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### **Asia Distribution and Retail**

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*China is presently experiencing widespread economic disruption owing to the outbreak of the coronavirus disease 2019 (COVID-19) and stringent government measures to contain it. This in turn is taking a toll on China's retail and distribution sector. While comparisons are inevitable with the economic toll taken by another coronavirus, SARS (2002-03), the difference for China, now, is that its economic fundamentals are more robust, its retail sector more vibrant, as illustrated by its thriving e-commerce sector, its technology more advanced, and its consumers more resilient. These present ample opportunities for retailers to transform and recover from the loss of business in physical retail.*

This article outlines the potential impact of the COVID-19 outbreak on various retail sub-sectors and different responses of retailers, and provides some implications and key tips for foreign retailers operating in China.

## Key takeaways

### China's retail sector will be negatively impacted in near term

- Retail sub-sectors/segments that are hardest hit by the COVID-19 outbreak include the services sector, especially food & beverages and tourism, apparel sector, gold, silver and jewelry sector, travel retail sector, luxury sector and offline entertainment sector. In terms of retail format, department stores and shopping malls will suffer the strongest impact from the COVID-19 outbreak.
- China's retail sales growth are expected to drop around 4 percentage points from 8.0% in December 2019 to 4.0% or below in the first two quarters of 2020. Under a more optimistic scenario, if the COVID-19 outbreak will be under control by end-March, retail sales growth will bottom out in June 2020 and rebound in the third quarter. Otherwise, under a pessimistic scenario where the outbreak will only be contained by end-June, retail sales growth for the third quarter will remain weak.

### Opportunities may arise for certain retail sub-sectors

- The COVID-19 outbreak will usher in another boom era for digital retail and e-commerce in China. Fresh food, groceries (especially health and personal care products) and consumer staples goods are expected to see rising online demand. Fresh food e-commerce platforms and on-demand delivery providers will also benefit from the surge in online orders.
- As people reduce outdoor activities, demand for other online services, such as online medical consultation, online education tools and mobile gaming will see a massive increase.
- Some traditional retail formats that can provide convenient and quicker services to consumers, namely community supermarkets and convenience stores, can better weather the crisis.
- New business models, unmanned and contactless services, and digital/social media marketing tools and solutions including KOL and KOC marketing, livestreaming and WeChat Mini Program marketing will flourish.

## Implications and key tips for foreign retailers

1. Go digital and fully leverage omni-channel capabilities;
2. Enhance “last-mile” delivery and fulfillment capabilities;
3. Embrace geographical diversification strategies;
4. Move into alternative product lines;
5. Set up AI-backed mechanism to update inventory levels, production and shipment information;
6. Fully leverage advanced technologies; adopt innovative business models and strategies;
7. Reassess strategies regularly and stay on top on new developments;
8. Provide support and guidance to customers and employees.

## I. Background

The first outbreak of the coronavirus disease 2019 (COVID-19) started in Wuhan, Hubei province, in mid-December 2019. The virus has since then spread across China as well as to 24 other countries. The Chinese government has shut down transportation networks including buses, trains, airplanes and ferries in Wuhan and surrounding cities in Hubei on 23 January 2020 and advised people not to leave the city. Subsequently, cross-city transportation was also limited. Other provinces and cities have also been hit severely by the COVID-19 outbreak, with various local governments extending the Lunar New Year holiday to delay people from travelling and banning public gatherings. Some countries and territories have imposed travel restrictions on China, and major airlines have suspended flights to China in the wake of a large-scale COVID-19 outbreak. These will pose great challenges to China's retail and distribution sector.

### **A brief comparison: SARS outbreak vs. COVID-19 outbreak**

Compared with the SARS outbreak in 2002-03, the current COVID-19 outbreak will likely cause more economic and business disruptions in China. However, the difference for China, now, is that its economic fundamentals are more robust, its retail sector more vibrant, as illustrated by its thriving e-commerce sector, its technology more advanced, and its consumers more resilient. These present ample opportunities for retailers to transform and recover from the lost of business of physical retail.

