Bridging the trust gap

The end of the luxury e-commerce dilemma in China

OC&C
Strategy consultants

uncommon sense

The importance of Chinese customers to the global luxury market

After a three-year pause from 2013-2015, the China luxury market is back on a solid growth trajectory. This recovery was largely driven by the strength of domestic consumption, stimulated by favorable government policies and by adjustments made by most brands to bring China prices much closer to European and US prices.

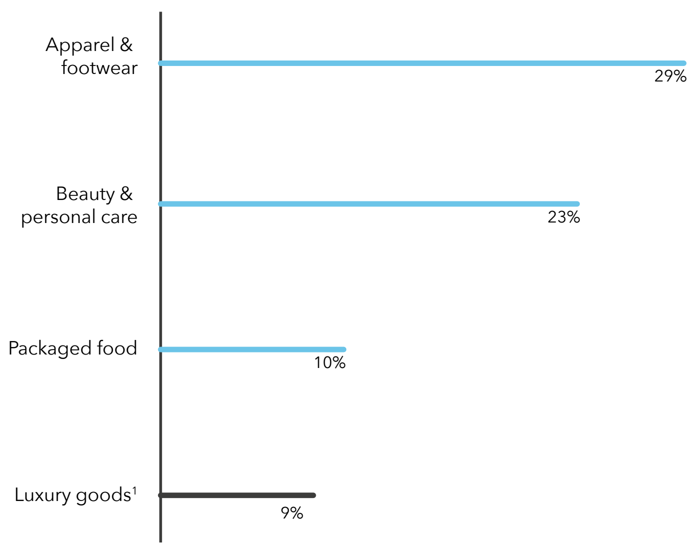
Chinese customers now account for 25%-35% of global luxury sales, most of it – between 2/3 and 3/4 – happening outside of China. However, shrinking price gaps between China and the rest of the world have been driving Chinese purchases back to China and we believe this trend will continue in the near future.

Most of this newfound growth has been happening online. Online sales now represent 9% of China's luxury fashion and accessories sales. But online penetration is still low compared to other product categories in China. Most surprisingly, the share of online sales in luxury fashion and accessories is lower in China than in other developed markets, where it is usually the opposite.

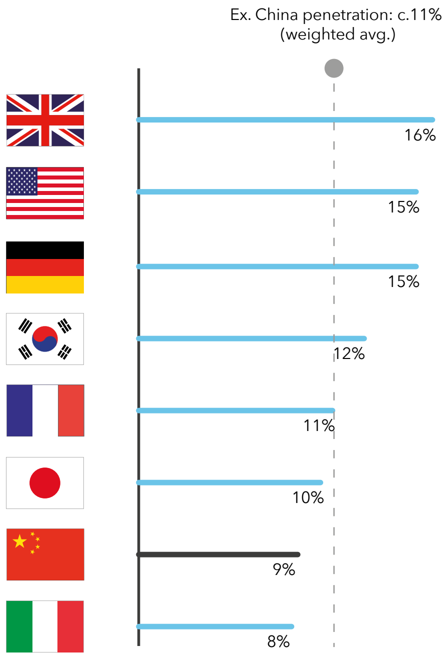
Chinese customers now account for 25%-35% of global luxury sales, most of it – between 2/3 and 3/4 – happening outside of China

HEADROOM FOR GROWTH IN CHINA LUXURY E-COMMERCE

E-commerce penetration in China: luxury[1] vs. other categories (2017)
% share of total rsp sales



Luxury[1] e-commerce penetration: China vs. other countries (2017) % share of total rsp sales



