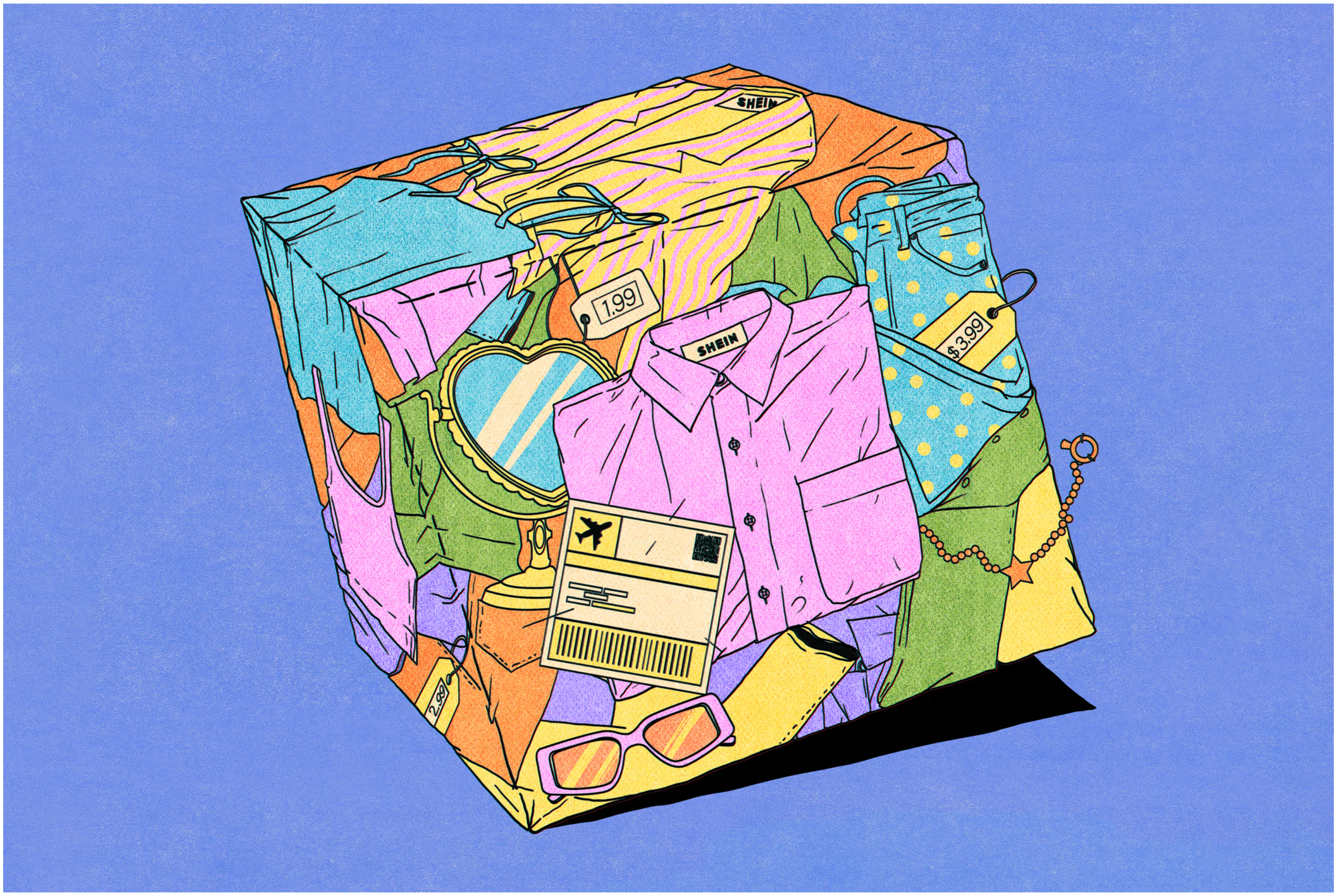


ILLUSTRATION BY MARIA JESUS CONTRERAS

RETAIL | COVER

How the World's Most Popular Shopping App Is Quietly Upending Retail

China-founded Shein is growing into a global titan. Analysts say many Western competitors ignore the app at their peril.

By Sabrina Escobar Follow

Updated June 26, 2023 / Original June 16, 2023

Lindsay Firko used to be a regular big-box customer, rarely making it out of her local Target without multiple shopping bags. But ever since the 28-year-old downloaded the app from online retailer Shein, her shopping sprees have changed.