**Exhibit 1: A brief comparison: SARS outbreak vs. COVID-19 outbreak**

	<b>SARS outbreak (2002-03)</b>	<b>COVID-19 outbreak (2019-20)</b>	<b>Fung Business Intelligence's views</b>
<b>Retail sales (growth trend)</b>	China's retail sales growth was on a rising trend	China's retail sales growth was on a decreasing trend	The COVID-19 outbreak is hitting a weaker economy; China's retail sales growth are expected to drop from 8.0% in December 2019 to 4.0% or below in 1-2Q2020. Under a more optimistic scenario, if the COVID-19 outbreak will be under control by end-March, retail sales growth will bottom out in June 2020 and rebound in 3Q2020. Otherwise, under a pessimistic scenario where the outbreak will only be contained by end-June, retail sales growth for the third quarter will remain weak.
<b>GDP composition</b>	Service industry contributed 46.5% to national economic growth in 2002	Service industry contributed 59.4% to national economic growth in 2019	Disease outbreak will have bigger impact on the service sector. Sharp decline in domestic and outbound tourism is expected.
<b>Outbreak origin</b>	Guangdong and Beijing	Wuhan	Wuhan is one of the most important cities and transportation hubs in Central China. Shutting down the transportation networks will heavily affect the distribution of goods to and from Central China. Wuhan is also a manufacturing base of automobile parts, digital products, and electronics parts. Supply of such products may be affected which in turn will affect sales.
<b>Major driver of economic growth</b>	Economy depended more on foreign trade	Economy depended more on domestic consumption	Reduced shopping activity will have a larger impact on the economy today than in 2003.
<b>Internet penetration</b>	Internet penetration rate: below 10%	Internet penetration rate: over 60%	E-commerce is more prevalent nowadays. High Internet penetration rate facilitates brick-and-mortar companies to shift their offline business online to reduce revenue loss.
<b>Logistics infrastructure</b>	Logistics infrastructure was less established	Logistics infrastructure was more established	Distribution of goods will be easier today compared with the situation in 2003. Logistics providers can use drones to reach places where roads are blocked.
<b>Technologies deployment</b>	AI technologies were not common	AI technologies were more mature and commonly used in retail sector	With the help of artificial intelligence (AI) technologies, retailers can offer more unmanned services or contactless solutions to consumers.

Source: Fung Business Intelligence

## II. Impact on various retail sub-sectors and responses of retailers

### Catering sector

Since the outbreak of the coronavirus disease 2019, many people have confined themselves to their homes; this has led to a surge in demand for food delivery services. It is reported that as of end-January, in Beijing alone, delivery platform Meituan and Ele.me together handled an average of over 400,000 daily delivery orders.

In response to consumer concerns about getting infected by food couriers and vice versa, Meituan and Ele.me rolled out “contactless delivery” across the country<sup>1</sup>. Customers can choose to have their food delivered to a designated area for pickup, which could avoid the need to interact with a courier in person. Meituan also launched a “Reassurance Card” app, which can be downloaded from its POS machine’s app store. Merchants using Meituan’s restaurant management system can print out information including names and body temperature of staff including chefs, staff who pack the meals and couriers handling the delivery on the receipts and show them to consumers<sup>2</sup>. Other restaurant chains including KFC, Pizza Hut, McDonald’s, Dicos, etc. also launched “contactless delivery” services. Moreover, Yum China is testing an in-store pickup version of this contactless delivery at some of its stores, where pickup racks have been installed in these stores<sup>3</sup>.

### FMCG and fresh food retailing

The Ministry of Commerce (MOFCOM) has urged supermarkets and hypermarkets to remain in operation and imposed strict control on supply and price of daily necessities in a bid to protect the stable supply of daily necessities of people. More than 200,000 branches of 300 retailers including CR Vanguard, RT-Mart, Walmart China, Carrefour China and Yonghui Superstores support the initiative<sup>4</sup>. According to the MOFCOM, 95% of supermarket chains are in normal operation. Some supermarket and hypermarket chains have even increased the replenishing frequency from twice a day to five times a day<sup>5</sup>.

