2022 Hainan Travel Retail Market Whitepaper

A Powerhouse of the New Retail

July 2022

By KPMG China and The Moodie Davitt Report

Foreword

It is our pleasure to present the second edition of our Hainan Travel Retail Whitepaper, discussing the challenges and opportunities for Hainan as it plays a role in reshaping retail business models in China.

In light of ongoing travel restrictions due to the COVID-19 pandemic, many Chinese travellers and consumers are focusing on Hainan as their attention has shifted to the domestic market. Further, many market players are seeing Hainan as a sustainable travel retail market thanks to its healthy growth. 10 offshore duty-free shops in Hainan made outstanding contributions to annual sales exceeding CNY60 billion in 2021, achieving 84% YOY growth. The first China International Consumer Products Expo May 2021 turned out to be the largest high-end consumer products exhibitions in the Asia Pacific region.

Hainan stands apart from other overseas travel retail destinations because of a series of innovative institutional measures improving the business environment. In 2021, more and more brands established their presence in Hainan. The ongoing pandemic has raised a greater sense of urgency and enthusiasm for brands to look for alternative ways to penetrate China's domestic market, ensure supply chain resilience and improve consumer experience through offerings in Hainan.

With the planned seal-off coming in 2025, the current period is an exciting moment for retail, with brands focusing intensively on the viability of their future business models, especially the impacts to stakeholders along the supply chain due to the new Sales Tax scheme. Brands are acutely aware of establishing proper Hainan structures and vehicles that will empower their commercial capabilities and allow synergy with the Greater Bay Area and the rest of mainland China.

The pandemic has also made consumers more acutely aware of the need for environmental sustainability and social responsibility, prompting many to increasingly identify with brands that align with their values in these areas. This has prompted brands to explore multiple channels for their ESG communication with consumers.

Through this paper, KPMG and The Moodie Davitt Report present insights on the Hainan travel retail market, with the goal of enabling duty free operators and brands to seize opportunities in this rapidly evolving landscape.

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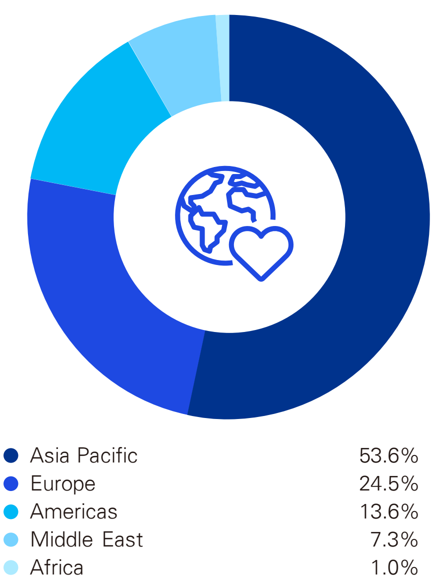
The global duty-free industry in numbers

According to Generation Research, the global travel retail & duty-free industry was worth US$86.4 billion in 2019, up 10 percent over 2018 and the last 'normal' year in the industry. The same source's 2020 figures, though, revealed the brutal impact of the pandemic with worldwide sales collapsing to just US$45.3 billion. All regions were adversely affected, except one: Hainan, where sales rose 127 percent.

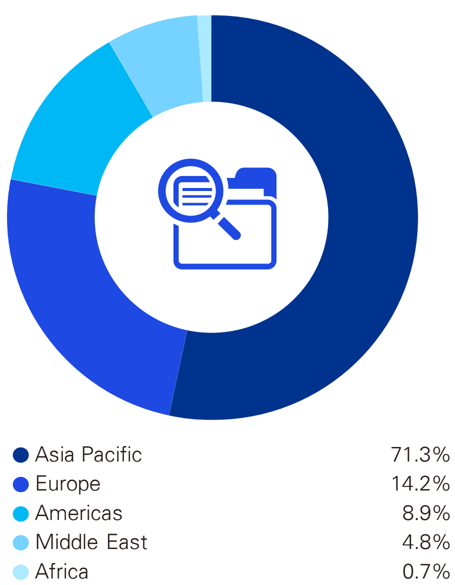
For the purposes of assessing the industry's post-pandemic future, we believe 2019 serves as an appropriate global benchmark although we do not anticipate a full recovery to 2019 levels until 2024.

The charts below show the 2019 and 2020 breakdown of global duty-free sales by region, channel and product category. They also paint a revealing picture of the impact of the pandemic.

2019 regional breakdown



2020 regional breakdown

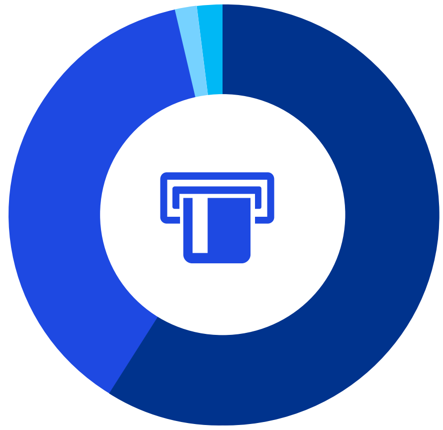


Source: Generation Research

2019 channel breakdown

Airport shops	50.9%
Other shops & sales	43.6%
Airlines	3.0%
Ferries	2.4%

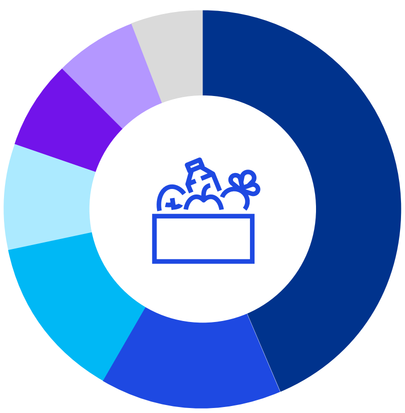
2020 channel breakdown



Other shops & sales	59.0%
Airport shops	37.6%
Airlines	1.7%
Ferries	1.7%

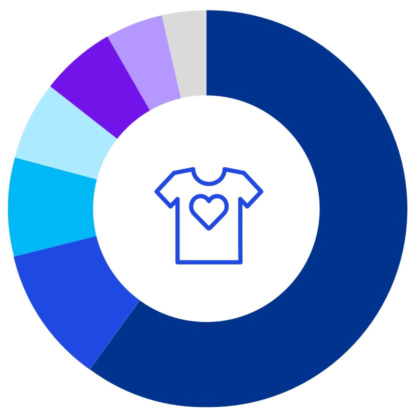
Source: Generation Research

2019 category breakdown



Fragrances & cosmetics	43.7%
Wines & spirits	14.8%
Fashion & accessories	13.3%
Tobacco goods	8.6%
Watches, jewellery & fine writing	7.4%
Electronics, gifts & other	6.5%
Confectionery & fine food	5.8%

2020 category breakdown



Fragrances & cosmetics	60.0%
Fashion & accessories	11.1%
Wines & spirits	8.1%
Watches, jewellery & fine writing	6.5%
Tobacco goods	5.9%
Electronics, gifts & other	4.8%
Confectionery & fine food	3.5%

Source: Generation Research

Duty free & travel retail sales by region 2009–2020 (in US$ millions)

Region	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Asia Pacific	10,295.2	13,000.2	16,665.6	19,902.2	22,317.9	24,729.4	25,294.4	27,375.3	30,827.3	38,831.9	46,370.4	32,285.2
Europe	16,176.1	16,758.8	18,910.4	19,272.3	20,139.3	20,581.9	18,856.7	18,732.9	20,060.7	20,802.7	21,174.8	6,437.3
Americas	7,605.2	8,702.7	10,280.8	10,855.7	11,162.5	11,725.3	11,276.4	10,853.4	11,655.2	11,799.8	11,728.0	4,048.7
Middle East	3,466.4	4,026.9	4,446.1	5,005.8	5,560.6	5,867.3	5,810.8	5,573.3	5,982.7	6,362.8	6,290.9	2,174.7
Africa	657.2	711.3	697.0	764.0	819.7	848.4	761.7	778.1	786.9	808.6	879.4	316.4
World total	**38,200.0**	**43,200.0**	**51,000.0**	**55,800.0**	**60,000.0**	**63,752.3**	**62,000.0**	**63,313.0**	**69,312.9**	**78,605.7**	**86,443.5**	**45,262.3**

Source: Generation Research

Duty free & travel retail sales by sales channel 2009–2020 (in US$ millions)

Channel	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Airport shops	21,385.4	24,103.5	29,435.9	31,927.8	34,671.2	36,832.4	35,530.1	35,515.2	38,207.7	41,501.9	44,009.2	16,996.9
Other shops & sales	12,211.5	14,144.7	16,270.7	18,466.8	20,095.6	21,714.2	21,772.4	23,363.0	26,554.1	32,285.2	37,729.1	26,707.5
Airlines	2,437.9	2,686.6	2,851.4	2,991.9	3,021.4	2,980.9	2,639.0	2,491.4	2,568.6	2,632.5	2,589.3	770.2
Ferries	2,165.1	2,265.2	2,442.0	2,413.5	2,211.8	2,224.7	2,058.5	1,943.5	1,982.5	2,186.0	2,116.0	787.6
World total	**38,200.0**	**43,200.0**	**51,000.0**	**55,800.0**	**60,000.0**	**63,752.3**	**62,000.0**	**63,313.0**	**69,312.9**	**78,605.7**	**86,443.5**	**45,262.3**

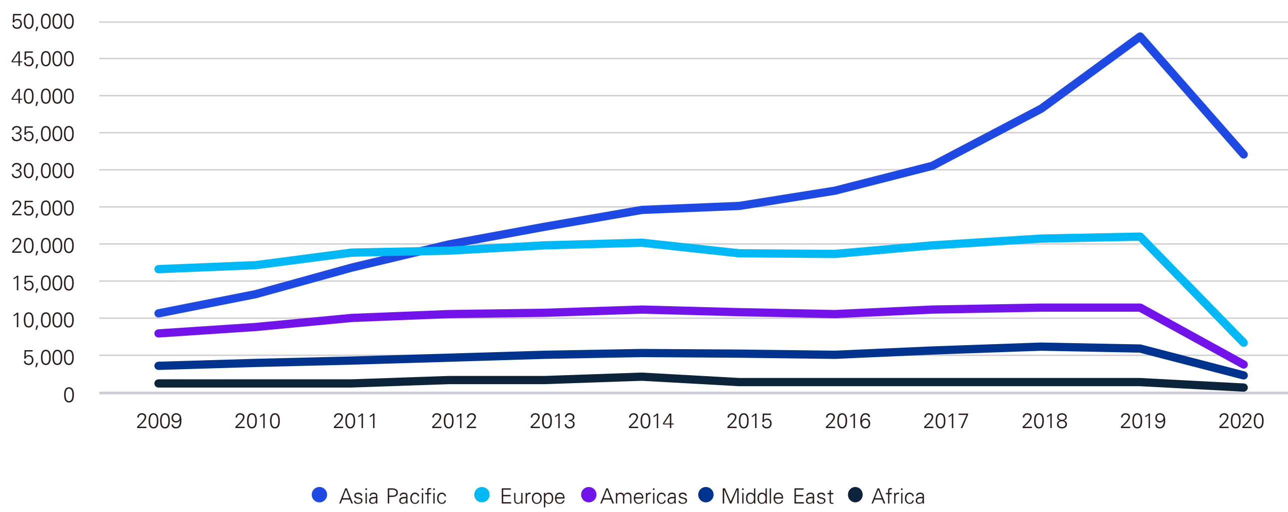
Source: Generation Research

Duty free & travel retail sales by product category 2009–2020 (in US$ millions)

