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China's apparel market, 2006

Today, international apparel enterprises are eyeing the Chinese market thanks to its huge market size and great potential. Fuelled by the impressive economic growth in recent decades, Chinese consumers' demands for clothing are ever increasing—not only in terms of quantity, but also in terms of quality, design, style and functionality. Together with government's effort to boost consumption, outlook for the Chinese apparel market is promising; though, it is vital to gain a deep understanding of the Chinese consumers and marketplace in order to make money from this highly competitive market.

This paper will help you understand the latest developments of the Chinese apparel market, including the consumer and market trends, and players' moves and strategies. In Issue 7 *"Performance of China's apparel product sectors, 2006"*, performance reviews of selected product sectors, namely, menswear, ladies' wear, children's wear, casual wear and ladies' underwear, will be provided to give a more detailed analysis.

I. "Apparel market" definition

For the purpose of the study, "apparel market" in the following analysis includes the following product sectors: menswear (men's suits, men's shirts), ladies' wear, casual wear (T-shirts, jackets, denim wear), children's wear, trousers, warm clothing (cashmere), leather wear, and knitted underwear.

II. Recent developments

1. Steady income growth continues to boost apparel sales

The continual income growth of Chinese residents has supported the apparel sales in China. According to the National Bureau of Statistics of PRC (NBS), per capita annual disposable income of

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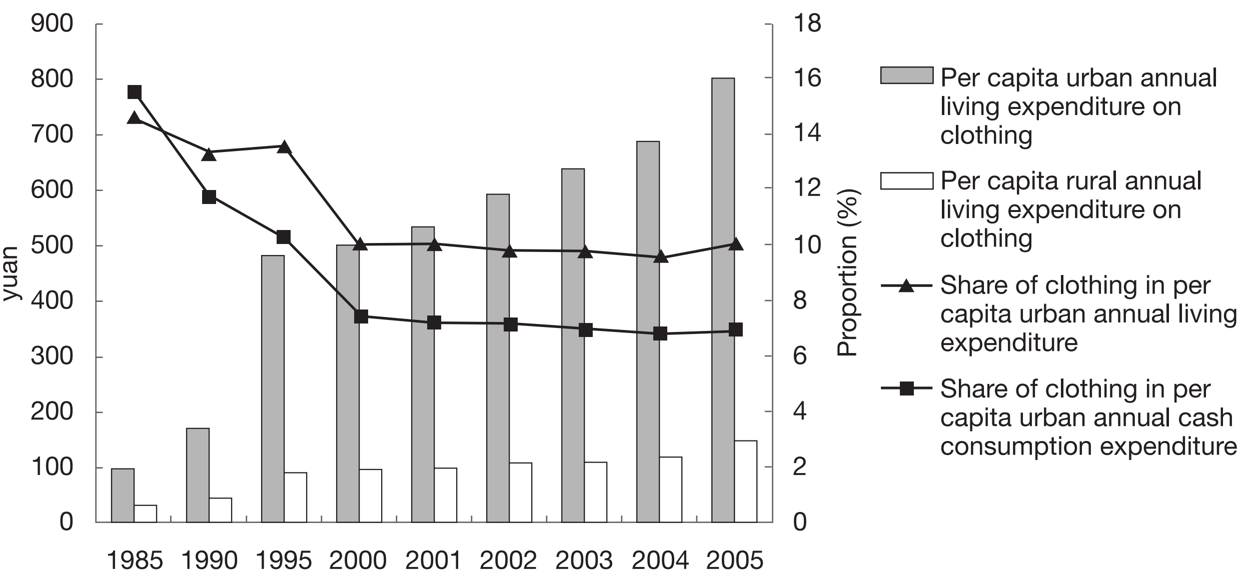
urban households reached 10,493 yuan in 2005, a real increase of 9.6 % year-on-year (yoy). Meanwhile, annual disposable income of rural households was 3,255 yuan, up by 6.2% from 2004.

Boosted by the strong economic growth, in 2005, China registered a rapid growth of 18.3% in the total retail sales of clothing of wholesale and retail enterprises above designated size[1], with the total sales value reaching 201.8 billion yuan. As income grows further and channel penetration goes up, the mid- to high-end market is expected to expand faster and sales in the second- and third-tier cities will be boosted as well.

Looking at Chinese consumers' spending on clothing, an upward trend is also identified. Per capita annual expenditure on clothing of urban households rose from 500 yuan in 2000 to 801 yuan in 2005; the figure of rural households also increased from 96 yuan in 2000 to 148 yuan in 2005 (see Exhibit 1). The growth is impressive.

However, one noteworthy trend is that Mainland consumers now spend a smaller proportion of their income on clothing largely due to the upgrading of consumption structure. The share of expenditure on daily necessities such as food, clothing and household facilities has fallen, while big-ticket items such as communications, medical services, education, cultural and recreation services have increased in the past decade.

Exhibit 1: Per capita annual expenditure on clothing* of urban and rural households, 1985-2005



Source: National Bureau of Statistics of PRC

* *Per the definition of the National Bureau of Statistics, "clothing" includes garments, clothing materials, footwear, hats, and other clothing, tailoring and laundering service fees.*

1 Above designated size: with annual sales of over 5 million yuan and an employment of or over 60 at year-end

2. Ladies' wear remains the largest sub-sector in apparel market

Ladies' wear remains the largest sub-sector in China's apparel market. According to the China National Commercial Information Centre (CNCIC), which conducts monthly surveys to over 260 major department stores across China, ladies' wear accounted for 28.6% of apparel retail volume sales in 2005, and was followed by knitted underwear (16.6%) and children's wear (8.0%). Exhibit 2 demonstrates the sales share of different product sectors in 2005. The picture is similar to that of 2003 and 2004.

Exhibit 2: Share of sales of different product sectors, 2003-2005 (%)

	2005	2004	2003
Ladies' wear	28.6	26.6	25.9
Knitted underwear	16.6	18.6	20.5
Children's wear	8.0	8.1	8.0
Casual wear	7.5	8.4	7.8
of which: T-shirt	3.7	4.1	3.8
Jackets	2.0	2.2	2.1
Denim wear	1.7	2.1	1.9
Woolen wear	6.9	7.2	7.9
Menswear	5.8	6.6	7.0
of which: Men's shirt	3.1	3.5	4.0
Men's suit	2.7	3.1	3.0
Thermal clothing	4.3	3.6	3.8
Trousers	3.5	3.6	4.1
Leather wear	0.2	0.2	0.2
Others	18.7	17.1	14.8
Total	100.0	100.0	100.0

Source: China National Commercial Information Centre (CNCIC)

3. The long-existed situation of oversupply of mass-produced garments persisted

The textile and apparel industry is one of the pillar industries of China. With its abundant supply of low-cost and skilled labors, the country has attracted textile and apparel manufacturers from all over the world to set up production bases. The production capacity is enormous.

