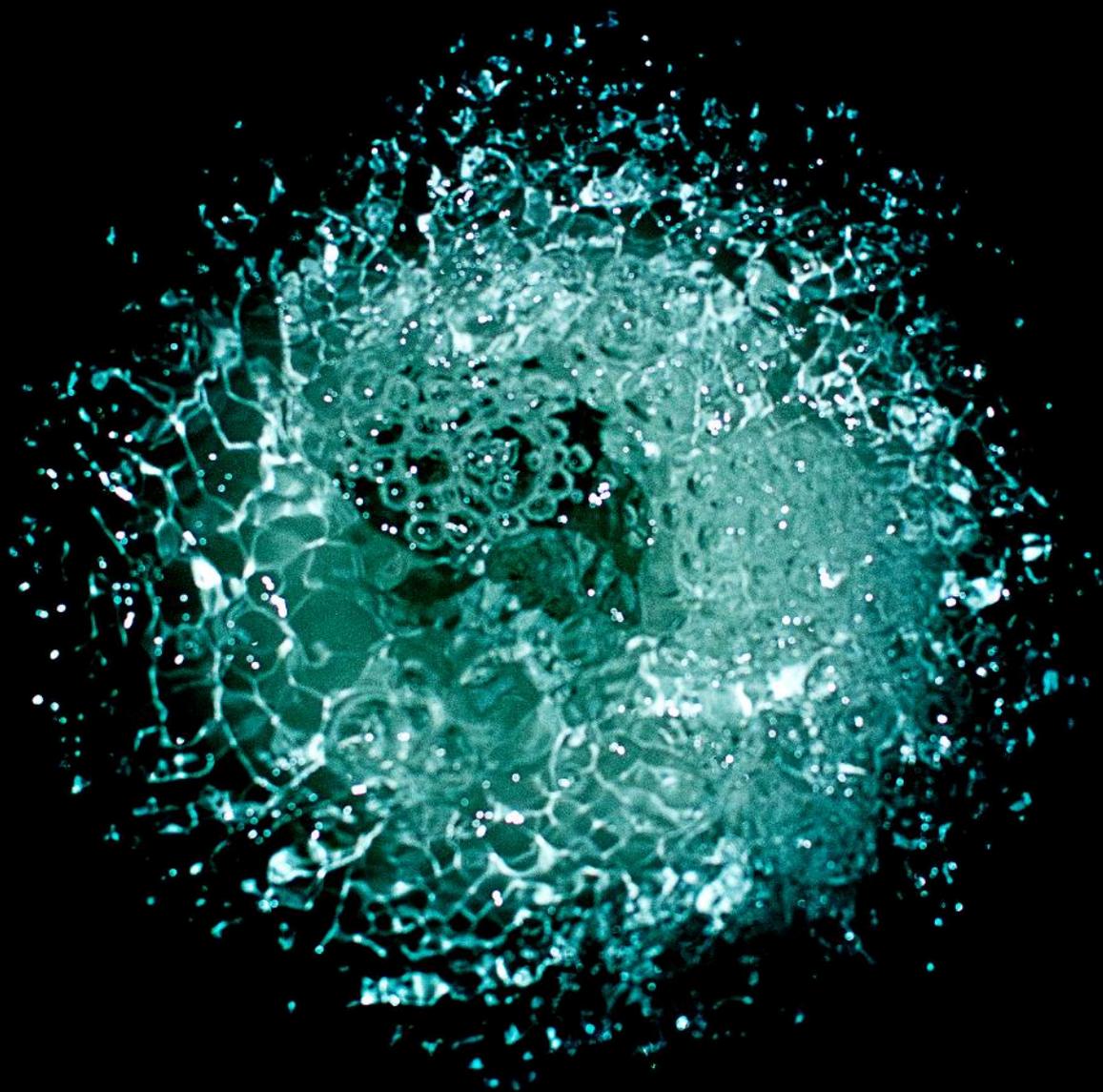


**Deloitte.**



中国连锁经营协会  
China Chain Store & Franchise Association



# **The Bedrock of Internet Fashion Brands**



Rapid development of e-retailing stands in sharp contrast to the decline of physical store retailing, and the different trends between online and offline business has led to the reform of operational mode and makes people to think about the future development style. Apparels constitute as one of the most mature sub-categories which started the earliest and form the largest scale among online shopping. Its sustained rapid growth has turned out a group of well-known internet fashion brand enterprises. According to EnfoDesk's data from tracking the transaction scale of the B2C apparels and accessories market in China, the size of apparels and accessories transaction in the B2C market already reached RMB654.9 billion in 2015. With such huge volume, the transaction size of this category in the first two quarters in 2016 still maintained a year-on-year growth of approximately 50%, far higher than the overall growth of the e-retailing market during the same period. The internet fashion enterprises have become an important force in the sub-division market, and have started to try to constitute a special eco-system through a unique operational concept.