Rather than strolling the aisles of her local Pittsburgh retailers, Firko now spends hours scrolling Shein. Every few months, she piles her virtual cart with a bounty of items at spit-take prices: trendy pants, skirts, and tops at $3 or $6 apiece, household and beauty items like a $2 bath mat or a $5 soap dispenser, and the occasional just-couldn't-pass-it up treat like a curly wig for her Jack Russell mix, Bailey. With more than a million products to choose from, she says her virtual cart often tops $250, even with the single-digit price tags.

"Walmart, Target, stores like that—I barely go into them now," says Firko.

That's the kind of sentiment that should send shivers down the spines of U.S. retailers. Shein, pronounced "shee-in," may be the most ambitious company you've never heard of. Shein, which was founded in China and later moved its headquarters to Singapore, was the most downloaded shopping app in the world last year (it was No. 2 in the U.S. after Amazon.com's [ticker: AMZN] app, according to Apptopia). The retailer took off during the pandemic-era e-commerce boom, rising to global prominence on the back of Gen Z's taste for the $4 shirts and $6 dresses, which it's able to churn out with its norm-breaking supply-chain model. Along the way, it picked up backing from some of the biggest names in venture capital, including Tiger Global and Sequoia Capital China, and a valuation of roughly $66 billion, dwarfing fast-fashion and affordable-apparel companies such as H&M (HNNMY; $24 billion market cap) and Gap (GPS; $3.4 billion).

But that appears to have been only Phase 1. There have been repeated reports of plans for a U.S. initial public offering, on which Shein declined to comment, and the company is putting down roots in the States, hiring U.S.-based employees and investing in distribution facilities. At the same time, it's taking its supply chain global, announcing plans to partner with hundreds of factories in Brazil, India, and Turkey. And Shein is growing its offerings, expanding beyond the cheap apparel that made its name into categories like home goods and beauty, and opening its platform to third-party sellers à la Amazon with its "Shein Marketplace."

Lindsay Firko spends hours scrolling Shein. One of her finds: a wig for her dog, Bailey. PHOTOGRAPHS BY ROSS MANTLE

"Customers are loyal to us because we give them the products they want and the price they love," says Donald Tang, Shein's executive vice chairman, in an interview with *Barron's*. "The first group of customers were Gen Z girls. Now we're in men's products, pet products, shoes, bags, accessories, and beauty products. Customers get married, have pets, they buy houses—we now have home goods, as well."

MORE RETAIL MUST-READS

Stores Get a Nice Surprise. Sales Jump.

Why Americans Are Still Splurging Even as the Cost of Living Bites Hard

Shoplifting Is Getting Worse. Companies Are Fighting Back.

How the I-95 Collapse Could Make the Holidays More Expensive

Despite that world-eating vision, few retailers are paying attention, experts say. Certainly, U.S. companies object to being grouped together with a start-up that has been the subject of allegations of everything from labor abuses and damaging environmental practices to mishandling customer data and copyright violations. And given the trade war brewing between the U.S. and China, some may be gambling that Shein's aspirations for the U.S. market will be quashed.

Ignoring the company could be a costly mistake. Just ask the fast-fashion retailers: According to Bloomberg Second Measure, Shein accounted for roughly half of U.S. fast-fashion sales as of November 2022. Now, its expansion plans put it on a collision course with industry giants like Target (TGT), Amazon, and Walmart (WMT). Perhaps most threateningly, Shein's business model opens the door for more disruption from other entrants with ties to China that are attempting to emulate Shein's success, including Temu, an online marketplace that launched last September and has since racked up more than 50 million downloads on the Apple and Android app stores.

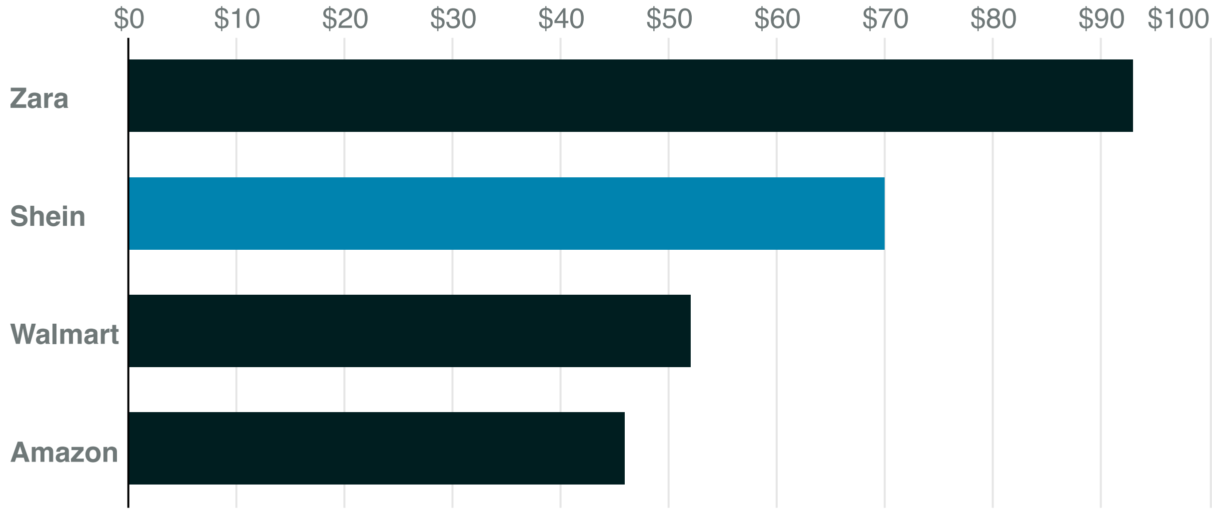
Make no mistake, says TD Cowen analyst John Kernan of Shein. "This is a formidable competitor, and a very different model than what U.S. traditional retailers are used to."