However, the overall production capability of the industry is less approving. With relatively low market entry barriers, there are a lot of low-grade manufacturers and duplicative investment. There are very few, if not none, influential global brands. Being weak in product design and development as well as brand building, most of the domestic manufacturers are at the low-end of the global value-chain, providing OEM (original equipment manufacturer) services for foreign brands or producing products with little differentiation targeting at the mass segments. The profit margin is very slim. And the sector is burdened with an oversupply of mass-produced garments.

On the other hand, in anticipation of the huge demands from global markets after the quota elimination in January 2005, many apparel enterprises had expanded their production capacity in recent years. However, numerous protective trade measures have been imposed on China followed the surge of Chinese textile and apparel exports. Growing trade disputes, plus the speculation over the Renminbi revaluation, have increased the uncertainties and risks for Chinese exporters. Burdened with overstocks of textile goods, some have turned their eyes on the domestic market and aggravated the oversupply situation. According to the Ministry of Commerce (MOC), almost 87% of the 84 surveyed textile product categories were oversupplied in the domestic market in August 2005.

4. Price pressure mounting on mass-produced garments: pressing needs for differentiation

Price pressures are mounting on garment producers due to rising land, labor and raw material cost. Expenditure on sales and management of apparel enterprises above designated size was also up by 27.01% and 23.84% respectively in 2005 according to the China National and Garment Association (CNGA).

Despite the surge in production cost, the supply-demand mismatch has resulted in decreasing apparel prices. In the low- to mid-tier markets, there is an oversupply of low value-added garment products. As such, price cuts and other kinds of promotional activities have become the most common tools to boost apparel sales. According to the NBS, the apparel price index continued its slide in the first quarter of 2006, and was down by 1.3% yoy (see Exhibit 3). Retailers now launch more holiday and seasonal promotions and offer steeper discounts. Ladies' wear sector is the major battlefield and it is common to see discounts up to 50-70%.

Exhibit 3: Clothing price index, 1998-2006 Q1

	2006 Q1	2005	2004	2003	2002	2001	2000	1999	1998
yoy % change of clothing prices	-1.3	-1.7	-1.5	-2.4	-2.6	-1.9	-0.9	-3.4	-1.1

Source: National Bureau of Statistics of PRC

Though, it is noteworthy that the downward trend on garment prices is largely confined to the mass segment. The mid- to high-end players employ more marketing tools than price tools to compete and thus, the retail prices of their products, as opposed to the general deflation in the sector, increased by 8.29% yoy in 2005.

Given the oversupply in mass-produced garments, there is a heightened importance on product upgrade. And this is exactly what some players are doing now. Instead of squeezing on price, some retailers are striving to sharpen their competitive edges by strengthening merchandise offerings and getting the "right" products, and putting increasing efforts in brand building, marketing and enhancing store experience.

5. Urban consumption remains the driving force of apparel sales

According to the NBS, per capita annual expenditure on clothing of urban households and rural households were 801 yuan and 148 yuan in 2005 respectively. Urban households spent five times more on apparel than their rural counterparts. This trend is expected to continue for some time as urban households still enjoy faster growth in annual disposable income.

Exhibit 4 demonstrates the per capita disposable income and per capital expenditure on clothing of urban and rural households by regions in 2004. The apparel market is more developed in the Eastern regions and indeed, the Eastern costal cities are the wealthiest parts of China where a wide range of clothing and high-priced apparel retailers are available to cater for the needs of the more affluent and fashion-savvy consumers.

Exhibit 4: Per capita income and per capita expenditure on clothing* of urban and rural households by region, 2004

	Urban households			Rural households		
Region	Per capita disposable income	Per capita expenditure on clothing	Expenditure on clothing/ income	Per capita net income	Per capita expenditure on clothing	Expenditure on clothing/ income
National Average	9,422	494	5%	2,936	120	4%
Eastern Region						
Beijing	15,638	725	5%	6,170	309	5%
Zhejiang	14,546	718	5%	5,944	259	4%
Shandong	9,438	593	6%	3,507	139	4%
Shanghai	16,683	581	3%	7,066	280	4%
Fujian	11,175	471	4%	4,089	160	4%
Guangdong	13,628	455	3%	4,366	117	3%
Liaoning	8,008	450	6%	3,307	155	5%
Jiangsu	10,482	441	4%	4,754	164	3%
Hebei	7,951	439	6%	3,171	127	4%
Tianjin	11,467	430	4%	5,020	181	4%
Central Region						
Inner Mongolia	8,123	635	8%	2,606	134	5%
Shanxi	7,903	544	7%	2,590	172	7%
Jilin	7,841	523	7%	3,000	134	4%
Hubei	8,023	511	6%	2,890	94	3%
Hunan	8,617	508	6%	2,838	112	4%
Heilongjiang	7,471	492	7%	3,005	124	4%
Henan	7,705	474	6%	2,553	108	4%
Anhui	7,511	460	6%	2,500	87	3%
Jiangxi	7,560	369	5%	2,787	107	4%
Hainan	7,736	233	3%	2,818	59	2%
Western Region						
Tibet	9,106	753	8%	1,861	158	8%
Chongqing	9,221	579	6%	2,510	79	3%
Xinjiang	7,503	536	7%	2,245	139	6%
Gansu	7,377	508	7%	1,852	82	4%
Yunnan	8,871	500	6%	1,864	62	3%
Ningxia	7,218	448	6%	2,320	122	5%
Shaanx	7,492	428	6%	1,867	92	5%
Qinghai	7,320	419	6%	1,958	122	6%
Guizhou	7,322	410	6%	1,722	56	3%
Sichuan	7,710	399	5%	2,519	93	4%
Guangxi	8,690	310	4%	2,305	64	3%

* *Per the definition of National Bureau of Statistics, per capita expenditure on clothing of urban households includes 4 categories: garments, clothing materials, shoes, and tailoring and laundering services fees. For analysis purpose, clothing here only refers to the garments category.*

Source: National Bureau of Statistics

III. Apparel consumers in China: latest trends to watch

1. Consumption structure upgrades

Various studies have shown that the consumption structure is shifting gradually to middle/ mid-high end apparel products in cities. Increasing income and upward mobility drive the consumption upgrade. According to a report released by BNP Paribas, this trend is set to continue in the next decade. The rising middle class, which are more brand-conscious and discerning, will become the most active apparel consumers in the next 10-20 years.