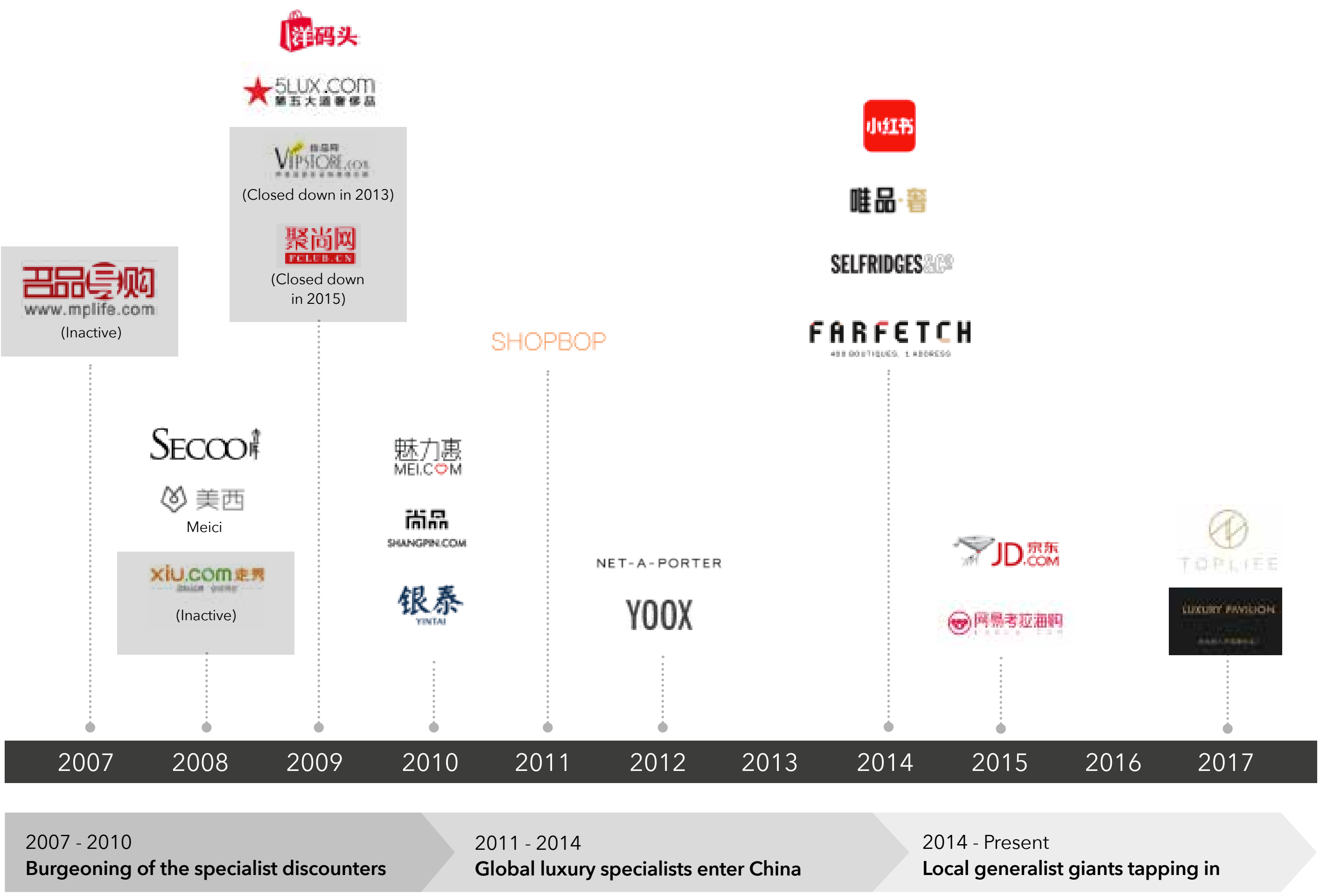
1. Defined as (1) designer apparel, (2) designer footwear, (3) luxury leather goods, but excludes luxury jewelry & watches, luxury eyewear, and premium beauty and personal care.
Source: Euromonitor data; Desktop Research; OC&C analysis

The stage seems set for take-off

Many luxury e-commerce platforms have sprung up in the past 10 years, attracted by the opportunity to fill this gap. It first started with local luxury specialist players – quite a few of them being discounters – such as Mei.com and Secoo.com; Other early entrants including Mplife and Xiu.com did not last very long. They collapsed before achieving viable economics against growing competition. Eyeing the huge market potential, global luxury specialists Net-A-Porter and Farfetch entered China in the early 2010s.

The last few years also witnessed local generalists Tmall and JD making more serious investments in luxury e-commerce, launching their own luxury specialist platforms. The market has been going through rapid consolidation with Alibaba and JD aggressively forming their own leagues. While Alibaba controls Luxury Pavilion and Mei.com, JD.com owns Toplife and has stakes in VIPLux and Farfetch; While Alibaba successfully lured brands such as Burberry and Stella McCartney on to its platform, JD was able to convince Fendi to do the same on its own – rumor has it that even Hermès is considering partnering with JD.

ENTRY TIMELINE OF KEY LUXURY E-COMMERCE PLAYERS IN CHINA



Source: Desktop Research; OC&C analysis

Yet, despite the huge online potential and growing platform availability, most luxury brands are still very hesitant and cautious about e-commerce in China.

As for their proprietary channel, close to half of the luxury fashion brands we checked[1] do not even offer the option to buy their products on their China website. For those who do, the online experience and services they offer are quite basic, apart from a few notable exceptions such as Burberry, Gucci and Coach. The website – even if it has commercial capabilities – is mostly positioned as a complement to the physical store, rather than a fully-fledge channel of its own.