Category	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Fragrances & cosmetics	10,708.0	12,060.1	14,344.1	15,793.7	17,260.3	19,289.5	19,763.5	21,464.4	25,605.9	31,324.1	37,769.9	27,173.3
Wines & spirits	6,681.9	7,367.8	8,432.6	9,091.0	9,862.3	10,437.0	10,150.7	10,463.3	11,350.7	12,165.8	12,769.7	3,662.5
Fashion & accessories	4,761.5	5,792.2	7,007.4	7,955.7	8,755.2	9,272.9	8,998.3	9,128.9	9,540.9	10,806.2	11,459.3	5,042.2
Tobacco goods	6,006.0	6,416.1	7,300.9	7,626.8	7,851.8	7,908.9	7,353.7	7,228.8	7,229.6	7,827.1	7,453.5	2,649.9
Watches, jewellery & fine writing	3,589.2	4,073.3	5,139.2	5,767.8	6,210.8	6,601.8	5,933.9	5,435.4	5,672.1	6,022.7	6,355.5	2,958.3
Confectionery & fine food	3,167.1	3,503.6	3,941.7	4,376.6	4,745.1	5,079.6	4,875.3	4,791.5	4,993.4	5,129.3	5,056.2	1,606.7
Electronics, gifts & other	3,286.3	3,987.3	4,834.1	5,188.5	5,314.6	5,162.6	4,924.7	4,800.8	4,920.2	5,330.4	5,579.4	2,169.4
World total	**38,200.0**	**43,200.0**	**51,000.0**	**55,800.0**	**60,000.0**	**63,752.3**	**62,000.0**	**63,313.0**	**69,312.9**	**78,605.7**	**86,443.5**	**45,262.3**

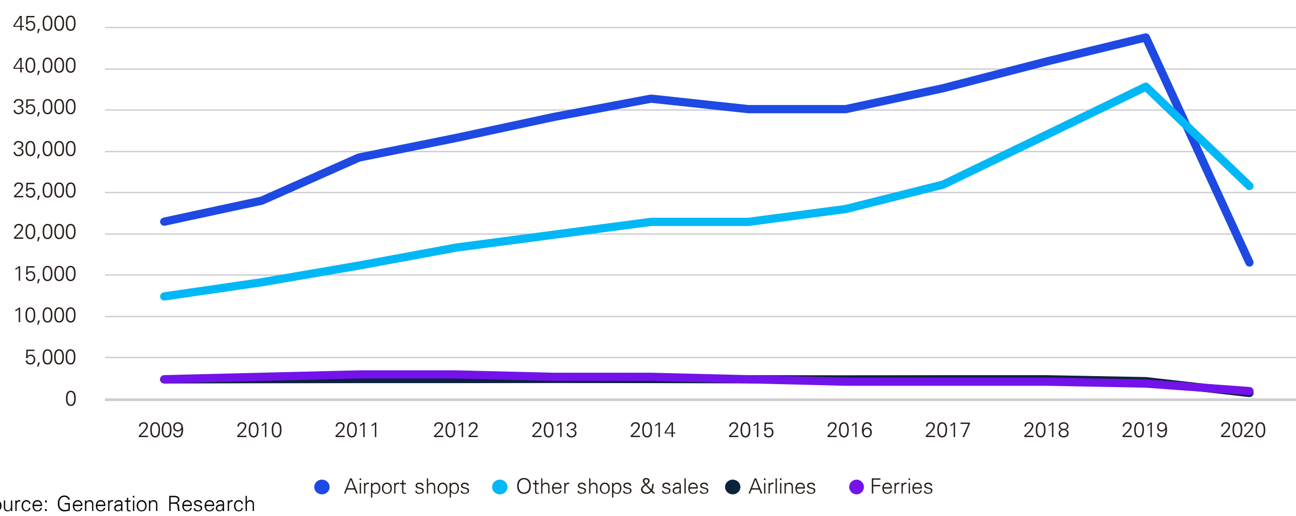
Source: Generation Research

Duty free & travel retail sales by region 2009–2020 (in US$ millions)



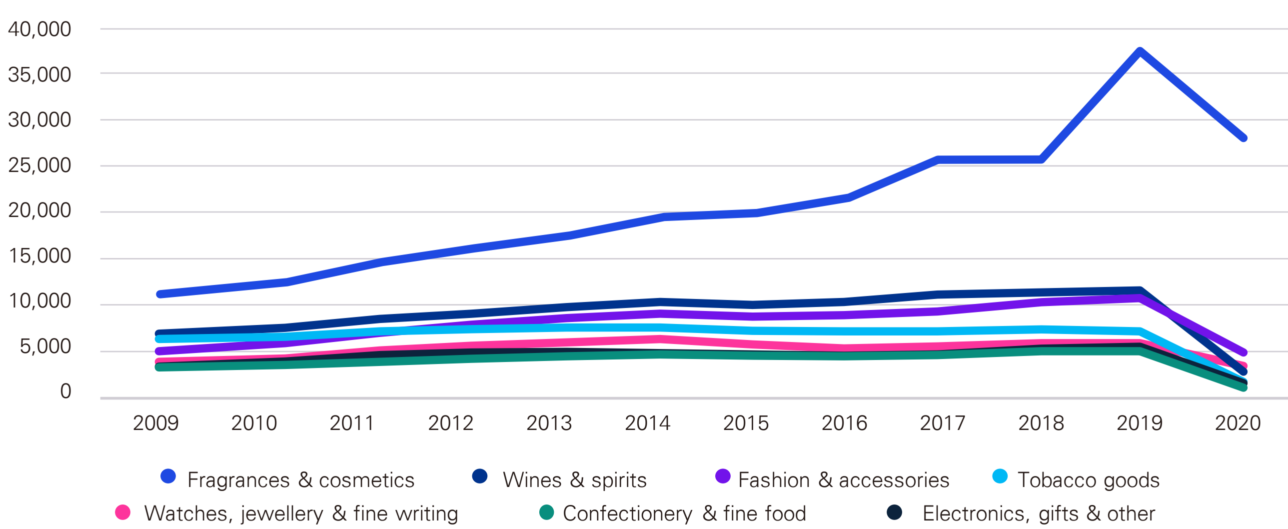
Source: Generation Research

Duty free & travel retail sales by sales channel 2009–2020 (in US$ millions)



Source: Generation Research

Duty free & travel retail sales by product category 2009–2020 (in US$ millions)



Source: Generation Research

Notable is the surge in market share for Asia Pacific in 2020 – up startlingly from 53.6 percent of worldwide sales in pre-pandemic 2019 to 71.3 percent in 2020, driven in large part by the Hainan offshore duty-free sector, memorably referred to as 'the lighthouse of travel retail'

Also note the sharp rise in category market share for cosmetics and perfumes, up from 43.7 percent to 60 percent – a direct reflection of the 'Hainan factor', where cosmetics generally and skincare specifically are a dominant category.

Also note the surge in sales by 'other shops' [principally downtown duty-free stores] compared with airport duty-free in 2020, with the former rising from 43.6 percent to 59.0 percent while the airport share fell from 50.9 percent to 37.6 percent. That startling change was driven principally by Hainan as well as the Korean downtown duty-free market (which became almost entirely daigou-driven sales into China).

While 2021 global figures are not yet available from Generation Research, the trends noted above continued as Hainan has flourished. The year generally saw modest recovery in line with improving passenger numbers but fell consistently well short of 2019 levels, especially in Asia Pacific where many markets were closed or heavily restricted. Many countries maintained either strict border closures or severe travel restrictions while the late 2021 emergence of the Omicron variant of COVID-19 slowed the passenger traffic significantly. In this context, Hainan again stood out with sales soaring 84 percent to US$9.47 billion.

In the first half of 2022, global duty-free recovery has been much more encouraging, though the Asia region has lagged behind the rest of the world with certain key markets such as South Korea, Thailand and Vietnam having only recently opened.

Nonetheless, with many global airports, airlines and travel retailers facing a variety of challenges, including the Ukraine/Russian conflict, supply chain management issues, staffing shortages, airports' inability to handle rising passenger numbers, the absence of high-spending Chinese shoppers, and a still highly active pandemic, 2022 duty-free sales worldwide will still fall well short of 2019 levels. Despite this, Hainan remains a beacon of light to the global industry.

Given that travelling Chinese shoppers have been driving the duty free industry's growth for the past two decades, their relative inactivity will continue to cost international duty free retailers dearly. However, if Chinese outbound travel restrictions are eased meaningfully in 2023, we anticipate a return to match or even exceed 2019 levels in 2024. This optimism must be tempered by caution given the fragile economic states of many countries, uncertainties over further COVID variants, the ongoing Russia/Ukraine situation and other challenges mentioned earlier.

China's position within a global marketplace

Given the severe restrictions on both inbound and outbound travel since the pandemic began, China's travel retail market has unsurprisingly not been immune to wider industry challenges.

But while both domestic and international travel (especially the latter) have been impacted by the pandemic, China has benefitted from some key strategic decisions.

Firstly, the country's 'dynamic zero Covid' policy has been successful in curbing infections and limiting deaths. While the fast-spreading Omicron variant has stretched resources and led to sporadic lockdowns and therefore travel curbs, China has been more successful in containing the virus and protecting its people as compared to many other nations.

That has meant that domestic travel in China, albeit with sporadic restrictions, has blossomed through much of the pandemic era – a stark contrast to the situation in many western nations. That has been a major factor behind China's major travel retailer's extraordinary rise to become the world's number one travel retailer by sales since 2020 [1] .

According to Frost & Sullivan, China's travel retail market only suffered a drop of CAGR of -5.8% during 2019 to 2021 (as compared to -32.6% for the world and -15.4% in Asia during the same period) and still reached RMB80.8 billion in 2021.

