530.5m ($77m). It is reviewing its store portfolio and scaling back franchised operations and has opened eight stores since the end of October, but closed 11. Its social-friendly design, data-driven curation and mix of mass and prestige have proved popular with young consumers. In 2021, it was reportedly China's third specialty store player in terms of market share, after Watsons and Sephora. Forty new stores will open this year.

**Harmay**
**Stores:** 9
Harmay stands out for its warehouse-like aesthetics, and each store has a unique visual identity. The retailer, originally an online sales platform, has appealed to young consumers for its sale of samples and has curried favor with international investors. But industry observers say the concept is losing steam as the competitive landscape heats up and consumers move on to newer concepts. They add that its assortment strategy is under par and that it is now having a tough time securing supply from brands.

**Bonnie & Clyde**
**Stores:** 6
Operated by brand accelerator platform Ushopal, Bonnie & Clyde offers high-end international niche brands and claims to have more than 10 million users aged 28-35 in its database and an average ticket value of Rmb5,000 ($726). It had initially said it would double its store count to 12 last year, but those plans appear to have been put on hold.

**Afiona**
**Stores:** 200
Founded in 1995 and based on a franchise model, Afiona has expanded its footprint to reach more than 200 stores in 56 cities, according to estimates. The concept is described by industry observers as more traditional than some of its newer competitors. However, it has won over consumers in lower-tier cities, where competition is less intense.

**Wow Colour**
**Stores:** 77
Targeting consumers aged 18-28 with a make-up centric offer, Wow Colour is another of the beauty collection stores that has exploded in recent years. It launched in 2019 and expanded fast.

# Brick-and-mortar retail


▲ The Colorist has opened eight stores since October, but closed 11

■■■lockdowns, however, retailers need to pull out the stops to meet consumer expectations, especially given the experience and convenience offered by online players. "All of them are adapting to the new reality," says distribution company Luxasia CEO Wolfgang Baier. "Local and international players both have to step up. There is not a clear winner."

But there is room for growth—and new players that can tap into demand for enhanced retail experiences, observers suggest. "There is room for between five and 10 [multibrand] retail players," Luxasia's Baier believes.

### Department store struggles

Traditional department-store players, meanwhile, continue to struggle, especially in bigger cities. "In tier-one cities, department stores are definitely becoming less interesting for younger consumers when it comes to beauty. It's very homogenous," says Bray. "I don't see why [consumers] would go to the beauty counter in a department store to buy any more."

> "Before the pandemic, it was still a shopping mall kind of culture, especially for premium brands. But people in first-tier cities are now looking beyond shopping malls for places that are much more creative and interesting and that is fueled by social-media culture"
>
> Chrysalis Beauty Co-founder and CEO Miriam Bray

In smaller cities, however, they still have a role to play, especially when it comes to brand awareness, she says. "For tier-two, tier-three or tier-four cities, [department stores] still very important because the culture is very different." "The opportunity of being there is quite limited, but bartering the right deal with the department store for a shop-in-shop or counter is something that brands need to do," says Digital Luxury Group Head of International Client Development Iris Chan. It's a step in garnering brand awareness in China. "But you've got to move on at some point, whether that means stay there plus other things, or move on to something different."

Certain department-store players are innovating. Mall operator SKP, for example, worked with South Korea's Gentle Monster to create a futuristic department-store concept combining luxury retail with art under the SKP-S, for SKP-Select nameplate in Beijing and subsequently Xi'an.

It has also opened three beauty-specific stores, which have reportedly been gathering traction with niche brands. "SKP stores are really a destination in terms of


▲ Harmay has appealed to younger consumers, but is facing tougher compeititon, while Afiona has won over consumers in lower-tier cities

style, and […] with their beauty section, and the types of brands they are bringing into that; people can go and discover that in a very cool, trendy environment. Concepts like that have a lot of legs," says Rooke. The new Moho Mall in Shanghai, designed as a cultural hub complete with an "urban oasis," and housing multibrand store Moho Beauté, is another example.

## Scaling down stores

When it comes to standalone stores, some brands have been reducing their footprints due to the difficult market. "Korean brands have been scaling down stores left right and center, that's indicative of a much broader issue in terms of K-Beauty in China," says Rooke.

