

WINNING THE RETAIL BATTLE IN A WORLD WITHOUT MASK RESTRICTIONS

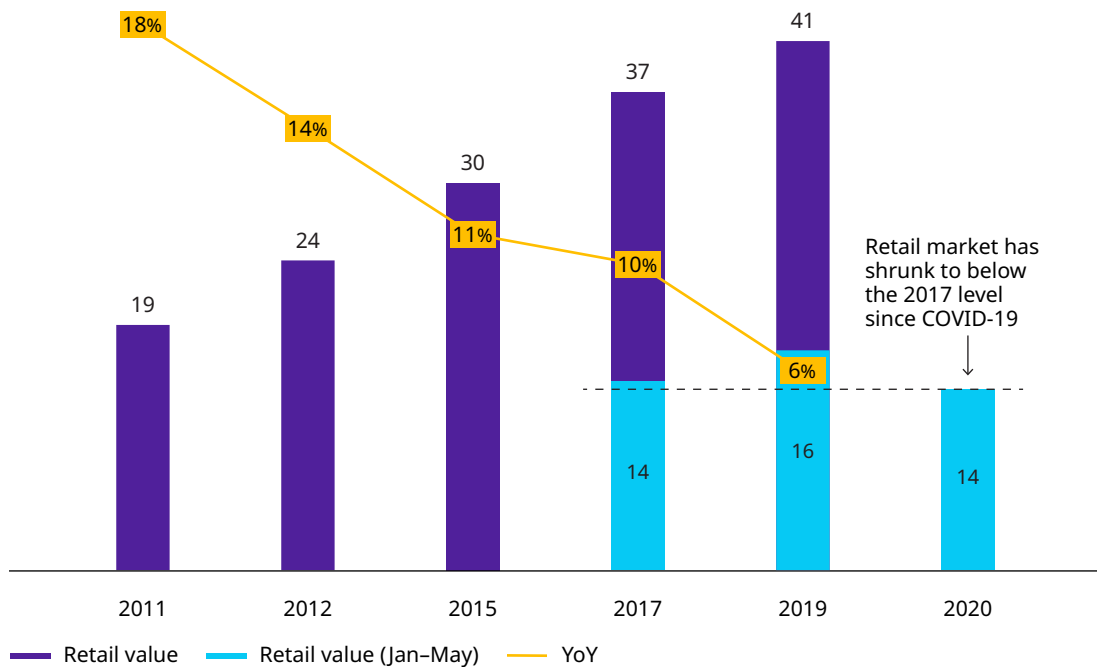


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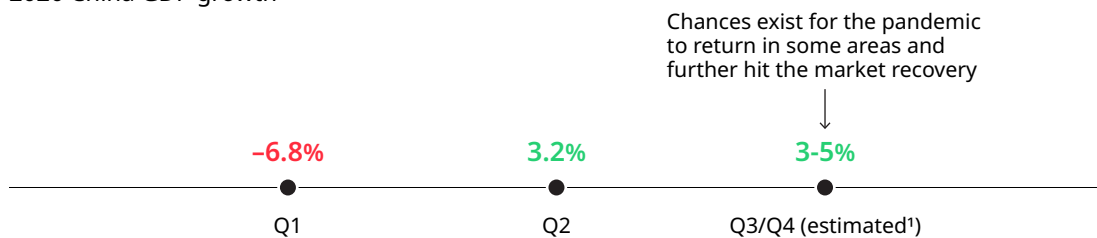
China's retail market has entered a new era with decelerated overall growth, and the COVID-19 outbreak has hit it even harder. The retail market's annual growth has been decreasing since 2011, from almost 20% to c.6% in 2019. While many retailers had just started getting used to this tough situation, the pandemic began, together with probably the most negative economic impact seen in decades. During the first five months of 2020, more than RMB 2 trillion has already been wiped out from the market. There is also the chance that the pandemic will return in some areas and so hit the retail market a second time.

