

# Beauty in China continues to grow

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## Despite slower economic data, China's beauty sector continues to see impressive growth

China continues to see strong growth, despite fears over an economic slowdown and the impact of the trade war with the US. Although China's economy grew at its slowest pace in almost 30 years, at 6.2% in the quarter ended in June, domestic consumption remains resilient and most of the main beauty players say their business shows no sign of softening.

Indeed, most are confident that China's beauty market will continue to grow robustly, as the middle class expands, millennial and Gen Z consumers continue to take a key role in consumption, government measures designed to boost domestic consumption bear fruit and the thriving e-commerce business enables brands to penetrate deeper into lower-tier cities with less developed physical retail.

Former L'Oréal China ceo Stéphane Rinderknech (who has just left the position of China head to take on other responsibilities at the group) reports that 2018 was a bumper year for L'Oréal China, which recorded its highest double-digit growth since 2004. China is now the group's second-largest market and is expected to become the largest in the near future. Brands including L'Oréal Paris, Maybelline, Lancôme, YSL, Armani and Kiehl's all hit RMB1 billion (\$150m) in sales for the year. "In China's beauty category, we do not see any sign of a slowdown. On the contrary, the consumer's aspiration for better brands, products, service and experience is still on the rise," comments Rinderknech.

At its annual results conference earlier this year, L'Oréal deputy coo Nicolas Hieronimus said that the Chinese middle class is set to reach 850 million by 2030, up from 300 million today (citing OECD figures), and that penetration of beauty per capita spend in China is only one fifth of what it is in markets such as the US and France, leaving much room for growth. He underlined that the prestige segment accounts for less than 20% of the Chinese market compared with 30% in other countries.

## Premium growth

Last year, the beauty and personal-care market in China reported 12.2% growth, according to Euromonitor International. Skincare still accounts for the bulk of the market. Prestige skincare is fueling growth, with the higher-end products much in demand. "Premiumization is a key factor in China's growth, especially for the millennials or the post-95s. They are really interested in trading up," comments Shiseido China region ceo Kentaro Fujiwara. "The premium category is booming now. Until the end of last year, the more premium products saw very high growth than the normal prestige." In skincare, there is also continued enthusiasm for Japanese beauty brands—J-Beauty—at the expense of the K-Beauty trend which has dominated in recent years.

However, categories that have traditionally been smaller, namely make-up and fragrance, are also seeing strong growth and are set to buoy the overall Chinese market further. Make-up sales rose 24.3% in China last year.

In a recent conference call, Estée Lauder Companies ceo Fabrizio Freda commented: "Make-up has been gaining favor among Chinese consumers. It now represents nearly one-third of our mix of business [in China]. Within prestige make-up, Estée Lauder, MAC, and Tom Ford were especially popular. MAC was the number-one prestige make-up brands on Tmall during the entire calendar 2018 and has become number two in prestige make-up in the total market."

Premium fragrance sales, meanwhile, rose 18.1% in 2018, according to Euromonitor. More consumers are not only buying fragrance but also using it—rather than just wanting to own it for the brand cachet as was the case in the past. Executives are hopeful that growing consumption of fragrance in China could give a lift to the global perfume market. "China has exploded in domestic in e-commerce for us; it's now at least 30% of our perfume sales in China," comments Interparfums ceo Asia Pacific Renaud Boisson. "There is a very good momentum for fragrance in Asia and especially in China."

When it comes to the market's players, China is defined by fierce competition as more global players expand there. Most of the major groups are looking to up investment in the market and bring more of their brands there, including Korean companies Amorepacific, Japanese players Shiseido and Kao, as well as Western groups like Estée Lauder Companies, L'Oréal and Clarins.

Something that may see more international players enter the market is China's potential move away from mandatory animal testing for domestic and imported cosmetics. Under current Chinese regulations, all imported cosmetics and personal-care products are subject to toxicological testing conducted on animals in certified China-based laboratories.

If the new measures are adopted, it would also enable companies with a strong anti-cruelty stance to enter the market. However, international law firm King & Wood Mallesons says global beauty manufacturers could continue to face numerous hurdles preventing them from obtaining the waiver, even if the draft regulations are passed.

While observers say that regulatory changes could come towards the end of the year, one industry player points out: "In China, I don't believe it until I see it, and we've been hopeful for five or six years."