Chinese company Yatsen's Perfect Diary, which expanded rapidly in 2020 and 2021, has closed a lot of its stores. Some brand standalone stores from Estée Lauder Companies and L'Oréal are also said to have closed. "A lot of that has been in the make-up space; make-up remains very tough," adds Rooke.

However, other companies have been scaling up. Natura&Co-owned Aesop, for example, opened its first two stores in Shanghai in the last quarter of 2022, and they have performed beyond expectations. "They've been in the market for quite some time, and they don't participate in the promotional side, as a lifestyle brand. From a store perspective, that makes them so much more attractive, because you can create that lifestyle brand within the store," says Rooke. "The Chinese consumers have been waiting for that."

"In the tier-one cities, the expectation of the consumer is the same as that of London, Paris or New York, the trend is for boutiques," says Luxasia's Baier. "In those hubs, you need to have those flagship boutiques, especially in skincare, where you have a lot of services and fragrances, where it can really explain the nuances of the brand and keep people with you," he says. "In tier-three or tier-four cities, I don't think the boutique setup [is ready] yet. The department stores plus a very good retailer can still play a very good role, and then you supplement that with pop-ups, during the festive season, to give a full brand experience," he adds.

Attention is shifting away from mall-based stores to street-front locations with a strong identity, observers say. "Three or four years ago, before the pandemic, it was still a shopping mall kind of culture, especially for premium brands," says Bray. "But people in first-tier cities are looking beyond shopping malls for places that are more creative and interesting and that is fueled by social-media culture."

As Chinese brick-and-mortar retail emerges from the torpor of the past year, new developments are likely to continue to emerge at a faster pace, from those that were put on hold to new, more experiential, interactive concepts.

For retailers that can rise to the challenge there are opportunities to be had. "It's very difficult to know what will happen in the second half, but my prediction is that you really have to have an experience in the store; there has to be a real reason to attract the consumers," says Rooke. Perhaps more than ever, retailers will have to do more to please consumers if they want to stay afloat. ■

# Open for business

How the return of Chinese travelers will impact beauty in travel retail

by Tina Milton

Three years of travel restrictions in China finally eased at the beginning of 2023 and the appetite for international travel is strong. China Outbound Tourism Research Institute expects Chinese travelers to take 110 million border crossings from mainland China in 2023, reaching about two-thirds of the 2019 level. In 2024,170-180 million border crossings from Mainland China are forecast, overtaking the 2019 level.

Asian distribution and travel-retail company Bluebell Group Managing Director Greater China Samy Redjeb remarks: "Since the re-opening of China's borders in January, there has been an outflow of roughly 250,000 travelers per day from the country to various destinations. The top destinations so far have been those with no entry Covid-related requirements, such as Southeast Asia [Thailand, Singapore, Vietnam and Indonesia] and Hong Kong/Macau. However, Japan and Korea are slowly returning to the top of the list as entry requirements are eased." He adds: "It will take some time for Chinese shoppers to return to pre-Covid numbers overseas due to several factors: The high price of air tickets, lack of flights, renewal of travel documents and visa applications, and an inherent caution with regard to destination 'safety'."

## Asian destinations

During industry association TFWA's China Watch webinar in March, 60.6% of respondents in Dragon Trail's January 2023 China Travel Sentiment survey indicated they wanted to venture outside mainland China this year. Hong Kong (20.7%), Macau (11.4%) and Thailand (11.1%) led the list of preferred outbound destinations in line with pre-pandemic trends, followed by Japan (5.9%) and Taiwan (4.7%). After South Korea (4.4%) and Singapore (4.2%), European destination France (3.4%) made an entrance, with Australia (3.1%) and Russia (2.7%) also featuring in the top 10.

Asian destinations will continue to be the preferred travel choice for the first half of the year at least. "And while shopping will remain a priority, a vast amount of their budgets will be geared towards experiences," insists Redjeb.

It's predicted that the second half of 2023 will be when the full return to Chinese overseas travel and spending gets started. Chinese planning and marketing consultancy Emerging Communications Project Manager Sylvie Huang and Head of Planning Rocky Chi tell *BW Confidential*:

> "Hong Kong needs a bit more time; however, retailers in Macau are achieving extremely high sales and targets since January and getting ready for more to follow"
>
> Blue Chip Group Managing Director Flora Lee

"From the second half, it is expected that China's policies against international travel will be further released and stabilized, with popular destinations switching to locations such as Europe, the US and Australia [according to the Most Desired Destination Survey]."