Exhibit 1. China's retail market has entered a new era with decelerated overall growth; the COVID-19 outbreak has hit the market even harder

China's total retail sales of consumer goods, 2011-2019
Trillion RMB



2020 China GDP growth



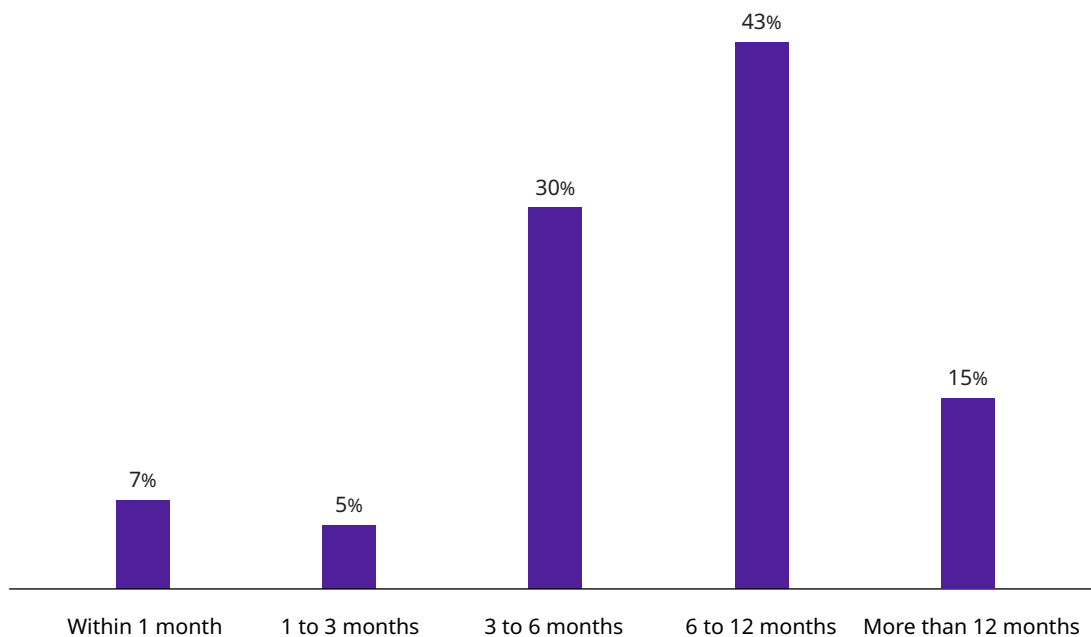
1. Consensus of various third party analyst reports

Source: National Bureau of Statistics of China, analyst reports

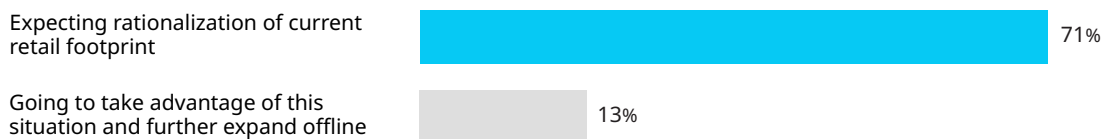
This turbulent situation is only going to accelerate structural changes in channel dynamics and consumer shopping behavior, resulting in China’s retail market entering a “post-COVID normal”. Online channels were already gaining market share for more than a decade, with new formats emerging every day. However, during the past six months, consumers have embraced online shopping much more than before, with even the elderly and high-income group shopping less offline and more online. Moreover, although offline stores will still have a role to play, the bar to draw traffic is increasing. Further market polarization is also expected, with trading up remaining robust in the middle and upper class segments, and trading down continuing to emerge in the lower income group.

Exhibit 2. Most retailers expect it will take more than six months to fully recover, and many are making changes to their retail footprint and channel strategy

How long do you estimate it would take your business to return to levels before COVID-19¹?



How will COVID-19 impact your company’s sales network for the rest of the year¹?



1. CBRE Asia Pacific Retail Flash Survey (N=33), conducted between April 28 to May 21, 2020

Source: Oliver Wyman analysis

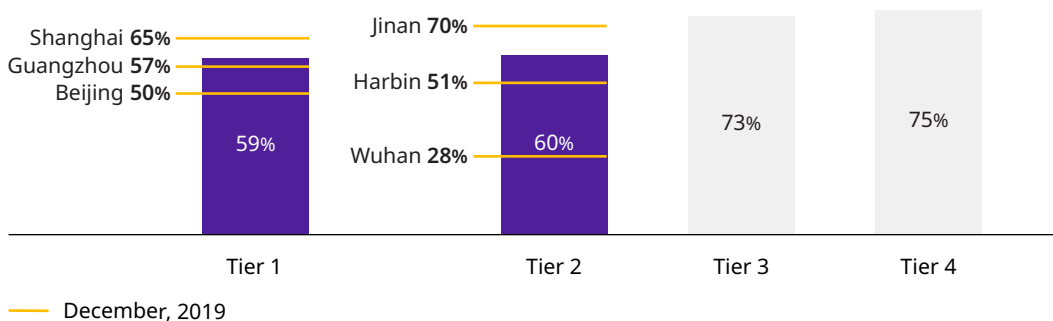
Retailers have already pulled many short-term levers, such as big promotions, assortment adjustments, and cost cutting, to survive this difficult time. Most of them expect it will take more than six months for their business to fully recover. Meanwhile, many leaders are also considering changes to their retail footprint and channel strategy to win in the post-COVID normal. To thrive in this new environment, they need to think carefully and differently, as the market has experienced profound changes. They should make quick decisions within their current footprint to prioritize daily investment and explore new avenues to drive future growth and pre-empt competitors.

