

# ENTERPRISE RISK MANAGEMENT REPORT

Effective risk management is essential to the achievement of the Group's strategic objectives. In place since 2010, the ERM System offers a systematic and disciplined approach to provide clear responsibility and accountability structures for risk management. It consists of three major components: risk governance; risk infrastructure and oversight; and assignment of risk ownership.

The Board is responsible for determining the Group's risk profile and risk appetite, with the latter defining the acceptable tolerance levels for key risks. The Board oversees the Group's risk management framework, reviews the Group's key existing and potential risks and their respective mitigation strategies, and ensures risk management effectiveness. The RMC holds regular meetings to review the management of these risks and the effectiveness of mitigation strategies and controls, while also actively identifying any positive business opportunities in relation to these risks.

## Risk Management Committee

The Group formed the RMC in 2009, comprising all three Executive Directors, as part of the Group's commitment to further enhancing our control environment. The RMC has written terms of reference that set out the responsibilities of the members and are available on the Company's website. The Committee held nine meetings at Group level to assess and re-assess the top 10 priority risks and the results of mitigation actions for the year ended 31 March 2018. The RMC assists the Board in providing leadership to the management in relation to risk management and internal control, and the Committee has overall responsibility for the establishment and maintenance of appropriate and effective risk management and internal control systems including the design, implementation and monitoring of such systems for the Group.

## Enterprise Risk Assessment

Risk assessment is the identification and analysis of existing and emerging risks in order to form a basis for determining how risks are managed in terms of likelihood and impact. Risk areas are categorised into strategic, operational, financial and compliance perspectives for further assessment and management. A bottom-up and top-down approach is adopted to ensure a holistic risk management process. The bottom-up approach is supported by cross-functional workshops with line management to identify and prioritise risks while the top-down approach reviews and assesses if risks are comprehensively identified, prioritised, and properly addressed by line management to accomplish the Group's objectives. At the Group level, a Group risk register has been maintained since the inception of the ERM System. This register has been regularly monitored and updated by taking emerging risks into account for continuous risk assessment purposes and for building the risk management-based internal audit plan.

The Group has in place Risk Management and Internal Control Self-Assessment and Fraud Risk Control Self-Assessment programmes, requiring overseas business units and major departments in the headquarters to annually assess the adequacy and effectiveness of risk management and internal controls for ongoing risk assurance purposes. This process enhances the Group's risk and control framework effectiveness.

## Enterprise Risk Management Process

The ERM System uses risk indicators and red flags to monitor the top 10 selected priority risks. The setting of risk indicators aligns with the risk tolerance regime, representing the magnitude of risk the Group is willing to undertake in order to achieve our business goals. Additionally, a balance scorecard system, which also incorporates a red flag mechanism, has been implemented, incorporating key performance indicators for core business units to measure their progress towards achieving business goals. The balance scorecard system and the ERM System are harmonised, allowing the Group to monitor a comprehensive set of indicators at the same time for better business performance and risk management.

The RMC meetings are held at least four times a year to review and discuss the risk management progress of each of the top 10 priority risks and to provide a continuous update on the business environment and to monitor any changes. During this process, the balance scorecard key performance indicators are updated and monitored on a monthly basis so that underperformed activities can be brought to management's attention on a timely basis. Risk owners are required to take mitigating actions to address these risks. Such actions are integrated in the Group's day-to-day activities and their effectiveness is closely monitored by the red flag mechanism. This mechanism is used as a basis for reporting and discussion in the monthly management meetings as well as in RMC meetings. If any risk indicators are highlighted by red flags, the responsible risk owners are required to re-assess the existing remedial action plans and promptly propose new plans if necessary. As an integral part of the Group's ERM to provide assurance on the effectiveness of the Group's risk management process and system of internal control, the IAMS Department carries out continuous assessment on the progress of risk management procedures while it also assesses the risk responses submitted by risk owners. The IAMS Department facilitates the RMC in reporting significant risks, material changes and the associated mitigating actions, highlighting these to the Audit Committee on a quarterly basis to enhance the accountability and quality of the risk management process. An illustrative diagram describing the ERM Framework is set out on page 143.



