



## China's homegrown beauty brands ride the *Guo Chao* wave

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**Powered by favourable demographics, higher disposable income and social media channels, China's beauty industry is experiencing rapid growth. With the right strategies, China's cosmetics brands should be able to capitalise on the *Guo Chao* trend and give the international brands a run for their money; especially in the post-Covid era where consumers spend a greater amount of time online searching for more value-for-money products.**

Nowadays, more Chinese youngsters are wearing and buying China's homegrown brands. The Chinese media have consistently referred to this trend or *Guo Chao* as a form of 'cultural self-confidence' which stems from the country's growing economic power and cultural might.

China's homegrown cosmetics industry is at the forefront of the *Guo Chao* trend. A 2019 study by Gartner found that the percentage of China's beauty brands using 'made-in-China'-related keywords for their online product listings increased

from less than 40% in 2017 to 72% by December 2018<sup>1</sup> – a testament to the *Guo Chao* trend in China's fast-growing cosmetics market.

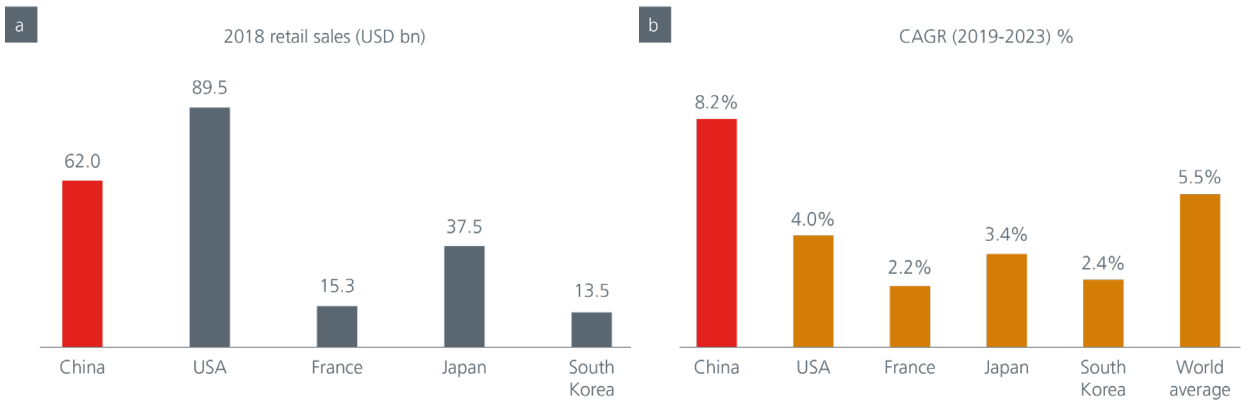
According to Euromonitor International, cosmetics sales in China, in 2018, amounted to RMB 410 billion (USD 62 billion) – making it the second largest cosmetics market in the world (see Fig. 1a). Still, China's beauty spending per capita of RMB 295 (USD 42) is very low compared to that of other major markets (USD 300)<sup>2</sup>. The low base explains why China's beauty spending is expected to increase at an annual growth rate of 8.2% between 2019 and 2023 – the fastest in the world (see Fig. 1b). With the average gross margin of companies in China's beauty and personal care industry ranging between 60% to 70%<sup>3</sup>, this booming market presents a lucrative opportunity for China's homegrown cosmetic brands.

### SECULAR GROWTH DRIVERS

Behind this phenomenal potential is China's structural demand for cosmetics. Beauty products

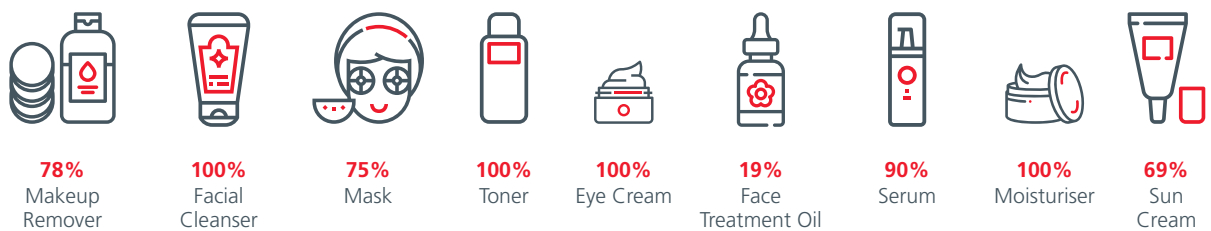
Source: <sup>1</sup>Gartner: 5 Digital China Cosmetics Trends, March 2019. <sup>2</sup>Euromonitor International 2019 and various sources gathered by Eastspring Investments, February 2020. <sup>3</sup>Bloomberg, data as at 28 February 2020. Gross profit margins range of Proya Cosmetics, Guangdong Marubi Biotechnology and Shanghai Jahwa United (from 2016 to 2019).