2. Rising demand for casual wear

Being more health-conscious, Chinese consumers have an increasing interest in participating in sports. They look for clothes that are comfortable and supportive to their related activities. Casual wear that are suitable for both sports and leisure activities are increasingly popular. China's hosting of 2008 Olympic Games also gives a good boost to the fitness drive and stimulates the demand further.

The trend towards casual style has also extended to China's workplace. An increasing number of enterprises in China have relaxed the dressing requirement and shifted to a "smart casual" dress code. This has greatly boosted the sales of "smart casual" apparel. Chinese office ladies are happy with the dress code relaxation as smart casual apparel is usually more comfortable and it offers flexibility for the ladies to do their own mix-and-match. A market survey conducted by Cotton USA in 2005 interviewing over 1,500 female white collars aged between 25 and 34 in 6 major cities, namely Beijing, Shanghai, Guangzhou, Dalian, Chengdu and Wuhan, shows that 90% of the respondents prefer wearing smart casual at work, though only 41% are allowed to dress in that way currently.

Following this trend, many foreign apparel brands including b+ab, Benetton, Sisley, Ashworth, Pacino, Nautica, Ermenegildo Zegna have launched smart casual line in China. Most of these clothes are made of pure cotton fabric, which in many people's minds represents comfort and high class.

3. Increasing appetite for fast fashion

Chinese consumers nowadays seek more fashion forward merchandise. Similar to other countries, China's fashion industry is trending towards shorter product life cycle and better product design and development. Through the formula of regular replenishment of small batches of new goods, fast fashion companies never overstock. This does not only win customers' heart by an allure of scarcity, but also help enterprises avoid losing money from marking down.

The success of Zara in China is a case in point. With a great capacity to launch a garment from design, production to distribution in just fifteen days, Zara responds to the constantly-changing tastes quickly and can develop as many as 12,000 apparel products a year. It is reported that the sales volume of Zara doubled that of the same size department store. This year Zara will expand its business in China and open 2 more stores in Beijing and Shanghai.

All in all, market demand is gradually changing—from few varieties, high volume, and long product life cycle to more varieties, small volume and short product life cycle. Fast fashion business model requires effective coordination of the whole supply chain, from design, manufacturing to distribution, in which domestic players are lagging behind. The success of fast fashion should have implications for domestic players to improve supply chain management and be sensitive to market developments.

4. Functional wear grasps more attention

Besides colors and comfort, Chinese consumers are now paying more attention to the functionality of clothing. Functional wear including anti-bacterial, fungus-resistant and deodorant underwear, radiation-, static- and UV-proof jackets, lightweight and quick-dry sportswear, shape-enhancing lingerie and FIR (Far Infrared Rays) underwear that simulates microcirculation are fast in gaining popularity.

As functional wear targets specific consumer segments and provides added value, its profit margin is usually higher. An increasing number of enterprises are now eager to have more functional wear in their product portfolio.

5. Fabric innovation: more extensive use of technology

Various studies have shown that Chinese consumers are now more sophisticated that they no longer have their purchasing decisions based solely on price and style, but also on the fabric used. Fabric innovation becomes a key area in apparel product development.

For example, the use of nano-fabric is heating up in recent years for its anti-bacterial, anti-radiation features, fungus-, abrasion-resistance and moisture management capability. Youngor, the market leader in menswear, has employed nano-fabrics in its wrinkle-free shirts. Bosiden (波司登) and Erdos (鄂爾多斯) have also employed nanotechnology in their down and cashmere products.

6. Comfort of clothing remains preferable over fashion

Though Chinese consumers nowadays focus more on the style and design of what they wear, comfort, softness and breathability of clothing still carry the greatest weight on their minds. According to the Global Lifestyle Monitor™ (GLM) survey, conducted by Cotton Incorporated and Cotton Council International in 2004, nearly 90% of the respondents in China are willing to forego fashion for the sake of comfort. Clothing made of natural fibers such as cotton and wool are particularly popular. Indeed, six out of ten respondents prefer cotton clothing. The Cotton USA survey mentioned previously also found that comfort was most important to apparel purchase decision. 76% of the respondents claimed that they tended to stick to a brand whose clothes were comfortable to wear.

7. Pursuing self-satisfaction and self-expression

According to Gallup Organization's ten-year study of the Chinese consumer market, Chinese people are demonstrating an increasing desire to express their individuality. More and more Chinese people now pursue self-satisfaction and self-expression. Instead of worrying about insufficient clothing, the increasingly affluent Chinese consumers are now concerned about whether the style, cutting and brands of the clothes can best express their tastes, social status, lifestyles and individualities.

8. Growing preference for richer and sharper colors

Chinese consumers were once perceived to be conservative; and plain colors were prevalent for their clothing. But the situation is changing fast along with consumption upgrade and consumers' growing desire to differentiate themselves from the rest. Apparel products now available in China are more diversified in colors. According to the China Textile Information Center, the popular colors for the spring/summer fashion in 2006 include yellow, orange, red, pink, purple and blue.

Besides, sharp and rich colors are no longer just confined to spring/summer fashion; many down and cashmere products are now also rich in colors. Not only ladies' wear, menswear is now also far more colorful. Yellow, red, pink and green, for instance, are now popular colors for men's shirts.

9. Marked regional diversity across the country

Marketers should acknowledge that consumption habits differ across the country. The regional diversity is largely attributable to the varying pace of economic development, climate, culture and customs. For details, please refer to Industry Series Issue 2 *"The development trends of the apparel market in China"*.

According to the Cotton USA, white collars in Guangdong and Shanghai are most trend-conscious with half of the respondents expressing interest in fashion trends. Respondents in Dalian and Wuhan, on the other hand, are more conservative with 45% of them going for more long-lasting and classic style. Respondents in Guangzhou focus the most on product quality with 82% of them choosing to purchase their clothing in specialty stores or well-known retail channels for quality assurance. Understanding the strong regional differences in China is essential for enterprises to customise their offerings and thus increase the chance of success.