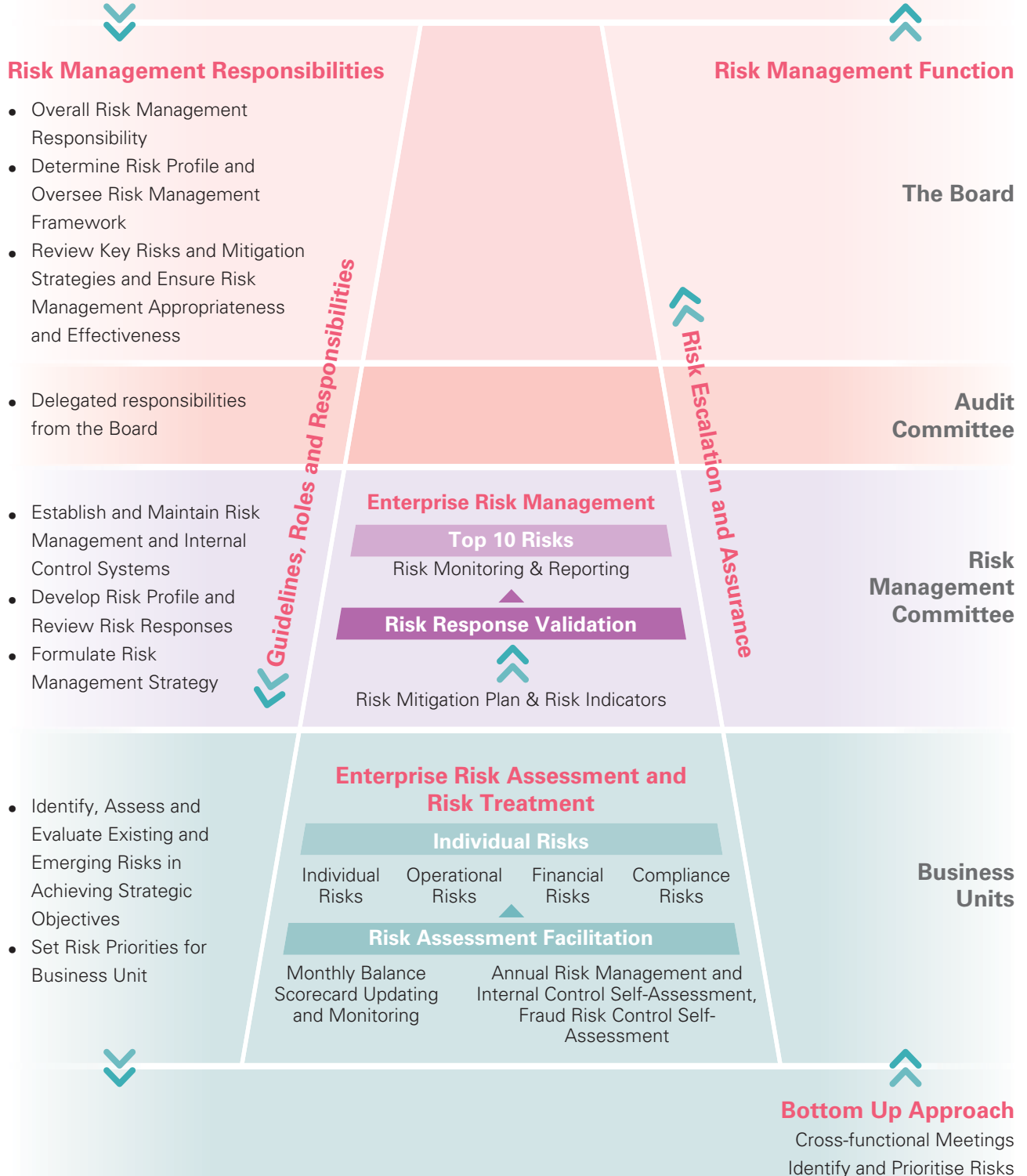


# Risk Governance & Infrastructure

## The ERM Framework

### Top Down Approach

Assessment and Management of Strategic Risks to Achieve Group's Objectives



### Management of Key Risks

Since the Group operates in a highly dynamic and competitive landscape, continuous and effective risk management is vital for achieving high performance and accomplishing business targets. Some key risks currently being managed are:

#### Online Threats and Opportunities

Online threats and opportunities remain the number one challenge faced by the Group. The continuous and exponential growth of everything involving the internet, including social media, digital marketing, e-commerce, mobile apps and payments is reflecting and further driving changes in consumer behaviour. At the same time business behaviour has evolved dramatically, especially in Mainland China, where an ambitious New Retail strategy has been widely promoted and where consumers are now highly connected and digital-savvy. There are therefore considerable opportunities to be gained from these new retail practices. However, during the year, our e-commerce business was negatively affected by the limitations of our current IT infrastructure and the lack of tools to manage and make use of our customer database. We have yet to fully leverage cooperation with third parties to increase our exposure to potential customers and drive our growth. Although we have begun to enjoy the benefits of an improved logistics service, further enhancements are needed to lower our costs and improve customer experience. In order to remain competitive, the Group needs to make concerted efforts to improve our system capability, business and system scalability, and operational efficiency.

In this regard, we are at the early stage of adopting a new e-commerce platform to replace the existing front- and back-end infrastructure for UX optimisation, business conversion effectiveness, operational efficiency, online and offline integration, multiple touch point data collection, consolidation and analysis. The Salesforce SaaS Solution is being implemented by the Group in a new “Customer Relationship Management” initiative to facilitate online and offline customer big data collection, integration and value analysis, and to drive business growth. The Group is also proactively considering opening new pop stores on major cross border e-commerce platforms to maximize exposure to new target customers. Since social media remains a remarkable phenomenon and a critical touch point that influences customer purchase decisions, especially through recommendations and posts from peers and KOLs, the Marketing team will continue to proactively develop social media platform partnerships and enhance our content management to promote customer interaction and boost sales.



Recognising that the delivery process from our previous Hong Kong outsourced warehouse to Mainland China was not meeting customers’ expectations of speedy dispatch and was also not a cost effective way for certain product categories, we established a bonded warehouse in Zhengzhou in October 2016. In addition, the newly engaged cross-border e-commerce oriented warehouse in Hong Kong has enabled us to lower operating costs and increase the speed of delivery.





### Product Competitiveness

The Group is well known for providing a large variety of trendy products with a wide price range that appeal to broad market segments. This continued success in product competitiveness has been largely built on our ability to strengthen our House Brands while sourcing and developing products that meet the demands of the market. However, consumers are changing their preferences faster than ever before and fierce competition from new and emerging competitors poses fresh challenges in the industry. In addition to pressures to provide the right trendy products with ever increasing frequency, market competitiveness is driving much faster product launches, shorter product life cycles, and increased security and integrity of product supplies. The Group has been taking action to address these challenges. These initiatives include, but are not limited to: engaging with some manufacturers to leverage on their product development capabilities; employing local sourcing specialists; adjusting our product portfolio and eliminating low productivity SKUs; re-engineering our internal product development processes and inventory management; and building closer relationships with suppliers. However, these measures will not achieve sustained success without alignment across every key functional area and without enhancing our ability to apply the latest technology and to utilise big data for better decision-making and to improve the customer shopping experience. We have therefore launched special projects to explore the application of technology to our operations and to recruit talents with the right skill sets.



