



INDIGO IS THE NEW BLUE

(青出於藍)

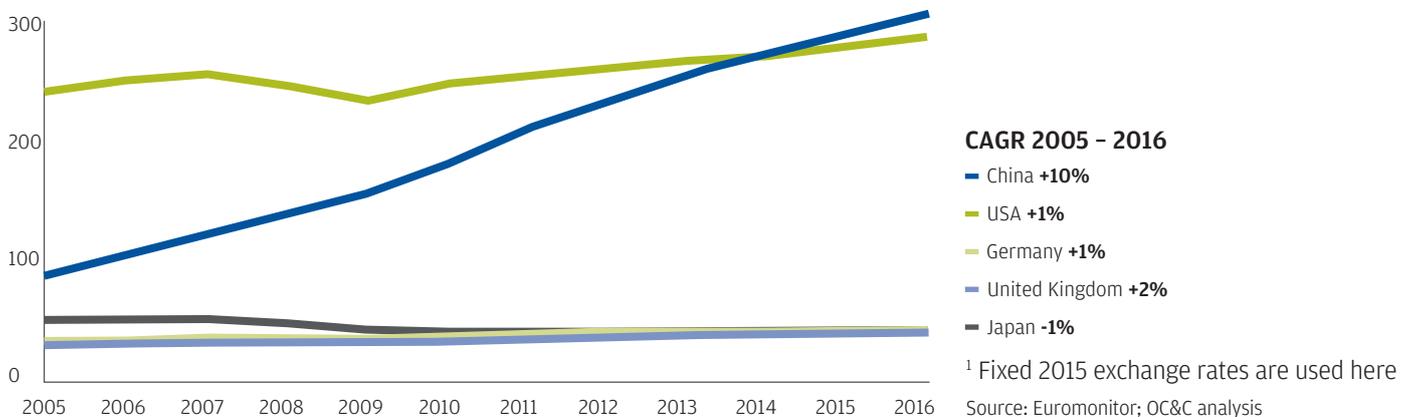
THE WARRING STATES: OVERVIEW OF CHINA'S APPAREL MARKET

China's apparel market, having experienced double-digit growth for decades and now surpassed US to be the biggest apparel market in the world, valued at close to USD 300 billion, has undoubtedly emerged as the key battlefield for brands. Albeit the recent slow-down to high single-digit growth since 2010, China still presents lucrative opportunities when compared against its international peers. More so, the vehement growth has benefitted players across all categories.

FIGURE 1:

Apparel Market Size Evolution for Key Markets, 2005-2016

Retail Value, Bn USD¹



However, beneath the attractive growth lies a complicated world

To begin with, international brands are found to be disproportionately favoured as local labels continue to lose ground to their foreign competitors. For instance, among the top 60 brands in China, combined share of Chinese players has dropped to 59% in 2016, down from 64% in 2011. Also, frontrunners are now predominantly international players, in which Uniqlo (优衣库), Adidas (阿迪达斯), and Jack & Jones (杰克琼斯) have occupied 3 of the top 5 spots, posing imminent threat to the #1 Heilan Home (海澜之家).

In addition to the diminishing dominance of local brands, huge reshuffle in leadership was also found among top Chinese players. Of the six local brands which ranked top 10 in 2011 - Metersbonwe (美特斯邦威), Semir (森马), Bosideng (波司登), Anta (安踏), Lining (李宁), and Baleno (班尼路) - only Anta and Semir remain in the top 10 in 2016. On the other hand, Heilan Home (海澜之家), La Chapelle (拉夏贝尔) and Peacebird (太平鸟) have risen to join the major league. In particular, Heilan Home has outcompeted all contenders to claim the top spot, proving that Chinese players also enjoy a fair chance to win.

The radical and remarkable shift have led us to a myriad of interesting questions, ranging from "What are the reasons that underlie the fall of Goliaths like Metersbonwe?", "What is the story behind the overnight success of Heilan Home and La Chapelle?" to "Why do Chinese shoppers turn their back against local brands?" and many more.

Through this study, we aim to unveil the "mysteries" about China's apparel market.