Products from the luxury brands we checked are widely available on various e-commerce platforms, but mostly from "non-authorized" supply channels – meaning that they are sourced from suppliers other than the brands themselves. Few brands are partnering with 3rd-party luxury e-commerce platforms. In general, they do not trust that these platforms can refrain from promotions and discounts, or that they can fully guarantee the authenticity of the products they sell. Moreover, luxury brands are concerned that 3rd party platforms may not be able to offer a luxurious-enough experience to their customers in terms of: brand assortment, online journey and services. Brands are asking themselves a variety of questions:

- Will other brands marketed on the site meet our usual adjacency requirements? Will product searches only yield results from an acceptable brand set?
- Will the online journey and overall experience be exclusive enough?
- Is there a risk that customer shopping experience gets interrupted by intrusions such as pop-up ads from non-luxury brands?
- Will customers feel that they are in a truly luxury environment – which is as convincing as in our stores?
- Can the online experience convey our brand's values properly?

1. 37 luxury brands are checked in total, including 23 top luxury brands and 14 more affordable luxury brands.


Younger generations – particularly online native Generation Z – are increasingly comfortable with, and demanding of, online channels

Luxury brands are facing a dilemma

On the one hand, they recognize that online growth is inevitable: Younger generations – particularly online native Generation Z – are increasingly comfortable with, and demanding of, online channels. They also realize that a presence limited to their physical stores will not be sufficient to support customer needs along their increasingly diverse and multi-channel purchasing journeys.

On the other hand, they are just starting to learn their way about e-commerce on their own websites and when it comes to extending their reach through 3rd party platforms, they do not know who to trust, who to partner with, and what capabilities will be necessary to nurture a successful collaboration.

To start addressing this dilemma, we decided to hear directly from customers and try to answer four key questions:

- Who are the luxury online shoppers in China?
- Why do they shop online?
- What are their preferred online shopping platforms?
- How should brands engage with them along their purchasing journey?

Our research was conducted through an online survey in June 2018, covering 5,000+ Chinese luxury shoppers across genders, generations, income levels, city tiers and regions. A luxury shopper was defined as someone who had purchased fashion products (e.g. apparel, handbag) from two or more brands in a list we provided, over the last one year. The list included 25 brands, from top luxury brands like Chanel, Louis Vuitton and Dior to more affordable luxury brands like Paul Smith, Maje and Kate Spade.

> More than a third of luxury shoppers (36%) are already buying luxury products through both online and offline channels, and a majority of them indicated that they intend to shop luxury goods online

Who are the luxury online shoppers in China?

Our survey showed that the majority (63%) of luxury shoppers are still buying luxury goods in offline stores only, while very few of them (less than 1%) are doing so through online channels only.

Brands' offline stores and duty free stores are their preferred channels, and the key reasons why they prefer to shop offline includes their stronger trust in product authenticity from these stores, as well as the experience and services, including the face-to-face interactions and personalized advice that they can get in these stores.

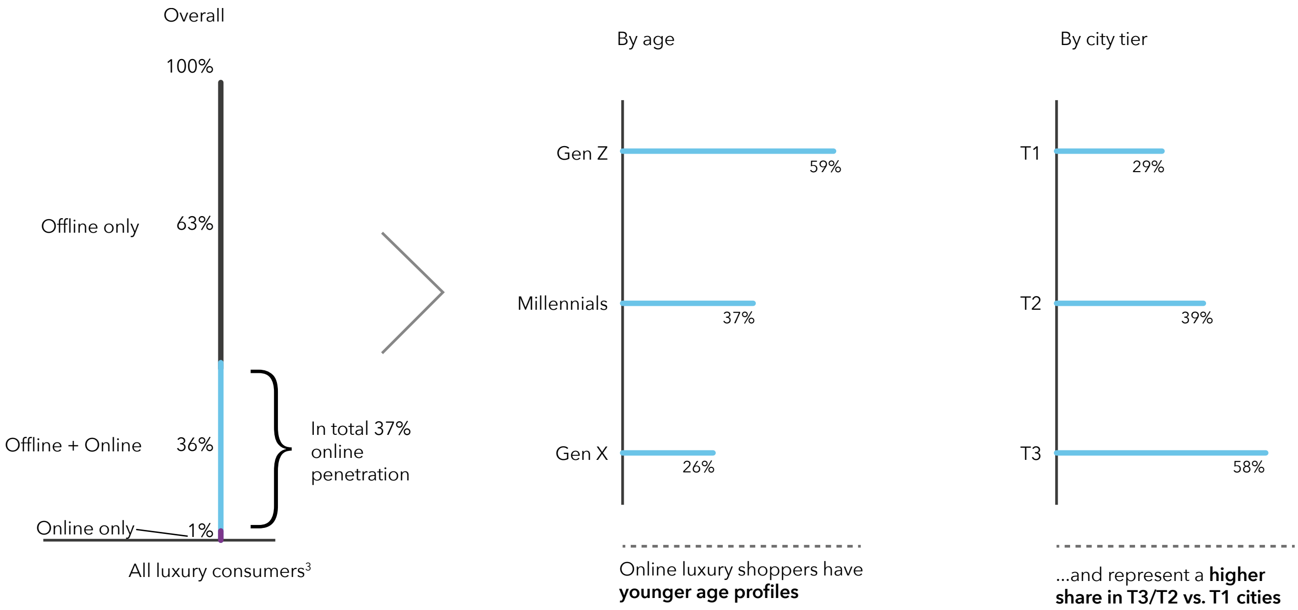
Meanwhile, more than a third of luxury shoppers (36%) are already buying luxury products through both online and offline channels, and a majority of them indicated that they intend to shop luxury goods online at least as often as they do now, or more often, in the future.

