



China's Unstoppable 2020 Luxury Market

A reduction in international travel is creating an exponential boost in domestic spending.

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At a Glance

- ▶ The luxury goods market in mainland China will likely achieve 48% growth in 2020, reaching nearly RMB 346 billion.
 - ▶ This increase helped double China's overall share of the global luxury market in 2020, with further growth expected through 2025.
 - ▶ A drop in international tourism contributed to double- and even triple-digit increases in the rate of domestic luxury spending for some brands but an overall decrease in Chinese consumers' total luxury spend.
 - ▶ Growth rates varied widely across regions, brands and categories.
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After an understandably rocky start, China's luxury goods market finished out 2020 with double- and even triple-digit growth rates for some brands.

The domestic sale of luxury goods in China recovered strongly in the wake of early Covid-19 lockdowns. A decrease in global travel prompted Chinese consumers to make their luxury purchases nationally rather than in international bargain hubs. As a result, the luxury goods market in mainland China began climbing in April 2020 and will likely achieve about 48% growth in 2020, totaling almost RMB 346 billion (*see Figure 1*).

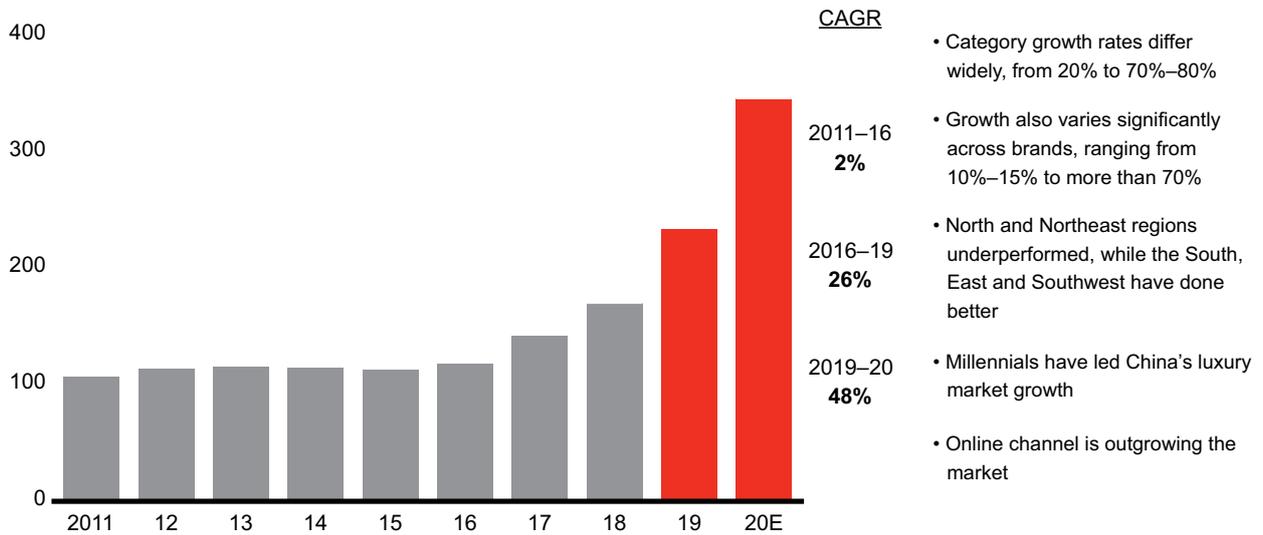
This same drop in travel led to an approximately 35% decrease in Chinese consumers' total luxury spend (a greater dip than any other group). The growth in mainland China does not compensate for the Chinese consumption lost overseas.

Even so, as the global luxury market declined at an expected rate of 23% in 2020, mainland China's share of that market nearly doubled, growing from about 11% last year to 20% in 2020 (*see Figure 2*). We anticipate this growth to continue, putting the country on track to claim the biggest share of the market by 2025—even after the world luxury market returns to pre-Covid-19 levels.

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Figure 1: China's personal luxury market is estimated to grow by about 48% in 2020