As a result of the COVID-19 outbreak, more people visit supermarkets rather than wet markets; the foot traffic (both online and offline) for supermarkets increases fast. Many supermarket chains leverage online delivery platform such as Meituan and JD Daojia to offer quick delivery service to consumers staying at home. Yonghui Superstores recorded 30% increase in order volume for its O2O delivery service during the Lunar New Year holiday<sup>6</sup>. To ensure there will be sufficient delivery and warehousing staff to handle the massive online orders, some supermarket operators such as Alibaba’s Freshippo and JD.com’s 7Fresh have launched programs to recruit temporary staff, targeting workers from factories which are temporarily shut down due to the outbreak<sup>7</sup>.

Another initiative launched by supermarkets amid the COVID-19 outbreak is tapping community retailing. Recently, Wumart joined force with third-party O2O local lifestyle service platform Dmall to launch "anti-epidemic stations" in a number of communities in Beijing. The stations act as logistics hubs to serve communities and help consolidate online orders made by residents, while providing contactless services for parcel collection and online payment. This initiative will be further extended to 4,000 communities in Beijing<sup>8</sup>.

### **Department stores and shopping malls**

Comparing with supermarkets and hypermarkets, department stores are more affected by the coronavirus disease 2019 as they sell mostly consumer discretionary products. According to the MOFCOM, only 35% of department stores resumed operation as of 9 February. To offset the effect of shortened operating hours and reduced customer footfall, some department store operators are actively transforming their business to take their offline business online. For example, Intime Department Store joined hands with Taobao and invited around 1,000 key opinion leaders (KOLs) and key opinion consumers (KOCs) to act as "shopping guides" and host livestreaming sessions to promote and sell products. They can also interact with consumers and answer their questions in real time. Cosmetics brands including Estée Lauder, Kiehl's, IPOE and Origins have reportedly joined the event<sup>9</sup>.

Some department store operators are leveraging social media platforms to better engage with customers. Chengxi Intime City in Hangzhou recently announced that customers can scan the QR code provided in Intime's WeChat official account to join a WeChat group, from which they can get product and sales information from merchants. Intime will assign sales timeslots to the merchants beforehand and make announcements in the WeChat group. Users can access the WeChat group according to the schedule to review product information and reference photos as well as obtain a QR code for purchase.

Recently, some major mainland Chinese shopping mall landlords have introduced measures to relieve pressure on retail stores and restaurants brought on by the COVID-19 outbreak, such as cutting rents and offering zero-rent periods. Selected examples are shown in Exhibit 2.

## Exhibit 2: Measures of selected landlords to relieve pressure on retail stores and restaurants

Landlord	Actions
<b>Wanda</b>	Rents and property management fees will be exempted for all tenants in all malls from 24 January – 25 February
<b>Poly</b>	Rents will be exempted for all tenants in all malls from 25 – 30 January
<b>Powerlong</b>	Rents will be halved for all tenants in all malls from 25 January – 2 February
<b>China Resources</b>	Rents will be exempted for all tenants in all malls from 25 January – 9 February
<b>Seazen</b>	Rents will be halved for all tenants in all malls from 25 January – 13 February

Source: CBRE

### Apparel sector

A number of foreign apparel retailers are closing some of their stores in China temporarily and shortened operating hours due to the lost of traffic as people are staying at home. For instance, Fast Retailing temporarily closed some 270 Uniqlo stores in China; H&M temporarily closed 45 stores in China; Lululemon also temporarily closed 38 of its 39 stores in China, but it joined hands with 28 yoga tutors to offer online yoga courses to maintain interaction with customers<sup>10</sup>. Meanwhile, some more localized apparel retailers such as Bestseller are striving to expand their business via WeChat Mini Program. Launched in March 2018, its WeChat Mini Program “WeWall”, which serves as an online community where Bestseller sales associates act as shopping guides to consumers, and share new products and promotions with consumers<sup>11</sup>. It is reported that daily sales generated from WeWall increased from 1.41 million yuan on 1 February to 9.17 million yuan on 6 February, while Bestseller’s online sales during 1-5 February were three times that of its offline stores<sup>12</sup>.