But while foreign investment may be rising, local brands are increasingly coming out with more quality and serious offers and could in the not so distant future begin to give international players a run for their money. "Local beauty brands are gaining traction and growing fast, though international brands and imported products still have a high share," comments AS Watson group chief operating officer Malina Ngai.

## The mobile market

In terms of distribution, online commerce has become key. Distribution company Luxasia group ceo Wolfgang Baier comments: "In China, for some brands, online can represent up to 40% of business". Key online players include Tmall and JD.com. Reaching 700 million Chinese consumers, Alibaba's Tmall has far outstripped its competitors in terms of market power to become the priority e-commerce distribution network for beauty brands in China. Tmall said its sales of beauty products rose by more than 60% in 2018.

But aside from its reach, Tmall has consolidated its position through its willingness to develop close partnerships with brands that sees them sharing data, engaging in brand building and also co-developing targeted products for Chinese consumers.

Tmall says 62 companies to date have partnered with it on developing products specifically for the Chinese market. "[Tmall] says there is around a 70% success rate for products that have been developed through this Tmall innovation collaboration, against around a 12% success rate of a new product that's launched in the market," comments Gartner L2 managing vice president APAC Danielle Bailey.

Given its importance, more brands are joining Tmall. At its annual Tmall Beauty Summit earlier this year, Alibaba said that it expects international and domestic cosmetics brands to open 1,000 shops this year on its Tmall platform to meet demand from Chinese consumers.

Even Chanel, which has until now refrained from selling in Chinese e-commerce outside of its own online store, launched a flagship store for beauty and fragrance on Tmall in August, as well as on Tmall Luxury Pavilion, the platform's dedicated site for luxury brands.

In June, Tmall revamped its Luxury Pavilion site to add more personalized features and a wider range of content, including a brand-generated content feed and sections dedicated to product launches and trends.

## Surge in social commerce

However, despite the strength of Tmall, as Luxasia's Baier notes, China's online market is very fragmented. "In China alone there is Alibaba, JD, The Little Red Book, WeChat, and a lot more in social media." Indeed, social commerce continues to rise. "Social commerce is now exploding. In China, social commerce is predicted to have a 31% share [of the online retail market] in 2020. And 70% of Chinese Gen Z prefer to buy directly via social media than from other channels. So KOLs [Key Opinion Leaders] will continue to be extremely important and online will be a massive growth area for all of Asia," says Baier.

A recent report by Mintel shows that beauty and personal care accounts for 48% of products consumed through social platforms there. "Although more consumers today still prefer traditional e-commerce than social-commerce channels, their expectations for the latter are more optimistic. Our research shows that consumers who are the future of China's economy, specifically the post-90s generation,

favor social commerce over traditional e-commerce platforms." Some 39% of respondents in the Mintel poll said they preferred using social-commerce channels over traditional e-commerce platforms, while 41% preferred the latter. Some 45% said they were interested in using social-commerce platforms more frequently in the future.

The rise of social commerce is seeing KOLs become an even bigger force to be reckoned with. Natural beauty distributor Green & Gorgeous CEO Michelle Yeh comments: "KOLs are ruling the market. More KOLs are either trying to create their own brands or equity in the brand to elevate themselves to a higher positioning," she comments. "You will see more brand/KOL partnerships in different ways. They used to just get paid for an article, now they have a commission structure on top of the fixed fee."

However, Mintel warns about relying too heavily on KOLs. "Rather than solely revolving around the use of KOLs, marketing strategies that are theme-driven or carried out in co-ordination with other marketing approaches will work to a brand's advantage in the long run," commented Mintel China research analyst Cici Wu.

Despite the rush to online sales, brick-and-mortar still has a role to play. Alibaba, for example, is also busy developing its offline retail business and is digitizing physical stores as part of its overall New Retail strategy. In addition, physical pop-ups and branded standalone stores remain popular. As well as that, traditional department stores still play a role in terms of image building and validating the legitimacy or prestige of brands for Chinese consumers.

Fung Business Intelligence reports that the slowdown of the department store sector appears to have bottomed out, with many major operators reporting steady growth in 2018. Chinese department stores have also moved to strengthen their O2O offer by introducing e-commerce platforms, mobile apps and WeChat Mini programs. A new retail world indeed.