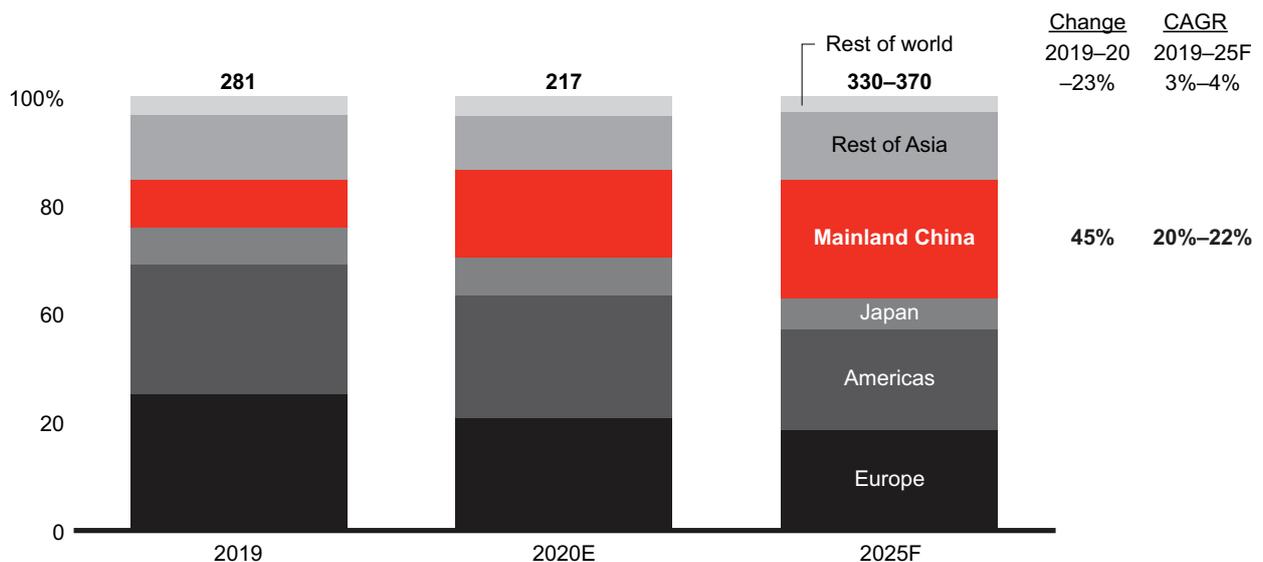
Mainland China personal luxury market (B RMB)



Notes: Hainan island's duty-free sales are part of mainland China luxury sales because it mainly serves local clients; Hainan island accounts for 7%–9% of 2020 China luxury market and is estimated to grow more than 100% from 2019 to 2020
 Sources: Bain-Altgamma 2020 Worldwide Luxury Market Monitor; Expert interview; Lit research; Bain analysis

Figure 2: Mainland China's share of the world luxury goods market nearly doubled in 2020, putting it on a path to become the biggest market by 2025

Regional share of personal luxury goods market (% , B Euro)



Notes: Mainland China 2019–20 growth rate 45% is in current exchange rate
 Sources: Bain-Altgamma 2020 Worldwide Luxury Market Monitor; Bain analysis

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Continuing historical trends, growth in China's domestic luxury goods market varied significantly across both brands (from 10% growth to more than 70%) and regions (with the north and northeast regions underperforming the stronger south, east and southwest regions). The year also saw variations in growth across categories, with leather goods and jewelry leading the way at a rate of about 70% to 80%. Ready-to-wear clothing and shoes saw growth of about 40% to 50%. Luxury beauty spending rose about 25%, and high-end watch purchases increased about 20%.

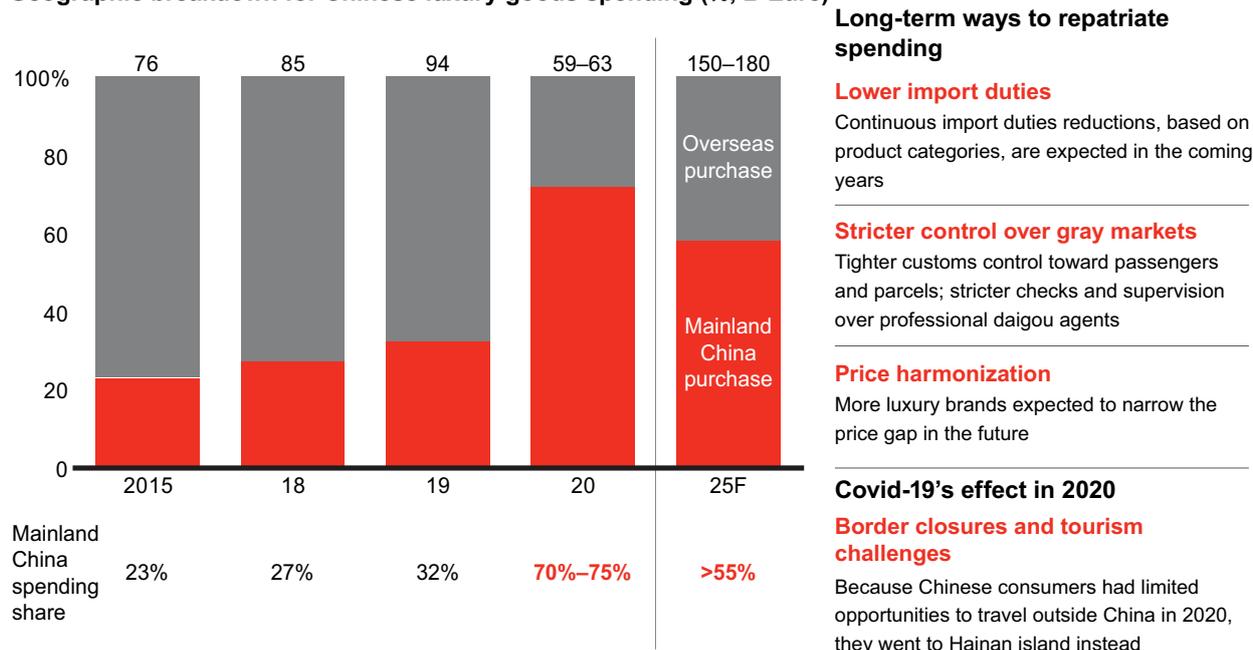
This year, our research (in concert with data from report contributor Tmall) indicates that four engines powered China's luxury goods market in 2020. These forces are further repatriation, millennial and Gen Z shoppers, continuing digitalization and the Hainan island duty-free stores—a new factor with a key role in this year's growth.