**Fig 1: Top cosmetics markets and expected growth**



Source: Euromonitor International 2019, based on 2018 exchange rate: CNY/USD.

**Fig. 2: Skincare process (% respondents taking the following steps) in China**



Source: OC&C: Unmasking the secrets of Chinese beauty. Page 5.

have become more of a consumer staple, rather than just a discretionary purchase. In this regard, Chinese millennials use significantly more skincare products (see Fig. 2), and also start using such products at a younger age than their parents.

With greater disposable income and aspirations to live a fashionable lifestyle, China's younger generation is more willing to buy premium beauty products, especially for colour cosmetics, which are easily driven by aesthetic trends. Fig. 3 shows that the sales growth of such products is significantly higher compared to mass-market products.

### THE RISE OF HOMEGROWN BRANDS

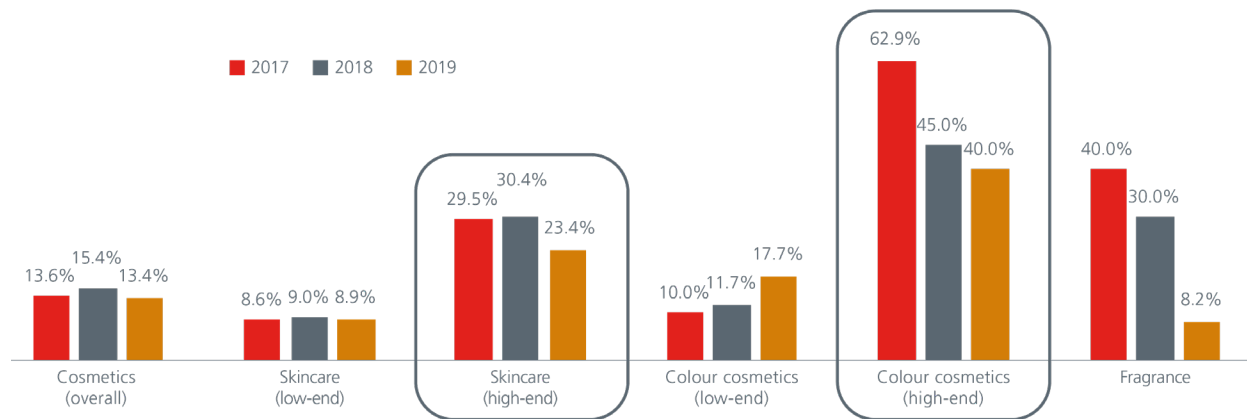
To date, China's beauty market is still dominated by foreign brands, as Chinese consumer behaviour

has historically been influenced by the Western, Japanese and Korean cultures. This is especially prominent in the Tier-1 and Tier-2 cities, where international giants have a daunting array of advantages: substantial financial resources as well as experience in research and development of high value-added skincare products.

That said, the behaviour of China's cosmetics consumers is dynamic. As such, domestic brands can have an edge over foreign brands in understanding consumer needs and local nuances.

This is in line with the *Guo Chao* trend, in which homegrown brands can look to strengthen their market visibility and presence.

**Fig. 3: Annual growth rates of China's cosmetics sales**



Source: Euromonitor International 2019.

As Fig 4 shows, Shanghai Pehchaolin Daily Chemical – a privately-owned cosmetics chemicals company which produces and sells cosmetics and perfumes – broke into 2016's top 10 cosmetics brands (in terms of retail sales value). Then, in 2019, it became the eighth largest cosmetics company in China. For the most part, the company's success has come from its strong product development and partnerships with online sales platforms. For example, during this year's 618 shopping carnival, Pehchaolin reportedly took just 15 minutes to register a 300% year-on-year increase<sup>4</sup> in sales turnover on JD.com – the second largest business-to-consumer e-commerce platform in China.

Homegrown brands continue to gather momentum, accounting for 56% of China's cosmetics market, according to research by the Hong Kong Trade Development Council<sup>5</sup>. Still, the market remains fragmented and it may take some time for homegrown brands to wrest control of the market from foreign brands.