Online luxury shoppers are present and growing across all generations but represent a higher share of younger age groups:

- As can be expected, the percentage of Generation Z (born after 1995) respondents shopping online is the highest (59%)
- Millennials (born between 1980 and 1995) come second, at 37%
- Generation X (born between 1960 and 1980) are more traditional in their channel preference (26% online) but they also indicate how keen they are to shop more often online in the future

Also, compared to Tier 1 cities, online shopping penetration is also higher among luxury customers in Tier 3 / Tier 2 cities, where brick and mortar presence of luxury brands is limited and in-store experience is not as compelling.

LUXURY ONLINE SHOPPING PENETRATION BY TOP CHANNEL[1,2] (% ALL RESPONDENTS, N=5,009[3])



1. Q8: In the past year, for luxury brand purchases, which channel(s) did you use? Please rank based on expenditure
2. Only channels that are ranked as top 2 in luxury expenditure by the respondents are counted
3. Refers to all valid luxury shopper responses regardless of purchase channels

Source: OC&C Luxury E-commerce Survey (2018); OC&C analysis

Our survey was not meant to measure amounts spent in luxury goods by each generation, but it confirmed what many luxury brands know already and why so many of them are so keen to rejuvenate their brand image: Generation Z luxury shoppers not only buy online more often, THEY ALSO SPEND MORE ON LUXURY GOODS! In our sample, 50% of Generation Z shoppers spent more than RMB 50K during the last year whereas this percentage was only 32% for Millennials and 34% for Generation X.

Generation Z consumers are more prone to spending on luxury goods than older generations for several reasons: they are often still living with their parents and are less motivated to save money in the hope of buying their own apartment in a real estate environment that has become unaffordable, they are also less constrained by work-centric moral values of their parents, and more open to just enjoy life. The combination of higher luxury spending and higher propensity to shop online makes the Generation Z age group particularly attractive to luxury brands.

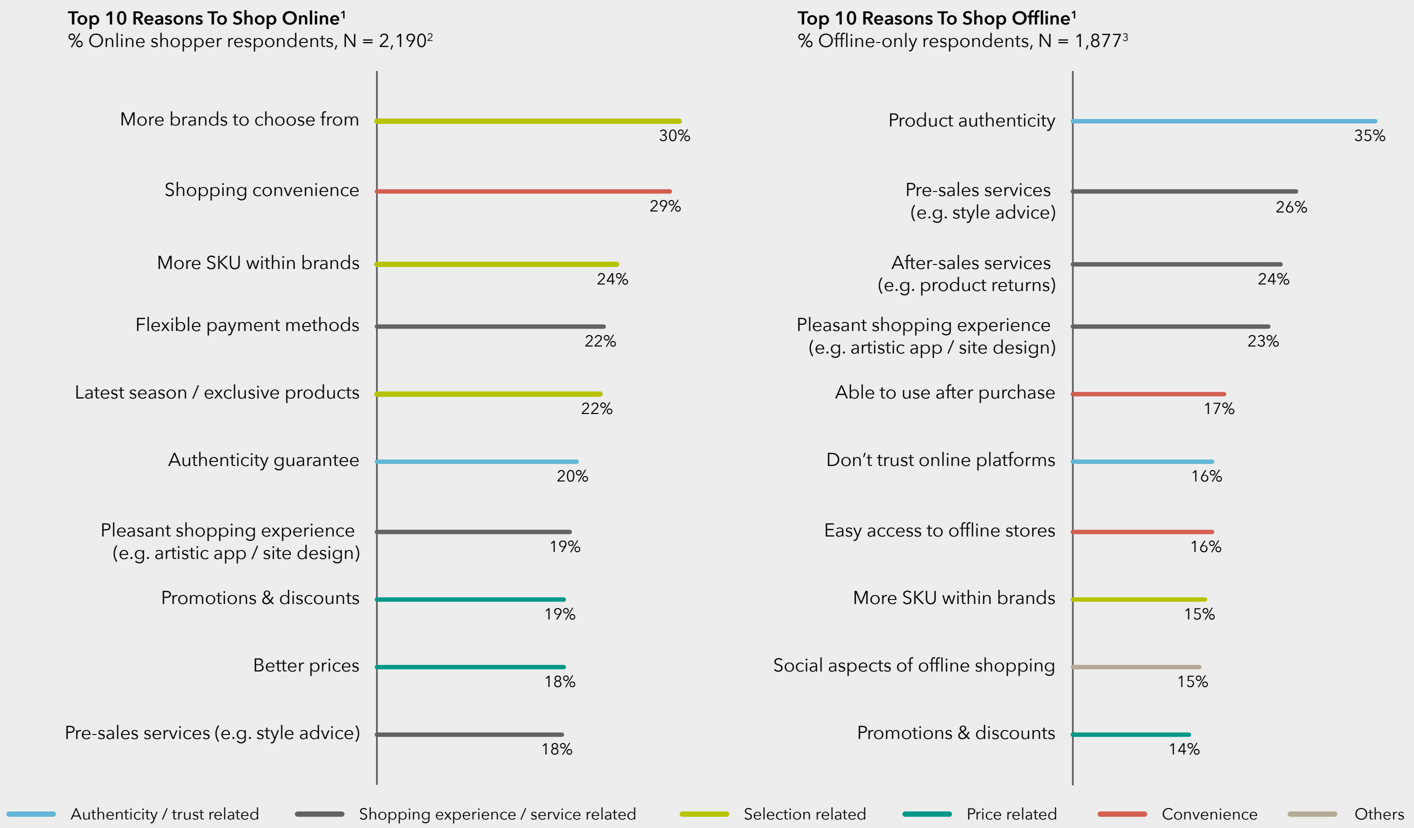
Why do consumers shop luxury online?

