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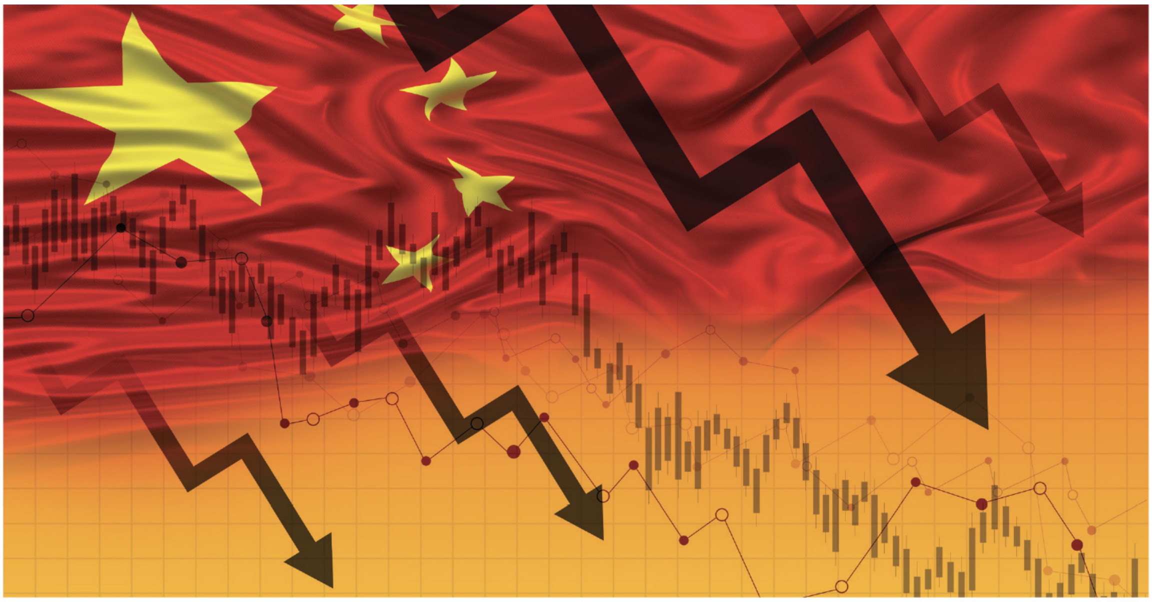

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Navigating complexity

China's recovery since Covid has been disappointing to say the least, while economic prospects and an unpredictable business climate weigh on companies' strategies for the country. At the same time, local brands continue to take a bigger share of the business, making the market a lot tougher all round for international players by Alex Wynne

The road to growth in China's beauty market is increasingly paved with complications. A tough economy has meant a much slower-than-expected recovery of China's beauty market since Covid. This combined with a more unpredictable—and in many ways riskie—business climate has led to a more tempered outlook from beauty players, after a decade of strong investment.

According to Bernstein, China's online beauty market—which accounts for roughly half of all prestige beauty sales—fell 8.8% on-year in September. "Luxury/premium brands underperformed, said Bernstein. "Mass-market brands' performance was mixed."

While e-commerce data only presents part of the picture, industry observers report the market's softening overall. "The macro-economic outlook is not very strong," Asian distribution company LUXASIA CEO Wolfgang Baier tells *BW Confidential*. "There is a restructuring of the Chinese economy. The tech sector was restructured and now it's the property sector, and with that, consumer confidence is weakening significantly. […] More consumers are saying: 'I don't know exactly what's going to happen, so I'm going to put some money aside'."