Some global apparel retailers which source a lot from China are reportedly looking seriously at moving their supply chain base to places like Sri Lanka or Bangladesh, particularly if Chinese factories and warehouses continue to close for another week or so<sup>13</sup>. A flexible supply chain is very important for global apparel companies, which allows them to have back-up plans and move between markets<sup>14</sup>.

Some domestic apparel brands, on the other hand, are facing excess inventory problem. It is expected that sales in the first two quarters of 2020 will be heavily affected. Brands need to handle excess inventory and think carefully about the orders they should place for the third and fourth quarters as they cannot easily shift their inventory and sell outside China, a move that could be adopted by their international counterparts. The pressure will be even heavier for brands that have been facing inventory problem for a long period of time, such as HLA and La Chapelle.

## Luxury sector

The luxury sector is one of the retail sub-sectors that will be greatly impacted by the outbreak of the coronavirus disease 2019. Although it is reported that spending by Chinese tourists overseas had not been hit much by end-January 2020, but given widening travel restrictions, it is forecasted that the situation would worsen in the coming weeks and months. According to Bain and Company's report released in November 2019, China was a major growth driver for the global luxury sector in 2019, with Chinese consumers accounting for more than a third of global spending on luxury goods in 2019<sup>15</sup>. With major airlines, namely American Airlines, British Airways, Cathay Pacific Airways, Air Canada, Air France and many others suspended flights to China<sup>16</sup>, the global luxury industry is expected to face a major sales hit amid the potential decline in the number of outbound tourists from China. Investment bank Jefferies forecasted a 35% decline in Chinese luxury spending in the first quarter of 2020<sup>17</sup>.

Luxury brands with business in China will be greatly affected – it is estimated that the footfall of luxury shopping malls and flagship stores dropped by 80% in Wuhan, Shenzhen, Guangzhou, Shanghai and Beijing. Burberry temporarily closed more than a third of its stores in China; Ralph Lauren temporarily shut down half of its 115 stores in China; and Capri Holdings Ltd. said 150 of its 225 stores in China were closed due to the COVID-19 outbreak<sup>18</sup>. Luxury brands that rely heavily on China to generate income would face bigger risks if they do not adjust their strategy and diversify their business. Brands like Chanel, Burberry, Dior, Valentino which have already started e-commerce business in China, would be able to better weather the crisis.

## Duty-free retailing

The escalation of the coronavirus disease could have a detrimental impact on airport passenger numbers, which would affect the global airport retail sales and duty-free retail sales. Over the past few years, airport retailers, especially those in Europe, have tailored their propositions, integrated Chinese payment solutions such as Alipay and WeChat Pay and invested in Mandarin-speaking staff to target Chinese passengers and maximize sales growth opportunities<sup>19</sup>. The massive reduction in the number of Chinese tourists has forced duty-free retailers to close some of their airport stores.

Examples include: China Duty-Free Group closed its mall in Haitang Bay; DFS stores in Hong Kong temporarily closed two of its four T Galleria stores<sup>20</sup>; Korean travel retailers Lotte Duty Free and Shilla Duty Free also temporarily shut down some of its outlets after coronavirus-infected persons were confirmed to have visited the stores previously<sup>21</sup>.

## E-commerce sector

E-commerce sector is the least affected sector so far; China's total online retail sales are expected to rise as more people stay at home and shop online. To offset the effect of falling customer traffic and decreasing sales, many brick-and-mortar businesses and traditional retailers have turned their focus online.

