

Retail and Consumer Markets

# 2011 China Retail Loss Prevention Survey

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## 1.

## Executive Summary



China's hundred largest retailers combined to sell more than CNY 1.66 trillion worth of product in 2010,<sup>1</sup> 21.2 percent more than in the previous year, while new trends emerged in the development of the country's retail industry. Mergers and acquisitions (M&A) became an important source of growth for retailers, who began to diversify their store layouts. In the face of soaring operating costs and profit pressures, online retailing began to take shape. With retailing in China developing rapidly, are domestic retailers' loss prevention capabilities keeping up?

KPMG worked together with the China Chain Store & Franchise Association (CCFA) to carry out the 2011 China Retail Loss Prevention Survey. By surveying and interviewing 66 representative retailers, the Survey seeks to gain a clear picture of the current state of inventory shrinkage in the Chinese retail industry, to analyse new measures that Chinese retailers have taken to prevent inventory losses, and to compare them with the overall shrinkage situation among domestic retailers.

Among our key findings:

- Retailers' average shrinkage rates increased slightly. The average loss rate among companies surveyed was 0.46 percent. Research since 2008 has shown a slight increase in year-on-year loss rates over that period. Retailers in China clearly still have much loss prevention work left to do.
- There are large discrepancies between different retailers' definitions of 'high-loss products'. The result is a lack of targeted anti-loss measures, particularly technological solutions. A portion of retailers has not yet even completely placed high-loss products under protection.
- Theft rings have become a serious problem. Only 15 percent of retailers surveyed claim not to have been affected. Furthermore, of those affected, only 10 percent claimed success in preventing the theft. This points to serious deficiencies in companies' ability to efficiently prevent organised theft.
- The majority of companies surveyed were continuing to increase their investment in loss prevention. Although a considerable number of them invested more heavily in loss prevention personnel than in loss prevention technology, our research has shown increasing numbers of retailers intending to increase future investment in technological measures.
- Companies are paying increased attention to the training of their loss prevention personnel. Specialised personnel training is seen as the most productive form of anti-shrinkage investment.

<sup>1</sup> China Chain Store & Franchise Association, May 2011 "2010 China's Top 100 Chain Stores"

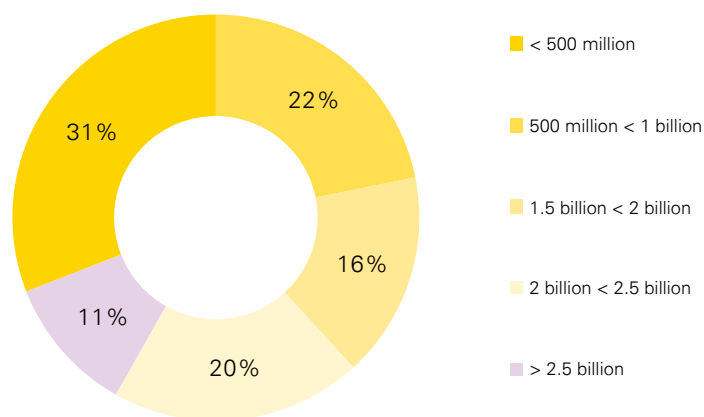


## 2. Survey Methodology

In 2011, KPMG China partnered with the CCFA's Retail Asset Protection (Loss Prevention) Committee for an extensive study of loss prevention in China's retail industry. A total of 66 China retailers participated in the survey. In April and May 2011, 56 retailers responded to a written questionnaire on loss prevention, while 10 participated in interviews. The participating retailers included state-owned, private, and foreign-invested supermarkets, department stores, outlets, and chain convenience stores. Among many other aspects, the survey's questions covered stock shrinkage quotas, major causes of losses, theft rings, and loss prevention investment.

Retailers that completed the questionnaire were classified into groups ranging from those with 2010 sales less than CNY 500 million to those with sales of more than CNY 2.5 billion. Viewed thusly, the survey covered an equitable distribution of differently sized retailers.

### 2010 Sales Total for Participating Retailers (in CNY)



Likewise, retailers offered a diverse range of responses when asked to evaluate the effectiveness of their loss prevention measures. 95 percent of respondents thought their loss prevention measures were "reliable" or "at industry average", while only five percent of respondents describe their loss prevention measures as "optimal". That is to say, the overwhelming majority of retailers believe there is room to improve their loss prevention measures.