IV. Distribution channels

1. Department stores

According to the 2004 survey conducted by CNGA, large-scale department store is the most popular distribution channel (29.5%) for apparel products. Mainland consumers consider product offerings in department stores to be reliable, genuine and of high quality.

Department stores in China can be generally divided into three classes—the high-, mid- and low-end based on their product offerings, store environment and management. The top apparel brands are mostly distributed through high-end department stores; and it is a predominant trend for department stores in big cities to sell western-branded products. In Beijing's high-end departments stores such as the Beijing Lufthansa Shopping Centre and Scitech Plaza, domestic brands only make up 40% of the product portfolio; for it is their development strategy to bring in premium international apparel brands to enhance their store images. High-end department stores place huge emphasis on shopping experience. For instance, product counters are set up to offer personalized services and create an irresistible buying experience.

Meanwhile, mid-range department stores target at the mass segment. To create a more upmarket image, they have been expanding the share of foreign brands to around 20-40% of the product offerings. Though, mid-range department stores are still the major sales channel for domestic apparel products; indeed they largely rely on renowned domestic brands to generate profits. Low-end department stores, on the other hand, target at the lower income groups like the blue collars.

For foreign apparel brands to enter the Chinese market, selling through standardized stores/ counters in high-end department stores is the priority choice as it helps promote brand image and reach the affluent consumers. Though, it is not easy to set up stores/ counters in these department stores as they impose strict entrance requirements in the aspects of market standing and sales record. Hefty entry and promotion fees by retailers also undermine the profit margins. Besides, limited size of the stores/ counters restricts the range of products offerings and the way the products are displayed.

2. Specialty stores

Specialty stores is another major distribution channel for branded apparel products. They are increasingly popular as apparel enterprises usually have better control over store operation, say they can decide the range of products and services offered, have more say in store decoration, collect feedback from consumers directly and avoid various fees levied by department stores. Specialty stores is challenging the department stores as the most popular retail channel for apparel.

Many renowned brands have their own specialty stores. They usually opened their first stores in the coastal and first-tier cities such as Beijing and Shanghai. In recent years, however, these markets have shown signs of saturation and the fierce competition for prime locations has driven up the rental cost. Meanwhile, disposable income is rising in the less developed cities, which demonstrate huge market potential. Thus, many are expanding to inland and the second- to third-tiers cities such as Hangzhou, Shenyang, Harbin, Chengdu, Tianjin, Wenzhou Wuhan, Dalian, Qingdao and Chongqing for the increasing purchasing power in these regions and the lower operation cost. (See Exhibit 5)

Exhibit 5: Major store locations of selected apparel enterprises in China

Company/ brand	No. of stores in China	Major store locations
	Premium brands	
Armani	17	Beijing, Chongqing, Dalian, Hangzhou, Shanghai, Shenyang, Shenzhen, Wenzhou
Celine	7	Beijing, Guangzhou, Hangzhou, Qingdao, Shanghai, Shenzhen
Cerruti 1881	36	Beijing, Changchun, Chengdu, Dalian, Guangzhou, Hangzhou, Harbin, Kunming, Ningbo, Qingdao, Shanghai, Shenyang, Shenzhen, Suzhou, Taiyuan, Wuhan, Xi'an, Zhengzhou
Ermenegildo Zegna	28	Beijing, Changchun, Changsha, Chengdu, Dalian, Guangzhou, Hangzhou, Ji'nan, Kunming, Nanjing, Ningbo, Shanghai, Shenyang, Shenzhen, Shijiazhuang, Suzhou, Taiyuan, Wuhan, Xi'an, Zhengzhou, Zhuhai
Kent & Curwen	38	Beijing, Changchun, Chengdu, Dalian, Guangzhou, Hangzhou, Harbin, Ji'nan, Kunming, Ningbo, Qingdao, Shanghai, Shenyang, Shenzhen, Suzhou, Taiyuan, Tianjin, Urumqi, Wuhan, Xi'an

Company/ brand	No. of stores in China	Major store locations
	Premium brands	
Louis Vuitton	11	Beijing, Chengdu, Dalian, Guangzhou, Hangzhou, Qingdao, Shanghai, Shenzhen, Xi'an
Polo Ralph Lauren	16	Beijing, Changchun, Chongqing, Dalian, Guangzhou, Hangzhou, Kunming, Nanjing, Shanghai, Shenzhen, Wenzhou, Xi'an
	Mid-high range brands	
Mango	20	Beijing, Changchun, Harbin, Ningbo, Shanghai, Shenzhen, etc
Esprit	84	Beijing, Changchun, Changsha, Chengdu, Chongqing, Dalian, Fuzhou, Guangzhou, Hangzhou, Harbin, Hefei, Ji'nan, Nanchang, Nanjing, Qingdao, Shanghai, Shaoxing, Shenyang, Shenzhen, Shijiazhuang, Tianjin, Urumqi, Wenzhou, Wuhan, etc
	Mid- range brands	
Baleno/ebase/S&K	2,837	Beijing, Guangzhou, Nanjing, Tianjin, Wuhan, Xi'an, etc
Bossini/Sparkle	628	Beijing, Chongqing, Dalian, Dongguan, Fushan, Guangzhou, Hangzhou, Langshan, Nanchang, Nanjing, Qingdao, Shanghai, Shenzhen, Suzhou, Tianjin, Wuhan, etc
Giordano/Giordano Ladies/ Bluestar Exchange	706	Beijing, Dalian, Guangzhou, Ji'nan, Shanghai, Tianjin, Wuhan,etc

Source: Respective companies' homepage, annual reports and newspaper articles

Many established brands have opened self-managed flagship stores at prime locations to further strengthen their image. Louis Vuitton, for instance, opened a three-storey, 17,000-square-foot flagship store last year in Beijing. Youngor, a prominent domestic player, has also opened a flagship store in Shanghai's famous Nanjing Road.

After rapid expansion in the early years, many retailers have come to know the importance of store management besides geographical expansion. Baleno has slowed down its store expansion plan this year after adding 1,000 outlets in 2005 and will focus more on improving store performance and cost control. On the other hand, Giordano has rolled out its first concept store in China, which features visual merchandising, exclusive designs and products of limited edition. It is hoped that the concept stores can create a "halo effect" for Giordano and drive the sales growth in regular stores.