Surprisingly, "price" did not appear as the top consideration for online luxury shoppers.

This was especially true for Generation Z respondents: 66% of them agreed to the statement that "Price is not my main consideration, finding items I like is most important" whereas the percentage agreeing to the same statement was 48% for Generation X and Millennials.

Instead, better choice (more brands, more products, more exclusive offerings) and better convenience were indicated as the key factors to drive online luxury purchase, a very different set of factors if compared with those expressed in favor of offline shopping, which were centered around authenticity and services.

TOP 10 REASONS TO SHOP ONLINE VS. OFFLINE[1] (% ONLINE/OFFLINE SHOPPER RESPONDENTS, N=2,190[2]/1,877[3])



1. Q15: What are the factors which encourage you to purchase luxury products online (vs. offline)?
2. Refers to all valid luxury shoppers who have used online channels, regardless of expenditure
3. Offline-only respondents in this graph are self-identified through
Q9: Which of the following statements best describes your luxury shopping experience?
Source: OC&C Luxury E-commerce Survey (2018); OC&C analysis

I care more about where I can get the latest designs from. Classic collections are too "common" for me. It seems everybody has them nowadays, I want something new and different

KEY PLATFORM SELECTION FACTORS[1] BY AGE GROUP (RANKING BY % ONLINE SHOPPER RESPONDENTS, N=2,190)

	1	2	3
Generation Z (born post 95) N=334	In-season products	Authenticity guarentee	Fast product renewal
Millenials (born 80-95) N=1,576	Authenticity guarantee	More SKU within brands	Shopping convenience
Generation X (born 60-80) N=280	Authenticity guarantee	More SKU within brands	More brands to choose from

1. Q22: What are the factors you consider when choosing a website to purchase luxury goods? Please rank top 3 based on importance
Source: OC&C Luxury e-commerce Survey (2018); Luxury Shopper Interviews; OC&C analysis

When it comes to choosing which online platform to shop on, "guarantee of authenticity" came up as the number one selection criteria. To reassure customers on the proper origin of products and build trust with them, "product traceability" appeared almost as a pre-requisite to win online.
In addition, consumers are also expecting very detailed product information such as product description, size / fit instructions, etc. – the more the better, so that they can get a better idea of what they are purchasing.

With regards to "assortment", there are differences between generations: Generation Z shoppers are looking for the latest in-season products while older generation customers are just looking for more choice of SKUs. Compared to older generations, Generation Z attach greater value to "character", "personality" and "unique design", evidenced by their enthusiasm for independent designer brands like Off-White, Vetements, and Supreme. Instead of getting what "everybody else already has", they are more keen to shop the latest in-season products as a unique statement of their personality.