Using a similar approach of calendar year sales converted to Euros at a standard rate, the preliminary* top travel retailer 2021 rankings looks like this:

Preliminary Top 3 Travel Retailer rankings 2021 (By turnover, € million)

Source: The Moodie Davitt Report
Note: Figures translated from local currency to Euros at 31 December 2021 exchange rates.

*Full results will be published by The Moodie Davitt Report in late July

1. Source: The Moodie Davitt Report

The Hainan success story

Airport domestic terminal retailing in China has remained strong through much of the pandemic as China's consumers, unable to travel abroad, spent much time discovering or revisiting the delights of their own country. One of the most significant trends in global travel retail over recent times has been the way that luxury brands have embraced duty-paid retailing at Chinese airports, knowing that they are not only generating sizable sales but also benefiting from a superb 'shop window' to customers all across China.

But the real stand-out has been Hainan's offshore duty free sector, which rose by +127%[2] and +84%[3] respectively through 2020 and 2021 – in both cases from an all-time record high base.

Despite an Omicron-driven slowdown in H1 2022, the market has recovered in the second quarter as the country successfully contained regional COVID clusters. Hainan has been a prime beneficiary, as witnessed by surging visitor numbers (and spending) in June 2022 as the Chinese Mainland's COVID situation stabilised.

An enhanced duty free shopping policy introduced on July 1, 2020 has also had an impact. Under the policy, the annual offshore duty-free shopping allowance tripled to RMB100,000 while the number of categories was extended from 38 to 45 (including cell phones and alcohol, the latter with a 1.5 litre per trip allowance); the previous single purchase limit of RMB8,000 (USD1,250) was removed; and the limit on cosmetics SKUs (or stockkeeping units) was raised from 12 to 30. In our view, this policy decision ranks as one of the most far-sighted, consumer-friendly, business-supporting measures to date.

Hainan's enhanced offshore duty free shopping generated a whopping CNY90.6 billion (US$13.55 billion) in sales over a two-year period after the policy was introduced in July 2020. Some 125 million individual products were sold to around 12.28 million customers. The average daily shopping amount reached CNY124 million (US$18.5 million), an increase of +257% compared with the figure in 2019[4].

Moreover, since early 2020, a scheme has allowed visitors with proof of travel to Hainan to spend their remaining annual duty free allowance online up to 180 days following their trip. And in February 2021, the Ministry of Finance, General Administration of Customs, and State Administration of Taxation jointly announced that visitors to the island could have their goods posted back to the Mainland instead of hand carrying them. Similarly, Hainanese residents travelling to the Mainland can pick up their goods on return, instead of having to carry them on the journey.

Another key source of momentum came with the issuing of licences to several newcomers in 2020, resulting in a proliferation of retailers in Hainan's capital of Haikou in the north and the shopping heartland of Sanya in the south.

In 2022, two key stimulus packages have been introduced to boost consumer consumption and assist the island's duty free retailers. The successful inaugural scheme, entitled 'Helping Business, Benefiting People and Enjoying Hainan' saw CNY10 million (US$1.5 million) worth of digital RMB distributed on 1 May 2022. A similar programme was launched on 25 June 2022 by five banks with another CNY20 million (US$3 million) investment in digital RMB to encourage shopping[5].

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2 ''People's daily economic focus: duty free shopping, moderate competition', Hainan Provincial Department of tourism, culture, radio, television and sports official website , Jan 2021, http://lwt.hainan.gov.cn/ywdt/ywdt_55370/xccx/202102/t20210201_2927189.html

3 'In 2021, the sales volume of duty-free stores in Hainan outlying islands exceeded 60billion yuan, an increase of 84% year-on-year', Department of Commerce of Hainan Province, Jan 2022, http://dofcom.hainan.gov.cn/dofcom/1100/202201/d4d5418d7459455f9953f8f0218f8109.shtml

4 'The new tax exemption policy for Hainan outlying islands has been implemented for two years, with sales reaching 90.6 billion yuan', PRC Customs official website, July 2022, http://www.customs.gov.cn/haikou_customs/605732/605733/4449927/index.html

5 "Hainan grants 10million yuan of digital RMB benefits and opens tax-free shopping concessions on outlying islands", Haikou government official website, May 2022, http://www.haikou.gov.cn/zfdt/mrtt/202205/t909035.shtml

Government support for the travel retail sector is further reflected in the hosting of the second annual China International Consumer Products Expo on July 26-30. The Expo recognises that offshore duty-free is a key component of the overall plan of the construction of Hainan Free Trade Port and a project of key national importance that will see an island-wide Free Trade Port system focused on trade and investment liberalisation created in the Hainan FTP by 2025 (with full maturity by 2035).

This hugely ambitious event offers an important opportunity for international exhibitors and visitors to gain a deeper understanding of Hainan's Free Trade Port policy. Simultaneously, the Expo will create many business opportunities for Chinese and international companies, positively impacting the province's duty free industry.

It is worth remembering that Hainan's offshore duty free industry is still not a mature sector. In fact the first Hainan duty-free store (in downtown Sanya) opened just 11 years ago. In 2011 the resort location, best known for its pristine environment, balmy climate, soft sand beaches and tropical scenery, gained the status of an 'offshore duty free' island, opening a new channel of business that has flourished since.

Since then, the sector has become an 'industry within an industry' and is currently the number one duty free retail destination for leading international beauty brands in particular.

Hainan Island is an integral part of China's objective to promote tourism within the country and boost domestic consumption. As a market Hainan has its own rules and its own unique customer base (predominantly Chinese). Hainan offshore duty free plays a dual role for brands – it is a big volume and value channel in its own right but it also offers a valuable showcase to consumers across China.

As mentioned earlier, the island's duty free stores generated total sales (including tax paid) of CNY60.17 billion (US$9.47 billion) in 2021, an +84% increase year-on-year. The results include duty free sales of CNY50.49 billion (US$7.94 billion), up +83% year-on-year [6].

The downtown duty free business – the dominant part of the business – operates out of two key areas – Sanya to the south and Haikou (the capital) to the north of the island. Later in 2022, the Haikou International Duty Free Shopping Complex, including the world's biggest duty free store and a host of other attractions, will open [7].

Battle of the giants: Hainan vs South Korea

Hainan's burgeoning offshore duty free sector continues to narrow the gap with the world's largest duty free market, South Korea.

As mentioned earlier, Hainan offshore duty free stores generated sales of CNY60.17 billion (US$9.47 billion) in 2021, an +84% increase year-on-year. The results include duty free sales of CNY50.49 billion (US$7.94 billion), up +83% year-on-year, with the balance being accounted for by tax paid sales [8].

While the South Korean market rose +15% year-on-year in 2021 to KRW17.83 trillion (US$14.74 billion) [9], that result came from a low base in 2020 when sales plummeted -38% over pre-pandemic 2019 to US$13.2 billion [10] – just ahead of 2017 levels.

In 2021, the pandemic-ravaged Korean duty free channel was primarily by sales to foreign customers, who generated 95.4% [11] of total revenue (up from 94% [12] in 2020). Almost all of that activity was through reseller activity to China. While sales through that unofficial channel have risen, profitability has fallen due to excessive competition between retailers and soaring Daigou agent commission fees.

6. 'In 2021, the sales volume of duty-free stores in Hainan outlying islands exceeded 60billion yuan, an increase of 84% year-on-year', Department of Commerce of Hainan Province, Jan 2022, http://dofcom.hainan.gov.cn/dofcom/1100/202201/d4d5418d7459455f9953f8f0218f8109.shtml

7. 'Haikou international duty free city, the world's largest single duty-free tourism shopping center, opened this year', People.com, Jan 2022, http://hi.people.com.cn/n2/2022/0119/c338424-35103112.html

8. 'In 2021, the sales volume of duty-free stores in Hainan outlying islands exceeded RMB60billion, an increase of 84% year-on-year', Department of Commerce of Hainan Province, Jan 2022, http://dofcom.hainan.gov.cn/dofcom/1100/202201/d4d5418d7459455f9953f8f0218f8109.shtml

9,11. 'Korean duty free sales rise +15% in 2021 to KRW17.8 trillion (US$14.7 billion) : The Moodie Davitt Report', The Moodie Davitt Report, Jan 2022, https://www.moodiedavittreport.com/korean-duty-free-sales-rise-15-in-2021-to-krw17-8-trillion-us14-7-billion/

10,12 'South Korean duty free market falls -38% in 2020; downtown sales hold up due to daigou trade : The Moodie Davitt Report', The Moodie Davitt Report, Feb 2021, https://www.moodiedavittreport.com/south-korean-duty-free-market-falls-38-in-2020-downtown-sales-hold-up-due-to-daigou-trade/

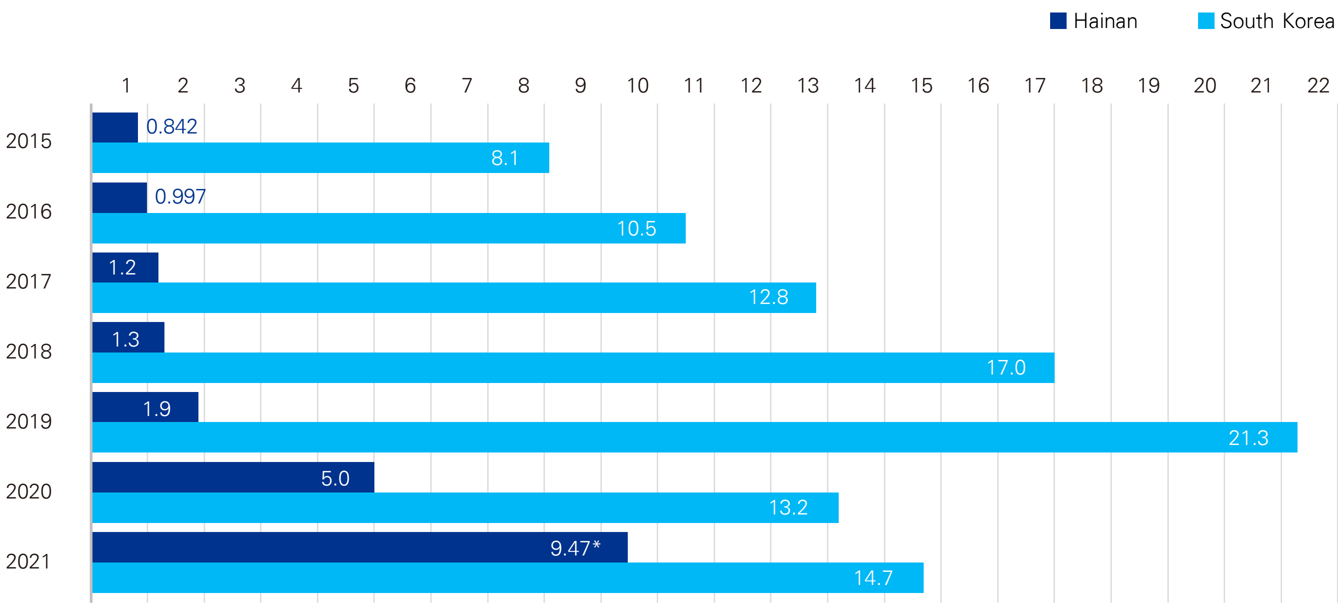
In short, Korea has largely become a Chinese market of sorts – a one-nationality dependence that has Korean travel retailers deeply concerned and seeking means to diversify. Although the country has now reopened for inbound and outbound traffic, the recovery is expected to be steady rather than meteoric. And fatefully, Chinese travel to South Korea is unlikely to kick start before 2023. An almost total reliance on a single customer base – no matter how lucrative – is always dangerous, a reality that has come back to haunt Korean duty free retailers.