In December 2005, the MOC issued a circular taking effect on 1 March 2006 to simplify and speed up the approval process for the establishment of, and opening of stores by a foreign-invested commercial enterprise. With the new rule in place, the approval process of opening foreign-invested retail stores of less than 300 square meters can be quickened, benefiting the growth of specialty stores.

3. Commodity exchange markets

Commodity exchange market, despite its wholesaling nature, is a popular shopping place for mass apparel products and attracts many low- to mid- income earners. It offers a wide variety of low- and mid-range unbranded apparel and fake premium apparel. According to the China General Chamber of Commerce (CGCC), there were 409 textile and apparel commodity exchange markets with an annual turnover exceeding 100 million yuan in China in 2005. They altogether have recorded a total turnover of 473.1 billion yuan.

The competitive edge of these markets lies in price, with product prices ranging from few dozen yuan to not more than few hundred yuan. The shopping environment of these markets is generally crowded and less comfortable. In terms of store decoration, services, product style and packaging, these markets can hardly compete with other distribution channels. In many such markets, large piles of apparel in plastic bags and paper boxes are commonplace and often results in wrinkles, dirt and even damages of the apparel products. Though, we have witnessed upgrading in some of these markets in China in recent years, with more modernized planning, better shopping environment and wider product offerings. By way of illustration, Hangzhou Sijiqing (杭州四季青服裝批發市場) has successfully transformed itself into a showcase for branded apparels and a platform to attract potential franchisees. Others such as Bejing Dahongmen (北京大紅門服裝城)and Bairong Commercial Trade City (百榮商貿城) have also introduced branded products to boost their image.

With improving shopping environment and competitive pricing, these commodity exchange markets are becoming more favorable to consumers.

4. Hypermarkets

Hypermarket sells mainly lower-priced anonymous and retailers’ private branded apparel. The products are mainly mass items such as loungewear, casual wear, children’s wear, underwear and socks. Price-competitiveness is the major attractiveness with product price around a dozen to a hundred yuan. Nonetheless, few consumers visit there to buy apparel products on purpose for the limited product choice and the often lack of fitting room. Low penetration of hypermarkets in less developed cities and rural areas also accounts for its small fraction of national apparel sales.

Traditionally, food and beverages make up the largest share in hypermarket’s product portfolio. However, there is a downward price pressure on these basic items amid the intense competition. Together with the increasing land and labor cost, the profit margin of the hypermarkets has been further squeezed. In an attempt to reverse the downward trend, some are aggressively expanding the higher-margin product offerings such as private labeled apparel whose gross profit margin could reach 30-40%. For instance, the Shenzhen CR Vanguard has introduced the private apparel brand “Victor & Victoria”; Walmart has launched private label apparel including “725 Originals” and “SE”.

5. Discount outlets

Discount outlet is a newly emerging apparel distribution channel in China and demonstrates huge potential. A discount outlet sells mainly discontinued or surplus stocks. Since outlets are mainly for closeouts and usually with relatively simple layout and decoration, people can often buy products at huge bargain.

Discount outlets are relatively new to China and they are currently most common in key cities such as Beijing, Shanghai and Shenzhen. Foxtown, The AIIKA Outlet, Beijing Lufthansa Outlet, 365 Outlet, LCX Outlet, Gong Mei Best Discount and Shoulian Discount are some of the popular ones.

The initial success of discount outlets in China is not without reason. Brand-driven consumption is gathering gear in China. Yet, a large number of consumers are still price-sensitive and find premium products unaffordable. For example, in Beijing alone, there are some 1.3-1.7 million consumers that would like to buy premium products but find them unaffordable according to industry estimates. The average monthly personal income of this consumer group is around 3,000 yuan. Discount outlets help them realize premium brand consumption at a more accessible price.

Despite their initial success, the development of outlets ahead is fraught with challenges. Regulations on outlets are insufficient. Some outlets are reported to have misled consumers by mixing their so-called discounted premium offerings with off-brand products.

6. Online shopping

Currently, there are many online apparel stores offering a wide variety of apparel products, ranging from accessories, children's wear, casual wear to ladies' wear. Most of the products are sold at a dozen yuan to several hundred yuan.

The market for online sales is huge. According to China Internet Network Information Centre (CNNIC), China's Internet population has surged enormously to reach 123 million by March 2006 and nearly 26% of them have online shopping experience. Online shopping is becoming more prevalent. The penetration of online shopping reached 31.6%, 27.4% and 20.1% in Beijing, Shanghai and Guangzhou respectively. Consumer-to-consumer (C2C) electronic commerce is also growing and the average penetration hit 16.2% in these cities. Taking purchasing frequency into accounts, Taobao (淘寶網) has the largest market share of 67.3% and is followed by e-Bay (29.1%). Apparel tops the purchase list in C2C electronic commerce among female users.

Most of the apparel online stores offer unbranded or second-hand products. Sometimes, some famous branded products can be found in these online stores, but in fact most of them are smuggled or bootleg products. So far, a few well-known apparel brands such as Giordano offer online sales services in China. Most others do build up website but are for promotional function only.

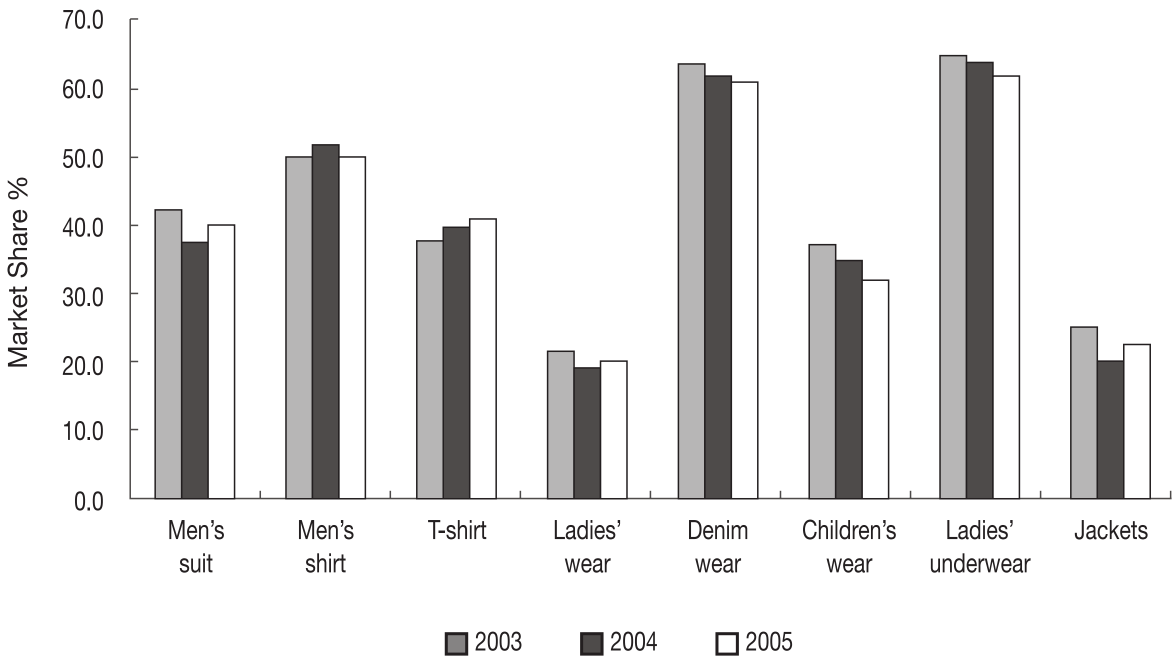
V. Competitive landscape of the apparel market