Engine 1: Repatriation

China's luxury market has experienced increasing repatriation since 2015, thanks to a reduction in import duties, stricter controls over gray markets and brands' price harmonization (see Figure 3). With the addition of Covid-19-related travel restrictions, mainland China's portion of Chinese global luxury purchases this year reached a peak of about 70% to 75%. However, we expect that share to subside over the next five years as global conditions normalize.¹

Figure 3: The mainland China share of spending on luxury goods peaked in 2020 as a result of historical trends and Covid-19 but will decline as global conditions return to normal

Geographic breakdown for Chinese luxury goods spending (% B Euro)



Sources: Bain-Altgamma 2020 Worldwide Luxury Market Monitor; Bain analysis

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In addition, this increase in China's domestic luxury market growth can paint a somewhat skewed picture of a brand's overall performance with Chinese consumers. Pre-Covid-19, domestic luxury brands' share of Chinese consumption varied from 20% to 50%. A brand on the lower end of that scale could easily double its domestic growth rate yet still capture fewer Chinese consumers than a brand that began with a higher percentage of Chinese clientele and saw a lower growth rate.

Some brands' ability to grow in China in 2020 was also limited by their supply chain's effectiveness in redirecting products from the rest of the world to mainland China, as well as the brands' capacity to welcome and serve consumers there.

On top of repatriation, a few specific phenomena also helped China market growth. First, consumer sentiment was positive when the lockdown ended. And second, increased wealth (such as capital gains)² and the government's encouragement of shopping (e.g., distributing coupons) also contributed to higher luxury consumption in 2020.

Engine 2: Millennial and Gen Z shoppers

China's millennials (born between 1980 and 1995, about 320 million) are the core consumers of luxury products on Tmall Luxury Pavilion. But Gen Z consumers (born after 1995, about 80 million who are at least 20 years of age) are now an emerging source of market growth in their own right, as well as having a powerful influence on increased digitalization (Engine 3).

Of the 757 million annual active consumers who shop on Alibaba retail marketplaces,³ including Tmall and Taobao, the majority are millennials and Gen Z. Though young, Gen Z are savvy consumers of luxury:

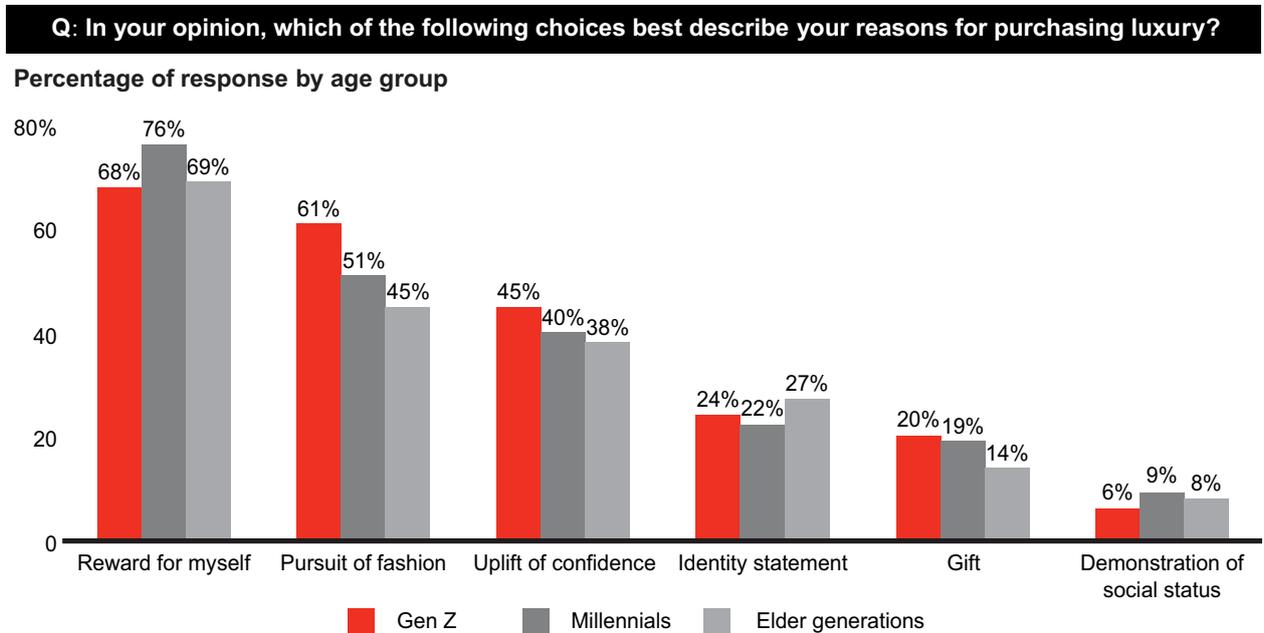
- They make their first luxury purchase at age 20.
- They place greater emphasis than other generations on the "pursuit of fashion" as a reason for purchasing luxury goods (*see Figure 4*).
- They show less preference for the "classics" and a greater preference for designer editions and cross-brand collaborations (*see Figure 5*).