## 3.

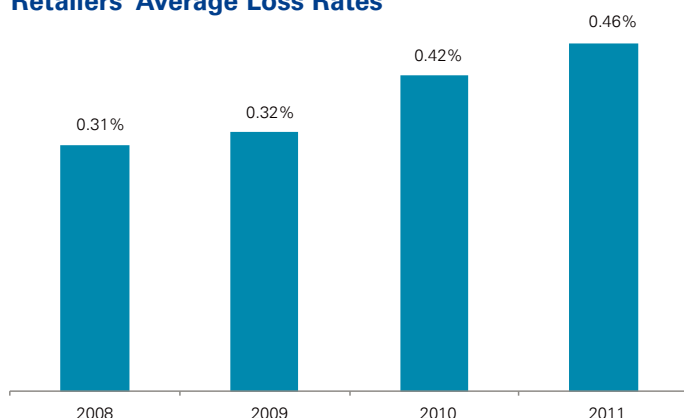
## Key Findings of the KPMG 2011 China Retail Loss Prevention Survey



### Average retail shrinkage rates showed a slight year-on-year increase

Retailers responding to our questionnaire reported an average inventory shrinkage rate of 0.46 percent in 2010. This finding, when paired with data amassed by the CCFA each year since 2008, shows a gradual increase in domestic retailers' average inventory loss rates from one year to the next, and an industry with much loss prevention work left to do. The data also indirectly illuminate Chinese retailers' continuing focus on "grabbing territory" by rapidly expanding their storefront presence through both organic growth and M&A activity. While retailers have expanded swiftly, loss protection measures at their new stores have lagged behind, pushing up average loss rates across the industry. To reverse this trend, retailers will need to work harder on refining their management of loss prevention measures.

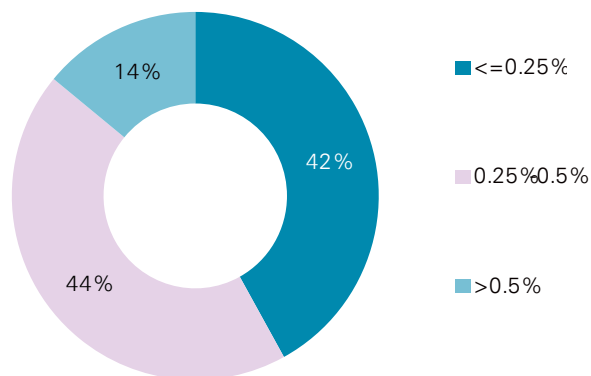
#### Retailers' Average Loss Rates



14 percent of interviewees reported loss rates greater than 0.5 percent during their last company-wide inventory stock check. Only four percent of respondents set their internal loss quotas higher than 0.5 percent, showing that—even with suppliers' loss compensation—some companies still cannot meet their internal targets for loss prevention.



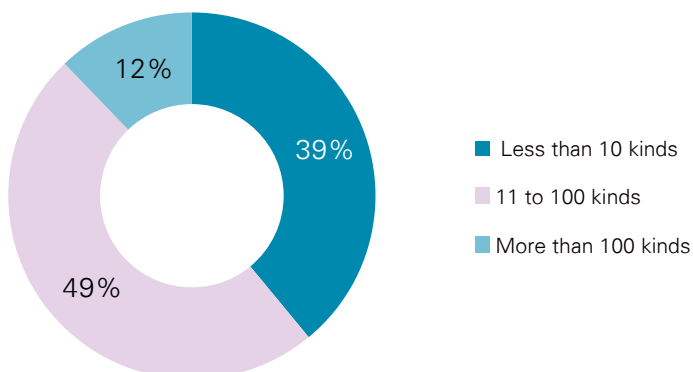
### Average Losses in Most Recent Company-Wide Stock Check



### No unified standards defining high-shrinkage products, and insufficient protection of high-shrinkage products

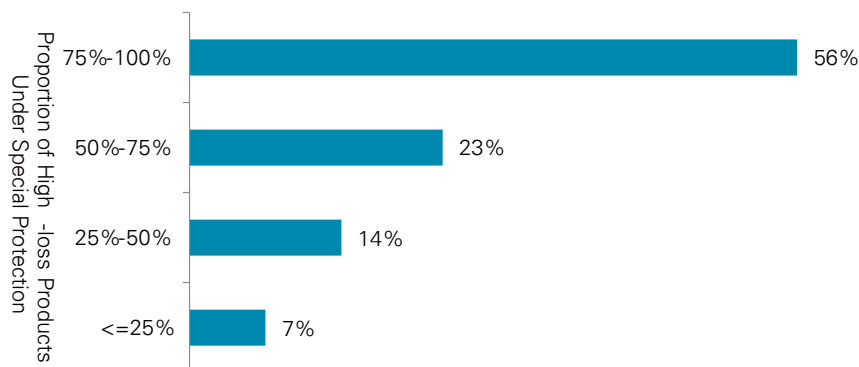
39 percent of companies interviewed reported having 10 or fewer products defined internally as “high-loss”, while 12 percent reported having more than 100, reflecting the industry’s lack of defined standards for high-loss products. In interviews, we found that some retailers defined high-loss products as “high in unit price, small in volume, and easily stolen”, while others used definitions such as “among the three most lost products in both amount and proportion lost” or “product most lost during inventory checks”.