### NICHE SEGMENTS

To thrive in this era of *Guo Chao*, domestic brands need to look beyond Tier-1 and Tier-2 cities. These

markets are already dominated by international giants. There will be more and better opportunities if they target smaller and lower-tier cities – a marketplace which, to-date, is relatively untapped by foreign brands. When doing so, they should highlight their strong Chinese origins and position themselves as pioneers in the different beauty care segments. These segments include:

- ▶ **Daily skincare:** toners, facial masks, cleansers and makeup remover form a key part of consumers' skincare routines. The demand for these products is more inelastic as customers focus more on functionality rather than efficacy. With lower price points and R&D thresholds, and low penetration of international giants, domestic start-up brands in this area can take advantage of local nuances to increase sales volume
- ▶ **Niche products:** once a unique ingredient is successfully purified for integration into various skincare products – such as stock solutions, ampoules or essential oils – the ingredient becomes a niche product. The beauty brand that comes up with the niche product becomes a 'price setter' and enjoys higher profit margins;
- ▶ **Speciality stores:** Cosmetics speciality stores are popular in lower-tier cities. In general, a single brand store keeps an inventory of 200-300 stock-keeping units (SKUs). Leveraging

**Fig. 4: Top cosmetics brands (companies) in China by retail sales value**

Rank	2010	2013	2016	2019
1	Procter & Gamble	Procter & Gamble	Procter & Gamble	L'Oréal Groupe
2	L'Oréal Groupe	L'Oréal Groupe	L'Oréal Groupe	Procter & Gamble
3	Shiseido	Unilever Group	Unilever Group	Estée Lauder
4	Unilever Group	Shiseido	Shiseido	Shiseido
5	Amway Corp	Mary Kay Inc	Colgate-Palmolive	LVMH
6	Colgate-Palmolive	Colgate-Palmolive	Mary Kay Inc	Unilever Group
7	Beiersdorf AG	Amway Corp	AmorePacific Corp	AmorePacific Corp
8	Mary Kay Inc	Beiersdorf AG	<b>Shanghai Chicmax</b>	<b>Shanghai Pehchaolin</b>
9	Johnson & Johnson	<b>Shanghai Jahwa United</b>	<b>Shanghai Pehchaolin</b>	<b>Jala (Group)</b>
10	Perfect Resources	Estée Lauder	Estée Lauder	Colgate-Palmolive
11	<b>Shanghai Jahwa United</b>	Johnson & Johnson	<b>Jala (Group)</b>	<b>Shanghai Chicmax</b>
12	LVMH	LVMH	Beiersdorf AG	<b>Shanghai Jahwa United</b>
13	Estée Lauder	<b>Jala (Group)</b>	<b>Shanghai Jahwa United</b>	Beiersdorf AG
14	<b>Jiangsu Longliqi Group</b>	Perfect Resources	LVMH	Mary Kay Inc
15	<b>Avon Products</b>	AmorePacific Corp	Amway Corp	LG Household & Health Care
16	<b>Jala (Group)</b>	<b>Jiangsu Longrich</b>	Johnson & Johnson	Johnson & Johnson
17	<b>Infinitus (China)</b>	<b>Shanghai Inoherb Cosmetics</b>	<b>Infinitus (China)</b>	<b>Yunnan Baiyao Group</b>
18	Kao Corp	Henkel AG & Co KGaA	Perfect Resources	<b>Infinitus (China)</b>
19	<b>Bawang (Guangzhou)</b>	<b>Yunnan Baiyao</b>	<b>Yunnan Baiyao Group</b>	<b>Guangzhou Adolph</b>
20	Coty Inc	<b>Shanghai Pehchaolin</b>	LG Household & Health Care	<b>Huanyan Group</b>

Source: Euromonitor International 2020. Note: Red indicates China's domestic brands.

cheaper rent, these stores are usually bigger and, also provide beauty services to boost sales. Furthermore, a customer loyalty programme can also more effectively capitalise on clients.

► **Colour cosmetics:** Within China's beauty and personal care market, colour cosmetics is considered one of the most dynamic beauty care categories, given China's image conscious younger generation. China's sophisticated original equipment manufacturers (OEM) solutions for colour cosmetics allow domestic players to produce formulas and textures for consumers who wish to explore new and

modern looks. Unlike skincare products, colour cosmetics are more subject to 'impulse buying' and are easily driven by aesthetic trends. Brand history is relatively unimportant, whilst a great social media marketing campaign is the key to success.

Domestic brands which can strengthen their positioning in the above segments will be able to capitalise on the *Guo Chao* trend; this, in turn, will lead to more sustainable growth and an expanded market share.



## HARNESSING ONLINE PLATFORMS

E-commerce and social media are accelerating the Guo Chao trend. Online channels, for instance, have allowed fledgling homegrown brands, which have limited financial resources to secure shelf space to sell beauty products directly to customers across the country. Back in 2010, online sales represented about 3.1% of the cosmetics sales in China. But in 2019, they represented 33.6% of the cosmetic and skincare sales across the country (see Fig. 5), while sales through traditional brick-and-mortar channels have continued to decline.