Based on Oliver Wyman’s understanding of China’s retail market, we wish to share three observations with ambitious retailers who want win in this post-COVID normal:

- Accept the fact that a lot of existing stores will never come back to profitability after the pandemic, so be bold and close them quickly to cut losses and double down on new strategic locations.** Offline traffic has been recovering gradually, but many stores are still under heavy pressure, especially in high tier cities. Within a city, the recovery rate can also be very different for different catchments or malls, with multiple factors at play, such as target customers (locals vs. tourists), product proposition (premium vs. mass market), and location (residential vs. commercial). In the first five months of 2020, c.10% physical stores were closed down, while it is usually only c.15% for a whole year. Even some profitable stores may never come back to pre-COVID performance levels, as consumer behavior has changed significantly. Thus it is critical to take a forward-looking view to estimate the future performance of each existing store to quickly make the right decision.

Exhibit 3. Offline traffic is recovering, but many stores are still under pressure, especially in higher-tier cities

Average daily mall traffic in April 2020 as % of December 2019, by city tier



Average daily mall traffic in April 2020 as % of December 2019, within Beijing

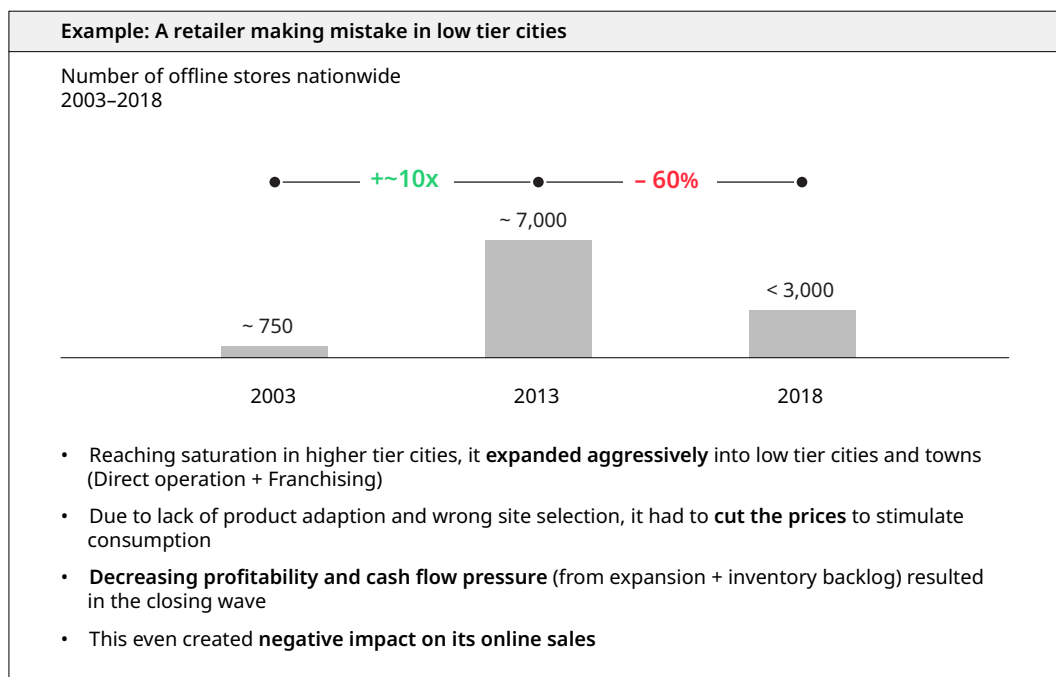
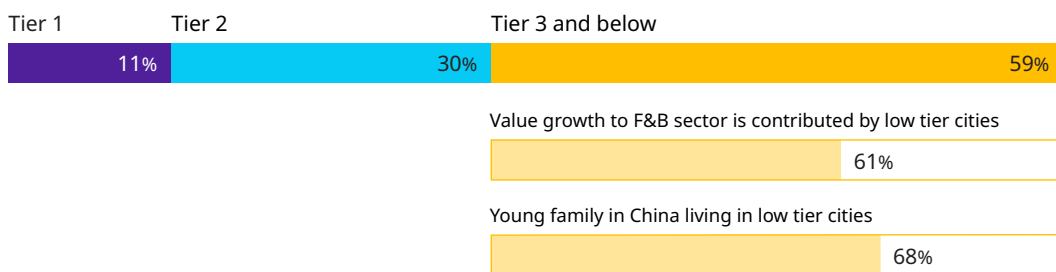
Above city average		Below city average	
Yizhuang	65%	Dongzhimen	45%
Tiantongyuan	57%	Sanlitun	44%
Shuangjing	56%	Wukesong	37%
Wangfujing	56%	Zhongguancun	36%