For Hainan, there are no such problems. Supported by highly supportive national and regional government policies; growing retail professionalism among the sector newcomers; and with the leading Chinese travel retailers' extraordinary new Haikou International Duty Free Shopping City set to open in September, Hainan seems set to close the gap significantly with Korean duty free in 2022. The Moodie Davitt Report believes that Hainan is on course to become the world's biggest duty free market over the next five years.

The Hainan Provincial People's Congress recently set an ambitious Hainan CNY100 billion (US$15.8 billion) sales target for its duty free stores in 2022, a +66.2% increase on 2021. While momentum slowed somewhat this year due to the recent COVID outbreaks on the Mainland which depressed visitor numbers to Hainan, causing several store closures, 2022 is likely to see a further improvement in the relativity of Hainan's duty free sector to its Korean counterpart.

This chart shows how the gap between Hainan's booming offshore duty free industry and its Korean equivalent – the world's largest duty free market – has narrowed dramatically during the pandemic.

Hainan offshore duty free sales v South Korea duty free sales 2015-2021 (in US$ billions)



Source: The Moodie Davitt Report

Notes: *Includes US$1.53 billion tax/duty paid

To the future: Opportunities and challenges

A key question and one asked constantly by analysts is when will Chinese nationals be able to travel freely again to international destinations, and what will happen to Hainan when they do.

The short answer is that whatever happens to outbound travel, Hainan's offshore duty free sector is here to stay. This is due in part to well-placed promotion of tourism, business and investment by Hainan Provincial Bureau of International Economic Development (Hainan IEDB), complemented by Hainan Hinews Media Co. via its New Hainan app, and Hinews.cn's duty free TV channel.

We expect further preferential and supportive policies to boost the island's duty free industry. Importantly, too, heavy investment in tourism infrastructure on the island is happening at pace. Far-sighted retailers' realisation that duty free cannot exist in isolation will ensure that offshore duty free continues to flourish. They are developing integrated travel retail complexes (Sanya International Duty Free Shopping Complex and Haikou International Duty Free City) that offer an attractive retail format and brand portfolio based on a 'culture + business + tourism' formula.

Amid these proactive investments, challenges remain. These can be described as follows:

- **Excessive discounting:** Always a temptation in a highly competitive market, but it simply creates a 'race to the bottom' which benefits no-one as service and merchandising standards always suffer in such a context. It also distorts the market in the long-term.
- **Differentiation:** Retailers must move away from offering the same products differentiated only by the level of discounts on offer. More exclusive products, more Chinese brands and a focus on emerging consumer trends such as interest in sportswear and sports equipment, pet-related goods, children's products and health and wellness items, will all boost sales and distinguish retailers from one another. One of the best ways to compete with online rivals is to offer something that by definition they cannot – "duty free exclusives".
- **Digital excellence:** Continue to marry the best of digital with the best of physical. Online versus Offline? No. Online + Offline. Duty free stores have a vital advantage over ecommerce rivals. They are advantages of the senses. Consumers can touch, smell, taste, and try on in a duty free store. They can talk to a human being. But consumers also need to be able to embrace the power of digital to communicate with retailers before they travel, while they are travelling (and in the stores), after they travel. In this respect, China is leading the world in the way it has embraced the digital world in duty free. For example, livestreaming has been a huge success, allowing brand launches and campaigns to reach vast audiences beyond the confines of the physical event, store or boutique.
- **Human resources:** A big challenge. Improved staff training is key to selling premium products. Many of the world's great brands are sold in Hainan duty free stores, and they are not only extremely protective about brand image, but to sell them successfully product knowledge and service expertise is a must. Staff training has been integral to the success of the world's top travel retailers.
- **Design and merchandising:** China can and should lead the world in the quality of its shops – at airports or downtown. There is no short-cut in good design. It is encouraging to see the quality of design and execution in the second and third phase store developments in Hainan.
- **Corporate social responsibility:** The duty free industry must give back to the community and not simply profit from it. In too many countries around the world (China is a notable exception), duty free is seen as a profiteering industry that doesn't contribute to society.
- **Sense of Place:** Hainan is one of the world's most remarkable tourist destinations, packed with natural and man-made wonders. Each retailer should foster a 'sense of place' and champion not only international brands but Chinese ones in general and Hainanese products too – international shopping with Chinese characteristics. China has a long and proud culture, great and unique craftsmanship. It is the responsibility of Chinese retailers to champion such traditions and artisanship.

Brief summary of this session

In 2010 China’s State Council declared its intentions for Hainan to become a “world-class island for leisure travel and vacation tours”. At the time, it said that by 2020 tourism service facilities, management and service quality would be fully in line with world standards.

In the intervening years, Hainan has taken giant strides along that journey. The province’s duty free industry has been the central pivot around which everything else has centred. It has become admired worldwide by the world’s biggest brands and the envy of many other countries.

Chinese President Xi Jinping has described international tourism as an important “business card” for the Hainan Free Trade Port. That business card has been shown to millions of Chinese visitors and many international tourists and businessmen since the first store opened in Sanya in 2011. Few could have imagined back then that Hainan would become such a remarkable success story and a role model in terms of government-private sector cooperation. The road ahead may have some unexpected twists and turns but the island’s resounding success is expected to continue.

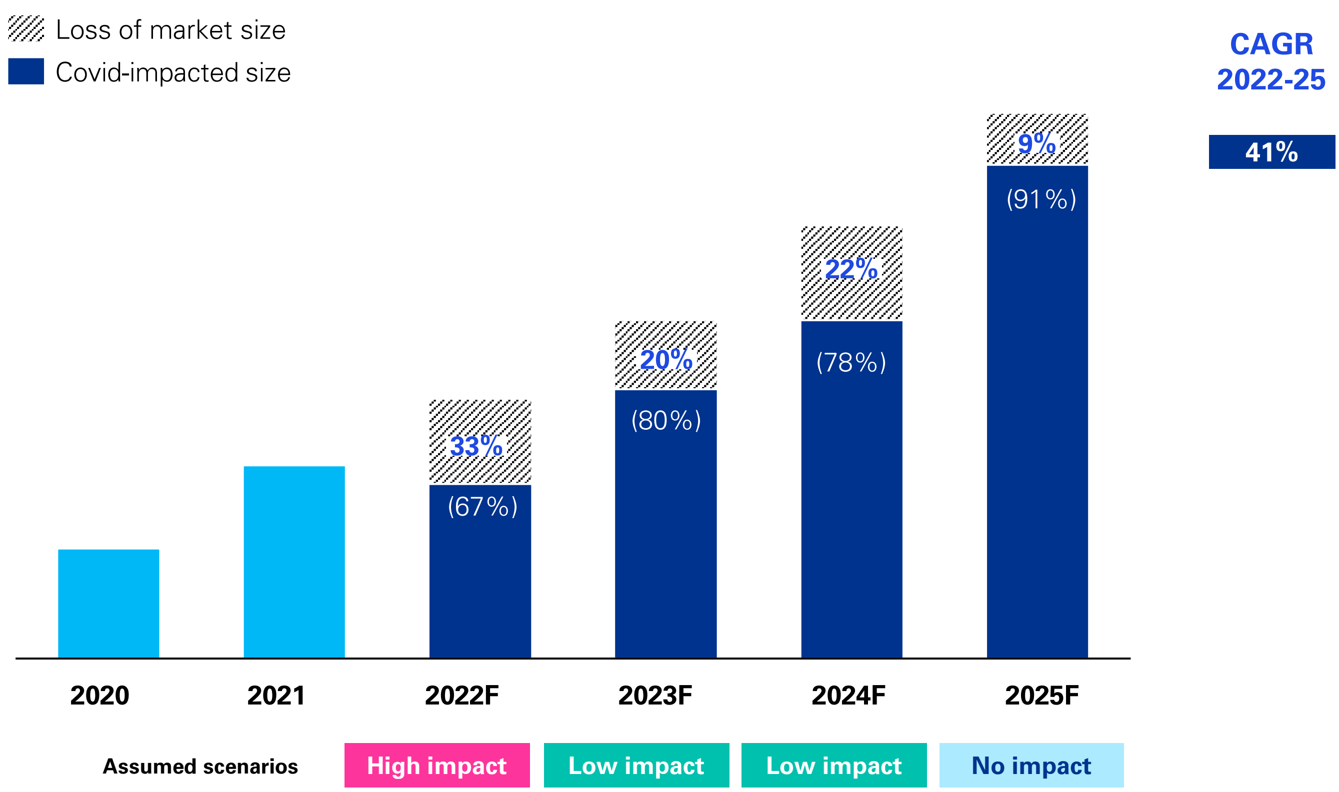
Dynamic Investment Destination, for brands

Hainan remains a go-to destination for Duty Free, with brands expanding their penetration and evolving their offerings

At the time of writing China is currently battling with the most recent wave of Covid outbreak with many major cities affected, resulting for the first time in a closure of some stores in Hainan. This is of course presenting an immediate challenge to 2022 sales forecasts as travel has been restricted for several months with visitor numbers sharply dropping. Based on this we believe the end of 2022 will see a slight drop in total duty-free sales made compared to 2021 due to this impacted couple of months.

However, the recent announcements made by the Hainan authorities of the stimulus they will bring to the market in the forms of shopping events, conferences and financial stimulus should give us confidence that this may be even higher if it delivers the desired impact.