At the same time, increasing numbers of traditional retailers and merchants selling on e-commerce platforms are leveraging livestream shopping and social selling to reach out to more customers. To support merchants to launch livestreaming tools for their business, Taobao Livestreaming announced several initiatives such as waiving fees for joining its platform, waiving service charge for merchants using its livestreaming tools, offering free courses to guide them using livestreaming tools and offering loans at discounted interest rates for merchants<sup>22</sup>. Another social commerce platform Mogujie, together with some livestreaming hosts, launched a number of measures to help merchants promote and sell their products through livestreaming, such as helping them to match with leading livestreaming hosts; supporting them with viewer traffic; broadening the variety of goods merchants can sell via livestreaming; and waiving commissions for using Mogujie platform.

Selling via WeChat and other social media platforms like Pinduoduo is also becoming increasingly popular. For instance, some brands and retailers allow their sales associates to promote and sell the company's products on their WeChat's "Friends' Circle" (aka WeChat Moment).

Amid the escalation of the COVID-19 outbreak, some leading e-commerce operators have rolled out relief measures for merchants. For instance, Alibaba unveiled relief measures for online merchants affected by the coronavirus outbreak, including waiving service fees for online stores operating on its flagship Tmall for the first half of the year and offering discounted loans via MYBank, a business unit under Ant Financial. Additionally, Alibaba announced that it will offer flexible job opportunities, a delivery and logistics allowance up to one billion yuan, digital services and remote work tools, etc. to help merchants better weather the crisis<sup>23</sup>. Meanwhile, Pinduoduo also rolled out a series of measures to help smaller merchants during the coronavirus outbreak. It has allocated 1 billion yuan subsidies for merchants; and offered vendors a 2-yuan commission for each order placed by consumers between 17 January and 2 February and shipped before 5 February<sup>24</sup>. Mogujie also announced that it will waive the deposits for merchants setting up businesses on its platform, extended the delivery period for merchants that have problem in maintaining regular delivery and provided financial support for those having difficulties in repaying loans.

### **III. Comments from Fung Business Intelligence**

#### **1. China's retail sector will be negatively impacted in near term**

The outbreak of the coronavirus disease 2019 has changed Chinese consumers' shopping preferences – physical shopping activity has fallen significantly as people are unable to travel around or have opted to stay at home for safety concerns.

Many foreign retailers, restaurants and entertainment companies throughout the country are suspending operations, while some local retailers, shopping malls and department stores are shortening their business hours. Reducing customer footfall will affect sales of brick-and-mortar stores.

Tourism industry is also heavily affected due to the restrictions in travel from/to China, and as a consequence retail will be impacted – limited passenger flows greatly affect sales of travel-retail stores and other brick-and-mortar stores.

To relieve the imminent pressure on retailers, some Chinese mall landlords have cut rents and offered zero-rent periods; and some tech companies have waived fees and offered loans to online merchants. At the same time, banks in China are urged to lower the interest rates and extend loans to companies that have been affected by the outbreak; and other financial institutions such as Ant Financial's MYBank unit would offer 20 billion yuan (US\$2.86 billion) in loans to companies in China, with preferential terms for Hubei firms<sup>25</sup>. These measures will soften the financial burden of retailers to a certain extent.

China's total retail sales growth stood at 8.0% in December 2019. In view of the currently widespread business disruption owing to the escalation of the COVID-19 outbreak and based on the SARS experience – with retail sales growth in China down from 10.0% yoy in January 2003 (one month after the first confirmed case in Guangdong province) to 4.3% yoy in May 2003 when the epidemic peaked, we expect China's retail sales to drop notably in the first two quarters of 2020 to below 4.0% yoy (assumption: the outbreak is under control by end-March), and through the third quarter (assumption: if the outbreak is under control by end-June) as people cut back on discretionary spending, especially of discretionary products and services, durable goods and luxury products.