"Convenience" is also an important dimension for customers shopping for luxury brands online. Before or during transaction, being able to talk to a representative and having flexible payment options such as Alipay are key services expected from online platforms. In addition, after-sales services such as a flexible return policy and product maintenance are also important to facilitate a smooth shopping experience. This is especially true for younger Chinese customers who have grown up "spoiled" by Tmall and JD.

In contrast, when shopping luxury products offline, the ability to see and touch products, and to try them before purchasing, remain the most important services demanded by customers, which online stores will never be able to offer for obvious reasons. But the next most important services expected from offline stores – e.g. worry-free maintenance and/or product exchange – could easily be extended to online customers as well, even on 3rd party platforms.

The implication is that the online and offline experiences remain very complementary and "require each other" to fulfill all customer needs and for different occasions. Therefore, their coexistence is likely to last and prosper. The key question for brands is to decide the right balance between online and offline presence and to be clear on each one's role and purpose.

What are customers' preferred online shopping platforms?

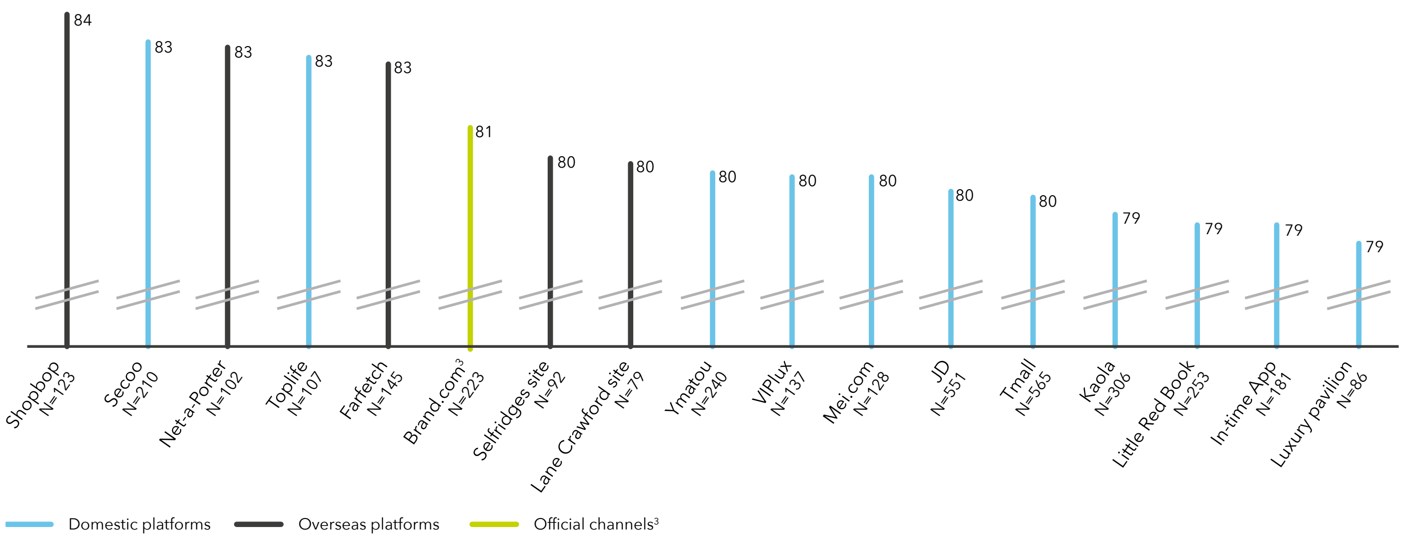
Choosing which e-commerce channel(s) to be present in is a critical decision for a luxury brand. We have found that a brand's e-commerce presence seems to influence online shoppers' perception of a brand's "luxuriousness" as much as, if not more than, brand adjacencies in offline locations, especially for younger customers. In addition, different platforms do have quite different traffic and customer profile implications for the brands.

In general, online luxury shoppers have consistently high awareness (mostly above 80% aided awareness) of the top online platforms – domestic and international – where they can potentially buy luxury products. Among third-party players, domestic platforms at the moment enjoy higher conversion, led by China's most popular e-commerce platforms Tmall and JD (c.20% for both), and followed by Kaola.com, Little Red Book, Ymatou, and Secoo.

Although they have not generated as much in transactions as the domestic platforms, overseas specialists like Shopbop, Net-a-Porter and Farfetch are better rated in terms of overall customer satisfaction, driven by their consistently better performance along Key Buying Factors such as "authenticity" and "extensive assortment".

It seems overseas specialists have more credibility and curation ability, while local e-commerce giants are more established especially in terms of infrastructure.
An interesting idea would be marrying the two and creating synergies, which is what JD has been doing with Farfetch. Among domestic platforms, Secoo.com and Toplife are the best rated – the former is highly recognized for product authenticity, while the latter scores high in convenience and experience related factors. Although not surprising, it is worth noting that Brand.com sites are seen as the most trusted channel, and one of the most attractive in terms of product offerings. However, most luxury Brand.com sites are lagging in services and convenience compared to large multi-brand platforms.