### Number of High-loss Products



Only 56 percent of respondents reported having placed more than three-quarters of their high-loss products under some form of special protection. In other words, many companies have identified high-loss products, but owing to a variety of reasons have not placed these products under some of special protection. Separately, our survey identified the three most lost products as: shampoo, chewing gum, and powdered milk.

### Proportion of Retailers Surveyed

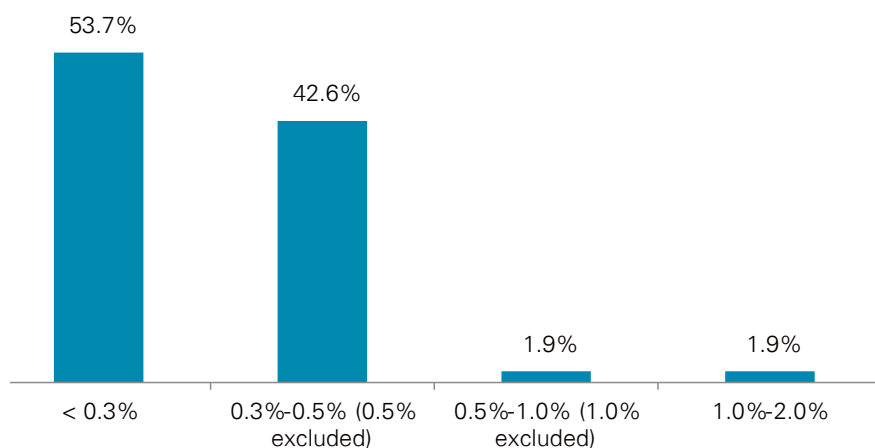


Preventing the theft of high-loss products should be a focus for retailers seeking to improve their inventory loss levels. Effective protection of different kinds of high-loss products will require companies to take targeted, diversified loss protection measures.

### Companies set challenging shrinkage targets, but still experience large differences in shrinkage rates across stores

Chinese retailers' targets for inventory shrinkage rates are challenging. Nearly 97 percent of respondents reported setting them lower than 0.5 percent. Of these, 54 percent set their target rate below 0.3 percent, reflecting these companies' high expectations of their loss prevention systems. Keeping in mind that average shrinkage rates for the Asia-Pacific region were 1.16<sup>2</sup> percent in 2010, domestic retailers' target rates are, without a doubt, far below the shrinkage rates of retailers both regionally and globally. One important reason is the significant degree to which supplier compensation lowered domestic retailers' reported loss rates.

### Companies' Internal Loss-Rate Targets



<sup>2</sup> Centre for Retail Research, Nottingham UK, 2010 Global Retail Theft Barometer



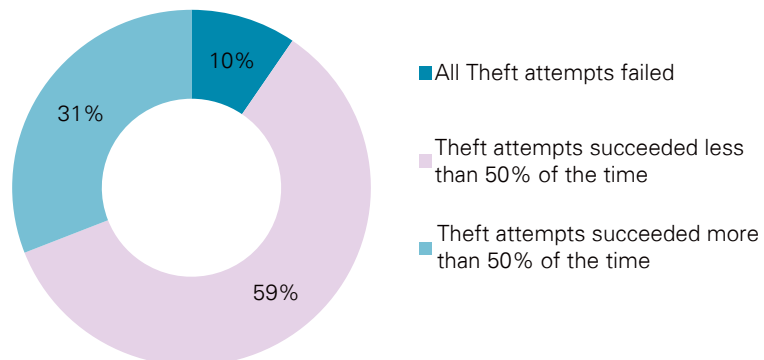
Our survey also illuminated store layout's effect on inventory shrinkage rates. 46 percent of the respondents surveyed said that their supermarkets experienced average loss rates of under 0.5 percent, while only 36 percent of respondents that ran large general merchandise stores could report the same. This indicates that the shrinkage rate of supermarkets is below that of general merchandise stores.

Retailers also experienced large disparities in shrinkage rates across storefronts. Nearly 80 percent of retailers surveyed reported their lowest shrinkage rates to be 0.25 percent or lower at some storefronts, while 49 percent of retailers reported their highest rates to be 0.5 percent or higher.