With Gen Z influence on the rise, we see a visible trend of luxury players catering to their tastes through cross-brands collaboration, limited-editions, customized products and so on. The effort seems to be working: Tmall data shows that Gen Z's purchase of luxury collaborations and limited editions grew 300% to 400% between January and October.

Gen Z consumers (and even the youngest millennials) were born and raised in a digital world. Now, the preferences of these shoppers are powering a continued increase in the digitalization of the luxury goods marketplace. For example, online purchases account for 35% of Gen Z's monthly FMCG expenditure, versus 27% for other cohorts.

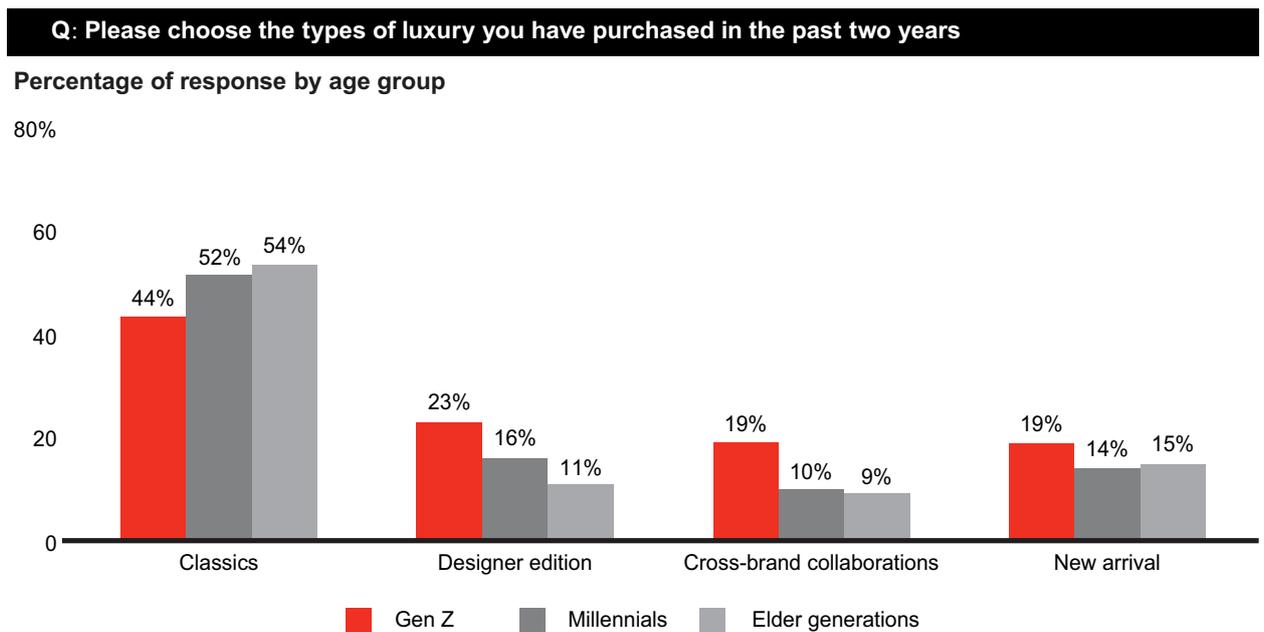
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Figure 4: Gen Z looks for the same values as other generations for luxury purchases, but puts more emphasis on the "pursuit of fashion"



Note: This question also offered the options of following peers, fitting into social network, and other, but were chosen by few respondents
 Sources: 2020 Tmall luxury consumer survey (n=3,000); Bain analysis

Figure 5: Gen Z places less emphasis on classics and shows a higher preference for designer editions and cross-brand collaborations



Notes: This question also offered the option of other, which was chosen by few respondents; classics include classic editions and their modified version; cross-brand collaborations refers to cross-brand codesign
 Sources: 2020 Tmall luxury consumer survey (n=3,000); Bain analysis

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In the luxury fashion and lifestyle category, Tmall leads online growth in China at a rate of about 120% YTD as of October (with final YOY growth expected to be 130% to 140%).

