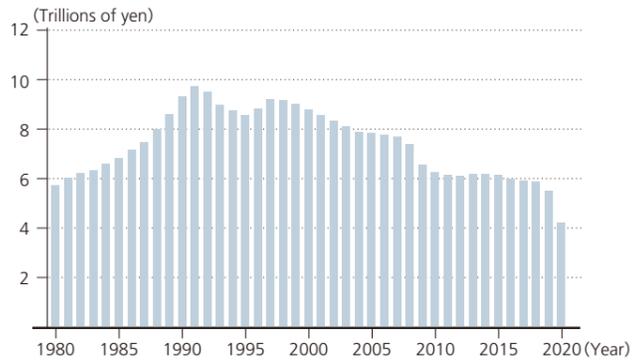


Acceleration of Business Model Transformation Urged by COVID-19

National department store sales



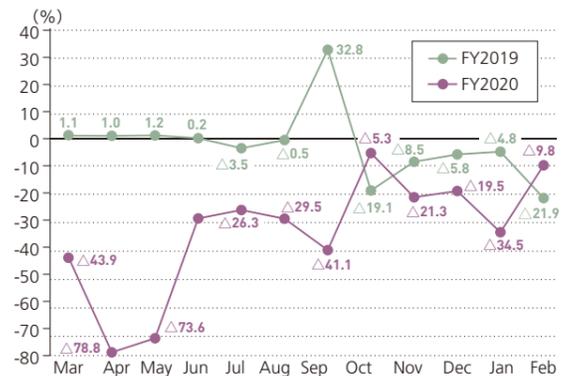
*Source: "National Department Store Sales" by the Japan Department Store Association

Shrinkage of department store market accelerated by COVID-19

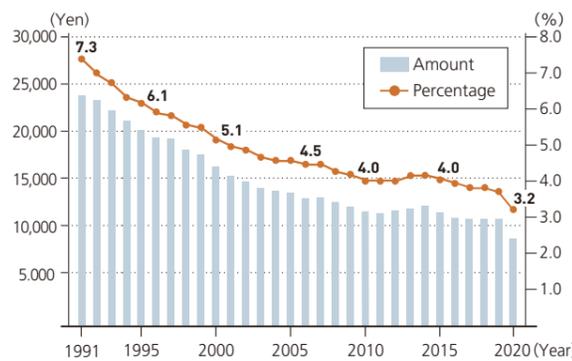
National department store sales are on a downward trend after peaking at ¥9.7 trillion in 1991 and fell below the ¥6 trillion levels in 2016. Recently, while mainly urban stores had strong sales thanks to brisk spending by inbound tourists and affluent people, the severity of rural stores was accelerated. Thus the disparity between urban and rural areas was further widened. What is worse, in 2020, inbound consumption, which had driven sales, was hit by the COVID-19 pandemic and evaporated at once. Domestic consumption also decreased to ¥4.2 trillion partly due to the temporary closure of stores for almost two months because of the declaration of the state of emergency and the impact of subsequent continuing crowd restrictions such as voluntary ban on leaving home to avoid infection risk.

The shrinkage of department store market is partly attributable to external factors such as the collapse of the middle class due to increasingly declining and polarized

Daimaru Matsuzakaya Department Stores monthly sales (comparable stores, YoY percentage changes)



Share of "clothing and footwear" in total household consumption expenditure

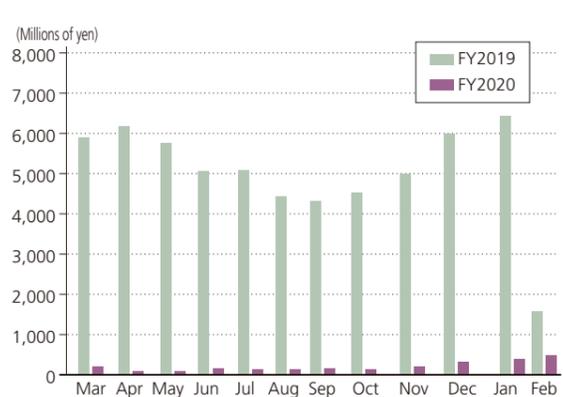


*Source: Monthly Expenditure per Household (two-or-more-person households) from the "Family Income and Expenditure Survey" by the Ministry of Internal Affairs and Communication

population, and furthermore, fiercer competition beyond industry boundaries mainly caused by rapidly growing e-commerce. However, we cannot deny that our essential problem is the obsolescence of the business model, which fails to respond to changes in customers. The COVID-19 pandemic has reset many things, and so to speak, 10-year changes have come all at once. Department stores stand at a crucial turning point. They will have to exit unless they can change at this point.