Indeed, while there is increased propensity to save, when the Chinese do spend, their habits have changed. "The way they are spending is different; they are spending on leisure or food, rather than on consumer products, and they're really looking for value for money or a luxury or niche item and spending more selectively," comments LUXASIA ■■■

Key happening

As expected, this year's 11.11 shopping festival was a more muted affair than usual. GMV of the major e-commerce shopping platforms rose by just 2.08% to Rmb1,138bn ($156bn) from October 31 (from 8pm) to November 11 (at 11:59pm), according to retail data service provider Syntun. This slight increase comes on top of last year's lackluster 11.11. Low prices and value were the central theme of 11.11 this year. Alibaba Group, for example, said its key aim was to provide "the lowest price across the whole network" by using dynamic price comparisons to ensure value. Competitor JD.com meanwhile, adopted the 'Really Cheap' theme for this year's event. As reported, JD.com also eliminated the pre-sales model this year and made products available for immediate purchase. Personal care and beauty ranked number four out of the top-10 sectors for the event. Skincare sales on the traditional e-commerce platforms came in at Rmb58.2bn ($8bn), according to Syntun. On the traditional platforms, Tmall represented 68% of sales, while JD accounted for 28%. The top-five ranking skincare brands on Tmall were: L'Oréal Paris, Chinese brand Proya, Lancôme, Estée Lauder and Helena Rubinstein. The top-five skincare brands on JD.com were: SK-II, Olay, L'Oréal Paris, Proya and Estée Lauder. Make-up and fragrance sales on the traditional e-commerce platforms reached Rmb20.4bn ($2.8bn), Syntun stated. When it comes to traditional platforms, Tmall represented 70% of sales, while JD.com accounted for 19%.

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▲ Estée Lauder Companies opened its first freestanding store for Le Labo in Shanghai, which was the brand's top-performing store in the world in the month of June

■■■ China and Singapore Country Manager Shan Chen.

Research company Circana reported that prestige beauty sales overall in Chinese e-commerce grew 27% in the eight months to August this year. Circana's data, while showing growth, also suggests that consumers are increasingly looking for value, with sets performing particularly well. "All beauty categories posted increases thanks to the growing popularity of the set format," says Circana Beauty Industry Analyst for China Samuel Yan. "Gift sets and value sets were especially popular."

Waning consumer confidence

Weak consumer sentiment and a slower overall economy means that the staggering growth rates of the decade pre-pandemic are likely to be a thing of the past. "The overall landscape has changed a lot, and it continues to change," says Miriam Bray, CEO of Chrysalis Beauty, the Chinese licensee of retailer Joyce Beauty. "Some factors are related to macro-economics and some to how consumer behavior is changing. Consumers require a lot more pull factors before they commit to buying something. In the high-end segment, consumers are much more demanding," Bray says. Commenting on the Chinese consumer during its first-half conference call, L'Oréal CEO Nicolas Hieronimus said: "Chinese consumers are more rational about their beauty purchases than they were before Covid, and they are really looking for efficacious products."

High youth unemployment—unemployment among those aged between 16 to 24 hit a record high of 21.3% in June, after which the Chinese government said it would stop publishing the statistic monthly—means younger consumers are reining in their spending. The government's decision to no longer publish such statistics is also fueling consumer uncertainty, according to market watchers.

Risk assessment

In addition to economic issues, politics in China and its impact on business has become much more difficult to predict and assess. For example, a wave of anti-Japanese sentiment hit the market this year, following criticism from the Chinese government over Japan's release of wastewater from Fukushima into the Pacific Ocean.

This has taken its toll on Japanese brands, such as P&G's SK-II and Shiseido. "That has seen quite a big backlash," says Clean Beauty Asia CEO Allie Rooke. According to Bernstein, Shiseido's online sales in September plunged 32%, as a result of the consumer boycott of Japanese brands. In the third quarter, Shiseido's sales in China fell 9%, largely as a result of the issue. Many Japanese players who had expanded heavily in China in recent years are now looking to take a more careful approach to China.

Changing regulations are another challenge. From January this year, each raw material in cosmetics products had to be registered under so-called "annex 14," representing significant red tape. A number of brands are currently going through the registration process, and an uptick in market entrants is anticipated in the coming months. "Probably early next year, we'll see quite a lot more niche brands enter the market, but most of those brands are part of big groups or already pretty established," says Rooke. "It's expensive, and it's a long process, unless you have a distributor; and distributors are really picky at the moment about the brands they take on."