KPMG forecasted Hainan duty free market under Covid impact
(%, 2020-2025F)



This is based in affected visitor numbers and spending power caused by the pandemic

	High impact (2022F)	Low impact (2023F)
Visitors* (mn #)	Discount rate: 28% 72% · 28% · **100%**	Discount rate: 14% 86% · 14% · **100%**
Average spending (CNY)	Discount rate: 6% 94% · 6% · **100%**	Discount rate: 8% 92% · 8% · **100%**
Overall impact (CNY bn)	Discount rate: 33% 67% · 33% · **100%**	Discount rate: 20% 80% · 20% · **100%**

Note: * Per HN authority visitor definition, 2025 includes total DF spend assuming market seal off
Source: Expert interview, government and tourism authorities statistics, duty free operators data, industry reports, Euromonitor, KPMG analysis

Our long term outlook for the market remains very positive, as Hainan continues its evolution as a world leader in duty free sales aimed at Chinese consumers. We have seen in the last year the announcement of a number of other 'duty free' areas being established in China looking to position themselves as potential options for customer and brands. These areas do have their merits but we see Hainan maintaining its own competitive advantage due to its natural resources (sun, sea and leisure), fast-growing retail industry and forward looking vision. [13.]

1 Consumer behavior	▪ For many consumers, duty free is now in the top 3 channel for purchase of luxury goods ▪ In a recent KPMG survey, Hainan selected as often as HK as a priority travel destination when borders reopen, with shopping number one reason after leisure & sightseeing
2 Retail env.	▪ Duty-free operator(referred as DFOs) retail space to reach 500k+ sqm by 2024 ▪ Additional 500k sqm in retail space to be added in 2022 by non DFO developers ▪ POS touchpoints to become much more varied then existing DFO focused points ▪ 60 five stars hotels expected in next 5-10 years
3 Further brand proliferation	▪ Number of SKUs held by each of the DFOs expected to grow by 3X in coming 3-4 years ▪ Perfume and cosmetics brands in Hainan have increased by 2.6x from 2020 ▪ Famous Retailers gradually opened their first stores in Hainan while other DFOs relatively new to Hainan will go to market with a mixed duty paid and duty free model
4 Tax and policy development	▪ 15% Corporate Income Tax rate for eligible entities ▪ Individual Income Tax to be capped at 15%, much lower then potential 45% in other mainland China, which will attract more talent to work in Hainan ▪ All goods will be exempted from import duty starting from seal off except those on the negative list. ▪ Streamlines indirect tax into 'Sales Tax' starting from seal off: B2B business may not be subject to sales tax, and a lower tax rate will be imposed on B2C business
5 Island seal off	▪ Island seal off will create more varied opportunities for brands to sell into the market ▪ DFOs advantage still driven by established traffic ▪ The overall pie will get greater for all with customers the ultimate beneficiary

Source: Expert interview, government and tourism authorities statistics, duty free operators data, industry reports, Euromonitor, KPMG analysis

13.Industry Securities – Analysis on Hainan Duty Free Operators Landscape, KPMG analysis

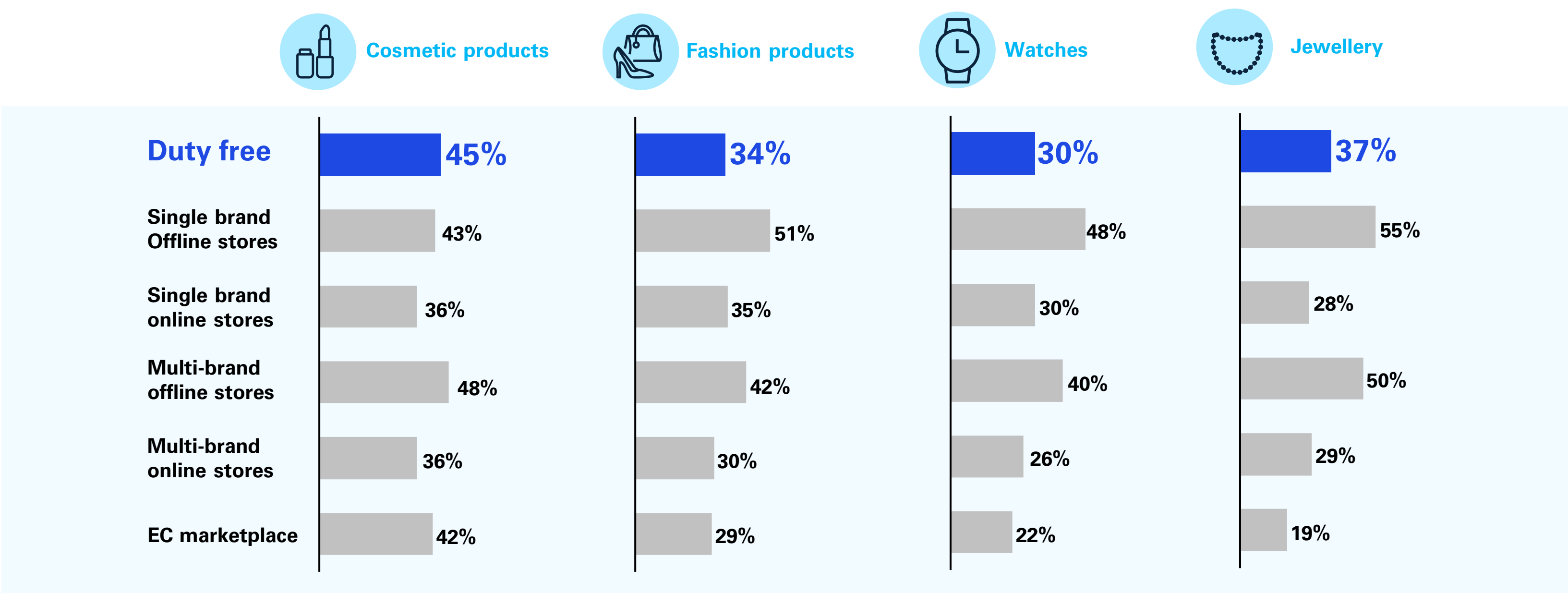
Hainan remains a go-to destination for Duty Free, with brands expanding their penetration and evolving their offerings

The duty free channel should be considered an integral part of the total go-to-market strategy for brands in China (with a slightly less level of importance for mid-premium segments). This overall rising importance is being driven by a wider push for value from the Chinese consumer, but also as a recognition that unique brands and SKUs can be found in the channel with Hainan responsible for 80% of the total mainland market[14].

This is being directly reflected in the numbers of visitor growth and consumer growth in Hainan from 2020 to 2021:

- Visitor numbers in 2021 grew by 25.5%
- Actual duty free customer number grew by 50%
- Average spend grew by 20% to CNY 7,368 per person[15,16].

Purchase channels used for luxury shopping in China in the past two years
(%, 2021)



Note: (1) Survey sample size: n=607 (cosmetics), n=960 (fashion), n=472 (watches), n=545 (jewelries)
Source: Global Consumer Survey 2021, www.statista.com/global-consumer-survey

14.The Economist Intelligence Unit (EIU), KPMG analysis

15.'2021 Dec tourism statics", Hainan Provincial Department of tourism, culture, radio, television and sports official website , Jan 2021, http://lwt.hainan.gov.cn/xxgk_55333/lytj/2021data/202201/t20220114_3129299.html

16. 'Duty free shopping in Hainan outlying islands in 2021, 49.5 billion yuan', The State Council of the People's Republic of China official website, Jan 2022, http://www.gov.cn/xinwen/2022-01/12/content_5667818.htm

One of the biggest questions asked by brands is what will happen when China's borders reopen. From our perspective we are seeing more and more signs that the Chinese consumers view Hainan as a key travel destination. In a recent KPMG survey, we asked a number of consumers where their preferred destination after borders re-open, with Hainan third only to Tokyo and Paris. This proves the quite amazing development that has happened in Hainan in the past few years that it is now considered an equal of Hong Kong and Singapore and ahead of London and New York in the eyes of Chinese travellers.

Preferred travel destination after borders reopen	All respondents	Gen-Z only
Tokyo	45%	39%
Paris	37%	36%
Singapore	29%	22%
Hainan	28%	34%
Hong Kong SAR, China	28%	34%

Given this information, it is crucial for brands in China to understand how this evolving customer behavior plays into their overall customer journey. Previously, Hainan was very much its own sales channel, but with this evolution, brands will need to directly integrate Hainan into their overall China sales channel strategy directly involving their local market teams.

Brands are proactively investing in Hainan, realising it needs to be a key part of their overall China strategy in its next evolution

Given the relatively recent explosion of growth in Hainan, it is obvious that brand penetration is not yet as strong as in some established markets. However, each of the Duty-Free Operators(refer to 'DFOs' as below) are now rapidly expanding their portfolio while more and more brands are being attracted to the market as it matures. This is resulting in a compounding effect that is ultimately benefiting the end consumer as their choice and availability of their favoured brands increases. As of mid-2021, over 700 brands were now being sold across all categories and we expect this to grow by 30 percent in the coming year as more retail space becomes available[17].

Increasing diversity of brands brings with it a natural increase in the products on offer. While Hainan is still dominated by the P&C category (approximately 58 percent of the market) [18] , this is changing as new categories such as wine and spirits as well as consumer electronics have expanded. Fashion, watches and jewellery make up most of the remaining market, and while there has been a hesitance from some luxury fashion brands to enter the market, we are seeing growing interest and openings in the mid-to-premium range. We expect this growing interest to continue in the coming year, especially if the pandemic situation leads to a build-up of stock in the mainland market among various retailers.

As Hainan evolves as a retail destination, there is clearly a high demand for luxury brands to be part of it. Whether this occurs within the existing DFOs or with other operators remains to be seen, but in our mind there is no doubt that brands will use the seal off as the opportunity to take control of their points of sale, brand image and pricing while also further reaching their clientele. This again will bring new jewels to Hainan's crown.

With these categories added, the coverage of shopper profiles and age groups will also expand beyond only beauty-driven target consumers – transforming Hainan into an all-round shopping destination and likely contributing to growth in overall visitors and conversion rates. To this point, the total number of individual products purchased in Hainan grew by 100% from 2020 to 2021 to 70.45 million individual items. [19]

Customers have also benefitted from ongoing development of policies to ensure the quality of goods in Hainan is maintained. By taking measures to include traceability of goods sold in Hainan as well as supporting the implementation of coming CSAR regulations, the Hainan authorities are building a strong consumer trust in Hainan among Chinese consumers as a place to purchase authentic products from international brands at reasonable retail prices. With the option to purchase from official channels being much more accessible, consumers are less likely to go for cheaper options via third party sellers or unofficial channels e.g. Daigou. This also allows brands to benefit from having greater control over prices and quality across China.