The apparel market is increasingly competitive. As China moves from a peripheral to a mainstream economy, many foreign firms are joining the battlefield.

1. Varying degree of market concentration across sectors

Apparel product sectors in China are in different development stage and they experience varying intensity of competition. As shown in Exhibit 6, market concentration is the lowest in the ladies' wear sector, with the top 10 brands accounting for around 20% of the market share. Meanwhile, denim wear and ladies' underwear have the highest market concentration.

Exhibit 6: Market share of Top 10 brands—selected sectors



Source: China National Commercial Information Centre (CNCIC)

2. Foreign players versus domestic players

(1) Foreign players

With a population of 1.3 billion and a booming economy, the rush for China's consumer fashion market is on. Instead of having direct competition with domestic players strong at the mass market, many foreign brands positioned themselves at the mid-high to premium segments as they entered the country. The strategies prove to be right.

Foreign brands continue to dominate high-end market

Today, foreign apparel brands from France, Germany, Italy, Japan, the U.S., the U.K. and Korea have dominated the high-end fashion scene in China. Indeed, international premium brands are optimistic about the luxury market and many are quickening the pace of expansion in China. Reporting a sales growth of 24% in 2005, Giorgio Armani proposes to increase 5 more specialty stores in the country in 2006. Ermenegildo Zegna, which has achieved a 41% sales growth last year, also plans to open 5-6 more retail stores annually over the next decade. Claimed to have made money in every store in China, Louis Vuitton will open 3 new stores in Chengdu, Wenzhou and Shenyang this year; it plans to expand the geographical coverage to an average of two new cities each year.

As we shall observe, most premium brands have chosen more affluent Beijing and Shanghai as their first stops in China, partly due to their showcase effect; it is then followed by Guangzhou, Hangzhou, Wenzhou, Ningbo and Chengdu.

More mid-tier foreign players enter the market

With growing consumption demand in the mid-tier market, many foreign players have embarked on various marketing and expansion strategies to grab a bigger slice of the mid-range market. Mid-tier Hong Kong players, drawing on their close proximity to China, have set foot on the market from the mid 1980's; and some of them such as Goldlion and Giordano have already established a strong foothold. The momentum increased with China's accession to the World Trade Organization (WTO). Today, Hong Kong brands such as Michel Rene, Episode and Jessica have already developed their sales network in first-tier cities and are moving to the less developed cities and the Western regions.

Though, many others are wary of their development in China. Unlike luxury goods, profits for mid-market foreign players are less guaranteed because of the fierce competition from Chinese firms, which enjoy huge price advantage.

Therefore, various strategies are employed to lower costs and safeguard earnings. For instance, understanding high prices give cachet in the eyes of Chinese consumers, it is common to see foreign firms start by jacking up the prices of their products and positioning their brands as “premium” even though they do not have a similar image overseas. For instance, the mid-tier US denim label Lee jeans are sold at a price between US$60 and US$80 in China, double the average retail price in the U.S. Price will then be lowered if the products are not well received. Levi Strauss & Co., which sells Levi's jeans at about 200 locations across China, markets the products as “super, super premium” at US$60 and up, which are almost double the prices in the US. Pierre Cardin and Etam, the prominent foreign players in the mid-range markets, also used the similar strategy when they first entered China.

Many mid-tier players have also moved their production base to China. For instance, over 70% of Hong Kong apparel enterprises work with OEM factories in Chinese cities like Ningbo, Wenzhou, Shishi and Dongguang for their lower labor costs, relatively developed transportation network and government incentives. Besides, some are adopting franchising operation to leverage on others' capital to achieve quick expansion.

Foreign brands pose huge challenges for domestic brands

Foreign players are stronger in brand building and marketing strategies. According to a recent study in 10 big Chinese cities by Hong Ye Zi Xun, a Chinese market research firm, nearly half of the respondents prefer foreign brands. In contrast, only less than 20% of the respondents favor domestic brands. Western apparel products are generally perceived to be of high quality and reliability; Chinese consumers also find wearing clothes of western brands as a way to enhance their status and confidence.

Clothing of western brands is particularly popular among youths who are generally more willing to spend. According to Harvard Business Review released this March, around 30% of the respondents aged between 18 and 24 have purchased western-brand clothing in 2005, the figures are about 20% and 10% for those aged 25-29 and aged 30-39 respectively. Foreign brands are posing big challenges for domestic players.

(2) Domestic players

Domestic brands have the lion's share in the mass segment

Domestic enterprises mostly started their business by developing cheaper products for the low-end segment or providing OEM services for foreign brands. They have a strong position in the mass market due to their competitive pricing. As the income level of the majority of Chinese consumers is still low, domestic branded garments sell well in the mass market. According to CNCIC, domestic brands dominate many product sectors in 2005 such as men's shirt, knitted underwear, thermal clothing, jackets, etc. Though, market shares of domestic brands are decreasing in the T-shirt and ladies' wear sector.

Exhibits 7 and 8 demonstrate the top 10 domestic apparel enterprises in terms of sales revenue and profits.