PLATFORM OVERALL SATISFACTION RATINGS BY ONLINE SHOPPERS, INDEXED TO 100[1,2,3]



1. Q28: For those platforms which you have purchased from in the past 6 months, how would you rate them against the following metrics? Only those who have made purchases on the platforms within P6M were asked
2. Weighted averaged ratings calculated based on top 10 key factors, indexed to 0-100 scale
3. Brand.com rating is not brand-specific

Source: OC&C Luxury E-commerce Survey (2018); OC&C analysis

How should luxury brands engage with online shoppers?

Brands’ e-commerce platforms are not only important for commercial transactions, but also critical for building brand awareness.

When asked about their most important touchpoints to learn about luxury trends and luxury brands, and to get product information, online shoppers responded that they rely on a variety of online channels, including official websites, social media sites, multi-brand specialist websites, online forums and magazines, more than on a visit to offline stores.

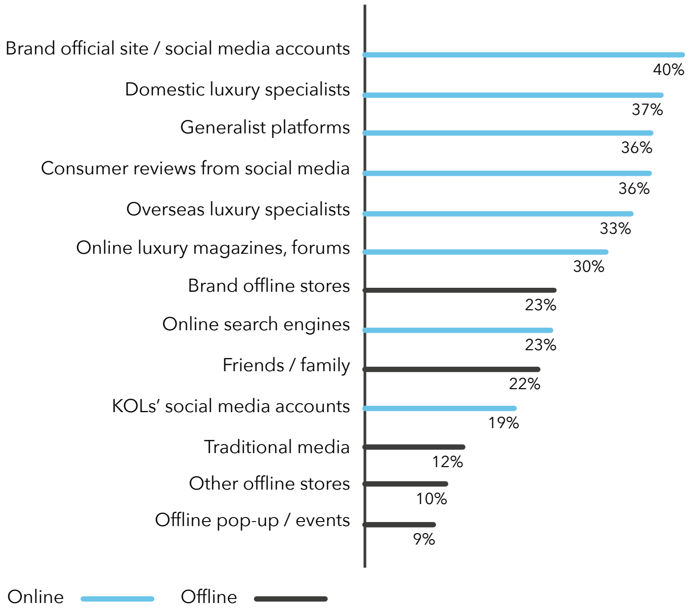
Although a large majority of online shoppers frequently visit luxury online platforms to seek inspiration on what they want to buy, customers from different generations use online platforms differently:

- Generation X shoppers tend to visit online platforms for transactional purposes, after knowing what they want (61%) more often than Generation Z shoppers (43%) do. By contrast, this would indicate that Generation Z customers tend to use online platforms more often as part of their exploratory journeys to help them figure out what they want rather than just for transactional purposes.

- Likewise, Generation X shoppers typically visit online platforms more often during promotion seasons (48%) than Generation Z shoppers (28%) do.

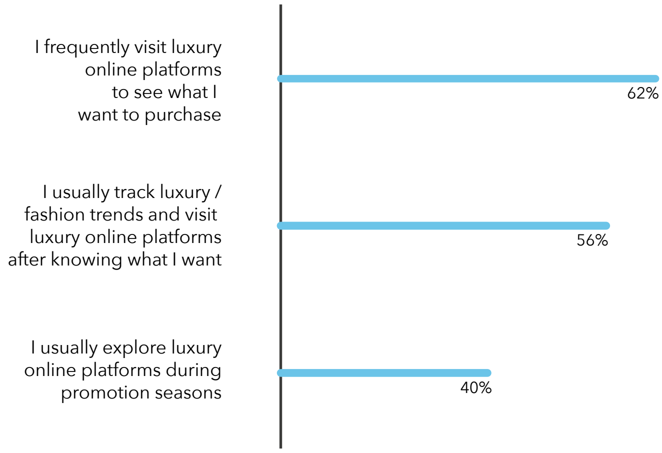
KEY TOUCHPOINTS TO LEARN ABOUT LUXURY TRENDS AND PRODUCTS

Touchpoints for trends and product awareness[1]
% Online shopper respondents, N= 2,190[2]



1. Q20: How do you usually learn about latest fashion, luxury trends and luxury brand knowledge?
2. Refers to all valid luxury shoppers who have used online channels
Source: OC&C Luxury E-commerce Survey (2018); OC&C analysis

SHOPPING JOURNEY FOR ONLINE SHOPPERS (% ONLINE SHOPPER RESPONDENTS, N=2,190[2])



1. Q19: Which statements describe your luxury online shopping behaviors?
2. Refers to all valid luxury shoppers who have used online channels
Source: OC&C Luxury E-commerce Survey (2018); OC&C analysis

The implication is that the more brands can be present on multiple platforms and touchpoints, not only on their own brand.com website but also on 3rd party websites, the better their chances to influence customers' discovery and purchasing journey.