17,18. KPMG analysis

19. 'In 2021, the growth rate of total retail sales of social consumer goods in Hainan ranked first in China' ,Hainan government official website, Jan 2022, https://www.hainan.gov.cn/hainan/5309/202201/0b1b061b8b33470781ab5560298fa7ca.shtml

Tax incentives and favourable policies will attract more brands to start carrying out a Hainan long-term strategy

Before 2025 (or once the island is sealed off, whichever earlier), Hainan tax incentives listed below will allow brands to enjoy lower corporate tax costs, and a greater ability to attract talents to wor in Hainan:

- **Duty:** Duty free for selected goods, including production equipment, transportation vehicles and raw materials for production. Regional Comprehensive Economic Partnership (RCEP) impact brought to Hainan
- **VAT and Consumption Tax:** Same treatment as regular.
- **Corporate Income Tax (CIT):** Enterprises in encouraged industries registered in the Hainan FTP with business substance are entitled to CIT at a reduced tax rate of 15%. Business substance is the key factor to the incentive entitlement.
- **Individual Income Tax (IIT):** For high-end talents or demanded talents working in the Hainan FTP with certain conditions met, their actual IIT effective tax rate will be capped at 15%. Business substance is also the key factor to the incentive entitlement.

In addition, policies to encourage foreign investment, introduce talent, visa-free entry for tourism, the continuous optimisation of government services, and improvement to the legal environment are also in full swing in Hainan FTP, enhancing the overall infrastructure of Hainan FTP.

In order to seize the above benefits, it is necessary for brands to set up relevant business entities and begin carrying out their Hainan long-term strategy.

The retail environment in Hainan is evolving to reach the maturity of leading global travel destinations

While demand is increasing, it can only be satisfied if there is a sufficient retail environment to support it. This is where we will see huge further growth in coming years by DFOs, with the total accumulated DFO retail size expected to grow from ~260k sqm to ~700k sqm by 2026. This will ensure DFOs can sufficiently respond to rising consumer demand and further cement their control over key points of sale and customer traffic, growing their competitive advantages on the island.

An additional 550,000 sqm of non-DF retail space is also expected to be built in 2022 by retail and construction groups as they identify and realise the market potential in the island in anticipation of the coming seal off in 2025. Sanya currently leads as the major tourism hub and preferred location for leisure visitors but Haikou will catch up in 2022 with total growth in retail size surpassing Sanya.

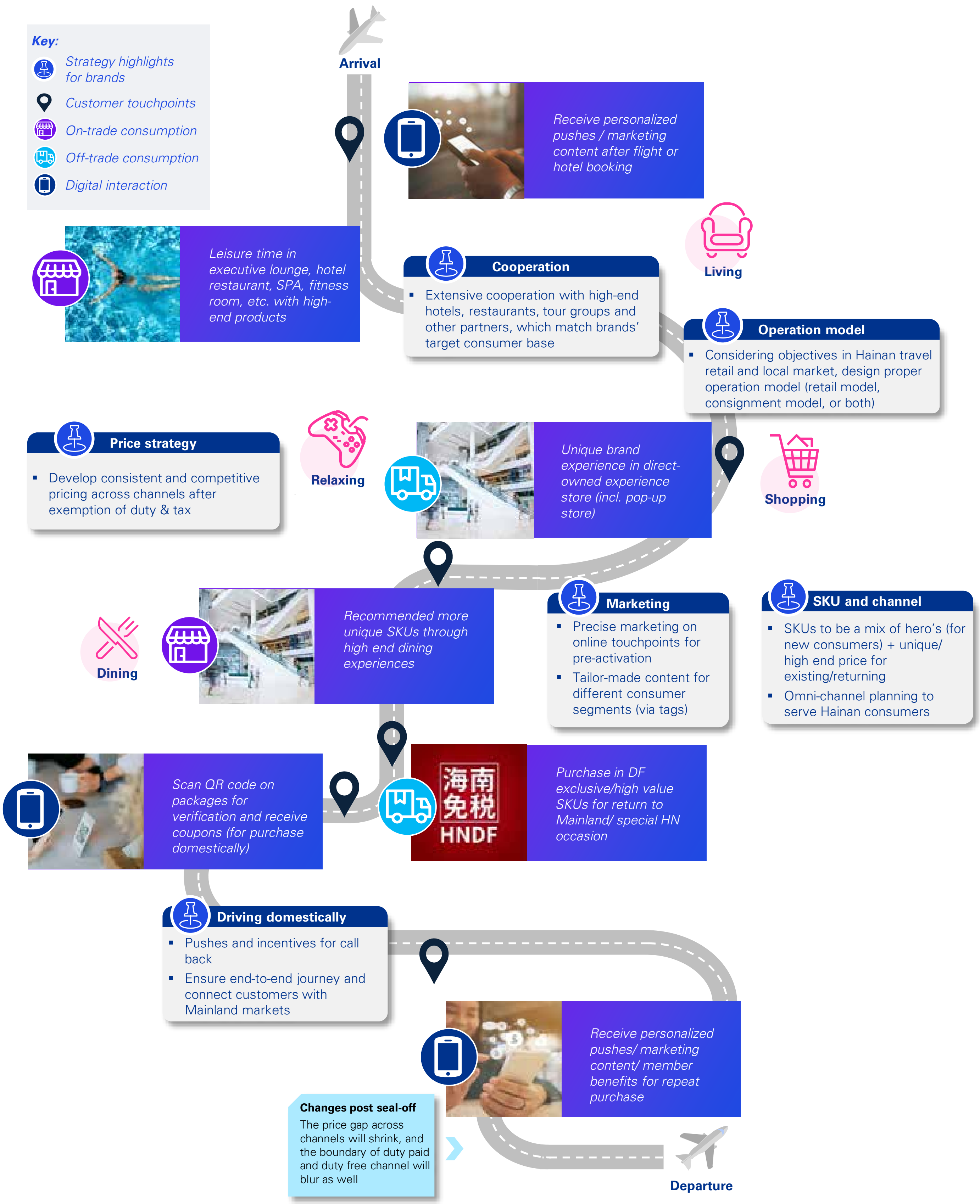
As a mechanism to counter the pandemic-impacted sales and to prepare for the planned island seal off, DFOs are pursuing innovative retail models – including DF replenishment online service and Cross-Border Electronic Commerce (CBEC) / mini programmes. These incredibly unique sales channels encourage the repatriation of consumption in mainland China. Prices are typically 5-10% higher than in Hainan to cover additional costs but still significantly lower than the rest of mainland China. Recent COVID restrictions have seen more open alternative duty-paid channels opening up.

As online sales channels evolve, we believe that they will go beyond being an area dominated DFOs. There will also be strong opportunities for brands

- Existing brands will be able to maximise sales and offer wider SKU assortments without the limitations from inventory and delivery costs
- New brands can leverage of CBEC channels to build sales quickly

What is most interesting for brands to consider in this respect is the overlap created in where local market and travel retail business typically operate. To be successful, going forward brands operating in Hainan will need to have a holistic view of their customers to be able to serve them consistently and not be hindered by different KPIs from different teams.

20. KPMG analysis


Key:
Strategy highlights for brands
Customer touchpoints
On-trade consumption
Off-trade consumption
Digital interaction
Arrival
Receive personalized pushes / marketing content after flight or hotel booking
Leisure time in executive lounge, hotel restaurant, SPA, fitness room, etc. with high-end products
Cooperation
Extensive cooperation with high-end hotels, restaurants, tour groups and other partners, which match brands' target consumer base
Living
Operation model
Considering objectives in Hainan travel retail and local market, design proper operation model (retail model, consignment model, or both)
Price strategy
Develop consistent and competitive pricing across channels after exemption of duty & tax
Relaxing
Unique brand experience in direct-owned experience store (incl. pop-up store)
Shopping
Dining
Recommended more unique SKUs through high end dining experiences
Marketing
Precise marketing on online touchpoints for pre-activation
Tailor-made content for different consumer segments (via tags)
SKU and channel
SKUs to be a mix of hero's (for new consumers) + unique/ high end price for existing/returning
Omni-channel planning to serve Hainan consumers
Scan QR code on packages for verification and receive coupons (for purchase domestically)
海南免税
HNDF
Purchase in DF exclusive/high value SKUs for return to Mainland/ special HN occasion
Driving domestically
Pushes and incentives for call back
Ensure end-to-end journey and connect customers with Mainland markets
Receive personalized pushes/ marketing content/ member benefits for repeat purchase
Changes post seal-off
The price gap across channels will shrink, and the boundary of duty paid and duty free channel will blur as well
Departure

The influence of regional Comprehensive Economic Partnership agreement on Hainan tourism retail industry

On January 1, 2022, the Regional Comprehensive Economic Partnership (RCEP) agreements came into force in China, Japan, New Zealand, Australia, Brunei, Cambodia, Laos, Singapore, Thailand and Vietnam, followed by The Republic of Korea on February 1, marking the official launch of the world's most populous, largest economic and trade-rich and most promising free trade agreement.

1. The RCEP Snapshot

RCEP benchmarks towards international high standards and forms a set of more open, free and transparent rules in the region, covering trading of goods, services and investment. Among them, the commitment to open up trade in services covers most of the service sectors, which is significantly higher than the current level of existing free trade agreements between the parties and ASEAN. In terms of trade in goods, more than 90% of the goods in the region will eventually realize zero tariffs, which can significantly reduce the cost of trade in goods and commodity prices in the region, so that the RCEP free trade zone is expected to fulfil the commitment of trade liberalization in goods in a relatively short period of time, thus becoming an important platform for building a new development pattern and bringing tangible benefits to RCEP members.

Compared with the prior free trade agreements signed by China, RCEP has obvious advantages in terms of the regional cumulative rules of origin and the flexible and relaxed origin standards, making it more possible for import and export enterprises of various countries to take actual advantage of preferential policies. Through RCEP, China has established free trade relations with Japan for the first time, which was also the first time that China signed a free trade agreement with the world's top ten economies, marking a major breakthrough in the implementation of China's free trade strategy, and has created a more favorable development platform for import and export trade.

2. RCEP and Hainan Free Trade Port

Since China first proposed the concept of Hainan Free Trade Port in 2018, Hainan has entered the fast lane of development, with offshore duty-free sales of nearly 60 billion yuan in 2021, and the investment in manufacturing industry has also achieved continuous substantial growth. In this critical period, the launch of RCEP is able to cultivate more unique development drivers and opportunities for Hainan.