### Organised theft rings have become a serious problem, augmenting losses from external theft

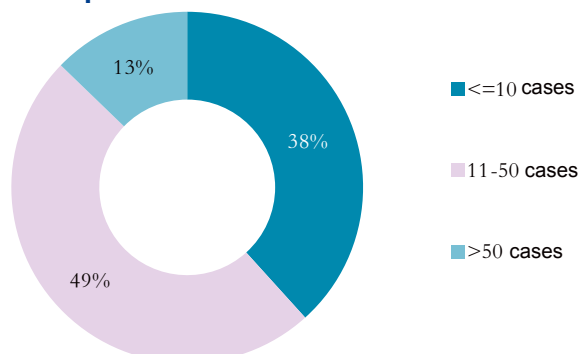
Our survey found that only 15 percent of enterprises claimed not to have been the victims of theft rings, while 24 percent of the companies we interviewed said that each of their retail storefronts were affected more than once a month, highlighting the widespread nature of the organised theft problem. The theft rings were highly effective: only nine percent of organised theft instances were successfully prevented. They were also more harmful than ordinary theft by individuals: 12 percent of respondents surveyed said that each instance of organised theft resulted in an average loss of more than CNY 1000.

#### Success Rates for Instances of Organised Theft



Our survey found that nearly half of large general merchandise stores with more than 3,000m<sup>2</sup> of floor space reported between 11 and 50 instances of external theft per month. 13 percent reported more than 50 instances each month. The large majority of these (77 percent) were uncovered by staff; 22 percent of enterprises reported an average loss greater than CNY 200 for each instance of external theft.

#### Instances of External Theft in Supermarkets with More than 3000m<sup>2</sup> Floor Space



For those general merchandise stores with less than 3,000m<sup>2</sup> of floor space, our survey found that more than two-thirds reported less than 10 instances of external theft each month. Only five percent of respondents reported more than 50 instances of external theft per month. The large majority of these as well (64 percent) were uncovered by staff. 18 percent of respondents surveyed reported average losses in excess of CNY 200 for each instance of external theft. In every case, regardless of how many instances of theft were reported, the average amount lost in each instance was noticeably higher in large general merchandise stores than in small ones, suggesting that the larger stores should be the focus of efforts to prevent organised theft.

Organised theft is one of the most difficult challenges currently facing the retail industry. It is not one that individual retailers can solve on their own; the only effective way to confront it is cooperation between government, trade associations, and businesses. The state should pay special attention to businesses' losses from a legislative standpoint, and work to create a complete consumer credit system. Trade associations and retailers should work together to exchange information relating to organised theft on a regular basis.

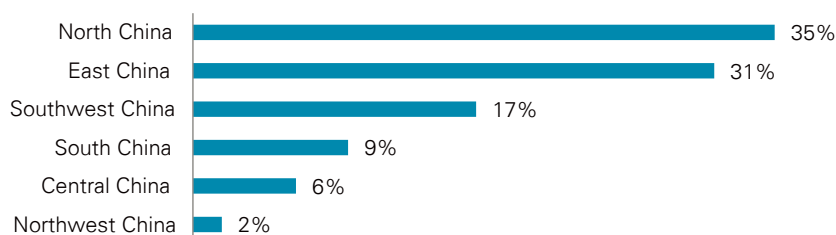
Interviewees attributed 65 percent of their inventory shrinkage to theft, of which 35 percent was external theft. This was a slight increase over the proportion of inventory lost to external theft reported in 2010. There was little change between the two years in other sources of inventory loss: among others, retailers cited both operational and process losses, and supplier fraud.

#### Percentage of Loss Accounted for



From a regional perspective, our survey found that inventory losses were most serious in northern, eastern and southwest China. Retailers named the same three regions when asked where external theft was most prevalent, illuminating the magnitude of external theft's contribution to inventory losses.

#### Regional Breakdown of Companies' Domestic Inventory Losses

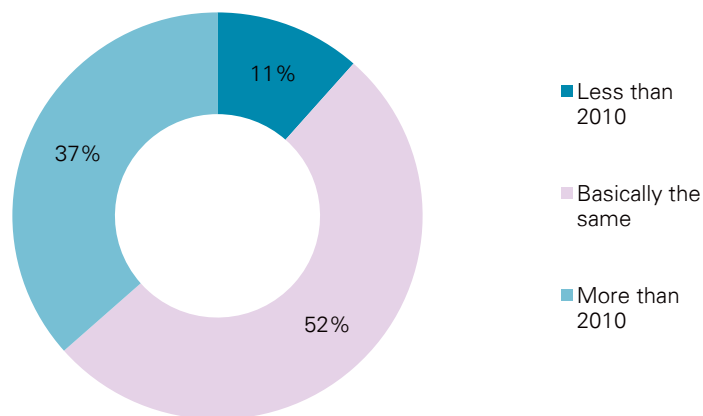


### The majority of companies have continued to increase investment in anti-shrinkage measures, with an increasing focus on technological solutions

52 percent of businesses reported investing as much in loss prevention in 2011 as in 2010, while 36 percent claimed to have increased their investment. The average increase reported was 12 percent, underlining the retail industry's increasing determination to stem inventory losses. Our survey also found that retailers invested slightly more in loss prevention personnel than in technology (56 percent versus 44), relatively inexpensive domestic labour costs naturally inclining retailers towards "human" solutions.