#### **2. Opportunities may arise for certain retail sub-sectors/ segments**

While the COVID-19 outbreak will hurt a host of retail sub-sectors and pose a negative short-term impact on China's retail sector, it will also provide opportunities for certain retail sub-sectors. In particular, the outbreak will usher in another boom era for online retail and e-commerce in China as more people opt to shop online. We expect China's total online retail sales to continue to increase, with fresh food, groceries (especially health and personal care products) and consumer staples goods,

in particular, to see rosier prospect. Fresh food e-commerce platforms and on-demand delivery providers will also benefit from the surge in online orders.

As people reduce outdoor activities, demand for other online services, such as online medical consultation, online education tools and mobile gaming will see a massive increase.

Some traditional retail formats that can provide convenient and quicker services to consumers, namely community supermarkets and convenience stores, can better weather the crisis.

New business models and business practices will emerge or evolve amid the ongoing coronavirus outbreak. For instance, some retailers and O2O delivery platforms have adopted contactless delivery strategy to avoid direct contact between delivery staff and customers. Some unmanned and contactless services including unmanned stores, robot restaurants, automated warehouses and facial recognition payment may gain (or regain) popularity. Some forward thinking companies have launched innovative apps that can measure and record names and body temperature of delivery staff.

Meanwhile, increasing numbers of brands and retailers will turn to online and social media channels to market and sell their products and services. This in turn will also provide new opportunities for the development of some present-day digital/ social media marketing tools and solutions such as key opinion leader (KOL) marketing, livestreaming and WeChat Mini Program marketing.

### **3. Enterprises will face significant challenges when meeting the sudden change in consumer demand**

The sudden change in consumer demand will have a serious effect on brands and retailers, e-commerce platforms, logistics companies and delivery platforms, among others; not all of them are well-equipped or prepared to handle the sudden increase in demand.

Not only is the sudden change in consumer demand affecting companies, the large-scale transport restrictions, travel bans, factory shutdowns and production delays are disrupting normal business operation. In particular, the outbreak has also caused significant logistics and shipment disruptions and greatly hampered parcel deliveries to and from China. According to media reports, delivery time for both domestic goods and cross-border e-commerce imported goods would delay as priority is given to delivery of medical goods.

## **IV. Implications and key tips for foreign retailers**

### **1. Go digital and fully leverage omni-channel capabilities**

To offset the drop in sales, brick-and-mortar retailers are advised to turn to digital channels, such as mobile apps and social media platforms to engage with customers, market their products and drive sales.

### **2. Enhance “last-mile” delivery and fulfillment capabilities**

To cope with increasing online demand, retailers could consider partnering with on-demand delivery platforms to expand delivery capabilities.

### **3. Embrace geographical diversification strategies**

Foreign retailers could avoid operating in Chinese cities/regions with widespread community transmission of the coronavirus disease 2019, namely Wuhan and nearby cities in Hubei province, and some cities in Henan, Zhejiang and Guangdong province, and focus on regions within China that are less disrupted or deepen focus in markets in other countries.

### **4. Move into alternative product lines**

To better meet the new needs of customers, retailers could consider moving into alternative product lines. For example, they could shift from selling discretionary products and services to offering personal and health care products, cleaning supplies, etc.

### **5. Set up AI-backed mechanism to update inventory levels, production and shipment information**

To handle the massive online demand, enterprises could set up an AI-backed mechanism to update inventory levels and provide real-time production and shipment information to various parties involved, and respond swiftly to the rapid changes.

### **6. Fully leverage advanced technologies; adopt innovative business models and strategies**

Retailers need to be more innovative – they could widely embrace technologies, especially AI and robotics, to implement automated operations and adopt “contactless strategies”; they should also launch more innovative marketing campaigns to attract customers and drive sales.

## **7. Reassess strategies regularly and stay on top on new developments**

For retailers that have temporarily closed their stores in China or reduced operation hours, they are advised to regularly reassess the costs of such actions and make timely adjustments. They also need to stay on top of the latest developments of the outbreak and adjust strategies as needed.

## **8. Provide support and guidance to customers and employees**

Enterprises could leverage social media platforms to communicate with customers and provide support. They should also provide guidance, support and assurance to employees, especially those who are affected by the temporary store closures.



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