For a first-time shopper scrolling Shein, the initial shock is the prices: a pair of kiwi- and lemon-bedecked swim trunks for $6, a glittery one-shouldered women's jumpsuit for $10, a three-pack of children's shorts for $6.56. Then there's the sheer volume. Unlike other retailers, Shein breaks its "new arrivals" section into individual days. On June 2, for instance, the retailer added 2,257 new women's styles—a tally that doesn't include whatever men's, children's, and home items hit the site that day. Some estimates have put the influx of new designs at about 6,000 to 8,000 a day.

It Adds Up

Despite single-digit prices, Shein orders tend to be larger than those of other big retailers.

Average Order Value



Note: April 2023
Source: Measurable.ai

The company attributes its low prices and vast selection to what it refers to as its “on demand” business model. While traditional apparel retailers forecast trends and order items based on what they hope will sell, fast-fashion companies look at what designers and retailers are offering and try to jump on whichever trends are taking off. Shein follows the second model, but with a significant twist. The company says it relies on user activity on its app to determine in real time which products are attracting the most interest and uses that information to quickly iterate on and make more of the most popular designs.

“This is kind of the product of the digital age,” says Sheng Lu, associate professor of fashion and retail studies at the University of Delaware. “It’s a study on how to leverage digital tools and data science to…create new products based on the market trends observed from interacting with consumers.”

To produce a new design, most retailers need to place bulk orders in the tens of thousands per item to meet manufacturers’ minimum requirements. That means, at best, the need to store and distribute that inventory, and, at worst, thousands of unsold pieces that eventually need to be marked down, eating into profits.

The Shein model miniaturizes that approach. The company partners with thousands of small Chinese manufacturers, which allows it to produce thousands of styles in batches of just 100 to 200 items. If a design is popular, Shein can crank up production quickly, often in less than a week. If it bombs, the company is left with just a handful of stinkers.

As a result, the company says it maintains low-single-digit inventory levels, well below the industry average.

“We are profitable,” Tang says. “That’s the power of the on-demand model. We have redesigned our supply chain to anchor our on-demand approach and eliminate overproduction. We are asset-light—we have very little unsold inventory, and we lease warehouses.”

This approach keeps overhead low, he notes. “We do not own supply-chain factories. We do not own delivery vehicles or planes…we do not own marketing platforms. We do not own anything at the last mile,” says Tang. The company retails exclusively online and mails goods directly from its warehouses and partner factories in China to consumers in the U.S. and elsewhere. (It doesn’t sell in China itself.) Shein links all of the pieces of its supply chain—from designers to manufacturers to raw material suppliers—with its operational software.

Replicating this type of infrastructure isn’t easy, says Derek Yan, senior investment strategist at KraneShares, a China-focused investment manager. “That speed and flexibility in the production is really phenomenal,” he says. “That’s the core advantage compared to Zara, H&M, and Forever 21.”

ILLUSTRATION BY MARIA JESUS CONTRERAS

Last year, Shein had global revenue of about $23 billion, with earnings of $800 million and just shy of 30% of its business coming from the U.S., according to people familiar with the company. Its revenue was up about 50% year over year, estimates Coresight Research. That outpaced the sales of the larger fast-fashion pack: Zara parent Inditex saw year-over-year growth of 17.5% in 2022; H&M and ASOS (ASOMY) were up 12.4% and 0.7%, respectively. Boohoo Group (BHOOY) saw a decline of 10.8%.