## Making preparations

The opening of China's borders was widely anticipated to be mid-2023 and came quicker than many travel-retail players expected. Blue Chip Group Managing Director Flora Lee insists: "After the return of PRC consumers, we are still opening more counters in duty-free stores and also fulfilling stocks, which takes longer than usual as no one was really prepared for the return."

PR and marketing activities for branding have been rolling out quicker than usual to address the increase in travelers and the opportunities that they present. "Some of our planned PR promotions for the second quarter were pushed forward to March to attract target consumers and everyone is actively working on marketing activities to boost sales," states Lee.

She reports sudden sales increases of over five-to-10 times the usual levels. The biggest change is noted in the Macau market. "Hong Kong needs a bit more time; however, retailers in Macau are achieving extremely high sales and targets since January and getting ready for more to follow," remarks Lee.

Travel retailers report that the return of Chinese travelers has given the beauty category a much-welcomed lift and echo Lee's sentiment that Macau has been a


▲ Hainan is likely to remain a hassle-free and 'safe' destination for Chinese travelers, and retail hubs such as the new Haikou International Duty Free Shopping Complex offer quality shopping opportunities

big beneficiary. As might be expected skincare is at the forefront of this, but other segments such as artisanal fragrance are enjoying growth, as consumers search for niche labels alongside classics from well-known international brands.

## New experiences

Affluent classes are driving the premiumization trend. With fragrances, alongside niche brands, Chinese travelers tend to purchase limited editions or brands not available in China when traveling abroad. "Services and the experience received while shopping matters a lot for them in offline stores," state Huang and Chi.

For skincare, affluent and HNW (High Net Worth) classes continue to fall for premium and ultra-premium brands. "They are not price conscious, but crave limited editions, initial launches and exclusive products, alongside add-on services and premium VIP experiences when shopping in travel retail," explain Huang and Chi. "Male consumption of skincare and fragrances is also growing."

With the make-up category, premium and luxury products are seen as the most accessible or affordable luxury products or experiences that emerging middle classes and non-affluent classes can adopt, according to Huang and Chi. "With more Chinese travelers coming from lower-tier cities, there would be more deals, but they are price conscious."

Fragrances are continuing to grow. "We would anticipate an increase in fragrances, but overall, I expect we will see fragrance give way to a higher market share for skincare. Space for a growing assortment could be a challenge and a stronger emphasis on pre-ordering reserve and collect services could support this; equally it will need a big awareness campaign along with it," says Blackjack Promotions Head of Client Services Kim De Vito.

However, there is caution over making any assumptions and changes too soon, which means there will need to be real agility to adjust quickly to market changes when they come.

Prices have fluctuated since borders closed, but brands and retailers say they are aiming to control them. "Given the short shelf life and quick turnaround of seasonal products, the price has been significantly lower for some of the mid-positioned brands and this will be the toughest assignment for them to break," Lee explains.

## Hainan's lure

While overseas travel is back on the agenda, industry players insist that Hainan will remain a core shopping location for Chinese shoppers. Travel retailers will continue to evolve beauty concepts to attract consumers with China Duty Free Group and Global Duty Free (operator of the GDF Plaza in Haikou) both confirming a focus on initiatives, such as adding more local brands to satisfy the demand for 'China Chic' products, alongside spa experiences in-store. At the Sanya International DF Shopping complex, China Duty Free Group plans to create what it deems will be the largest standalone beauty complex in the world.

"Hainan will remain the top 'safe' and hassle-free destination for Chinese travellers to fulfil their desires post-Covid," insists Redjeb. "The island offers both a shopping paradise and a nature escape. It boasts more than 12 duty free shopping malls and over 260,000 hotel room facilities."

Amid the euphoria over the return of Chinese travelers, there are elements that beauty players still need to watch out for. "Chinese travel-retail shoppers won't fall for foreign brands naturally anymore, or purchase in bulk just because they are in overseas destinations – shopping experience matters," insist Huang and Chi. "Cultural sensitivity includes whether the product suits Chinese skin conditions and occasions, alongside not being treated as a cash cow. Negative sentiments spread so fast on Chinese social media and a single store's experience represents the whole brand." For now it is important to proceed with caution. ■