THE POWER TRANSITION: RISE AND FALL OF LOCAL BRANDS

Former leaders such as Metersbonwe and Bosideng have been suffering from poor store performance and lower margins in recent years. This is reflected in their mounting inventory, lower sales, surging rents, and increasing labour costs which forced these former behemoths to years of store closures. For instance, Metersbonwe's network has shrunk massively from c.5200 stores in 2012 to c.3700 stores in 2015. Similarly, Semir has shut down c. 300 stores on a yearly basis over the past 4 years.

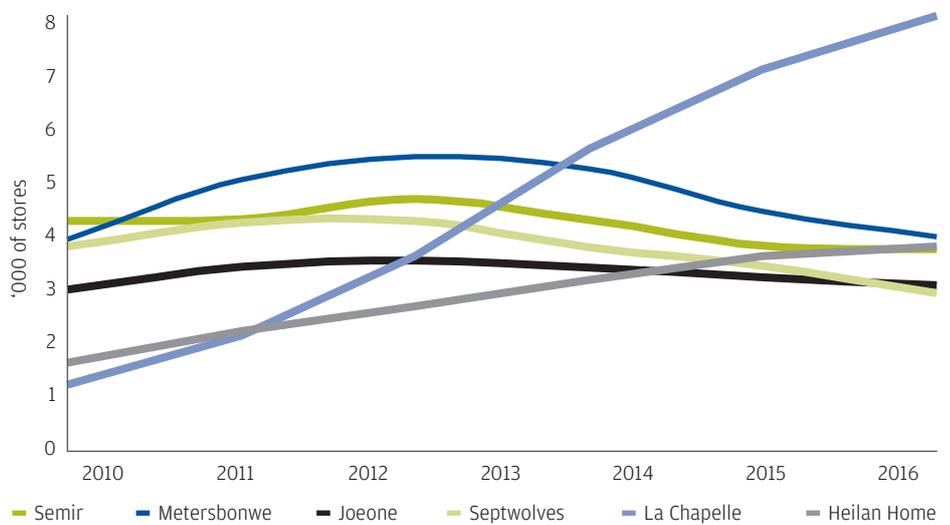
The revision of offline presence is not part of the strategy to shift from offline to E-commerce. For most of the top Chinese apparel players, E-commerce currently only accounts for 5-10% of sales, while overall online penetration for apparel is already close to 20-25%. Furthermore, instead of lowering offline store numbers, top international players like ZARA and H&M have holistically integrated both initiatives to lubricate the transition from brick-and-mortar to omni-channel.

New comers, Heilan Home and La Chapelle, have emerged as clear winners among the domestic league in recent years. Fuelled by their aggressive and IPO-funded offline expansion, the two local giants have registered impressive growth at a CAGR (Compound Annual Growth Rate) of 27% and 33% respectively in the past 5 years. In particular, Heilan Home's offline network has grown by 50% since 2013 and has reached 4200+ stores in 2016. Over the same period, La Chapelle Group has also added 3500+ stores across its brand portfolio and has commanded an extensive network of 8900+ stores by 2016.

Neck-breaking offline expansion - often funded by IPOs - followed by extensive store closure, appears to be the "fate" of many local giants. Will Heilan Home and La Chapelle be next? Or will they cement a long-lasting legacy?

FIGURE 2:

Store Number Evolution for Selected Chinese Apparel Players
Number of Stores by Company



Source: Company website

This has led us to a critical question in retail: Can this growth be sustained? Looking at the like-for-like growth of Heilan Home and La Chapelle, the answer is more complex than it seems. For Heilan Home, the prospect appears to be more pleasant, in which annual per-store revenue has experienced healthy growth of 7% CAGR while average store size remains relatively stable at c.185 sqm since 2013. However, La Chapelle is displaying worrying signs with its annual per-store revenue dropping to a CAGR of 3% in 2016.

Chinese Online Pure-Play Apparel Brands

Thanks to the e-commerce boom in China, online pure-plays (淘品牌) are also emerging as an increasingly recognizable force. For instance, HStyle (韩都衣舍) has amassed 10+ million followers on Tmall, with its revenue exceeding RMB 1.2 billion in 2015 upon a 52% YoY growth. Inman (茵曼) has achieved RMB 1.1 billion of revenue in 2015, up from RMB 0.59 billion in 2013.