### **The internet gene propels the development of internet fashion brands**

The rise of internet has brought numerous opportunities and challenges, and for those fashion brands relying on the internet, they are not only offered a platform for growth but are strongly supported in terms of enterprise operation and accessibility to funding through the internet.

- **The internet provides a rapidly growing platform and an expansive development space for the enterprises.** In spite of the current huge volume, online apparel transactions still retain rapid growth. According to China Internet Network Information Center's research on the categories of goods purchased by online shoppers, over 79.9% of these online shoppers have experiences in buying clothes, shoes and hats online in 2015, which accounted for the no.1 share among all categories.
- **The internet gene helps the implementation of intelligent management.** The internet has also become a powerful tool for operation and management of the internet brand enterprises. Take the supply chain as an example, compared with the traditional model under which the output is directed by the purchasing meeting, the internet apparel enterprises are capable of being more refined and intelligent in multiple aspects of demand forecasting, capacity distribution and product pricing, which can help to realize flexible supply based on the understanding of consumer preferences.
- **Direct, long-term and efficient consumer interaction.** The interactivity and openness of the network allow the internet enterprises to establish relationship with the consumers in a more direct way. Through interaction with the consumers, a more accurate picture of the clients can be obtained and through this a well-rounded customer relationship management can be achieved.
- **The possibility to construct an ecosystem.** Compared with traditional brands, the process to hatch and cultivate an online brand is relatively shorter, which brings more convenience and uses lower costs to bridge resources and conduct management on mature platforms, and therefore easier to forge a exclusive ecosystem compared with the traditional brands so as to obtain exponential growth.
- **Funding support.** Sustained high growth expectation attracts lots of capital to the internet-related industry during the past years. These huge sums of money provide strong support for further development and growth of the internet enterprises.

### **Internet fashion brands vs. local traditional fashion brands**

With gradual maturity of the online shopping and the formation of customer habits, the online apparel market has become a sub-division with substantial influence. According to estimated data from JNBY's prospectus, apparel sales volume via online platforms by 2020 will be accounting for about 24% of the total apparel sales, with a growth of 5% compared with 2015. And influence of the e-brands upon the whole industry will be more obvious. However, what cannot be overlooked is that the traditional offline brands still constitute the dominant force in the market, and with further omni-channel progression, there will be more collisions and integration between the two aspects. To better understand the current condition and trend in the development of different enterprises, Deloitte has carried out comparative research on operational model, earning performance, operating conditions and capital market operations of some representative enterprises, with the following conclusions drawn:

- **Despite relatively smaller business revenue and asset scale, internet brand enterprises enjoy higher asset turnover rates.** There is obvious difference in terms of business revenue and asset scale between the leading e-brands including HSTYLE and Huimei Group and the traditional fashion brands such as Metersbonwe and Semir, with the latter ones about 5-8 times over the former ones by business revenue. Their larger scale could to some extent be attributed to more expansive coverage by their physical storefronts and longer development cycle. However, total asset turnover rates of the e-brands enterprises are obviously higher than those of the traditional fashion players, and such higher asset turnover rates to some extent clarify that the e-brands are able to generate higher sales volume through lower asset input, which on one hand can be ascribed to the lighter asset structure of the internet brand enterprises, and on the other hand this is closely related to the smart supply-chain management of these enterprises.
- **Internet brand enterprises need to enhance their profitability.** Although the online distribution channel allows the internet brand owners to avoid most part of the store rentals, internet brand enterprises are not displaying stronger profitability than the traditional brand players. High platform fees, advertisement fees, endorsement fees and high expenditures on logistics and storage shouldered by internet brand enterprises have become the main obstacles for them to gain high profits.
- **E-brands are weak in generating stable operating cash flows, thus high reliability on external financing.** According to cash flow data of the internet brand enterprises, fluctuations in profit generation and the rapid growth stage they are at all make them inadequate to generate stable operating cash flows, so they need to rely on external funding or borrowing to replenish their capital so as to satisfy further expanding demand.