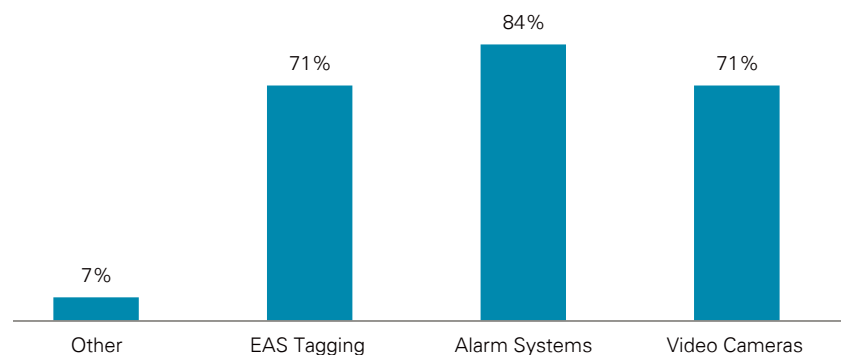
However, in our interviews with retailers we also found that a sustained rise in labour costs had resulted in an increased focus on loss prevention technology. We therefore expect to see a rise in retailers' investment in loss prevention equipment and technology.

#### Companies' 2011 Loss Prevention Investment Projections vs. 2010



The increasing importance retailers attach to loss prevention technology is evidenced by their utilisation of electronic loss protection. 71 percent of enterprises reported using EAS electronic security tags, monitoring systems and alarm systems in tandem to more effectively prevent losses.

#### Retailers' Reported Usage of Electronic Loss Prevention Measures





## Specialised training for loss prevention personnel is seen as the most productive form of anti-shrinkage investment

When asked which investments in loss prevention team training provided the most value for the money, retailers listed (in descending order of effectiveness): professional loss prevention training, loss prevention training for new employees, employee incentive programmes, and loss prevention training for management. Retailers increasingly emphasised specialised training for loss prevention personnel, enthusiastically developing their own internal training programmes and inviting external professional organisations to do the same. For example, on March 19, 2010 in Shenzhen, CR Vanguard, one of China's largest supermarket chains, opened a loss prevention school. The school's first course offering, initiated the same day, was training for recently promoted loss prevention managers. In our interviews, we also found that a large retailer had cut instances of internal theft a dramatic 30 percent through the use of specialised loss prevention training.<sup>3</sup>

### Which Form of Loss Prevention Investment Offers the Most Value for the Money?



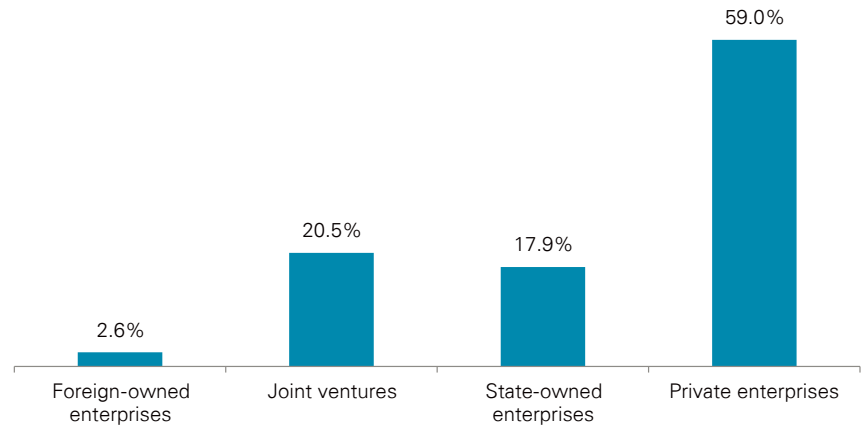
Only 35 percent of enterprises surveyed claimed to have provided loss prevention training to all of their divisions. 31 percent of companies had provided training to their procurement departments, while 33 percent had provided training to their logistics departments. This is an increase over 2010, but still a sign that retailers' loss prevention training remains insufficient.

## Private suppliers are in an extremely weak position relative to retailers

In those instances where suppliers compensated retailers for losses, private suppliers were in the majority, accounting for 59 percent of cases. Joint ventures and state-owned enterprises accounted for almost all of the remainder. The small proportion of remaining cases involved foreign-owned suppliers. The numbers illustrate private suppliers' lack of bargaining power relative to retailers.

