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Korea's luxury market: Demanding consumers, but room to grow

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Key themes from the 2011 McKinsey Korea Luxury Consumer Survey

Every year since 2006, sales of luxury goods in South Korea have risen at least 12%[1], to an estimated $4.5 billion in 2010. In the first four months of 2011, sales at department stores were up more than 30% compared to 2010. [2] This continues an established trend, as last year's report on the market showed (see report at csi.mckinsey.com: "Living it up in luxury.") Still, insiders are asking whether it can last.

For one thing, according to McKinsey's survey, the percentage of household income that luxury consumers spend on luxury is already higher in South Korea (5%), than in Japan (4%)[3]—and the Japanese luxury market has been stagnant in recent years. Moreover, the performances of famous brands in Korea have been mixed. For example, LVMH and Ferragamo continued to do well, but others, like Gucci Group and Dior, saw sales drop in real terms in 2010.[4]

Thus, while the headline news is that the luxury market is still growing strongly, uncertainty is also mounting. In this year's report, McKinsey addresses these concerns, which come in the form of three key questions: Can South Korea keep it up? What's changing? And what do these trends mean for the players in the luxury industry?

To answer these questions, for the second year in a row, McKinsey surveyed 1,000 Koreans who had purchased at least 1 million Korean won ($930) in luxury goods in the previous year across four categories —fashion apparel, leather goods, shoes, and watches/jewelry. Among the respondents were 200 "heavy purchasers"—those who had spent at least 10 million Korean won ($9,300). We also interviewed 24 senior executives of luxury-goods companies. Here's what we found.[5]

1. Can South Korea keep it up?

Yes. A number of trends, small and large, are creating a model of sustainable growth for the next three to five years.

Let's start with the proposition that not all consumers are created equal; to a startling degree, it is mainly the heavy purchasers who are keeping the Korean luxury market rolling with such force. For example, Lotte department store estimated that the number of "Most Valuable Customers"—those who spend 15 million won ($14,000) or more a year—rose 14.4% in 2010, compared to 9.2% for other kinds of luxury consumers. The number of VIP customers at Shinsegae department store —those who spend more than 8 million won ($7,400) —grew 35%, compared to 12% for other consumers.[6]

Shopping at the high end also appears to be habit-forming. McKinsey found that heavy purchasers are much more likely to say that they enjoy their goodies "as much as I always have" vs. non-heavy customers (33% to 12%). This difference in attitude was reflected in their actual spending: The big-spenders indicated that they had spent more on all four luxury categories in the previous 12 months. Non-heavy buyers were pickier: While they spent more on watches and leather, they spent less on

1 Euromonitor
2 Ministry of Knowledge Economy
3 McKinsey analysis
4 Financial Supervisory Service
5 The report surveyed at least 200 luxury consumers for each product category; luxury consumers were screened based on purchase history of select luxury brands (ranging from affordable "masstige" brands to "super premium" brands) and included 85 luxury fashion apparel brands, 57 luxury leather goods and shoes brands, and 47 luxury watch/jewelry brands.
6 Asia Economy, "VIP customers have increased at department stores," August 28, 2010

apparel and shoes. The difference? Heavy purchasers are continuing to "trade-up" across all categories, while the rest are finding cheaper, non-luxury alternatives [Exhibit 1].

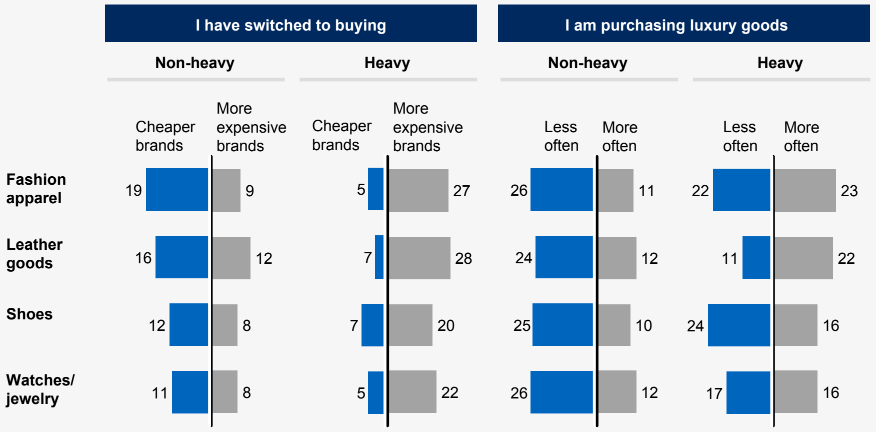
Add it all together, and what it comes down to is that Korea has more and more high-spending luxury buyers; these buyers are by no means sated; they like what they buy; and they don't pinch their won too hard. In itself, this is a strong platform for growth.