Exhibit 7: Top 10 domestic apparel enterprises by sales revenue, 2005

1	Youngor Group Co., Ltd	(雅戈爾集團股份有限公司)
2	Hongdou Industrial Co., Ltd	(紅豆集團有限公司)
3	Heilan Group	(海瀾集團公司)
4	ShanShan Enterprise	(杉杉投資控股有限公司)
5	Bosiden Co., Ltd	(波司登股份有限公司)
6	Qingdao Jifa Group	(青島即發集團)
7	China Judger Group	(庄吉集團)
8	Fukoda Holding Co., Ltd	(富可達控股股份有限公司)
9	Romon Group Co., Ltd	(羅蒙集團股份有限公司)
10	Metersbonwe Group	(美特斯邦威集團有限公司)

Source: China National Garment Association (CNGA)

Exhibit 8: Top 10 domestic apparel enterprises by profits, 2005

1	Youngor Group Co., Ltd	(雅戈爾集團股份有限公司)
2	Bosiden Co., Ltd	(波司登股份有限公司)
3	Hongdou Industrial Co., Ltd	(紅豆集團有限公司)
4	Heilan Group	(海瀾集團公司)
5	Xinlang Sinoer Dress Co, Ltd	(山東新郎希努爾集團股份有限公司)
6	ShanShan Enterprise	(杉杉投資控股有限公司)
7	Fujian Seven Brand Group Co., Ltd	(福建柒牌集團有限公司)
8	China Judger Group	(庄吉集團)
9	Zhejiang Baoxiniao Garment Co. Ltd	(報喜鳥集團有限公司)
10	China Ting Group Holdings Limited	(浙江華鼎集團有限責任公司)

Source: China National Garment Association (CNGA)

Generally weaker in branding and supply chain management

China's apparel industry has developed largely on the comparative advantage of low-cost and skilled labor. Most of the domestically produced garments are intended for the mass market and lack product differentiation. Most of the Chinese apparel enterprises do not put much emphasis on product development. Statistics reveal that the resources devoted to research and development (R&D) by Chinese apparel enterprises above designated size only accounts for 0.16% of their sales revenue, much lower than the 5-10% level of their European counterparts.

There are a few, if not none, local designer brands in China. Some domestic players have resorted to imitating the designs or counterfeiting foreign-brands and some even use pseudo-Italian or -French brand names. But as core competitiveness is weak, domestic brands have much shorter product life cycle. According to Hong Ye Zi Xun, around 2,000 domestic apparel enterprises are eliminated each year amid the competition. The average product life span of the top 500 domestic apparel brands is just 1.5 years, way shorter than the foreign brands.

Besides, domestic players have invested little in improving supply chain management and this has resulted in higher logistics cost and lower efficiency compared with the foreign counterparts. Poor supply chain management also inhibits quick market response and increases the risk of overstocking. According to CNGA, logistics cost accounts for 8.6% of the total production cost of the U.S. apparel enterprises whereas the figure stands at 21.3% for Chinese enterprises. There is a huge room for improvement.

Domestic players strive to improve their competitiveness

Initially shell-shocked by the arrival of foreign competitors, a number of domestic players now seem to be relishing the fight by moving up the value chain rather than relying heavily on price wars and have started to target their products to the mid- and even the high-end segments.

Branding is one of the most significant competitive strengths of foreign apparel enterprises. Domestic players in general are weaker in this aspect but some have been working hard to intensify their brand building efforts. Hiring celebrities as spokespersons is the most common strategy; and a number of domestic players are beginning to understand the benefits of event sponsorship previously dominated by international brands. Those events with mass appeal are hugely attractive to marketers. For instance, Septwolves has sponsored 4 million yuan on Real Madrid's China tour. The Li Ning Group, a domestic sportswear retailer, will also sponsor several Chinese teams in Beijing's 2008 Olympic Games to generate brand awareness and improve core brand value.

Some established brands wish to increase their global influence and have adopted a more internationalized image. Baoxiniao, a prominent player in menswear sector, has renamed itself to Saint Angelo early this year to dilute its Chinese image. Similarly, Hodou has changed the logo of its high-end menswear and ladies' wear series to HOdo. Through sponsoring the Beijing Olympic, the Li Ning Group hopes to increase its global exposure and become the top 5 global sports good brand by 2018.

Quality improvement is another way to enhance competitiveness and the success of Hongdou Industrial Company, the second largest Chinese apparel enterprises in terms of sales revenue, has proved this strategy effective. Hongdou has paid huge efforts in enhancing its design capabilities. Early in 1997, the company has worked with the world-renowned ESMOD Costume Design Institute to build and train its team of designers. To incorporate more foreign elements into its design, the company has also hired famous fashion designers from Taiwan and Japan. The efforts have been paid off and Hongdou was awarded “The Most Popular Garment Brand Among Chinese Youths” in 2004.

On the other hand, some domestic players are catching up quickly by making use of information technology to better manage their supply chain. Some are adopting applications such as Management Information System (MIS), Computer-Aided Design (CAD), Electronic Data Interchange (EDI), Enterprise Resource Planning (ERP) and Global Positioning System (GPS). Established players are trying to get rid of the previous labor-intensive operation and slow production capabilities by introducing capital investment to improve overall efficiency and be more responsive to market demands.

Yet, it is noteworthy that not all domestic players, especially those OEM enterprises with low value-add, have the capital to invest in technology. According to the CNGA, less than 10% of the apparel enterprises have adopted CAD or MIS and just 0.3% of the enterprises were using ERP in 2005.

Cost control is also increasingly important. China’s apparel production is concentrated in the Pearl River Delta, Yangtze River Delta and the Bohai-Rim Region. Faced with rising production costs in the more developed costal cities and the ever-growing competition from other Asian countries such as India, Vietnam and Bangladesh, some enterprises are gradually relocating their production base for low-value-added products to inland cities to lower the costs. According to the CNGA, investment in apparel industry has surged in the Central and Western Chinese cities. For example, investment in Chongqing, Sichuan, Henan, Hunan and Jiangxi registered a massive growth of 588.32%, 568.70%, 168.14%, 102.07% and 92.19% respectively in 2005.

3. Expansion strategies

(1) Multi-brand and brand extension strategy

As the market becomes more sophisticated, many apparel enterprises have adopted the multi-brand strategy, i.e. to market many different brands for different market segments under its umbrella. This strategy enables enterprises to leverage on the well-built platform of the prime brand while exploring new market segments.