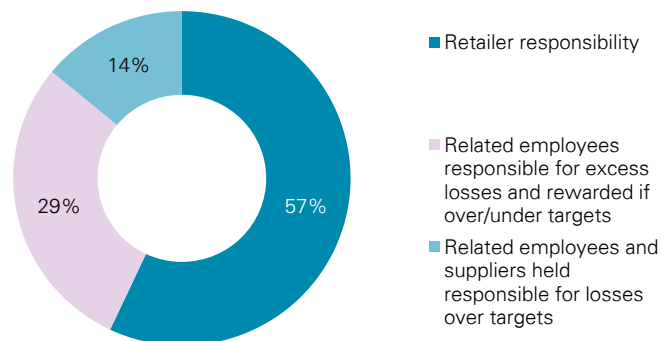
<sup>3</sup> China Resources Vanguard Co. Ltd. Website

### Percentage of Suppliers Offering Loss Compensation, by Type



Over half of the retailers surveyed elected to absorb the cost of inventory shrinkage themselves, more than in last year's survey. At the same time, 44 percent held their employees or suppliers financially responsible for inventory loss. Among those retailers that shared losses with suppliers, over 70 percent have stipulated compensation rates of less than 0.5 percent in their contracts with suppliers.

### Party Held Responsible for Cost of Inventory Loss



63 percent of retailers reported working together with all or some of their suppliers to formulate loss prevention strategies, a sign that retailers have gradually begun to realise the importance of suppliers to their loss prevention plans. They have come to understand how cooperation with suppliers on packaging, logistics, operational planning, and corruption in procurement can be an effective tool for reducing inventory shrinkage.

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## Trends in Retail Loss Prevention



### **Supplier compensation practices have steadily become more transparent and standardised, but the retail industry will soon face greater pressure to prevent losses**

On 17 February, 2011, the PRC Ministry of Commerce commissioned the CCFA to draw up draft standards for contracts governing the purchase and sale of goods between retailers and suppliers. The standards were to cover sensitive areas of the retailer-supplier relationship, including discounting, charging, payment period, inventory shrinkage and risk management. In our interviews it became apparent that most large chain retailers are aware of the current unsustainable nature of “supplier compensation”, and have taken steps to standardise both the scope and rates of compensation stipulated in their contracts with suppliers.

Although the results of these efforts remain to be seen, we believe that the release of the new contract standards will bring with it increased transparency and standardisation for supplier compensation. Retailers will be able to track the data on compensation from their suppliers more easily, which will allow more precise analysis of the authenticity of retailers’ inventory loss rates. Additionally, once supplier compensation is weeded out of the loss rate data, there is a possibility that the rates will rise markedly over the short-term, forcing retailers to re-double their efforts to prevent shrinkage.

### **Management of loss prevention will become integral to companies’ comprehensive risk management considerations**

Retailers efforts to prevent inventory loss will shift from a narrow focus on shrinkage management and “theft prevention” to “asset protection” and “comprehensive risk management”. The transition will require enterprises to invest more resources than they already do, not only to protect their tangible assets, but also to avoid brand or reputational damage brought on by lapses in food and personal safety.





Retailers' management obligations vis-à-vis loss prevention will continue to expand, forcing the industry to place loss prevention in the context of its larger risk management strategy. Meanwhile, loss prevention management will see increased division of labour, with responsibility for fields such as fire safety, personal safety, and foodstuff safety being divided between specialised teams or employees.

As part of a greater government emphasis on food safety—and public safety generally—we expect the rolling out of a succession of policies, laws and regulations targeted towards the retail industry. As an example, the Standards for the Monitoring of Public Order in Large Supermarkets released by the city of Beijing in August of 2011 set out clear regulations governing: standards for large supermarkets' application of "facial recognition" loss prevention video monitoring equipment; video monitoring of foodstuffs sales areas; and different types of alarm systems. Businesses will have to consider issues of compliance and day-to-day management as they relate to planning and loss prevention strategies.

### **Retailers will do more to reduce losses of raw and fresh products**

Owing to their short shelf-lives and variable quality, fresh and raw food products typically see losses far in excess of those of normal household goods. Although retailers find it quite difficult to control these losses, goods of this kind are an important means by which retailers drive increases in sales and foot traffic. As such, retailers who can reduce losses of fresh and raw food products should see a direct increase in profits. Below are some of the methods leading domestic retailers have adopted to control losses in this area:

- Using historical sales data and consumer habits to formulate their procurement plans
- Setting unified standards for taking delivery of goods, and strengthening their delivery inspections
- Improving their techniques for refrigerating, arranging, and displaying raw and fresh products
- Ensuring that their inventory management abides by the "first in, first out" rule



- Preventing losses while measuring the weight of goods through improved employee training and anti-shrinkage awareness, as well as preventing surreptitious label swaps
- Instituting profit margin checks for fresh and raw goods