While still being relatively small and with a prime focus on the mass market, it is without doubt that online pure-plays have already assumed an important role and will continue to influence the market.

To explain the remarkable dynamics in China's apparel market, we have identified two key questions:

- **How are local brands generally perceived by Chinese consumers?** What are Chinese consumers looking for when they pursue Chinese brands vs. international labels?
- **Are there differences in the way Chinese brands operate, that could explain their challenges?** What are their strengths and weaknesses against key drivers of retail performance?

THE PATRIOTS: SHOPPERS OF CHINESE APPAREL BRANDS

Customer is king - if local apparel brands are to regain dominance, the development of a strong understanding about Chinese shoppers is pivotal.

OC&C launched an exclusive consumer survey during March to April 2017, covering 2,450 respondents from different demographic groups across 22 cities in China. Through the survey, we have extracted invaluable insights concerning 52 local brands across different apparel categories and price points.

FIGURE 3: Menswear...



Womenswear...



Unisex...



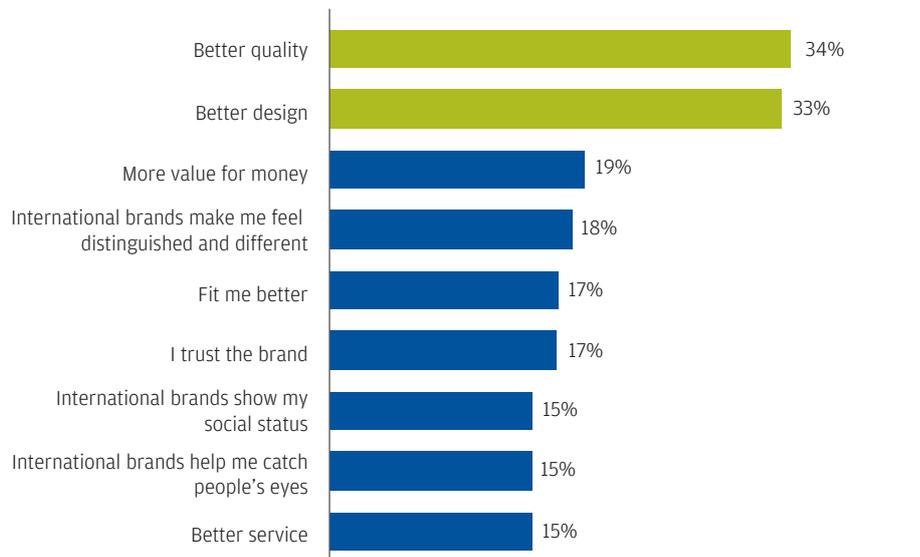
(1) Profile of Patriots

Comparing to shoppers of international apparel brands, “patriots” of local brands are younger and typically from lower income brackets. They are also frequent and small-ticket shoppers, with a smaller annual spending on apparel. Similar to international brand shoppers, product suitability and quality are their most important buying criteria for apparel products in general. However, given the income constraints, supporters of local brands have placed higher emphasis on “value for money”. And it is the No.1 reason why consumers choose Chinese apparel brands with 40% of respondents claiming the factor as the top reason for patronizing Chinese brands.

“SUPPORTERS OF LOCAL BRANDS HAVE PLACED MUCH HIGHER EMPHASIS ON VALUE FOR MONEY”

FIGURE 4:

Top Reasons for Purchasing International Apparel Brands
% of respondents, N=1,209