The growing number of international brands that have now registered for the Chinese domestic market, migrating from cross-border alone brings up a number of challenges, says Bray. "It's still a big question mark, how to complete the O2O for cross-border brands," she says. Recent market entrants have included Tatcha and Grown Alchemist. Many brands choose to stick with partners they know, who often have deep understanding of online models, but less expertise in brick-and-mortar, according to Bray. How to successfully navigate market entry for younger brands is a minefield, necessitating the right partner and strategy, says Bray.

Meanwhile, the importance of KOLs to a brand's fortunes is also seen as risky business. Mega-influencer Austin Li recently came under scrutiny once more after comments during a livestream were deemed offensive to lower-income consumers. "In the current environment, it was a pretty big faux pas," observes Rooke. Given that business with Li has at times represented as much as 20% of sales for certain brands, according to observers, many players took a closer look at their livestreaming strategies in the runup to the 11.11

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LUXASIA CEO Wolfgang Baier

shopping festival.

Indeed, shopping festivals too, which continue to account for a large part of the market due to the sheer volume of product they shift, are eliciting more questions from brands. International brands' reliance on shopping festivals is a sensitive topic. "The efficacy of the shopping festivals is becoming less," says Rooke.

Deep discounts during such campaigns have become the norm. For this year's 11.11, low prices and discounts were more prevalent than ever, as the main platforms looked to encourage a more reluctant consumer to part with their cash. This has meant that finding a balance between offering promotions to cater to consumers' changing expectations and protecting the bottom line is increasingly complex. Brands that have engaged less in promotions have reaped rewards. "Brands that were more conservative are now having a much better time, because they are now the aspirational brands in the market," says LUXASIA's Baier.

Local appeal

Despite the economy, the top end of the market continues to perform well, sources suggest, especially in skincare and fragrance. In skincare, demand is shifting away from clean and natural beauty towards functionality and efficacy, observers say. "Consumers want efficacy and they want science," says Bray. "Organic and green claims are also limited by advertising laws," she points out.

While the premium skincare market remains dominated by international brands, Chinese beauty players are increasingly ramping up R&D capacity to compete. "Especially in the more expensive price bracket, we're seeing more brands and more sophisticated visuals, formulations and ingredients," says Bray. "Younger Chinese consumers are more receptive to high-end Chinese brands. The Chinese brands are playing the game of clean beauty, natural and organic, and they can claim that because they are tested and certified here.

"In make-up, C-Beauty make-up brands are really growing tremendously," says LUXASIA's Chen. At Sephora, for example, which has been expanding its C-Beauty offer, make-up artist brand Maogeping has exploded in the past year or so. "These are the type ■■■

China at a glance

• **Population:** 1.41 billion
Urban population: 64% of population
Men vs women population: 51% male/49% female
Youth population (ages 15-34)*: 25.2% of population

• **Predicted GDP growth 2023 **:** +5.4% vs 2022

*Sources: World Bank 2022 data, except * Statista 2021 sata, **IMF*

China's beauty market

• **Total beauty & personal care sales 2022:** $78.94bn, -6.4% vs 2021

• **2022 per capita spend on beauty and personal care:** $55.90 vs $59.70 in 2021

Source: Euromonitor International

• **Online sales:** E-commerce is currently estimated to account for around 50% of prestige beauty sales in China, a proportion that is anticipated to remain roughly stable in coming years, according to industry sources.

China beauty and personal care sales:

Category	2022 sales $bn	% change 2022/2021
Skincare	41.01	-5.9
Haircare	9.43	-2.4
Color cosmetics	8.24	-15.4
Men's grooming	2.33	-6.1
Fragrance	1.96	-6.2
Premium beauty & personal care	**29.83**	**-5.9**
Mass beauty & personal care	**46.54**	**-6.5**
Total beauty and personal care	**78.94**	**-6.4**

Source: Euromonitor International, retail sales value at current prices

China prestige beauty e-commerce sales 2022

Category	2022 sales $	% growth rate*
Skincare	12.48bn	+36.4
Make-up	3.43bn	+29.4
Fragrance	1.18bn	+41.5
Haircare	491.41m	+30

*Source: Circana, *data is non-comparable to 2021 due to added channel coverage*

China prestige beauty e-commerce sales January-August 2023

Category	Sales $	% growth rate
Skincare	6.8bn	+32
Make-up	1.7bn	+16
Fragrance	565.9m	+2
Haircare	297.1m	+46

Source: Circana

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▲ Sephora opened a version of its "store of the future," in China in 2023, complete with a livestreaming room

■■■ of brands that are coming up right now," says Chen. This has meant significant shifts in the brand landscape. "International brands are being killed a little bit by the local brands in China," Bray comments.