Another thing worth noting is the importance of social media platforms, particularly WeChat. Brand websites and social media accounts were mentioned as the top sources of inspiration and research. And over the past few years, many brands have started to engage in collaborations with WeChat to connect with their customers and to attract new ones among younger generations. However, at the moment, most of these collaborations are still experimental, consisting of events and pop-up stores with limited assortments for limited periods of time.

EXAMPLES OF LUXURY BRAND POP-UP STORES ON WECHAT

Bottega Veneta 2018
Chinese Valentine's pop-up store in WeChat Mini-program

Calvin Klein 2018
Chinese Valentine's pop-up store in WeChat Mini-program

Hermes 2018
Pop-up store on WeChat for a few shoes and scarf SKUs

GENERATIONAL DIFFERENCES IN ONLINE LUXURY SHOPPING JOURNEY

QUESTION	GENERATION Z	MILLENNIALS	GENERATION X
			
"Do you buy luxury products online?"	"Yes! I love the convenience of shopping online, and online usually has the latest in-season/exclusive products."	"Sometimes. In online channels, I can easily compare and choose from a more extensive assortment both in terms of brand and product."	"Not so frequently. To me, the key attraction of online would be the more extensive assortment; also there are discounts and promotions online."
"How would you describe your decision process for online luxury shopping?"	"I know pretty well what I want. Sometimes I just buy stuff without researching or browsing around – But when I do, I prefer using luxury specialist platforms."	"I use brand official sites and WeChat accounts for research, and I also frequently visit luxury e-commerce sites for inspiration and to see what I want."	"I usually get inspiration from brand websites and luxury e-commerce sites. In addition, before making purchase decisions, I will check customer reviews for the product on Little Red Book."
"What are your top considerations when selecting online shopping platforms?"	"Product authenticity is a factor, but not my main concern…I care more about where I can buy the latest designs."	"Product authenticity on the platform is my key consideration. Convenience is also important for me."	"Product authenticity. Besides, offering the right brand and style options are also important, because many platforms still have insufficient options…"
"Where do you shop for luxury products online?"	"I'd say I know most, if not all, luxury platforms in China – But usually I only visit and buy from several of my 'go-to' ones, because I know they have the latest products from brands I like, e.g. Farfetch."	"I buy from different sites, such as Tmall and JD, and also the cross-border sites like Kaola… And brand official websites as well."	"I would buy from the big names, such as Tmall, JD, Secoo, and brand official websites, etc. I sometimes make purchases on Little Red Book."

Online and offline channels are no longer divided in the eyes of consumers

What does this mean for brands?

As consumers become more demanding and retail technologies continue to develop, retail models are evolving from traditional channel silos to multi-touchpoint journeys.

This is particularly true in China, where digital channels and social media play an increasingly important role.

Online and offline channels are no longer divided in the eyes of consumers. They aspire to a personalized shopping experience that is convenient and seamless across touchpoints. For luxury companies, e-commerce can no longer be about setting up an "e-commerce department" separated from other existing channels. Instead, it should aim at linking online and offline channels to create a seamless integrated multi-touchpoint journey. A transformation to an omni-channel business model is necessary and inevitable.

A few points to take-away from our consumer research to help shape luxury brands' high-level e-commerce strategy in China:

- Brands can no longer remain in denial of third-party platforms. While proprietary channels such as brand.com and WeChat play irreplaceable roles in branding and sales, it is also critical for brands to recognize that third-party e-commerce platforms, together with social media channels, also play critical roles in transactions and consumer interaction. For many luxury brands, a key next step would be to form a clear view on who strategic third-party partners are, establish clear rules of engagement, and build a trustful relationship with them.

- A well-thought-through understanding of customers' omni-channel journey is key for future success. There is a range of things consumers look for when they shop online – product offerings, convenience etc., which are very different from offline. Products and services offered in different channels therefore require precise design and should be carefully tested out.

- e-commerce is the key battlefield for brands to energize brand image and attract younger customers. Make sure you have a solid view on what is the most important to the new generations, and therefore which online channels are required to interact with them.

E-commerce strategy, or digital strategy more broadly, is without doubt the most urgent topic faced by every luxury brand in China, as the country's new generations continue to boost luxury sales online. To get online is easy, but to do it right requires much more than just adding a little shopping cart icon on top right corner of your webpage. Hearing from your customers and understanding what they want will be the key to winning in the ever-changing luxury digital landscape.

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