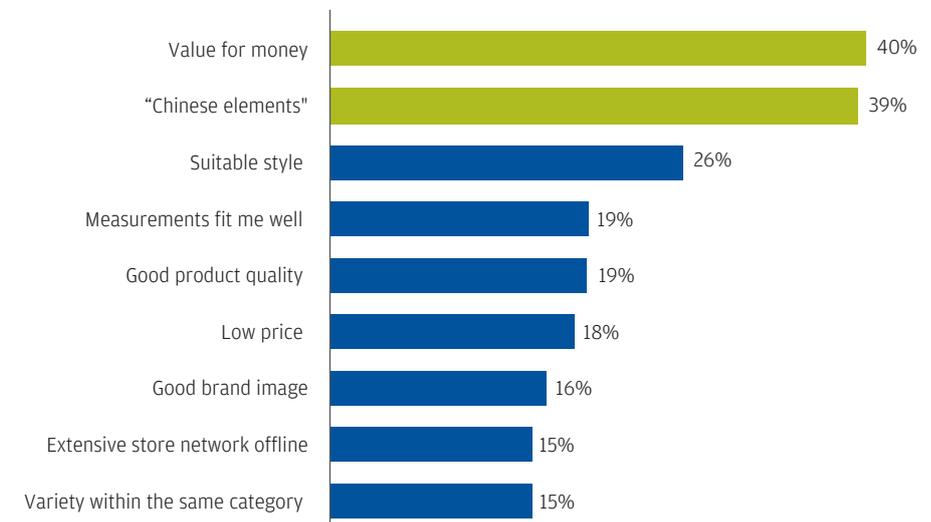


Q: Why do you prefer international brands? Rank top 3 reasons

Source: OC&C apparel proposition survey (2016), OC&C analysis

FIGURE 5:

Top Reasons for Purchasing Chinese Apparel Brands
% of respondents, N = 2,371

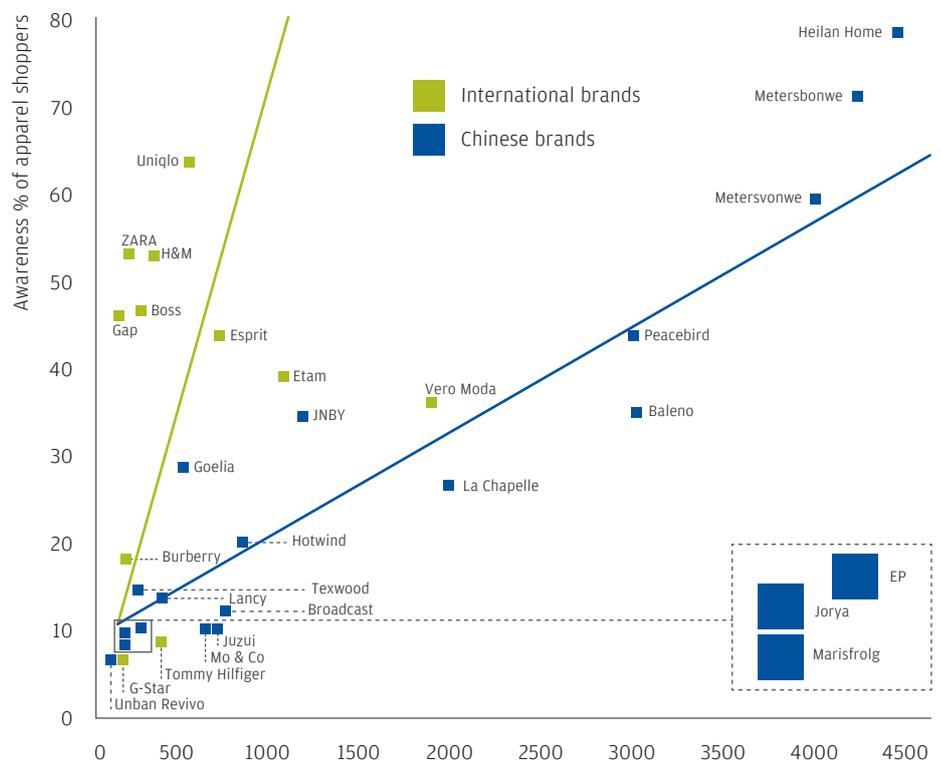


Q: Why do you prefer Chinese apparel brands? Rank top 3 reasons

Source: OC&C apparel proposition survey (2017), OC&C analysis

“CHINESE BRANDS HAVE SEEMINGLY SUFFERED FROM (LOWER EFFICIENCY IN BRAND AWARENESS BUILDING) THROUGH THEIR OFFLINE PRESENCE”

FIGURE 6: Correlation Between Brand Awareness and Store Network Size
X Axis: Est. Numbers of Stores in China; Y Axis: Brand Awareness



Source: OC&C apparel proposition survey (2017), OC&C analysis

Store #

(2) Brand-related Behaviour of Patriots

Chinese shoppers also demonstrate lower level of engagement with local brands.