In fragrance, which overall is said to be underperforming after a major boom at the height of the pandemic, niche brands are consistently doing better than the market as a whole. "In fragrance overall, you see 4% or 5% growth, but premium and niche fragrances are seeing 12-15%," says Baier. Recent market entrants selling well include Jo Loves and Matière Première, according to observers, the latter benefiting from KOL Austin Li's endorsement.

But homegrown brands represent increased competition in fragrance too. "There is a lot happening on the local brand front in China, which makes me very confident that fragrance will continue to have strong potential in the country. I see a lot of Chinese consumers wanting to go back to authenticity, which is why they are attracted to their local brands and their craftsmanship. We need to embrace that and to be relevant and understand what the Chinese client can appreciate in an Italian brand," comments Bulgari Global Managing Director of the Fragrances Business Unit Jonathan Brinbaum. Also in fragrance, consumers are migrating from traditional fragrance formats towards body categories and candles, says Bray.

Retail reinvention

New retail developments in key cities are manifold, with large flagships in luxurious, often street-based settings. Among them, is Diptyque, which just opened a flagship in Shanghai's Old City, while Le Labo's first freestanding store in Shanghai was the brand's top-performing store in the world in the month of June, its opening month, according to owner Estée Lauder Companies.

Sephora also opened a version of its "store of the future," in China, complete with a livestreaming room. Such initiatives are leaving mall-based players behind, raising questions for international brands. Increasingly, an offer centered on the big international brands is no longer enough to succeed, given the profusion of alternatives, observers say. The latest retail developments in China are not just some of the most sophisticated in the world when it comes to their concepts, they are also at the forefront in tech integration, and this is a significant area of investment. Personalization is another focus, with local authorities assigning licenses to several major beauty players to formulate products in-situ.

The pace of growth for multi-brand retailers like The Colorist, Harmay and Bonnie & Clyde, which boomed during the early pandemic years, has slowed, although the former is expanding once more, according to its revised IPO prospectus issued over the summer. Outside China's tier-one and tier-two cities, department stores, multibrand stores and local chains like Afiona are seen as key to the beauty retail landscape.

Online, meanwhile, brands are looking to alternatives to Alibaba. While a presence with the online giant remains a necessity, the costs of doing business on it and the ever-evolving alternative landscape means brands are increasingly diversifying. It is also thought that Alibaba saw a rather disappointing 11.11 this year. The company did not release sales or growth figures on the event, saying only that GMV grew.

Douyin, meanwhile, continues to see its share of beauty grow, although video formats are reportedly shifting away from a hard sell and towards a more entertainment and content-driven approach. "The number of consumers who watch livestreaming more frequently (more than five times every week) has increased, and more brands are opening brand flagship stores on Douyin resulting in an increase in consumer trust in the channel, [contributing] to the growth of beauty sales on Douyin," says Circana's Yan. The tech landscape continues to shift extremely fast, making it difficult to stay ahead.

Trending

During the 6.18 shopping festival in June, the shift towards wellbeing and product efficacy in beauty was marked, according to data from social commerce specialist Yaso. Beauty devices were also hot property, with domestic brand Seayeo selling out of its LED facial beauty light in 20 seconds on Taobao, achieving turnover of $13.9m.

China's key beauty retailers

Alibaba (Tmall/Taobao)
Alibaba continues to lose market share in beauty, although it remains the market's biggest player. The company implemented a restructuring early this year and has made significant investments in AI. It is also working on improving user engagement and enhancing price competitiveness; however it continues to be up against tough competition from emerging platforms.