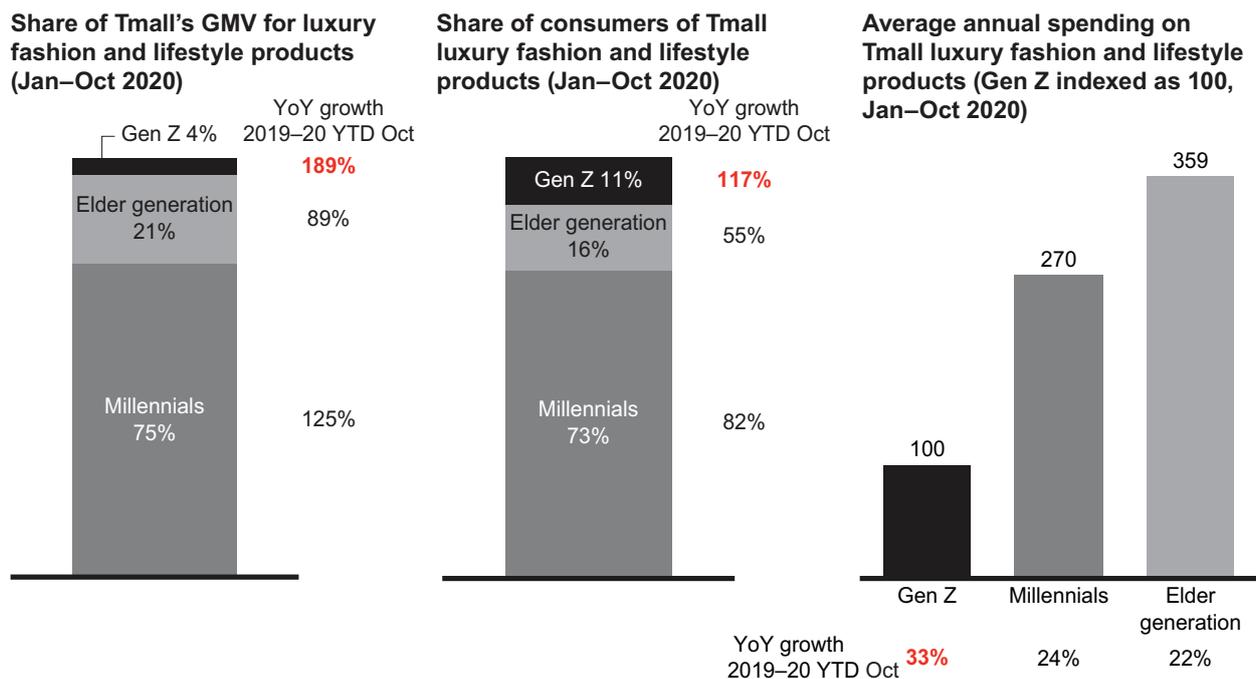
Meanwhile, millennials continued to form the core of a rapidly expanding online luxury consumer base.

Millennials comprise more than 70% of Tmall's luxury fashion and lifestyle consumers—and of the category's gross merchandise value (GMV). And although Gen Z's contribution to the category's GMV is currently less than 5%, that consumer base saw a YOY growth rate of more than 100% and a corresponding YOY GMV growth rate of more than 150% for the category in 2020. Furthermore, Gen Z's annual spending, currently less than half of millennials', is expected to catch up as the younger cohort enters the workforce and increases its income (see Figure 6).

Engine 3: Digitalization

Younger consumers shop differently than their elders. According to iResearch,⁴ Chinese Gen Z consumers spent, on average, five hours per day on mobile devices in 2020, 10% longer than average—so it makes sense that their top sources of information for luxury goods are entirely digital. In a recent Tmall survey, the group cited e-commerce, Little Red Book and brand Chinese websites or apps as their top three sources of information (see Figure 7).

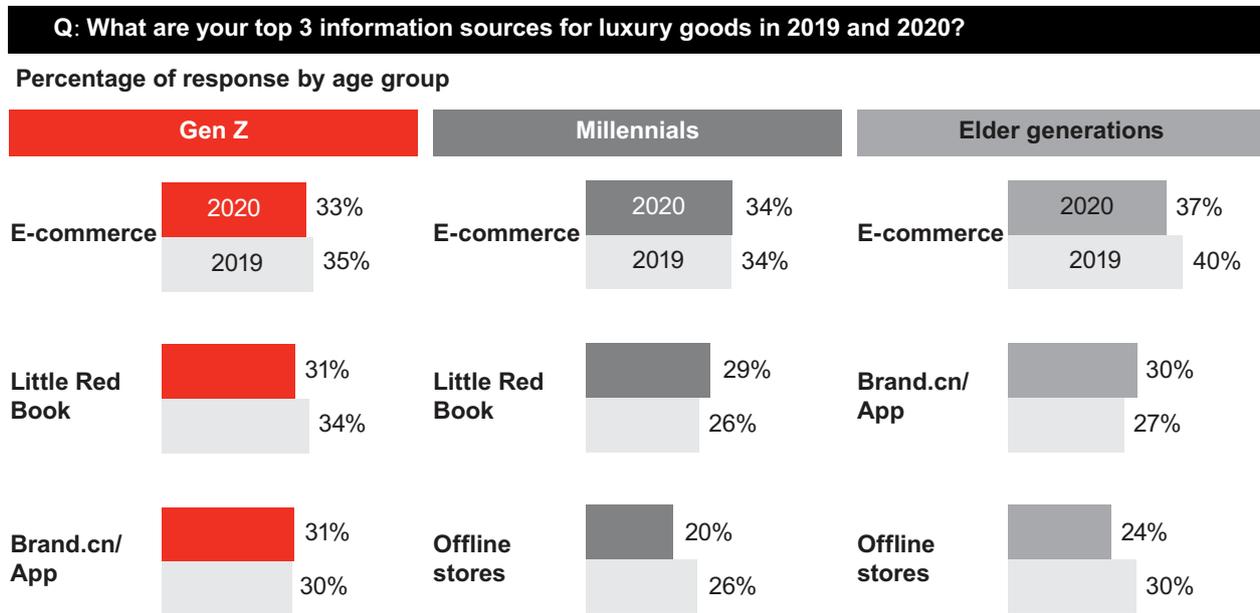
Figure 6: Millennials represent more than 70% of Tmall's luxury fashion and lifestyle market, while Gen Z is the fastest-growing group



Sources: Tmall; Bain analysis

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Figure 7: Gen Z shoppers gather information differently than others, with the top sources being entirely online



Notes: E-commerce refers to marketplaces, including horizontal ones such as Tmall/JD and vertical ones such as Farfetch, and excluding more content-focused platforms such as Little Red Book/Douyin
Sources: 2020 Tmall luxury consumer survey (n=3,000); Bain analysis

On the e-commerce front, China's annual luxury online penetration increased from about 13% in 2019 to 23% in 2020 (see Figure 8).