### **SNAPSHOT: Trending**

Male beauty categories are thriving, as young Chinese men have become more conscious about their appearance. A report from health and beauty retailer Watsons says Chinese males now spend more than two hours a week on male grooming. Key product category sales include face masks, BB creams, concealers and eyebrow pencils. Sales of male beauty products increased 140% in 2018, according to Ifo Asia, which notes the trend is being driven by male KOLs used by major international brands to entice young women, but which is also opening up the male beauty market. "Male consumers are developing more advanced skincare or even make-up habits, with a growing trend in professionalism, segmentation and refinement," former L'Oréal China ceo Stéphane Rinderknech told *BW Confidential*.

### **SNAPSHOT: Key happening**

The introduction of new Chinese e-commerce laws designed to regulate the daigou trade has given rise to a new B2B2C model for third-party Taobao merchants. Natural beauty distributor Green & Gorgeous ceo Michelle Yeh, whose company has begun importing beauty brands on behalf of Taobao merchants as a result of the new law, says the impact has been huge, especially on cruelty-free brands. Taobao merchants selling cruelty-free brands now need to be incorporated, and cruelty-free brands are facing higher costs as they need to pay registration and import duty. "Taobao merchants are feeling the squeeze and suppliers are feeling the squeeze; just imagine if you told Amazon merchants now you have to be incorporated, you would put a big dent in the market," comments Yeh. "Big Taobao stores have their own Hong Kong warehouses; it's the small-to-medium merchants that drive huge volumes because there are so many, [that are most affected]. They have had to sacrifice margins and accept the B2B2C model."

### **SNAPSHOT: China's key beauty retailers**

#### **Tmall**

Alibaba-owned e-commerce site Tmall has become the premier online destination for brands operating in China. After initial hesitation, international prestige brands from all of the major global players have flocked to the site in recent years. In August, Chanel said that it would open a store on Tmall for its fragrance and beauty offer. The platform has also ramped up its partnerships with brands to co-create products for the Chinese. The site generated \$30.8bn in sales during its 2018 Singles' Day shopping festival, up from \$25.3bn in 2017. Tmall's sales of beauty products rose by 60% in 2018.

#### **JD.com**

China's second-largest e-commerce site JD.com has been steadily adding international beauty brands, such as Biotherm, Helena Rubinstein and L'Occitane to its platform. It operates a social+ commerce partnership with social messaging app WeChat (Tencent), which has 1.1 billion monthly users, according to Statista.

#### **Watsons**

**N° of doors:** 3,700

Owned by Hong Kong's AS Watson group, health and beauty retailer Watsons operates 3,700 stores in 470+ cities and claims to welcome 660 million shoppers a year. Recently, the retailer has invested heavily in developing O2O capabilities, in-store services and its loyalty program.

## **Sephora**

**N° of doors:** 230

LVMH-owned perfumery chain Sephora entered China in 2005 and today operates around 230 stores nationwide, as well as a branded e-commerce platform and a store on Tmall. Recent times have seen the retailer invest heavily in applying digital features to its stores in a bid to compete online, as seen at its Shanghai concept store unveiled last year.

## **Parkson**

**N° of doors:** 44

Owned by Malaysia's Lion Group, Parkson opened its first department store in China in Beijing in 1994, and today operates 44 stores in 31 cities. In 2018, the group launched a high-end specialty beauty store concept, Parkson Beauty, in Changsha, which offers international luxury brands including La Mer, La Prairie, YSL, Chanel and Lancôme. The company hopes to expand the concept to more cities.

## **SKP Beijing**

**N° of doors:** N/A

This state-owned luxury mall recently underwent a four-year rebranding and refurbishment of its 140,000m<sup>2</sup> (1.5 million ft<sup>2</sup>) space in a bid to become one of the world's leading luxury department stores. The store stocks major international prestige brands, and saw record sales of RMB13.5bn (\$1.9bn) in 2018, according to Fung Business Intelligence.

## **SNAPSHOT: China at a glance**

**Population:** 1.38 billion

**Urban population:** 59.2%

**Sex ratio:** 1.06 male/female

**Youth population:**

**Aged 15-24:** 12.32%

**Aged 25-54:** 47.8%

**GDP (purchasing power parity):** \$23.21 trillion (2017, est)

**GDP growth:** +6.9% (2017, est)

**GDP per capita:** \$16,700

**Internet penetration:** 53.2%

**Mobile penetration:** 1.474 billion; 107 subscriptions/100 inhabitants

*Source: CIA World Factbook*