Douyin
China's version of TikTok continues to grow exponentially, taking market share from Alibaba—and taking over second place from JD.com, according to certain sources. Its beauty sales grew more than 50% in the first half of 2023, according to sources, while rivals Alibaba and JD both saw declines. Douyin is notably seeing success in lower-tier cities. Increasingly, successful activations on the platform are centered on content, rather than a hard sell.

JD.com
JD continues to shift its model from its own stores to brand flagships, opening up opportunities for prestige players, but it continues to see its market share shrink. Recent initiatives include a tie-up with Joyce Beauty, with the partnership including projects both online and in Joyce's brick-and-mortar stores.

Watsons (3,780 stores)
With its vast store network, Watsons is by far the leading brick-and-mortar retailer in China, with an estimated market share in 2022 of around 15%. The retailer continues to harness its O+O strategy.

Sephora 330 stores
Sephora was said to be looking to recruit a new China head to overhaul its operations in the face of sluggish sales. The retailer has expanded its C-Beauty offer and international niche brands. Its "store of the future" in Shanghai, which opened in June, has an array of digital features, as well as a livestreaming room. Sephora has a market share of around 2.5%, according to estimates.

The Colorist (196 stores)
After scaling up fast in 2019 and 2020, KK Group-owned chain The Colorist has reduced its footprint over the past year, and is currently operating around 200 outlets, according to its revised IPO prospective filed earlier this year. Its revenues dropped 29.9%, although in the first quarter of this year, sales gained 36.5%. The chain plans to open between 120 and 129 stores this year, as it expands into lower-tier cities.

Afiona (around 200 stores)
Franchise network Afiona continues to expand, entering 12 new cities last year, opening 56 new stores, revamping 60 others, improving profitability and ramping up activity online, notably through Douyin. Afiona's concept is described as more traditional than some of its competitors, but it has succeeded in winning over consumers in less competitive lower-tier cities.

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>
> Bulgari CEO Jean-Christophe Babin

While China has always been a difficult and expensive market to operate in, the current climate and many economists' pessimism over the country's long-term growth prospects have seen companies look to re-evaluate their China strategies.

Although major players stress that they remain committed to the country, their risk planning for China has no doubt intensified in recent years. L'Oréal reorganized its structure in China earlier this year in light of what it called the 'increased complexity of the Chinese market.' The group named Laurence Ma to the newly created role of Deputy CEO in Charge of Divisions—L'Oréal China, and also appointed current Travel Retail President Vincent Boinay President of the North Asia Zone and CEO of L'Oréal China.

However, industry players canvassed by *BW Confidential* continue to point to the sheer numbers of consumers in China, as soon as questions about the issues of risk or difficulties in the market are raised. "China has always been a complex market. But we shouldn't be too worried about China, as there is such a huge mass of highly educated potential clients who come into the labor market every year," Bulgari CEO Jean-Christophe Babin told BW Confidential. "There is a kind of normalization, if I may say, of China, which won't prevent millions of new potential consumers to enter the labor market every year. China will continue to drive the luxury market, although probably in a more balanced way." However, he added: "It will take some time for the RMB to be strong again, as its weakness is the outcome of a weak economy. The country needs to change its economy from investment in infrastructure and real estate to internal demand and consumption."

Another positive for the Chinese local market is the crackdown on "daigou" (or resellers) in Hainan island and also a change in daigou policies in South Korea. The daigou trade, which exploded during Covid, had seen a large secondary market develop in China. Now that the daigou trade is being reined in, the domestic market is set to benefit, as consumers look to make their purchases through traditional channels in China. In addition, that travel is still curtailed means that more Chinese continue to buy at home rather than in travel retail or abroad. And this practice is likely to remain, even if travel resumes on a major scale, given the availability of quality retail and authentic product in China. In short, the 'domestication' of some of the Chinese travel-retail business is set to continue.

However, without a doubt, China is no longer beauty's Eldorado. "It's a very different landscape in terms of openness and how quickly you can do it, and the bullishness of the consumer," Baier sums up. "A strategic approach to China is important, where you say how do I build the brand and how do I protect the bottom line." In such a context, caution is the order of the day. ■