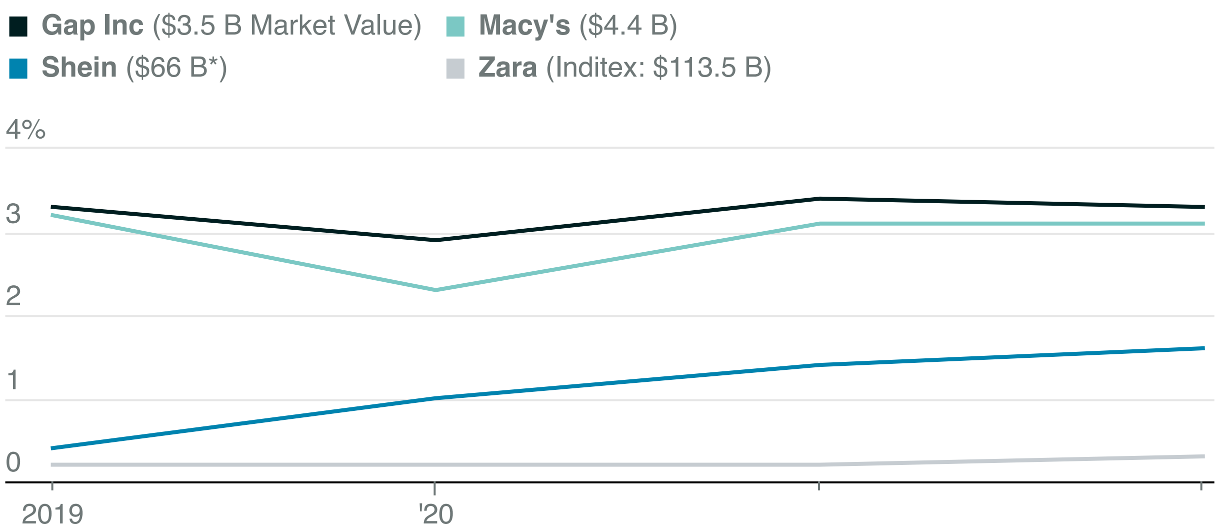
But the potential impact of Shein's rise could be much broader. The company's appeal among middle-class teenagers and young adults threatens to pit it against midtier legacy apparel retailers, or what Neil Saunders, managing director and retail analyst at GlobalData, calls the "murky middle"—the Kohl's (KSS), Gaps, and Macy's (M) of the world. Shein held about 0.1% of the U.S. apparel market in 2017, according to

GlobalData. By 2022, it was 1.6%. A small sliver, but "exceptional growth," says Saunders.

Shoppers Without Borders

China-founded Shein controls a growing share of the global apparel market.

Apparel Market Share



Note: Zara is an Inditex brand.
*private market valuation
Sources: GlobalData; FactSet

Still, few in the industry seem to have registered Shein as a threat. "When I ask, 'Are you worried about competition from Shein?' almost none of them are," says Lu, the University of Delaware professor. "They see themselves as very different from Shein."

Barron's reached out to 11 brands identified by analysts as potential competitors to Shein. Three declined to comment, and six didn't respond. One retailer, which agreed to comment if we didn't use its name, said its business model was different from fast-fashion brands like Shein, from its bricks-and-mortar strategy to its price points, quality, and sustainability initiatives.

Different or not, consumer spending is finite, and every dollar spent at Shein is one less going to legacy retailers, says Brian Ehrig, a partner and retail analyst at Kearney. That's often overlooked, he says, because many competitors underestimate the purchasing power of Shein shoppers. The average Shein order value in the U.S. was about $70 this April, compared with $93 for Zara, $52 for Walmart, and $46 for Amazon, according to data aggregator Measurable.ai.

Another common misconception is that Shein caters solely to low-income consumers, Ehrig says. To place an order from Shein, you need a debit or credit card, something that less-affluent shoppers have historically struggled to access.

"If you were to walk into any deep-discount store, you're gonna see a lot of people paying cash," Ehrig says. "Shein is actually serving a little bit more—I'm not going to say affluent, but a customer who has access to credit, which is not the bottom 20% of the economy."

As Shein expands into home and beauty, it threatens to creep into territory claimed by big-box retailers such as Target and Walmart, as well as e-commerce companies such as Amazon. An Amazon spokesperson says that it considers Shein a partner, noting that the company sells some products on Amazon's marketplace. The spokesperson adds that Amazon's marketplace model sets the company apart from others.

But that particular moat may not last. In April, Shein launched a third-party marketplace in Brazil, which it plans to roll out in the U.S. and other countries. The marketplace will allow Shein to add local sellers, reducing shipping times and letting it sell bulkier items.