But it is not the only one. For a start, younger buyers continue to indulge in the occasional luxury splurge, proving a valuable complement to traditional buyers—women in their 40s or 50s. More than a third of the under-35s surveyed said that they were buying more than in the past; only 18% of the over-50s were. At the Shinsegae department store—the kind of place where luxury trends start—sales to 20-somethings rose at a stunning annual rate of 74% from 2005-10, compared to 9% for 50- to 60-year olds.[7] If young people learn to love luxury, it could well become a lifelong habit.

Men are another emerging customer segment. Luxury goods for men account for only 9% of the market, half the equivalent percentage in Japan, a gap that will surely narrow.

Finally, while Seoul dominates the country in every way—economically, culturally, politically—the rest of Korea is also prospering, and wanting to show it. The three major department stores are planning to open 15 new locations—13 of them outside the Seoul metropolitan area[8]—and consumers outside Seoul commonly named greater accessibility as one of their top reasons for why they are buying more luxury. With more

Exhibit 1:
Heavy versus light purchasers: Trading up, and down, over the previous year
Percentage of category consumers who selected answer



SOURCE: 2011 McKinsey Korea Luxury Consumer Survey

department stores in range, the likelihood is that higher spending will follow.

Broader trends are also shaping the market in positive ways. To start, there is the simple fact that there is still room to grow in South Korea (per capita income: $20,300). Private consumption was flat in 2009, but grew a healthy 4.1% in 2010. It's worth noting, too, that while Korea has a relatively low percentage of women working fulltime, that figure is rising.[9] And since women make 90% of luxury purchases, the fact that they are earning more money is hugely significant. To take just one example, in 2008-09 the number of women making 100 million won ($93,000) or more rose almost 10%, twice the rate of men.[10]

Given all these trends, it is not surprising that when McKinsey asked two dozen senior luxury executives what they thought of Korea's growth prospects, more than 60% said they were confident the good times would continue to roll [Exhibit 2].

2. How is the market changing?

The Korean luxury market has become a more challenging place to compete, for two reasons. First, consumers are seeking more distinctiveness and are more willing to try out new brands. Second, they are becoming more price-sensitive; they want to be convinced that they are getting value for their purchase.

Koreans have tended to buy luxury goods as a way of signaling social status and for self indulgence. People wanted other people to know that they were wearing something expensive, so they bought famous brands, often with conspicuous logos or labels. That attitude is becoming passé with dizzying speed; in 2011, 45% of those surveyed agreed that "owning luxury goods is not as special as it used to be," compared to just 21% in 2010. As a result, Koreans are beginning to think more about differentiation than display; 39% of heavy buyers and 26% of all respondents say that "I increasingly

7 Korea Retail Yearbook, 2010
8 Mirae Asset Securities, "Mass extravagance, and renaissance of the department stores," April 25, 2011
9 World Bank
10 Korea Statistical Office, Economic Intelligence Unit

prefer luxury brands or items that help me stand out from the crowd.” [Exhibit 3]

The desire for more individuality is leading to the introduction of new luxury brands, making the market more competitive. Contemporary brands, such as Miu Miu, that target younger customers or designer fashion houses such as Alexander McQueen, have made strong entries into the market.