The power of social media is another key factor. Chinese cosmetics influencers (or key opinion leaders) are continually building a community by sharing their daily beauty routines on Weibo (the Chinese equivalent of Twitter), Xiaohongshu (a popular e-commerce social media platform), and via live-streaming broadcasts on various social platforms. These opinion leaders, generally paid

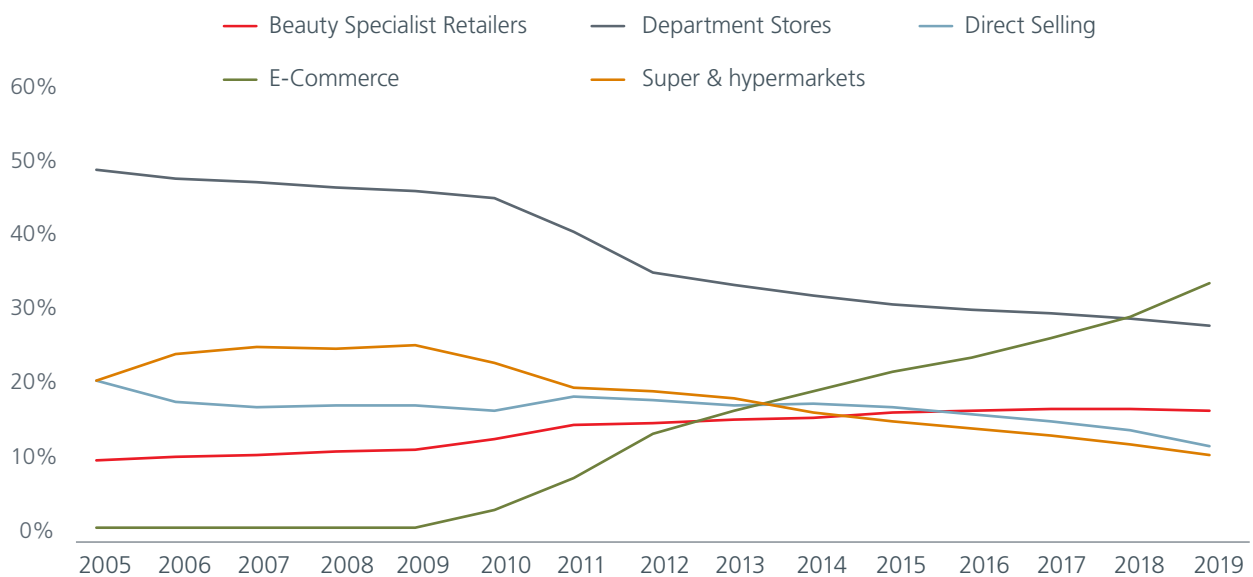
to promote certain products, are highly influential amongst millennials and play an important role in bridging the gap between cosmetics brands and consumers by explaining the importance of skincare regimen and make-up application as a form of good social etiquette.

Case in point: In November 2019, as beauty influencer Austin Li Jiaqi (who has earned himself the moniker of 'Lipstick King') discussed a homegrown brand's premium serum facial mask on his live-streaming channel, more than 400,000 boxes of the product were sold online in just 8 minutes and 12 seconds<sup>6</sup>.

## AN EXPANDING UNIVERSE

With Chinese consumers constantly being encouraged to try new brands and buy more quality skincare and cosmetics products, more domestic players are emerging in China's booming beauty market to compete with the global giants.

**Fig. 5: Breakdown (%) of China's cosmetics & skincare products sales by different distribution channels**



Source: Euromonitor International 2020.



For domestic brands with innovative and niche products but limited exposure to the younger generation, *Guo Chao* provides an avenue to refresh and enhance their brand image. The coronavirus outbreak, which has largely been contained in China, has encouraged a greater number of consumers to shop online and search for more money-for-value products. China's digital-savvy make-up brands are thus perfectly positioned to take advantage and face down their foreign rivals.

That said, although high-end beauty products can command higher profit margins, they require significantly more upfront investment outlay for research and development, along with recurrent costs and marketing expenses to safeguard the brand name and its niche products. Indeed, a single wrong product or marketing decision can cause substantial losses. On the other hand, if a domestic brand can cater to users' specific requirements and partner with OEM manufacturers for large-scale production of a niche product, the chances of success will be higher.

China's cosmetics market remains complex and fragmented, and many cosmetics brands are still privately owned. Currently only three out of China's top 10 homegrown cosmetics brands are listed<sup>7</sup>. However, the increasing financial resources needed for research and development are likely to compel more private companies to be listed on the stock exchange. An expanded investment universe will offer greater opportunities for discerning investors.



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