For the past three years, there have been periodic reports that Shein is planning to go public in the U.S.; the latest was that the company is now raising funds for a U.S. listing in the second half of 2023. The capital injection of an IPO would help Shein continue to evolve its business and make it an even more formidable competitor to U.S. retailers, says Brendan Ahern, chief investment officer at KraneShares.

Shein declined to comment on any IPO plans, but it's clear that it's moving to increase its U.S. presence. The company opened its first U.S. distribution center last year and plans to open two more by 2025 to speed up its shipping times, which can be as long as two weeks for standard shipping from China. The company is engaging with the American press in a way that it shied away from in previous years, and has ramped up its hiring in the U.S., including bringing Tang on in 2022. Before joining Shein, Tang helmed a media conglomerate and helped broker a series of high-profile deals, including Dalian Wanda's takeover of AMC Entertainment in 2012 and Bear Stearns' foray into the Chinese market back in the early 2000s.

"The U.S. is one of the most important markets and one of the biggest markets that we have, so we pay an extraordinary amount of attention to it," Tang says.

Despite those efforts, the path to becoming part of the U.S. retail fabric is far from clear. A drumbeat of investigations into the company's carbon footprint, alleged mistreatment of workers, and accusations of stealing others' designs have turned off some shoppers.

"If Shein doesn't reconcile these problems, I'll probably end up shopping more on Amazon and doing more discount hunting," says Brejaé Chamberlain, a 21-year-old hairstylist from Chicago.

Chamberlain used to place a Shein order at least once a month and was often paid by the company to review products on her TikTok account, but says she's now rethinking the partnership. Three other Shein shoppers who spoke with *Barron's* say they were also considering buying less from the company—though none have yet done so.

Brejaé Chamberlain says she was often paid to reviews Shein products on her TikTok. PHOTOGRAPH BY NOLIS ANDERSON

But the bigger threat for Shein may be brewing in Washington. As TikTok has illustrated, companies with Chinese ties—especially those capable of gathering significant data about their users—are in the middle of the growing tension between the U.S. and China. Shein is already drawing congressional ire: After an April hearing in which experts testified that some Shein garments contained cotton from China's Xinjiang Uyghur Autonomous Region, a group of legislators sent a letter to the Securities and Exchange Commission asking that any IPO be put on hold until it can be verified that the retailer isn't using forced labor by China's minority Uyghur population. And just this week, a bipartisan group of lawmakers introduced two bills that would change the rule that allows companies like Shein to avoid paying duties when shipping packages valued at less than $800 dollars from China to the U.S.

Also driving the backlash against the company is Shut Down Shein, a lobbying group that says Shein is able to sell products at such a low cost only because it is employing unfair labor practices and skirting billions in dollars in tariffs.

"Their business model is anti-competitive…. Other international companies that want to do business with America are not doing those things, and they are following the law, so we are fighting for a level playing field," says Chapin Fay, executive director of the group. Shut Down Shein itself may be evidence that, behind the scenes, U.S. retailers are indeed concerned. Fay declined to disclose which organizations are funding the group, saying only that it's a coalition of American brands and human-rights organizations.

Shein disputes the allegations and says that its low prices are a result of its streamlined inventory and supply-chain management. Tang says the company makes its manufacturers sign a code of conduct, implements yearly internal audits, and uses proprietary technology to trace the origin of the products' materials.

No matter how the battles in Washington play out, Shein has opened the door for disruptive international retailers to hurl themselves into the U.S. market. Take Temu, an online marketplace launched by PDD Holdings in September. Like Shein, Temu sells a mind-boggling array of cheap products that are shipped directly from Chinese manufacturers. Temu has been the most downloaded app on Apple's app store for much of 2023—and in May, it surpassed Shein in U.S. consumer spending, according to Bloomberg Second Measure.

In a brief for the April congressional hearing, U.S.-China Economic and Security Review Commission policy analyst Nicholas Kaufman reported that, since 2019, more than 10 Chinese retail start-ups have copied the Shein model, all with the intention of selling to Western markets. "Their rapid proliferation raises concerns that they will rely on controversial practices similar to those of Shein and Temu to undercut competitors and gain a foothold in the U.S.," he wrote.

"China is very Darwinistic—only the strong survive," says Ahern, the KraneShares CIO. "If you've survived it, you can survive a lot. You're at the top of the heap."

Shein has emerged as the first Chinese-born retailer to break big globally, but whether it can reach "top of the heap" status on the world stage is still uncertain. What is clear though, is that the company has the potential to become an apex predator, and it's time for competitors to start watching their backs.

Corrections & Amplifications: Shein partners with thousands of small Chinese manufacturers. A previous version of this article incorrectly said the company partnered with tens of thousands of manufacturers.

Write to Sabrina Escobar at sabrina.escobar@barrons.com