### **Retailers will outsource a portion of their loss prevention to specialised third-party vendors**

While it is not uncommon in other parts of the world to see retailers outsource a portion or all of their loss prevention to specialised service providers, the same is not true in China. In recent years, however, a few specialised service providers have emerged in some economically developed areas such as Shanghai and Guangdong; additionally, a number of foreign service providers have also begun to enter the Chinese market. In our survey, we noted a portion of retailers planning to outsource their loss prevention to suppliers. The benefits to outsourcing loss prevention include:

- Providers' specialised services can assist the company in improving its loss prevention techniques
- Costs related to loss prevention are fixed
- Knowledge transfer can provide retailers with cutting-edge loss prevention technology and know-how
- Retailers no longer have to recruit and maintain specialised loss prevention teams
- Specialised service suppliers can help companies that have grown rapidly through M&A activity to integrate their loss prevention systems

As with the outsourcing of other business functions, we expect the development of loss prevention outsourcing to continue apace. Retailers opting to outsource should select a service provider that suits their needs after performing thorough due diligence. Failure to perform the proper due diligence could impede confidence building between the two entities.



# 5.

## Selected Loss Prevention Recommendations

To help Chinese retailers strengthen stock loss management and increase profitability, KPMG China and the Retail Asset Protection (Loss Prevention) committee under the CCFA recommend the following measures, based on the findings of the China Survey 2011:

### Step up protection of high-loss products

“High-loss products” refers to those products with a high unit price or that are easily stolen. Products with high-loss rates include, among others, bath products, chewing gum, clothing and milk powder. Products like tobacco and alcohol, which are not easily stolen despite their high unit price, account for a relatively small proportion of the total inventory shrinkage losses, and thus cannot be considered high-loss. Before businesses move to place high-loss products under special protection, ample data analysis is required to establish benchmarks for judging what constitutes a high-loss product. For some retailers, because of differences in store layout and types of products offered, what constitutes a high-loss product may differ from store to store. Effective loss prevention in the face of a constantly-evolving inventory shrinkage reality requires active monitoring by enterprises, and must be accompanied by timely adjustments to the list of high-loss products.

There are a number of measures that retailers can take to protect high-loss products:

- Set up separate counters for sales and cashiers
- Establish separate inventory and shelving areas for high-loss products
- Improve loss prevention technology through the use of source tagging technology and installing CCTV cameras in vulnerable areas
- Protect high-loss products with undercover and regular loss prevention personnel
- Improve tracking of high-loss products’ daily and monthly inventory turnover

### Increase exchange of loss prevention best practices and personnel across stores

Retailers currently operate across a number of store layouts. There are differences in loss prevention capability between layouts, and even across different storefronts within the same layout. This can cause large variations in loss rates across storefronts. In our interviews we found that a portion of retailers saw differences of a thousand percent or more in loss rates



between storefronts. It is therefore essential that retailers improve the sharing of loss prevention best practices and personnel across stores. In our interviews, the retailers themselves offered a number of useful ideas, including periodically (monthly, quarterly, or bi-annually) holding a company-wide symposium on loss prevention, establishing a shared theft database, inviting their most outstanding loss prevention teams to share their experiences, and using technological tools to transmit precautionary information on prevention of organised theft between stores.

Separately, it is essential that retailers improve the exchange of loss personnel across stores. This will allow for the spread of information on successful loss prevention practices between retail locations, and improve the loss prevention capabilities of staff across all of the retailers' different store layouts.

### **Establish regional and intra-industry mechanisms for sharing information with public security organs**

The past few years have seen retailers grapple with the increasing, seemingly intractable problem of organised theft. The problem has affected both their profits and regular operations. In our interviews with retailers, nearly all were enthusiastic about the idea of preventing internal and external organised theft through the establishment of a shared database. The resources available in such a database would include information on retail employees' backgrounds and credit histories, and files on criminals and organised crime groups. Since the majority of organised crime is local or regional, the establishment of mechanisms for regional information sharing is essential. In August of 2011, Wal-Mart, Carrefour, Vanguard, Watsons and other major retailers announced the establishment of a loss prevention coalition in Guangdong province. Improving flow of information between retailers the police and other public security organs will also undoubtedly do much to prevent incidences of organised theft.<sup>4</sup>

### **Strengthen focus on and proper application of new loss prevention technologies**

A gradual increase in labour costs has resulted in an increasing focus on technological solutions to loss prevention problems, especially among large retailers. As certain loss prevention technologies have matured, their associated costs have dropped, leading many retailers to gradually ramp up their purchase and use of anti-shrinkage technologies, software for statistical analysis, and early warning IT systems to strengthen loss prevention.