This is evidenced in lower share of mind for Chinese brands vs. international brands, especially in the womenswear segment where international players enjoy extremely prominent presence. For categories like menswear, local brands are in much better positions as they encounter less competition from foreign challengers.

Interestingly, while a great majority of shoppers have identified “physical store” as the major channel to acquire brand-related knowledge, Chinese brands have seemingly suffered from lower brand awareness building through their offline presence. For instance, despite having 1,000+ stores in China and being the best-known local women’s brand, JNBY

(江南布衣) is only known to 35% of respondents. ZARA, on the other hand, commands c.50% brand awareness with less than 200 stores and Uniqlo achieves 60% awareness with c.500 stores.

Three reasons for lower awareness for local brands are department store focus, un-differentiated positioning, and low marketing investment. Local players have relied heavily on department stores, where exposures are often limited by small store fronts (i.e. concessions) and unfavourable store locations (i.e. higher floors). Take Shanghai as an example, department store accounts for 67% of stores for EP (雅莹), 59% for La Chapelle and 50% for Marisfrolg (玛丝菲尔). However, international labels have leveraged shopping mall and high-street as the

predominant channels. In Shanghai, all H&M and C&A stores are either located in malls or on high-streets. Department stores also lend to less impactful and undifferentiated visual merchandizing which hinder store’s capability to build awareness.

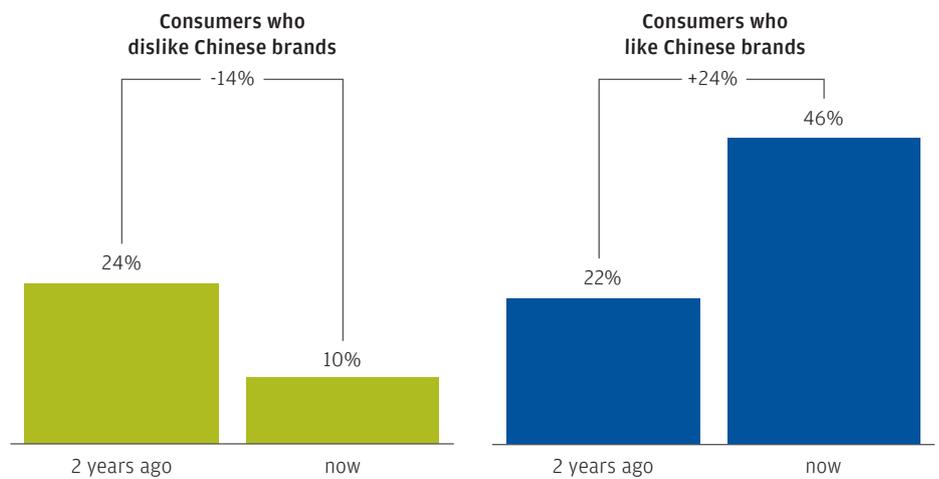
Apart from ineffective channel strategies, Chinese brands also lag behind in marketing investment. For example, in 2016, La Chapelle has devoted less than 2% of its revenue to marketing and Heilan Home has dedicated just above 3% of its revenue; whilst leading international players have typically invested 5-10% of their revenue in marketing and advertising. The less aggressive marketing effort by local players has, to some extent, furthered the gap.

(3) Perceptions toward Chinese Brands

The picture is not all gloomy. Our survey suggests that perceptions toward local labels have become increasingly positive. When we asked about consumers' attitudes toward Chinese apparel brands, the % of consumers who like Chinese apparel brands have more than doubled to 46% in the last two years. Furthermore, consumers aged between 16 and 44 have become key advocates with a majority being "satisfied with Chinese brands". Judging by these encouraging signs, we are confident that local players have opportunities to win the hearts and wallets of Chinese consumers.