Source: Windata

- Conquering lower tier cities has become much more difficult than ever in the post-COVID normal.** Firstly, consumers have less money to spend after the pandemic. The economy in lower tier cities is very dependent on SMEs, which are more vulnerable to the pandemic than big companies. It is not surprising that c.60% of young consumers (小镇青年) are now more worried about the outlook of their personal income. Secondly, consumers have become more polarized. While c.50% in tier 4 cities claim they now prefer less-expensive products, c.30% claim they will keep trading up. Thus, it is not easy to find a clear proposition. Thirdly, there will be more fierce competition for good locations. Though traffic recovery in lower tier cities is faster than in higher tier ones, many only have a limited number of high-quality retail sites, and many new mall openings in lower tier cities have been delayed or even cancelled due to the pandemic. The lower-tier-city market is still big and attractive in the long term, but retailers need to be very cautious about investing heavily now as the cost of making a mistake could be very high.

Exhibit 4. Lower-tier market is big, but retailers can easily make a costly mistake

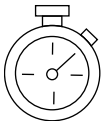
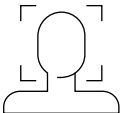
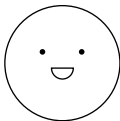

Retail sales of consumer goods, by city tier, 2019



Source: National Bureau of Statistics, Kantar, Desktop research, Oliver Wyman analysis

- Invest in smaller targeted stores and mega flagship stores as they will thrive; and work hard to re-invent a differentiated proposition for mid-sized stores.** Undoubtedly consumers will keep visiting physical stores in the post-COVID normal. However, while they now want almost everything, the bar to persuade them to visit and pay is much higher. Retailers have experimented many new store formats. Some have launched small stores with a very targeted purpose, flexible locations, and relatively low cost to ensure profitability. Others have opened mega flagship stores to offer extraordinary customer service and experiences. The key challenge is with mid-sized stores, which number the most as they are usually the “core” store format for many retailers. Today most of them offer a wide range of products without a very distinct proposition, are usually transaction-driven without superior customer experiences, and have relatively higher rental and staff costs. Thus it is imperative for retailers to find the right proposition for mid-sized stores to adapt to the new normal in consumer needs.

Exhibit 5. To re-invent the proposition is not easy, as consumers want everything from the stores but don't want to pay