The business model of department store was born approximately 100 years ago. Department stores are called *hyakkaten* (literally, stores selling hundreds of products) in Japanese because they were large stores selling various products ranging from men's and women's clothing to kimono, children's clothing, furniture, home appliances and food. In the past, department stores mainly purchased products on a no return basis and took inventory risk, which is called *kaitori* in Japanese. But in the 1980s, a new form of transaction without inventory called *shoka shiire* expanded to around 80%. In *shoka shiire*, purchase is recorded when

Daimaru Matsuzakaya Department Stores duty-free sales



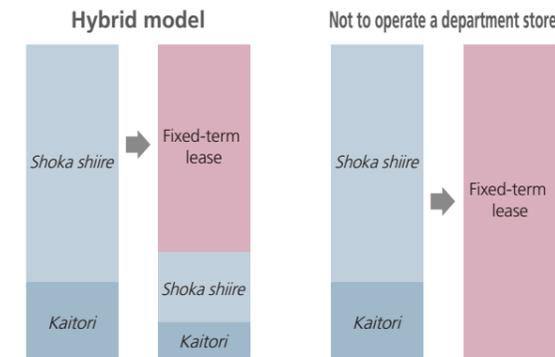
the product is sold to a customer and the product is not recorded as department store inventory. And the focus of the business shifted from merchandising to marketing or brand assortment. At the same time, department stores overly depended on clothing, particularly women's clothing, against the backdrop of the DC brand boom, instead of carrying a full line of products, which is the origin of the word *hyakkaten*. It was then that department store sales peaked.

In the meantime, around that time, the breakdown of consumer spending in Japan began to rapidly change. According to the Family Income and Expenditure Survey by the Ministry of Internal Affairs and Communication, the percentage of expenditure on clothing and footwear decreased to 3.7% in 2019, almost half of 7.3% in 1991. However, department stores could hardly get out of past successes and continued to allot too much space to women's clothing. It widened the gap with customers' tastes and buying behavior. Drastic structural changes are absolutely necessary to eliminate the mismatch between the content provided by department stores and the era.

Seek a new business model

Therefore, we decided to take two major directions as a new department store business model.

The one is an option "not to operate a department store," that is, a 100% transition to a real estate rental business. One of its examples is GINZA SIX, which was created in 2017 by developing the two blocks including the former site of the Matsuzakaya Ginza store as one. The other is to build a "hybrid model" that combines real estate rental with *kaitori* and *shoka shiire* under the "department store brand." Its typical example is the new main building of the Daimaru Shinsaibashi store, which opened in 2019.



The advantage of *shoka shiire* is to realize sales growth, which enables us to seek greater return. On the other hand, the advantages of fixed-term lease are not only to realize

Medium-term bold overhaul of sales floor configuration

- 1 Decrease originally curated areas by half
13,200㎡→7,000㎡
- 2 Restructure and expand content by shifting to lifestyle-based one
e.g. cosmetics → beauty/wellness
- 3 Introduce new content by shifting to experience-based one
e.g. education, entertainment, incubation

stable revenue and the reduction of operation costs but also to increase the variety of tenants to strengthen the response to service consumption and experience-based consumption, which makes the store look fresher. It is important to find the optimal balance for each store considering its customer target, the characteristics of the area and the building form.

Currently, the perspective of sustainability is essential for store planning. Approximately 80% of Scope 1 and 2 GHG emissions of the Group come from electricity use at stores. That is to say, we will be able to greatly contribute to realizing a decarbonized society by reviewing the store environment. In light of this, the Daimaru Shinsaibashi store whose reconstruction was completed in 2019 switched to 100% renewable energy. And Shibuya PARCO was chosen by the Ministry of Land, Infrastructure Transport and Tourism as a "Leading Sustainable Building Project (CO₂ Reduction Leader)." Going forward, we will expand these initiatives to other stores.

Evolution through the merger of real and digital

We will take this direction to change the business model of physical stores. The current COVID-19 pandemic has revealed how much the business centered on physical stores is constrained by "time and place." It is needless to say that digital response is vital to overcome that. However, our major battlefield is increasing the value we offer through person-to-person communication, which is our strength. Expanding e-commerce with an omnidirectional full line of items using digital technologies is not the direction we will take. The starting point is to create a world view based on the content provided in physical stores and our own curation. We will try to build our own media focused on people and overcome the time and place constraint by further improving physical stores and merging them with digital. And we will provide the content that creates new experience value through the media to develop into "media commerce" that achieves multiple revenue streams.