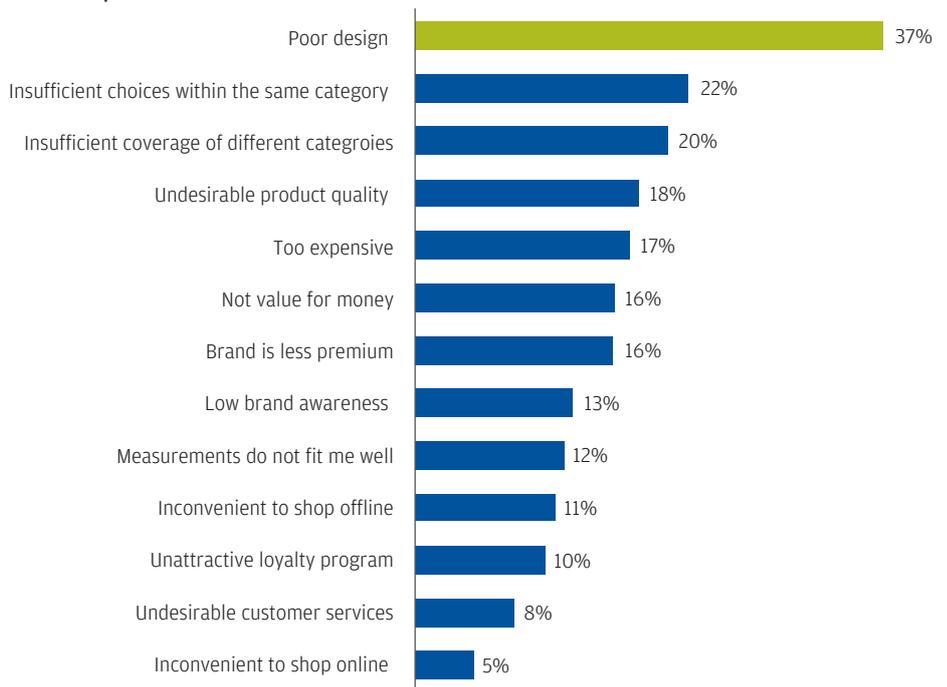
With China's surging consumer sophistication and rise of individualism, local brands must revisit their propositions. Unlike the past, Chinese consumers now demonstrate unprecedented desire to express their personal identity and perspectives on life through fashion. This has translated into salient demands for brands, products, and retail experience that resonate on an emotional level. Given the undifferentiated offerings (i.e. identical style and marketing message) and limited originality from local brands, it is unsurprising that Chinese consumers are underwhelmed by their design and variety. While recognizing the progress achieved by local brands, there is still a long march to the Promised Land. To succeed, Chinese players must ready themselves for the threats and opportunities ahead.

FIGURE 7:
Evolution of Consumer Preference for Chinese Apparel Brands
% of respondents, N=2,542



Source: OC&C apparel proposition survey (2017), OC&C analysis

FIGURE 8:
Top 3 Reasons for Not Purchasing Chinese Apparel Brands
% Respondents, N=799



Source: OC&C apparel proposition survey (2017), OC&C analysis

THE LONG ROAD TO WESTERNIZATION: ZARA WANNABE SYNDROME

In order to become more “aspirational”, many local players have deceptively decorated themselves with foreign names.

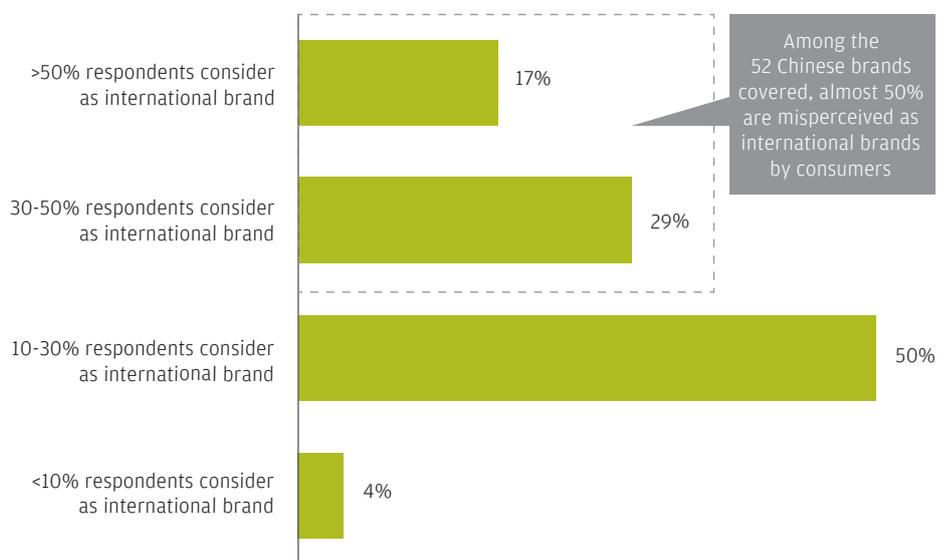
The tactic, however ludicrous it may seem, has worked to some extent. Among the 52 Chinese apparel brands covered in our survey, half of the brands are perceived as international brands by more than 30% of the respondents.