 <p>They want it NOW</p> <p>E.g. Fast delivery (<1 hour) from offline stores</p>	 <p>They want it PERSONALISED</p> <p>E.g. Customized skin tests, DIY products</p>	 <p>They want the SERVICE</p> <p>E.g. Make up tutorials, group classes in store</p>	 <p>They want the EXPERIENCES</p> <p>E.g. All-in-one passport photography, Game arcades</p>
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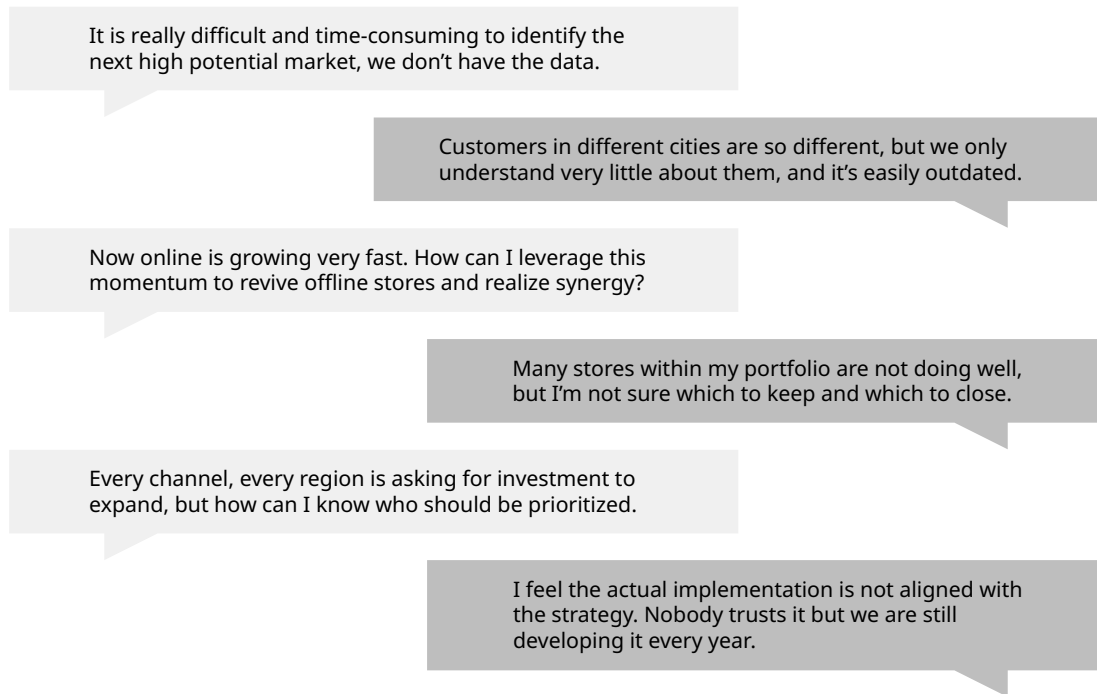
At the same time...



Source: Desktop research, Oliver Wyman analysis

With the macro environment and consumer behavior changing so dramatically and quickly, retailers who want to win in the post-COVID normal need a next-generation offline expansion strategy. Retailers must clearly find the right balance between existing and new stores, higher and lower tier cities, and core and new store formats at a super granular level. However, many companies have found this difficult to do as it requires a huge amount of multidimensional market and consumer data, an analytical approach that can generate business insights, and effective tools to guide internal communication and implementation. As a result, they either spend months developing their strategy before being beaten out by another competitor or find a big disconnection between their strategy development and its implementation.

Exhibit 6. CEOs/CFOs/Strategy Directors talking about their pain points with expansion strategy development and implementation



Source: Oliver Wyman analysis

Over the years, we have developed a unique analytical approach combined with Oliver Wyman's proprietary database and digital tools to help develop and implement effective expansion strategies. We have equipped many retailers in China with three core capabilities:

- Clear visibility of market potential (both online and offline) in multiple dimensions and at a super granular level
- Deep understanding of the latest nuances in consumer trends & preferences in different places, powered by our social listening techniques
- Forward-looking view of the retail site quality, fit, and potential to guide strategy development and implementation, enabled by our Bluespider geospatial analytical tool

Having these three key capabilities in hand will make it much more efficient and accurate for retailers to develop effective offline expansion strategies to win in the post-COVID new normal, develop new store formats that cater to the needs of consumers, and make the right decisions for store network rationalization. Our unique offerings make life easier for both senior executives and frontline operational teams.



COMPREHENSIVE VIEW OF MARKET POTENTIAL

enabled by a proven approach and proprietary data, covering >200 cities, >90% of China's market

Unique offerings:

Super granular level

- City level
- District level
- Catchment level
- ...

Multi-dimensional

- Online vs. offline
- Historical vs. future market
- Other meaningful angles, such as age group, gender, etc.



LATEST NUANCES IN CONSUMER NEEDS

reflected in format design and site selection, by using our social listening techniques

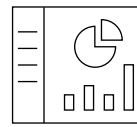
Unique offerings:

Real-time consumer voice

- Huge amount of data
- Collected in real time
- From multiple sources/languages

Insight driven

- Nuances in consumer behavior, needs, and preference to inform business decisions
- Powered by advanced analytics



CLEAR PICTURE OF RETAIL SITES

to assess current and future store network, powered by our Bluespider web-based geospatial analytical tool

Unique offerings:

Full pic of retail sites (>10K)

- Proposition
- Traffic & productivity
- Consumer ratings
- ...

Visualized digital tools

- For both senior leadership and teams at the front line
- "Mission control" dashboard for everyone, everywhere

Contact us for more information about the next generation of effective offline expansion strategies and our proprietary tools.

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

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