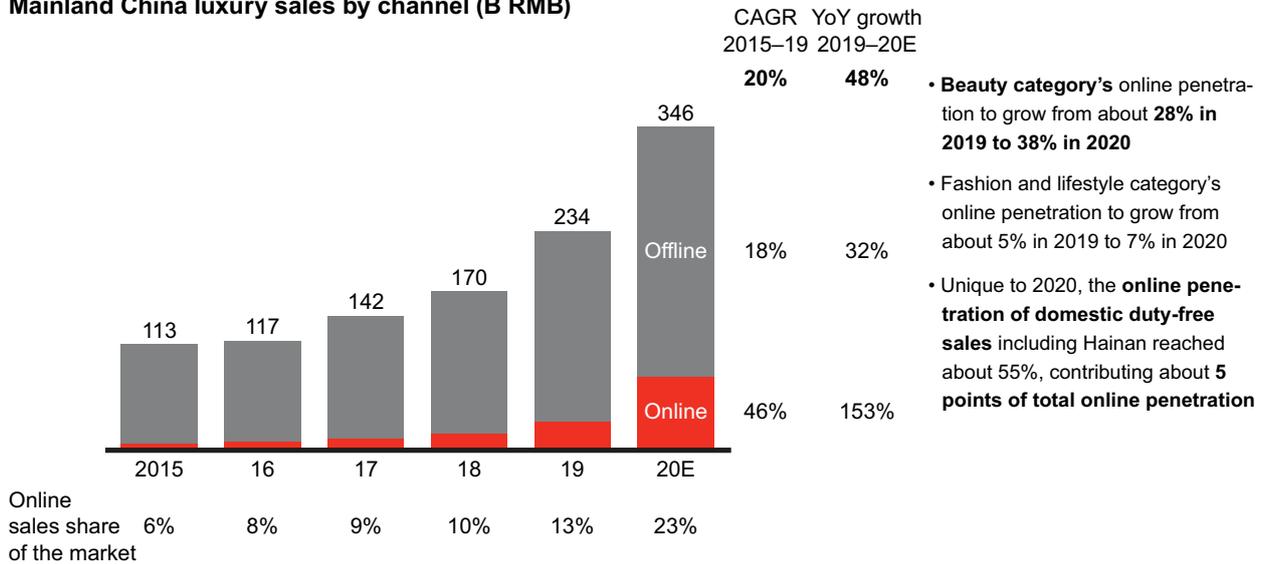
- In the luxury beauty category, e-commerce grew by about 60% YTD as of October and online penetration will increase from approximately 28% in 2019 to about 38% in 2020, driven by skin-care and fragrance.
- The luxury fashion and lifestyle category, starting from a small base, has grown by more than 100% YTD as of October and is expected to increase online penetration from about 5% in 2019 to about 7% in 2020.
- Unique to 2020 is the online growth of domestic duty-free goods, including those from Hainan, which sold about 55% of its merchandise online, contributing to an increased online penetration of nearly 5 points.

But the primary focus of digitalization in 2020 is omnichannel expansion. Although online sales are booming, China's luxury brands have no intention of neglecting their offline footprint. Some are expanding that footprint into Tier 2 cities, and some are opening a second store in the same cities. An omnichannel model enables optimal control over merchandising, pricing and communication strategy while maintaining direct contact with China's luxury consumers.

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Figure 8: Covid-19 helped online channels increase luxury sales by about 150% and capture 23% of the market, driven by beauty and domestic duty-free

Mainland China luxury sales by channel (B RMB)



Notes: Without the impact of duty-free, online luxury sales YoY growth 2019–20 is about 80%–90%; in 2020, China duty-free sales are estimated at about 45–50B RMB. Hainan duty-free sales make up 55% of total China duty-free sales, with online penetration of about 25%–30% (if visitors to Hainan do not exhaust their annual duty-free purchase credits, they can make additional purchases online and receive products with home-delivery); duty-free outside Hainan makes up 45% of China duty-free sales, with online penetration of 85%–90% (duty-free platform members can make purchases and have products delivered to their homes, regardless of their travel history); online sales include only the official online channels
Sources: Bain-Altqamma 2020 Worldwide Luxury Market Monitor; Expert interview; Lit research; Bain analysis

Luxury brands increasingly view e-commerce not only as a sales channel, but more importantly as a marketing channel—one that can raise consumer awareness, enhance brand equity and recruit new consumers. Brands can leverage their online features for impact. For example, they might enable product customization, publicize limited-edition product launches, connect their customer relationship management (CRM) platform with consumer data, live-stream unique events or connect online and offline marketing. Online platforms focus less on GMV and more on helping brands build their images and equity through the proper online luxury environment.