Apart from traditional technologies like CCTV, EAS, and standard alarms, retailers are increasingly applying source tagging technology. Since source tagging involves manufacturers placing electronic anti-theft tags on products during the manufacturing and packaging processes—as opposed to the older method wherein the tags were placed on products during stocking—it requires retailers and manufacturers to work in concert. Since source tagging makes the anti-theft tags less conspicuous and less easily damaged or destroyed, it reduces inventory losses, and makes it possible for products that were previously in display cases to be placed on open shelves. As a

<sup>4</sup> Guangdong Yangcheng Evening News: Sun Jing. August, 11 2011. "Guangdong Retail Sector Annual Losses due to theft exceed 1 billion"

product that a customer can touch is one they are more likely to buy, source tagging can result in a large increase in sales, and greater profits for retailer and manufacturer alike. Source tagging products whose profit margins are high but were not previously suitable for open display can make an especially pronounced difference in retailers' profits. 69.3 percent of retailers in Europe, 68.7 percent of retailers in North America and 47.3 percent of retailers in Asia-Pacific hoped to have firm plans in place for the use of source tagging technology by the end of the 2010 calendar year. However, at present, only 45.2 percent of North American retailers, 39.7 percent of European retailers and 27.4 percent of Asia-Pacific retailers (including 40 percent in Australia) actually have formally adopted plans for source tagging. Regardless, retailers' adoption of source tagging is rapidly increasing.<sup>5</sup> In our interviews, one large international retailer reported the effectiveness of source tagging. Product losses dropped 50 percent, and sales income increased 300 percent.

### Reference best practices to improve loss prevention

Retailers may compare and analyse loss prevention best practices (such as technologies, information-sharing mechanisms, personnel training, and process design and implementation) amongst leading retailers. By doing so, they can diagnose causes of their stock losses and discrepancies between leading retailers in order to develop a proposal to enhance loss prevention performance.

<sup>5</sup> Centre for Retail Research, Nottingham UK, 2010 *Global Retail Theft Barometer*



## 6.

**About KPMG**

KPMG is a global network of professional firms providing audit, tax and advisory services with an industry focus. With more than 140,000 employees worldwide, the aim of KPMG member firms is to turn knowledge into value for the benefit of clients, people and capital markets.

**KPMG's Consumer Industry sectors**

Our Consumer Industry sectors—Retail, Food and Beverage, and Consumer Products—have a global network comprised of major practices around the world, with particular strength in the Asia-Pacific region.

Our network gives us the ability to provide consistent service and thought leadership to our clients, while always maintaining a strong knowledge of local issues and markets.

Our Global Consumer Markets team has knowledge centres in key markets around the world, with capabilities spanning audit, tax, transactions and performance issues.





# 7.

## About the China Chain Store & Franchise Association

The China Chain Store & Franchise Association (CCFA) is the only national retail trade association registered with the Ministry of Civil Affairs of the People's Republic. Established in 1997, it currently has 900 corporate members with 160,000 outlets, including domestic and multinational retailers, franchisees and suppliers.

The CCFA's member companies come from over 50 industries and sectors, including retail, food and beverage and services. Most are reputable Chinese or foreign-owned chain retailers, major suppliers and related intermediaries.

Dedicated to fostering the development of retail chains in China, the CCFA's main job is to represent members while representing trade interests and safeguarding members' lawful rights and interests. Member services encompass the following key areas: policy coordination, corporate cooperation, industry training, information integration, international exchange, trade research, industry self-discipline and the promotion of sound corporate and industry development.

For more details on the CCFA, please visit its websites at [www.chinaretail.org](http://www.chinaretail.org) (English) and [www.cfa.org.cn](http://www.cfa.org.cn) (Chinese).

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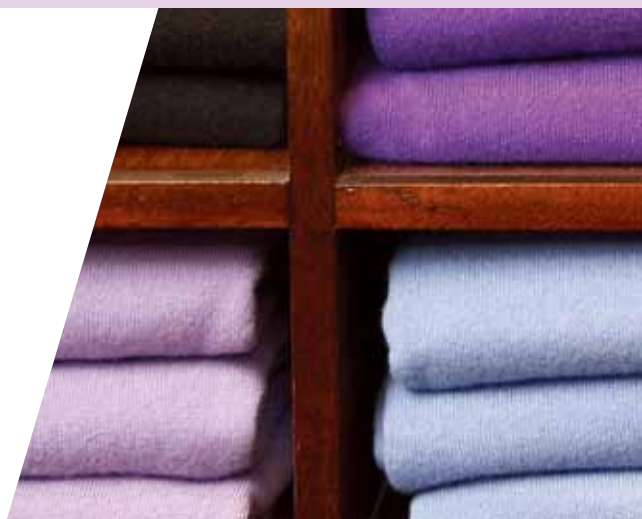
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