(1) The synergistic development between RCEP and Hainan Free Trade Port

In 2021, Hainan's total import and export trade with 14 RCEP members reached 58 billion yuan, accounting for about 40% of Hainan's total foreign trade value. Hainan Island is located at the forefront of Southeast Asia, Australia and New Zealand direction, occupying the core fortress of the RCEP market, closely connecting China's 1.4 billion population consumption market with the ASEAN 600 million population market, bringing huge demographic dividends and opportunities to the manufacturing and consumer goods industries. At the same time, this geographical advantage is also expected to make Hainan a regional hub for air and shipping transport, and a transit station connecting China, Japan and South Korea with Southeast Asia, Australia and New Zealand.

With the blessing halo of Hainan Free Trade Port policy, the launch of RCEP is expected to further drive the convergence and rapid growth of regional people, logistics, capital and information flows in Hainan. RCEP's tax reduction arrangement will greatly enrich and expand the range of zero-tariff products in the free trade port in the short term, especially before Hainan seal-off.

In the long run, the effective combination of RCEP and Hainan Free Trade Port policy will provide more favorable and stable supply chain support for local industries in Hainan, form a diversified supply chain system, and effectively realize the expansion, transformation and upgrading of the local industrial chain.

(2) New opportunities for Hainan's travel retail industry

RCEP will have pricing advantage towards some travel retail bestsellers

The RCEP agreement aims to establish a unified market free trade agreement by reducing tariffs and non-tariff barriers, reducing the tariff cost of ordinary imported goods, which will provide room for price reduction for goods, and may have pricing advantage towards similar goods in travel retail channel. Tariffs are prescribed based on origin of the goods. Among the top three categories in Hainan duty-free sales, the main products affected by RCEP are cosmetics originating in Japan, South Korea, Australia and ASEAN countries. According to China's tariff commitment table to South Korea, from February 1 2022, China's tariffs on facial cleanser, soap (except laundry soap), toothpaste, mouthwash imported from South Korea will be reduced by 1%-1.5%, and will be cleared in the next decade (2031); According to China's Tariff Commitment Table for Australia, tariffs on perfume imports originating in Australia and ASEAN member countries to China are reduced from 10% to 3%, lip and eye cosmetics from 10% to 5%, and shampoos from 6.5% to 3%.

Most of the luxury goods such as watches and jewellery, which rank second and third in Hainan duty-free sales, are mainly from Europe and the United States that are not covered by the RCEP agreement. It is worth noting that the retail price of duty-free goods is not only affected by the tax rate adjustment, but also benefits from the brand's direct procurement model, eliminating layers of distribution markups, and is also affected by the comprehensive impact of brand positioning, market competition and retailer strategy. While the RCEP will have pricing advantage towards travel retail duty-free products, it will on the other hand promote Hainan's duty-free industry to further reduce costs and improve efficiency by upgrading its operating model, optimizing supply chain arrangements, and adjusting competitive strategies and retail management.

RCEP will promote competition, transformation and upgrading of the duty-free industry in Hainan

At present, there are 5 Hainan offshore island duty-free licenses granted, and 10 offshore duty-free shops are in operation in Hainan. After the successful launch of RCEP, the 15 member countries will undoubtedly take greater steps in reducing tariff barriers, and over 95% HS codes have chances to be covered in the zero tariffs list in the future, which will further promote the further shift of extraterritorial trade to inter-regional trade. A new round of domestic duty-free business competition will be triggered. At present, there is no precedent in China for foreign capital or Sino-foreign joint ventures to hold state-owned duty-free retail license, but it is observed that domestic and foreign entities have actively entered the duty-free market through new models via e-commerce platforms and cross-border cooperation.

With the achievement of RCEP and the recovery of domestic travel consumption, the competition in Hainan's travel retail industry will become more diversified, and gradually show a trend of "blossoming everywhere".

RCEP's encouragement of e-commerce will further promote the development of travel retail industry in Hainan

The RCEP agreement encourages the development of e-commerce, including paperless trade, electronic authentication and electronic signatures, protection of online consumer rights, electronic customs clearance, tariff-free, free flow of data, etc. With the implementation of the RCEP, the entire cross-border trade, including customs clearance, warehousing, logistic and trading, will become more transparent and efficient, and the cost will be greatly reduced, which will bring price advantages and a convenient development environment for cross-border e-commerce.

Since the outbreak of COVID-19 pandemic, the travel retail market in Hainan has burst with great potential, resilience and flexibility. In the future, RCEP domestic travel retail business may take cross-border e-commerce as the entering point, strengthening cooperation in the fields of travel retail market with OMNI channel through digitalization empowerment, promote the regional capability of industrial chain, provide consumers with high-quality and lower-price products and services, and greatly enrich consumer market choices.

Dynamic Seal-off Setting toward 2025

The island seal-off will be the biggest driver of change, driving Hainan towards its future as a leading retail destination

By far the biggest change in the market situation will be that caused by the island seal off targeted for 2025. As has been clear from the Hainan authorities, the intention is for this to be an enabler of greater growth and development of the retail environment in Hainan so that the existing duty free operators, brands, residents, and visitors can all benefit. There are different scenarios that could be used by the authorities in how they may wish to implement it, and the most important decision will be whether the DFOs and brands will have the same taxation policies applied to them or if there will be an advantage one way or another.

For brands, this would create the opportunity to operate direct owned or consignment style stores at prices much closer to the DFOs (the main distinguishing factor as to why they are not able to effectively do this today). This will appeal to those luxury and premium brands, and those that want to get greater control over their end customers and management of their brands in the market.

Brands will need to further consider whether their operations will become a travel retail managed business or a local market managed business, as the traditional categories of duty paid and duty free will no longer exist.

01 DFOs maintain channel benefit i.e. everything stays the same

02 DFOs are given a benefit through tax rates

03 No difference in principle between DFOs and brands i.e. brands can sell in same channels at same effective tax rates (the same benefit)

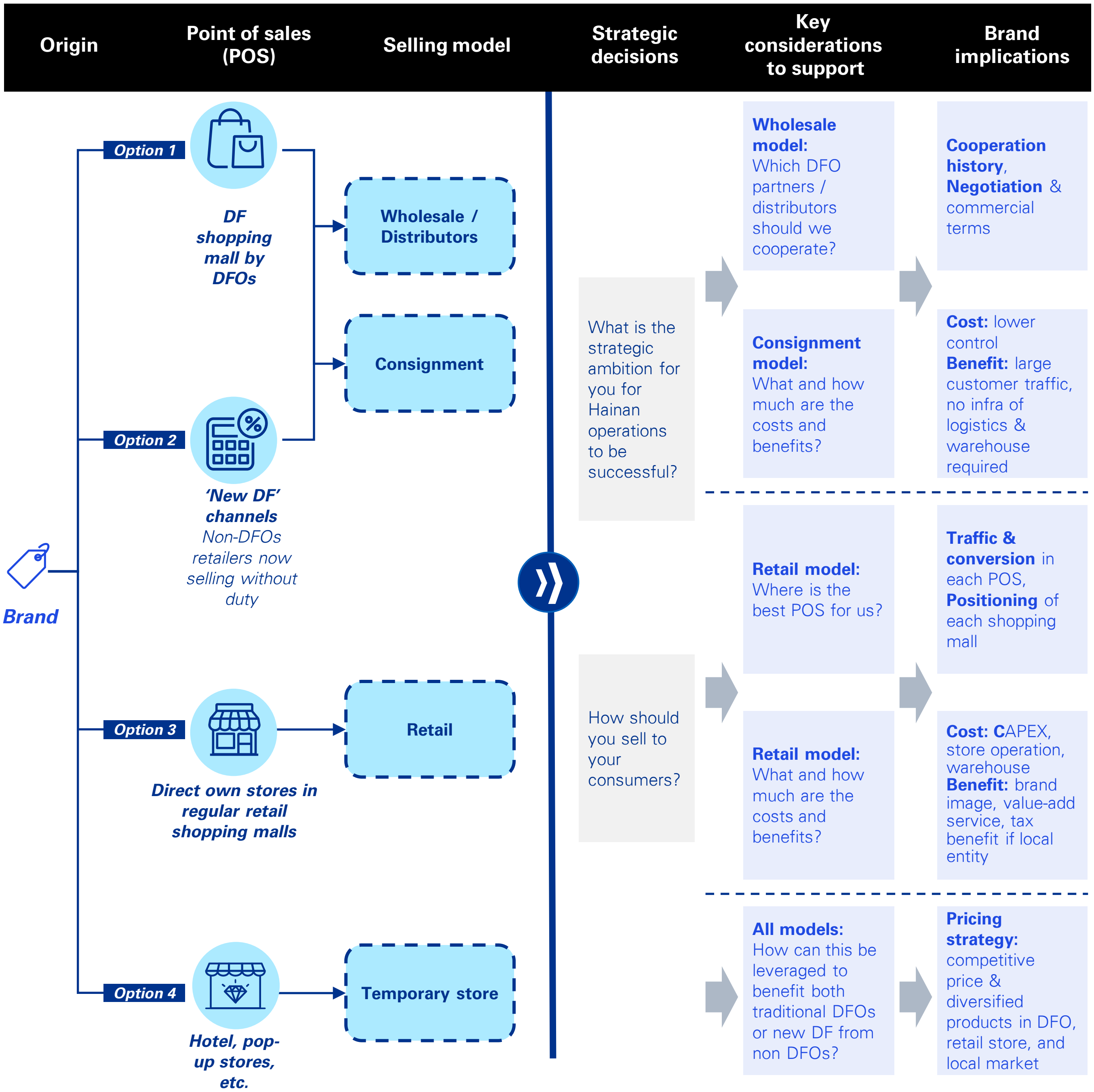
Source: KPMG Hypothesis

Scenarios 2 and 3 may create the biggest impact on the relationship between the DFOs and brands and offer the greatest opportunity to other retailers to contribute towards the growth of Hainan. This in turn would mean that how each of these stakeholders should approach the market will completely change.

This will likely be the most difficult question to face internally, however we have already seen the most strategic brands beginning to see how they can benefit from Hainan as an overall platform which is not limited to being run by one unit or another.

For DFOs the key question is how they can position themselves. Will they remain in what is mostly a wholesale style relationship with their brands, or will they seek alternate models to attract specific brands and in turn drive greater traffic into their locations? Further, are their set-ups agile enough to work with these different models, and if not, what will they need to achieve this agility?

All of this needs to be considered against the backdrop of the general investment going into Hainan from other retailers and developers who now may offer alternate points of sale to traditional DFOs. This investment will bring greater overall benefit to the market and will offer more choice to brands and customers alike in their retail experience in Hainan.



Source: KPMG Hypothesis

2025 island seal-off will further reduce the overall tax burden significantly, and promote the construction of a high-level free trade port, which will benefit brands over the long term

After the island seal-off, brands can benefit from tax incentives, giving them bigger margin and more control on pricing, improving the overall tax efficiency and attracting more talents.