Many brands are also showing a stronger commitment to a comprehensive digital strategy, including a presence on all key digital channels. Moreover, luxury brands are now instilling sophistication, quality and attention to detail—core components of luxury players' engagement strategies that did not fully transfer when brands first rushed to digital—into these new engagements.

In 2020, brands actively developed and strengthened ways to connect online and offline channels. Most luxury brands have adopted live-streaming for consumer education or presentation of curated selections. Successful luxury live-streaming on Tmall during Singles Day attracted millions of views and interactions in a matter of hours. Brands are also carrying out loads of offline activities, such as fine-jewelry exhibitions and fashion shows, invitation-only product presentations, pop-up stores for seasonal collections, flagship launches and themed cafés. These offline events often hire celebrities and are frequently accompanied by simultaneous online activation through key opinion leaders to

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create buzz. However, online and offline marketing activation at the current scale is extremely costly and is a primary driver of the performance gap between larger and smaller brands.

Overall, Tmall saw a significant YOY boost to consumer assets among Gen Z and millennial consumers, who accounted for about 2.4 billion impressions and searches of luxury on the platform in September 2020 alone.⁵ This number marks an increase of nearly 100% over the same period in 2019.



Engine 4: Hainan offshore duty-free shopping

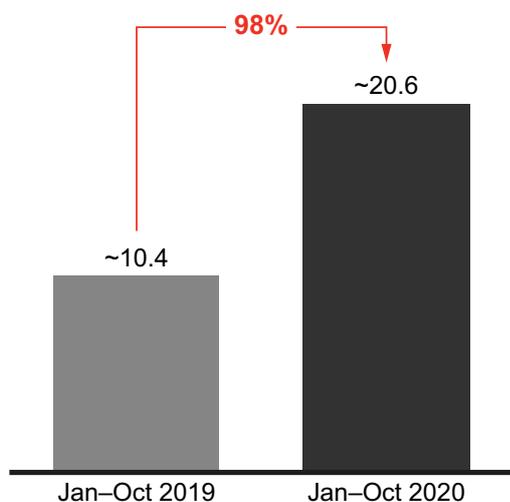
Hainan has allowed duty-free purchases for a decade. But that business boomed in 2020, driven by Covid-19 travel restrictions and attractive shopping policy changes (such as an increased duty-free quota of RMB 100,000 per person per year, compared with the previous RMB 30,000 per person per year quota). Total Hainan duty-free sales reached RMB 21 billion by the end of October 2020. Sales were up 98% vs. 2019 (see Figure 9).

China Duty-Free Group is the only duty-free operator in Hainan today, but we expect to see the arrival of more operators to the island as more licenses are granted. Chinese authorities also released an overall plan to transform the entire island into a free-trade zone, with the first milestone being the establishment of a basic free-trade policy system by 2025.

Luxury brands view Hainan as an opportunity not only because it offers a short-term alternative to duty-free shopping in traditional destinations like Hong Kong and South Korea, but also because it is part of the government's plan to keep Chinese consumption in mainland China. However:

Figure 9: Hainan's duty-free sales surged 98% in the first 10 months of 2020, driven by Covid-19 travel restrictions and favorable policy changes

Hainan's duty-free sales (B RMB)



Listed duty-free prices on Hainan can be 10% to 40% lower than brands' official listed prices



Note: The discount range is based on the comparison between the listed prices of about 75 hero SKUs on Brand.cn and official Hainan duty-free stores in Dec 2020
Sources: Hainan customs data; Lit research; Bain analysis

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- Several brands have concerns about Hainan's wholesale model. They see risks to their brand image and opportunities for "daigou agents" (who purchase overseas for local consumers), especially if duty-free operators add promotions on top of the duty exemption. (Price comparisons show that Hainan-listed duty-free prices for fashion and lifestyle goods can be 10% to 25% more competitive than official mainland-listed prices. For luxury beauty, those numbers jump to 25% to 40%.⁶)
- Luxury brands have reservations about Hainan's highly commercial and transactional shopping environment, which leaves consumers queuing for hours outside stores. They hope that new premium shopping malls will be developed over the next few years, in time to be ready when the whole island becomes duty-free.
- Most brands manage Hainan through their global travel retail division, creating challenges for local teams to holistically plan and serve China's luxury market.