### Cybersecurity and Personal Data Privacy Risks

Cybersecurity and personal data privacy have been rated as our top risks to manage, which has also been true for most companies in recent years. The increasing number of leaks and the global trend towards more stringent regulations reflect the magnitude of this risk. The recent highly publicized data leakage or misuse incidents of some well-known companies, which are drawing extreme regulator and media attention, serve as a wake-up call for organisations to immediately strengthen their internal controls to prevent personal data from being compromised and causing harm, such as identity theft and financial loss to customers. As the Group operates in a business environment that needs to collect and manage a vast amount of customer personal data from various legal jurisdictions, we are exposed to data loss risks that may result in potential fines, as well as damage to our reputation and business. To manage these risks, we have established a comprehensive privacy policy together with workshops on personal data privacy compliance for selected staff members. Our management team is charged with the responsibility to ensure regulatory requirements are followed. Each member of the management team is requested to acknowledge that they have familiarized themselves with the relevant training materials provided on our intranet. An external consultant recently facilitated a cybersecurity training course for Board members and cybersecurity is one of the top 10 risks covered in our ERM. The Group allocated substantial IT resources to enhance our cybersecurity regime over the last financial year. Meanwhile, we aim to engage an external certified professional to help assess our protection against cyber attacks. Improvement plans will be formulated if gaps are found and reassessments will be undertaken to ensure that adequate and sufficient remedial actions are in place.

### Talent Acquisition, Staff Retention and Training

Competition for talent continues to remain a challenge for the Group due to the overall low unemployment rate and easier access to higher education opportunities for young people. The Group recognises that human capital is one of the most important assets we have and we need to actively develop new recruitment channels to attract, develop and retain talents in order to support our future growth.

### **New Recruitment Channels**

In addition to expanding our traditional recruitment channels, we have also leveraged the power of various social media, mobile apps and other electronic channels to acquire talents and raise our profile with the public. We have also made use of internal resources and networks by re-launching our Staff Referral Scheme.

### **Home Grown Talent – Future Management Pipeline and Sales Force**

Our home grown talent programmes cover a wide range of students – from the Management Trainee Programme for university graduates to the Sales Trainee Programme for secondary school students – so that we can develop a strong talent pipeline for every level of staff. Our Management Trainee Programme targets high potential new university graduates, offering them an individually planned, fast track career path to managerial level in our frontline sales operations, logistics department or e-commerce business. During 2017, the programme was further expanded to our Finance and Accounting Department. The Sales Trainee Programme and the Earn and Learn Pilot Scheme, which runs in cooperation with the Vocational Training Council, will equip graduates with professional product knowledge and selling skills to further develop their career in our Group.

### **Bonding Enhancement Activities**

To enhance bonding between Management Trainees, we have established the MT Society with the purpose of giving continuous attention, support and development opportunities to participants. Past and newly-joined trainees can meet regularly for networking and experience sharing. Other activities for staff networking include Company events, such as outings, charity events and also activities organised by our Staff Recreation Club. These initiatives enable us to promote our work-life balance and family friendly philosophy to our staff.



The Group firmly believes that care for staff and good communication with them are the best means to attract, motivate and retain talents. To ensure new joiners are well integrated into the Company, in addition to our orientation programme, we conduct an individual Pulse-Check Programme and small group sharing sessions to express our care and listen to new joiners' feedback, providing follow up actions when needed. Mentors are also assigned to new staff in the shop environment itself to provide further guidance and personalised support to new joiners.

### **Training and Development**

The Group has in place a series of effective functional training and development programmes to upgrade staff competence and promote team spirit. During the year, the Group successfully extended the Junior Beautician Trainee (JBT) programme, Big Sister scheme and the Sa Sa e-learning platform to our Mainland China office. While the JBT programme helps to equip new joiners with relevant knowledge, the Big Sister scheme creates a harmonious working environment, strengthens bonding relationships, and improves frontline staff retention. The one-stop e-learning platform consolidates all training and development courses in one database, enabling frontline staff to access all relevant training information and learn at times that are convenient to them without requiring extra travel and expense. This is particularly relevant and effective in Mainland China, where geography has long been a barrier for traditional instructor-led training courses.