A handful of Chinese brands have taken an even more aggressive approach; Metersbonwe and La Chapelle have publicly stated their vision to become the “Chinese ZARA”. A significant portion of their strategy is guided by the “visible ZARA blueprint” - mimicking the look and feel of ZARA stores and replicating ZARA’s designs and collections. Yet, after all the efforts, results remain a bit disappointing, in which the difference in productivity per sqm remain staggering (in the magnitude of 1 to 3, if not more).

In the hope of explaining the performance discrepancies, we have conducted a high-level outside-in appraisal - only based on publicly available information of top Chinese players’ practices against our Retail Excellence Evaluation (RExE) framework. What we found during this review is that - as we could suspect from the general indicator of low inventory turns - the majority of Chinese brands seem to operate at sub-standard level on most dimensions of OC&C RExE.

FIGURE 9:
Consumer Misperception of Brand Origins

% Chinese brands considered as international



Source: OC&C apparel proposition survey (2017), OC&C analysis

“THE MAJORITY OF CHINESE BRANDS SEEM TO OPERATE AT SUB-STANDARD LEVEL ON MOST DIMENSIONS OF OC&C REXE”

FIGURE 10:
OC&C Retail Excellence Evaluation Framework (RExE)

	1	2	3	4	5	6	7	8	9	10	11	12
	Positioning and Product	Planning & Forecasting	Allocation & Replenish	Promotions & Clearances	Supply Chain Optimization	Store Operations	Format Strategy	Site Selection	Store Openings	Multichannel Capabilities	CRM Capabilities	Traffic Generation
Relevant KPI Examples	Brand Awareness	Full Price Sell-Through Ratio ^b	Out of Stock Rate	Stock Returned to DC Avg. Discount on total sales	Distribution Costs/ Unit Production Cost % of Revenue	Pay-to-Sales Ratio	Store build Cost	Maturity Curve vs. Plan Rent as % of Revenue	Store Opening Lead Time	M-C Share of Sales/Queries	Marketing Spend as % of sales	Avg Footfall Per Store



“PRICE FACTOR IS NO LONGER THE TOP CONCERN FOR CHINESE CONSUMERS”

Positioning & Product

Apparel brands need to be very crisp with their proposition to win the hearts and minds of their target consumers.

Our analysis suggests that most local players lack clarity in terms of their proposition with extensive overlaps against their competitors ranging from target customer demographics, style, occasions, and pricing. On the same floor of a department store, you will find multiple brands with similar styles, all highlighting “Elegance” and “Femininity” as key brand elements. The competition is further intensified as the players target the same occasions of the same customer group – “Women in her Twenties to Thirties” (轻熟女). This leads to extreme difficulty for brands to establish close emotional connection with consumers.

The situation is exacerbated by undifferentiated designs from local brands. Unlike international labels, Chinese players don’t invest as heavily in building design capabilities. This leads to much smaller design teams with less competitive salary and career path. Therefore, local brands fail to attract top-tier design talents, which limits their capability in originating trend-leading and in-trend designs. Instead, they copy trend-setters like ZARA and H&M. That said, successful local designer brands like JNBY have proven that, with design handled properly, domestic brands can also prosper alongside their international peers.

After spending years playing catch-up in product quality and fit, it is now the time for local brands to switch gear to proposition development and design innovation.