A final consideration: parallel imports

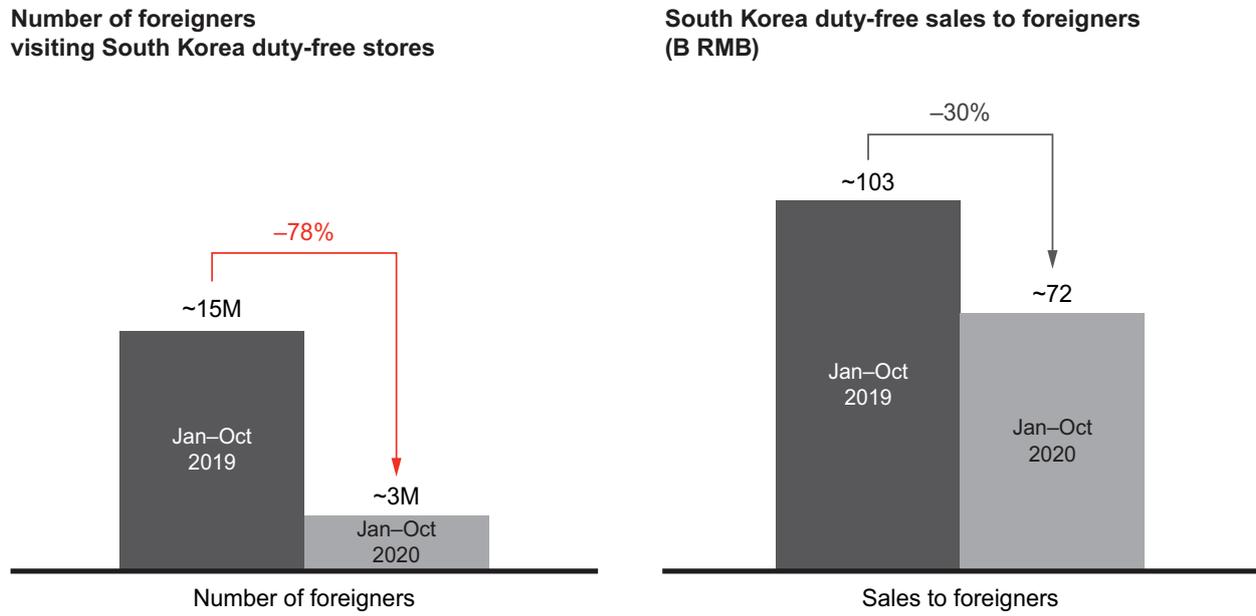
Many travel retail operators were faced with excess inventories when the pandemic stopped international travel. As a result, parallel imports has had a noticeable impact on reported growth rates on the mainland.

For example, by October 2020, the South Korean duty-free market had achieved RMB 72 billion in sales to foreigners—a 30% decline compared with the same period in 2019. However, over the same period, the number of total foreign visitors declined by 78%, suggesting that a large portion of South Korean duty-free sales were achieved by parallel imports, with mainland China as the most likely destination (*see Figure 10*).

Such inventory dumping disrupts pricing: the average selling price (ASP) of select luxury beauty items saw a price gap of 30% to 40% between the official and parallel import channels (compared with 20% to 30% in previous years). The pressure created by this price gap likely led to a 2020 drop of up to 5% in official-channel ASP (compared with growth of up to 5% in previous years).

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Figure 10: Foreign visitors to South Korea duty-free stores were 78% fewer YOY in 2020, while duty-free sales to foreigners declined by only 30%, suggesting parallel import activity



Note: About 90% of foreigners who purchase duty-free products in South Korea are daigou operators and mainly for mainland China
 Sources: Korea Duty Free Shops Association; Analyst reports; Lit research; Bain analysis

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Looking ahead

We expect China to progressively reopen its border, beginning with other Asian markets in Q2 or Q3 2021. However, global conditions are unlikely to return to normal before 2022 or even 2023. Besides, Chinese consumers will probably remain cautious about international travel even after borders reopen, and Hong Kong is unlikely to return to its pre-crisis level of luxury sales. Therefore, most luxury brands believe that positive domestic growth will continue in 2021 at about a 30% level, with challenges increasing during the second half of the year.

As for the engines that power growth:

- The dividends of lockdown-driven repatriation will inevitably diminish as Chinese luxury-goods consumers begin to travel again in 2022 or 2023 (most likely). However, mainland brands will have at least one year and possibly two to woo shoppers and convince their consumers that domestic shopping is a better, more sustainable experience.
- Gen Z and millennial consumers will continue to spend on luxury. Nearly three-quarters of existing consumers in those cohorts have said they would increase or maintain their luxury spending in 2021.
- We believe Chinese luxury consumers' online shopping behavior has permanently changed, having passed previous hurdles. Nearly 40% said they plan to increase their share of online luxury shopping over the next few years; another 40% said they plan to maintain their share. Most brands share the consensus that luxury online penetration (including omnichannel) will reach about 20% to 25% within three years.⁷
- Hainan duty-free shopping is the first step in the development of a domestic duty-free channel with the new licenses being granted. This will contribute even further to the repatriation trend discussed above. As for Hainan island, the evolution of its retailing model and shopping environment will determine whether it can compete effectively with other holiday destinations.

Regardless of the potential for short-term changes, the momentum of China's luxury goods market is poised to continue.

1. The sources of overseas purchases in 2020 were two-fold: (1) January sales that occurred before Covid-19 lockdowns, and (2) parallel imports and "daigou agents" (who purchase overseas for local consumers) from travel retail operators, which count as outside-China sales.

2. Mainland China's main stock indexes increased by 10% to 35% since the beginning of 2020.

3. For the 12 months ended September 30, 2020.

4. iResearch analysis of China mobile internet traffic in July 2020.

5. 2.4 billion impressions and searches means that, on average, each millennial or Gen Z consumer received or conducted 7 to 8 impressions or searches per month.

6. If bulk-purchase discounts are added (e.g., buying five units of the same item and getting 20% off), the price gap increases to 35% to 50%.

7. 2020 online penetration of 23% includes about 5 points from China online duty-free sales, which will likely go away in the medium term.

About the authors and acknowledgments

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