### Mainland China Business Prospect

The Group’s Mainland China sales improved, particularly in the second half of the year, as a result of the overall market recovery of our brick-and-mortar retail business as well as internal improvement initiatives including store network consolidation, underperforming stores’ closures, logistics and warehouse operation improvements, Category Management and Product Development Department (“CMPD”) restructuring, and a new Business Intelligence team overseeing our analytics and inventory management. Building on the improvement in our operational efficiency, we will formulate a strategic store-opening plan to tap the growth momentum of the market. However, the geographical spread, continuous changes in the popularity of different shopping malls and fierce competition for key shopping destinations pose challenges to our existing store network development team. To tackle these challenges, we will be working closely with more real estate agencies to leverage their specialized expertise and network so that we can expand our choice of locations. While we note there are wider choice of store locations with lower rents, the competition for popular shopping malls where rent rates have gone up is still intense. In order to remain competitive, we will roll out a new store image and also proactively approach popular shopping mall operators to secure our presence in their top “go-to” locations. Internally, we have established guidelines on shopping mall selection and implemented more frequent progress reviews. The Group expects that these robust enhancement measures will drive our stores to operate more efficiently and increase our presence in our target provincial capitals, thereby improving overall sales and profitability.

### Ethical Business Practices

The Group is committed to enforcing ethical business practices by setting the right tone at the top. However, we recognise that unethical incidents may still happen even when we have a robust internal control system in place. In order to enable the Group to evaluate and manage fraud risks through a more systematic and proactive approach, fraud risk assessment is incorporated as an integral part of the Group’s risk management structure to continuously manage and mitigate fraud risks. All business units and departments are required to formally assess and report annually their fraud risk exposure via the Fraud Risk Control Self-Assessment. To proactively protect against fraud, we have introduced a set of fraud monitoring indicators for regions or business units with high fraud vulnerability. All fraud cases, either reported through the whistleblowing channel or identified by the analytics, will be conducted independently by the IAMS Department or jointly, as appropriate, with other departments in the Group or with external investigators. Prompt and consistent disciplinary actions will be taken according to company policy and the results, together with corrective actions, will be reported to the Executive Directors and Audit Committee. We believe that by so doing, we can safeguard the Group’s assets, contribute positively to the Group’s reputation and image, and thus reduce the direct and indirect costs of doing business. During the financial year and the period up to the date of this report, the following key activities were undertaken in order to promote the overall culture of ethics and enhance the existing fraud risk management system:



### Communication and Training

Participants/Target	Course/Induction/Workshop/Action
All New Staff	Induction training on key corporate policies, including whistleblowing policy, conflict of interest policy, etc
PRC, Malaysia & Singapore Suppliers	Letters to suppliers – Code of Business Conduct and Ethics
IAMS Department	Delegates attended four external fraud prevention workshops

**Assessment and Enforcement**

Area	Actions
Internal Audit Scope	Fraud risk assessment is embedded in every single audit assignment
Enforcement	Fraudsters are held accountable by enforcing relevant disciplinary actions
Hong Kong Head Office & Overseas Offices	Fraud risk self-assessment conducted
Selected Fraud-prone Areas	Regular review on trends and exceptions by both relevant departments and IAMS

**Third-party Risks**

The Group has been relying on third-party service providers, such as outsourced manufacturers, software vendors, manpower service providers, contractors, warehousing and logistics service providers, in some key aspects of our business. Our aim is to improve performance by leveraging their specialised expertise, well-developed service network, operational efficiency and better scalability. Nevertheless, we are potentially exposed to risks that may include but are not limited to business disruptions, investigations by authorities leading to financial losses, and reputational damage as a result of under-performance or noncompliance with local rules and regulations. In order to counter these risks and make our business more secure, the Group has established comprehensive key performance indicators and involved an external professional to closely and continuously monitor their performance, enhance internal transparency in regard to emerging risks, involved executives and other functional teams as necessary, and laid down clear terms and conditions in service agreements. Although the Group tends to maintain long-term relationships with thirty-party service providers, we may terminate the services of under-performing vendors. In addition, from time to time we compare their service level to that of the market, which allows us to bring in new vendors with better service quality while managing our costs.