By way of illustration, the Hong Kong based Baleno Holdings Limited has its core brand Baleno targeting at consumers aged 18-40. It also owns S&K, I.P. Zone, Bambini, Baleno attitude and ebase, etc which target at different market segments. (see Exhibit 9)

Exhibit 9: Selected brands under Baleno Holdings Limited

Brand	Target consumer group
Baleno	Mass consumers aged 18-40
S&K	Youths aged 16-28
I.P. Zone	Street fashion lovers aged 15-25
Bambini	Youths aged 15-22
Baleno Attitude	Female white collars aged 20-28
ebase	Females aged 15-35

Source: Company website and Li & Fung Research Centre Analysis

The ShanShan Enterprise owns 22 sub-brands including LaFancy, Cosdear, Fins Designers apart from its core brand Firs. Another case in point is the Fujian Septwolves Industry Co. Ltd, which owns Mark Fairwhale targeting male consumers aged 20-25 and S/J Jeans.

On the other hand, some enterprises have adopted brand extension strategy, i.e., using the current brand to enter a new product sectors as a way to utilize the brand equity, cement the core brand attitude and lower product introduction cost. For instance, the ShanShan Enterprise whose prime product is men's suits launched its sportswear line "shanshan sports" early this year to capture the big sports fad. The Hongdou Industrial Co., Ltd is another example. With menswear as its prime products, the enterprise is extending its business scope to the high-end ladies' wear sector. Septwolves has even entered the fields such as beer, cigarettes, watches and shoes, etc.

(2) Chain operation—franchised stores versus self-managed stores

Chain operation is one of the major development trends in China's apparel sector. Growing brand awareness and increasing demand for higher quality clothing among the Chinese consumers favours the expansion of retail chains as they usually present a better company image than standalone stores. Many apparel retailers have adopted multiple distribution strategies with a combination of both franchised stores and self-managed stores.

According to the China Chain Store & Franchise Association (CCFA), franchising operation has been growing at a fast rate in recent years. In sectors such as casual wear, sportswear, children's wear and underwear, we note that the growth rate of franchised stores is outpacing that of the self-operated stores. Franchising operation is currently most common in the casual wear and sportswear sectors. For example, 80% of Metersbonwe's 1,300 specialty stores are franchised stores.

With the promulgation of the *"Rules of the Administration of Commercial Franchising Operation"* in 2004, the business environment for franchising operation is more regulated. And unlike the past, where most franchisers are big enterprises, today more and more small and medium-sized apparel enterprises are adopting franchising operation.

Franchising operation has several advantages. Through franchising, apparel enterprises can strengthen their brand image, build a captive distribution network quickly especially in less developed second- and third-tier markets and expand market share with limited capital. Franchisees, on the other hand, enjoy the advantage of starting up a new business quickly based on a proven trademark and formula of doing business without having to build a new business and brand from scratch.

However, one should never downplay the potential risks of franchising operation. Firs, a prominent player in the menswear sector, recorded a 12% sales drop in 2000 in a one-off company reform to adopt across-the-board franchised operation. The sales drop was disappointing given the fact that Firs had been the number one menswear brand for seven consecutive years. The failure of Firs is partly attributable to its loosening control over the franchised stores. Excellent management from franchisers and the discipline of franchisees are crucial for delivering a consistent brand image. It was reported that some franchisees of Firs had lowered the price of men's suits by one-third without prior notice and refused to make new orders due to unsatisfactory sales performance. Other problems encountered by franchisers also include poor staff and store management of the franchisees.

Thus, some apparel enterprises are sceptical about franchising operation and prefer to adhere to self-managed store operation for consistent brand image and pricing strategy. Also, it is often easier for enterprises to collect instant market feedback from self-managed stores. Youngor, another leader in the menswear sector, has nearly half of its stores self-managed and plans to further increase the proportion.

There are both pros and cons of self-managed and franchised operation. Many apparel enterprises in China have adopted a combination of both—mostly self-managed stores in first-tier cities and franchised stores in second- and third-tier cities. Nonetheless, these enterprises have to pay extra effort to balance the interests of self-operated stores and franchised stores. Often, self-managed stores receive more support and resources and can offer a larger range of products than franchised stores. And sometimes driven by own interests, franchisees may work against the goal of the franchisers.

To prevent franchisees from ruining the whole brand image, franchisers are suggested to provide more training and support for franchisees. Some enterprises, for instance, will assess the location and store environment before granting franchisees the right to open the stores. Some have also provided free decoration and furnishing services to ensure a consistent brand image. On the other hand, enterprises should avoid offering big discounts to franchisees too frequently or they may tend to resort to price cuts to grab sales, disrupting the price structure of the products.

China National Commercial Information Centre (CNCIC)

中華全國商業信息中心簡介

China National Commercial Information Centre, formerly under the Ministry of Internal Trade of PRC, is a reputable national statistics centre in commercial area. Authorized by the State, CNCIC is responsible for collecting, compiling, analyzing and releasing market data; and producing magazines, reports and numerous publications. One of the important functions of CNCIC is to provide support for the government officials and bodies in formulating macro-control policies in the commercial area.

CNCIC possesses a powerful database and data tracking system. Over 260 large-scale retail enterprises report their sales data and other detailed information to CNCIC every month. Apart from that, CNCIC also has special access to more than 5,000 commercial enterprises' yearly statistical and financial data.

With a wealth of market data, comprehensive coverage and well-developed information system, CNCIC is known for excellence in providing information-based solutions for enterprises, such as formulating strategic expansion plan and conducting marketing research on the Mainland.

Li & Fung Research Centre Member of Li & Fung Group

利豐研究中心

The Li & Fung Group is a Hong Kong-based multinational company consisting of three distinct core businesses: export trading, distribution and retailing. Founded in Guangzhou in 1906, Li & Fung Group, with an annual turnover exceeding US$8 billion, operates in some 40 countries and regions and employs over 24,000 people worldwide. One of its core competency is Supply Chain Management (SCM).

Li & Fung Research Centre ("the Centre") researches and publishes reports on wide-ranging topics: Chinese economy, consumer market, retail sector, trade-related issues, and consumer goods industries, etc. Apart from providing internal consultancy for the Group and its clients, the Centre also participates in formulating business strategies in the Mainland market.

The Centre has been actively promoting the application of SCM. In 2003, the Centre published the book "*The Orchestrator of Global Supply Chain Management*", which is regarded as a very useful reference among businessmen and academics in the Chinese mainland, Taiwan and Hong Kong.