#### Internet fashion brands vs. international traditional fashion brands

- **International fashion brands enjoy ultra-high profitability.** In terms of profitability, the international fashion brands still take the leading positions because of advantages in brand premium. According to 2015 annual reports, profitability of Inditex, H&M and GAP were 14%, 12% and 8%, respectively, while that of HSTYLE and Huimei was only 3% and 1%, respectively.
- **Different features in supply chain.** The domestic brands own natural advantage in consumer interaction and digital operation due to their internet genes. Through unique physical store management and feedback mechanism, as well as cooperation with the international top colleges, ZARA obtains strong supply chain management capability and high efficiency in forecasting sales and inventory management.
- **Change from traditional storefronts sales channel to omni-channel mode.** In 2015, operating revenue of Inditex rose by 18.7% to RMB149.86 billion, which could be attributed to opening of new stores and increase of store sales revenues, and online sales were also a main contributor. The change in ZARA's distribution channel reflects the trend of traditional offline brands' activity towards the online manner. With gradual improvement of the traditional brands' omni-channel progression, there will be fiercer competition among enterprises, and the domestic fashion brands will be facing more direct impact from the international fashion players.

#### Internet fashion brands are facing challenges

Through the above analysis, it is found that with the Chinese economic growth slowdown, the disappearance of demographic dividends and the constant changing consumer groups, internet fashion brands are also facing multiple development problems.

- **With the disappearance of demographic dividends in China, the retail consumer markets overall are entering into a "stock" era.** China's demographic dividends gradually decline since the turning point of 2012, and the consumer markets are confronted with a deadlock in growth. The Chinese retail consumer market are transforming from extensive operation towards intensive cultivation marked by "stock" integration and industrial upgrade. This means the internet fashion brands are gradually losing their price advantages compared to the traditional apparel brands, and according to Deloitte's research, price is still the most key factor to attract the internet users.

- **With vague orientation, the internet fashion brands are in homogeneous competition.** Since most of the internet fashion brands are young, their brand content and culture are yet to be established and transmitted. Meanwhile, they are eager to incubate sub-brands facing different consumer groups in a rapid manner, there is lack of synergy among these sub-brands, and this not only leads to unachieved scale economy but dilutes the brand influence of the original brand. There is fierce homogeneous competition among the internet fashion brands, and with the price as the key, they sacrifice enterprise profits and their brand image.
- **Internet fashion brands are faced with difficulties in omni-channel construction.** With a different developing path with the traditional fashion brands, the internet fashion brands are national brands from the day of birth, so there is not so-called regional divergence. If a physical flagship store network is engaged, substantial investment is required even if only the key cities are covered. Meanwhile, with further going-online of the international brands with ZARA and Uniqlo, the channel advantage of the internet fashion brands are also facing direct challenges.
- **With growth of the main consumer group, the internet fashion brands may be confronted with an embarrassing upgrade.** With the Millennials generation born after 1985/90, these consumers are entering their prime time of their life (30-45 years old). The key consumer group are saying goodbye to “losers” and stepping into the middle class, therefore the widow period when “winning losers’ preference is everything” has gone. The brands are facing a new choice in their product orientation.

#### The next-step of the internet fashion brands

- **Go for platforms and construct the industrial ecosystem.** For the internet fashion brands, playing alone can hardly help them to handle the rising operating cost and the fierce competition from online and offline players. It is urgent for them to put together their advantage resources and to sort out the relationship among different interested parties so that an industrial ecosystem can be constructed. Through straightening out the supply chain and extend the value chain, the internet fashion brands can be expected to enhance their brand image, enhance the overall eco-brand’s market share, and construct a safety boundary.
- **Be small and smart, and focus on the sub-divided markets.** Instead of constructing a platform ecosystem, the internet fashion brands can also choose the “small and smart” path to focus on a certain highly sub-divided market. As mentioned before, the Millennial consumers show strong demand for personality, so the consumer group is highly sub-divided itself. To follow the consumers psychology, to use the advantage resources to focus on the potential sub-divided markets and to become the no.1 in these sub-divided domains are becoming more and more essential.
- **Content is the key, and to attract flow through IP operation.** If the previous key consumer groups are purchasing the “goods” themselves, then the Millennial consumers are buying the experience brought by the “goods” as well as the value acknowledgement thereof. Such consumer logic has become the soil for the breakout of the content transmission model represented by the “net-idol economy”. Mobile social media have realized highly vertical accurate marketing, which increases the traffic conversion rate through high-frequency content display and share.
- **Break the boundary for integration of online and offline whole channels.** In the new retail ecosystem concentrating on consumers, the boundary between online and offline will be absolutely broken. Due to the internet fashion brands’ natural disadvantages in brand recognition and consumer loyalty, integration between online and offline activities will eventually be the result.



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