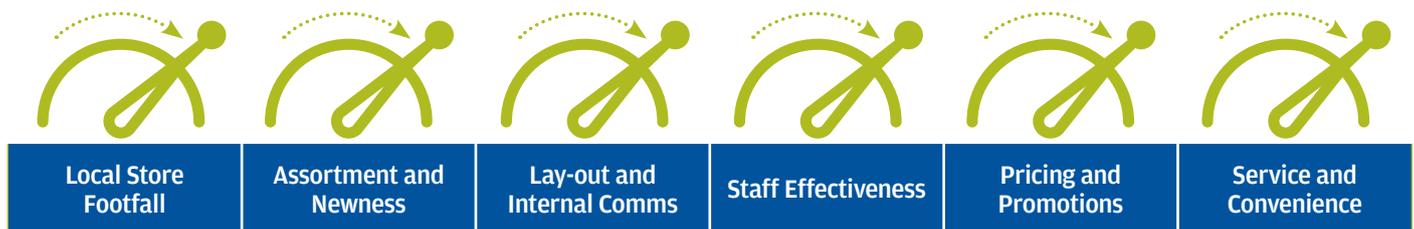
Promotion and Clearance

Discounts and sales is a double-edged sword. While being powerful solutions to inventory problems, they can also harm your brand and bottom line when misused.

Many apparel brands have been running promotions so frequently that customers have become conditioned by the constant rounds of discounts. This leads to higher % of sales at discount prices which compresses margins to record-low levels. More importantly, with only 17% of Chinese shoppers indicating “competitive pricing” as a top 3 buying factor, price per se is no longer the top concern for Chinese consumers and the effectiveness of promotions has become increasingly questionable.

Our experience suggests a more disciplined approach: “end season with short clearance interspersed with regulated in-season promotions” to be more productive and healthier.

FIGURE 11:
Store Operations Productivity Levers



Store Operation

Retail is detail. To win, it is essential for retailers to operate their stores with a very high standards across multiple levers, processes, systems and KPIs to ensure flawless execution.

Synchronization is key.

The best strategies, if they are not executed on-time in the store, are often useless. Best practice apparel retailers devote a lot of attention to ensuring that product assortment across stores are consistent and synchronized with marketing campaigns.

As local apparel brands aggressively expand their offline presence, control is often lax, with consumers ending up with inconsistent in-store experiences. For instance, in lower-tier cities, it is not uncommon to spot unmotivated sales staff and problematic visual merchandizing in stores. Even within the same city, there is stark contrast between stores in key shopping clusters vs. stores in small neighbourhoods.

Players who innovate and offer unparalleled in-store experience will reap great rewards as consumers start to focus more in this key criteria.

Supply Chain Optimization

A world-class supply chain has always been the cornerstone of success for leading apparel brands, particularly for fast-fashion players like ZARA.

The construction of an agile supply chain, despite being a vital piece to the puzzle, has been overlooked by most players in China. The absence of a consumer-centric and efficient supply chain has resulted in serious inventory problems for many aspired fast fashion players. For instance, Metersbonwe's inventory book value has reached RMB 1.8 billion 2016, representing 21% of annual revenue. For both Septwolves and Lancy, inventory even amounts to 30+% of annual revenue (vs. ZARA: 11%).

The inventory turnover ratio of local players is equally disturbing with most sampled brands having missed the 2.0 standard (vs. ZARA: 4.3).

To tackle the supply chain challenge, brands needs to consider whether their supply chain include these 4 major elements:

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- 1** Thorough incorporation of real-time analysis of sales data
- 2** Clear architecture and customized treatment of sub-collections
- 3** Short and centralized line of communications between key stakeholders
- 4** Extensive and efficient logistics and distribution network

ENDING REMARKS: INDIGO IS THE NEW BLUE

The Chinese apparel market is and will be characterized by dramatic evolutions driven by rapidly evolving consumer sophistication and preference as well as dynamic channel shifts.

Apparel brands, both Chinese and international, will need to stay on their toes and leverage REXE to constantly review their capabilities in order to maintain their competitiveness in the fast changing Chinese market. This includes establishing a clear proposition, in-trend designs, consistent store experience, efficient supply chain, and many others by addressing internal challenges now. Those who fail to invest in these capabilities are destined to lose in the world's largest fashion market.

As the Chinese saying goes: "Indigo is the new blue." Thus, through determination and persistence, students shall surpass masters.



China Graduate Fashion Week 2017 - Day 4



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