While the specifics of new tax policies that would be put into place are not yet finalised, the below are some examples of policies that could be put in place to support the seal off:

- **Duty:** Duty free for all imported goods excepted those on the Negative List
- **Sales Tax:** VAT and Consumption Tax to be simplified and streamlined into Sales Tax. According to the top-level design concept of Sales tax, it would be levied in the final B2C stage, meaning the prior B2B flows free of turnover tax. This could be a landmark driver of wholesale and retail business for those entering Hainan.
- **CIT:** Enterprises registered in the Hainan FTP (except for industries listed on the Negative List) with substantial operations would be entitled to a reduced tax rate of 15 percent.
- **IIT:**IIT would be levied at 3%, 10% and 15% rates for all individuals staying in Hainan for 183 days or more per year.

Detail rules of the above tax landscape will become clearer with the policy specifics to be released in due course.

Meanwhile, the Hainan government is currently optimising and improving policies related to trade, investment, cross-border capital flows, transportation, and data, with the aim to construct an effective free trade port.

In view of above, it is very necessary for brands to set up relevant business entities to capitalise on the above opportunities, and benefit from Hainan's evolution over the long term.

Dynamic ESG Showcase

Value journey for ESG with harmonious coexistence

The State Council released the Guiding Opinions on *Accelerating the Establishment and Improvement of a Green and Low-Carbon Circular Development Economic System* in February 2021. In this document, the government outlined clear objectives for the development of a green and low-carbon development production system in 2025 and 2035, aiming to achieve full-cycle green environmental protection from product design, material selection, procurement, and manufacturing,.etc

Consumers are increasingly expecting companies to adopt more sustainable business practices and take steps to outline the environmental, social, and governance (ESG) impacts due to the long supply chain in the consumer goods sector, the pandemic that is accelerating the shift in consumer spending patterns to online, the massive waste generation in the e-commerce sector, and the global threat of climate change. ESG is being actively incorporated by many companies into their business strategy, products, and value. Enterprise ESG supply chain management necessitates collaboration between multiple departments (such as finance, legal, risk management, and procurement,. etc).

The Strategy of Supply Chain Sustainable Development ----- Environmental Protection

Vision	Primary concern	Subdivision Goal	Facts/data/cases

Sustainable Development of Supply Chain

Environmental Protection						
Environmental footprint	Traceable raw material	Green package	Sustainable Logistics and supply chain	Sustainable construction	Display design	Biological diversity
1. Water footprint 2. Carbon footprint 3. Waste footprint 4. Biodiversity footprint	1. Product screening considers raw material certificate 2. Palm oil certified sustainability 3. Leather origin traceability	1. Sustainable packaging design • Package with paper certified by FSC • Reduce filler weight and volume • Reduce the tape width 2. Customized packaging design • Limit product capacity and packaging design	1. Low-carbon transportation • Switch from air transportation to shipping or trucking • Advocate the use of new energy vehicle • Reduce package size • Increase container utilization 2. EcoVadis Service Assessment Provider 3. Logistics online solutions • Optimize transportation routes	1. Increase the proportion of green power supply 2. Green building certification requirements (WELL, LEED) • Assessment of lighting, insulation, air conditioning and heating	1. Reuse store display materials 2. A multi-sensory experience space for cross-media interaction 3. Cooperate with suppliers to carry out sustainable program innovation	1. GBS biodiversity assessment for operation site • Effects of land pressure and fresh water pressure 2. Cooperate with brands to promote biodiversity

Environmental conservation is ingrained in every aspect of our business, not just a trendy slogan.

If you are tired of energy conservation and emission reduction, pollution reduction and carbon reduction, then you may wish to see it from a more practical point of view that how to promote a sustainable supply chain in the context of environmental protection.

Environmental footprint: The amount of energy use, water use, waste generation and impacts on biodiversity that occur in our own operations, and even in the life cycle of our commodities.

Raw material traceability: While clothing and cosmetics may look stylish and presentable, you might not consider the environmental costs incurred during their manufacturing process.

Supply chain sustainable development strategy - Corporate Social Responsibility

Vision	Primary concern	Subdivision Goal	Facts/data/cases

Sustainable Development of Supply Chain

Corporate Social Responsibility

Product Evaluation and Recycling

1. Assist brands in promoting product green design concept
   - Promote green chemistry concept
   - Analysis product composition and function
2. Empty bottle recycling service
   - Membership rewards points
   - Product redemption incentives

Customer Service

1. Consumer research and supplier feedback
   - Investigate consumer demand for products
   - Feedback customer suggestions for brand products' iteration
   - Customer experience satisfaction survey
2. Innovation management and digital checklist
   - Online and offline consumption interactions
   - Inventory analysis and planning using big data

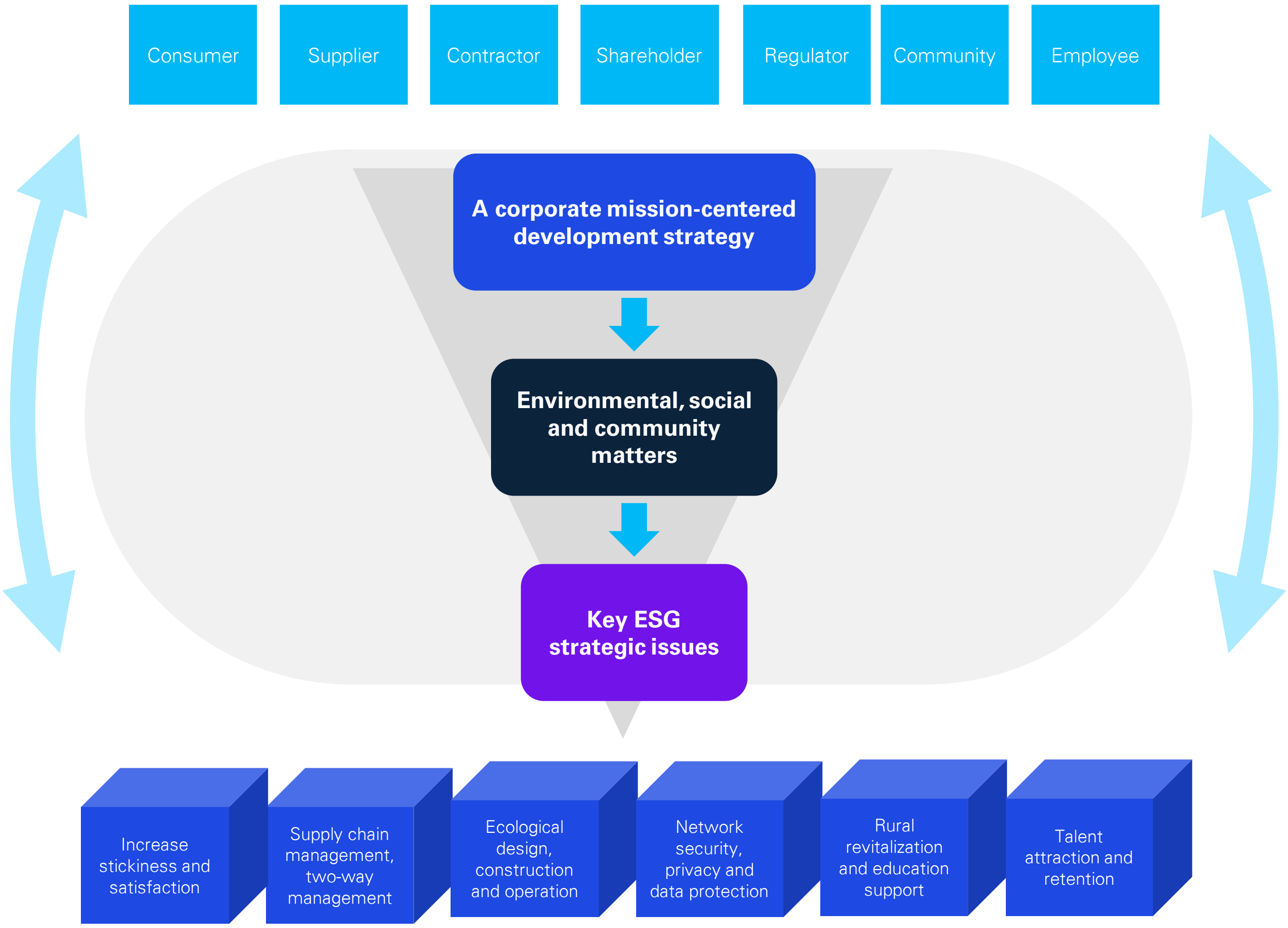
Community Investment

1. Provide employment opportunities for poor communities
2. Customized philanthropic products to support vulnerable groups
3. Support people with visual impairments
   - Audio journal information
   - Promote specific skin care products
4. Promote career integration and empower women
   - Promote the social and occupational integration of the unemployed
   - Improve women's initiative and leadership
5. Establish corporate social impact center

On the society level, the sustainable development of the supply chain includes everything from tangible goods to intangible full-chain services like consumer research, customer satisfaction analysis, and smart logistics warehousing. It also includes the composition, effectiveness, packaging, and post-use treatment of goods. Companies nowadays are keen to engage in a variety of CSR activities in addition to their daily business operations.

These activities include community involvement, exploring the possibilities of initiatives that combine elements of commercial promotion and public welfare, and enhancing their influence. In this process, companies collaborate with supply chain stakeholders rather than working on their own, which is frequently viewed as a better approach.

Supply chain ESG is integrated into the development strategy to increase corporate value



For the retail industry, goods are a business card, and the supply chain is the support behind it. Through the full cooperation with contractors, suppliers, and service providers, retail enterprises have created a safe, environmentally friendly, and healthy environment for employees and customers and have provided high-quality goods to society in a high-efficiency and low-loss way, which is a company practice we are familiar with.

Enterprise value is not only shown on the balance sheet. Let's join hands, start with the top-down design, integrate ESG into the company's business, promote the enterprise development strategy around the concerns of stakeholders, and interpret the enterprise value in ESG report.

Final word

Ultimately the seal off will help to further change Hainan for the better and its why we have invested our time and capabilities to understand the key factors to be successful in the market. KPMG are the leading advisors in Hainan, working with the largest number of brands and DFOs on the most innovative business models. Contact us to help you:

- Analyse the current and near future development of Hainan policy and market
- Identify the applicability of policies to your business decisions in preparation for Hainan market entry
- Adopt an appropriate Hainan entry strategy, including holding structure, vehicle options (branches and companies) and business models (service, trading or mix function, etc.)
- Select the effective plan for implementation to achieve the strategy objectives
- Identify the appropriate growth strategy from POS type to location selection

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