Another complicating factor is that consumers are becoming more assertive about seeking out the best prices. While the McKinsey survey shows that Koreans (and heavy purchasers, in particular) are still more likely than the Japanese, Europeans or Americans to be willing to pay full price for luxury, at the same time, more and more are seeking out bargains. Online information and greater exposure to overseas markets have made it much easier to compare prices, narrowing the hometown premium. Koreans have thus joined the global trend of buying more at discount/sales, particularly when it comes to shoes and apparel [Exhibit 4]. Sales at Shinsegae’s Chelsea premium outlet, for example, have grown 37% a year since 2007, and luxury revenue in hypermarkets has far outstripped expectations.[11]

One surprise is what is still not happening: online shopping. Online is an important channel; more than 40% of respondents said that they browse luxury sites before buying. However, they generally draw a distinction between using the Internet for research versus actually buying online, which still doesn’t happen very often. The implication is that even though people are getting more price-sensitive, they still see the in-store experience as an important aspect of luxury shopping, and their concerns about authenticity, sizes, and service have not yet been addressed.

Exhibit 2:
Executive survey: Views on growth

Percent responded (n=24)

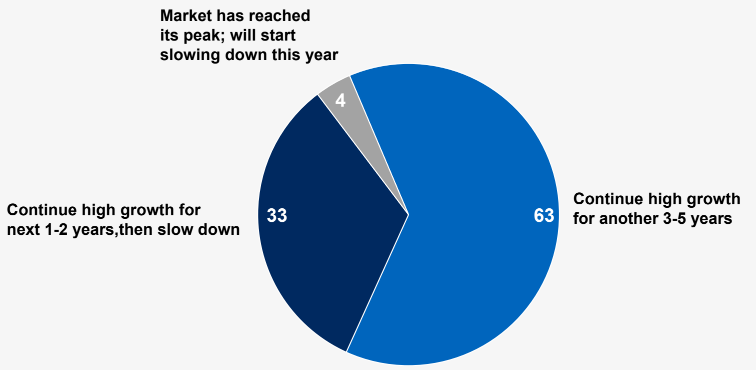
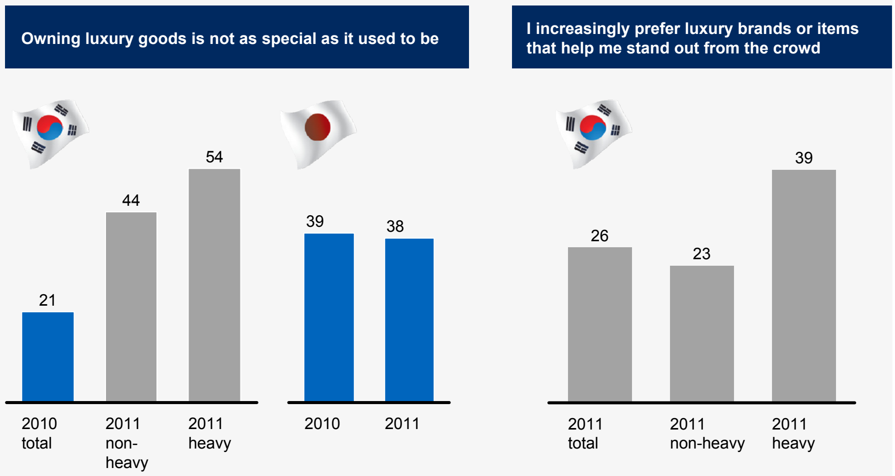


Exhibit 3:
Are luxury goods becoming too common?
Percentage of respondents who agree or strongly agree



SOURCE: 2011 McKinsey Korea Luxury Consumer Survey

3. What does this all mean for the luxury players?

It is no secret that non-Japan Asia is the key to the future of the luxury goods industry. Europe, the US and Japan are all mature markets, packed with aging, cautious consumers. They are still crucial, of course. Japan, for example, rings up more than $9 billion a year in sales; even natural disaster and a nuclear crisis caused only a small blip (see McKinsey’s most recent Japan luxury report at csi.mckinsey.com: “No seismic shift for luxury in post-quake Japan”). Korea’s market is only half Japan’s size, but it takes on importance because it is still growing. The challenge for the luxury industry, then, is to take advantage of this window of opportunity, while adapting to the increased complexity of the market.

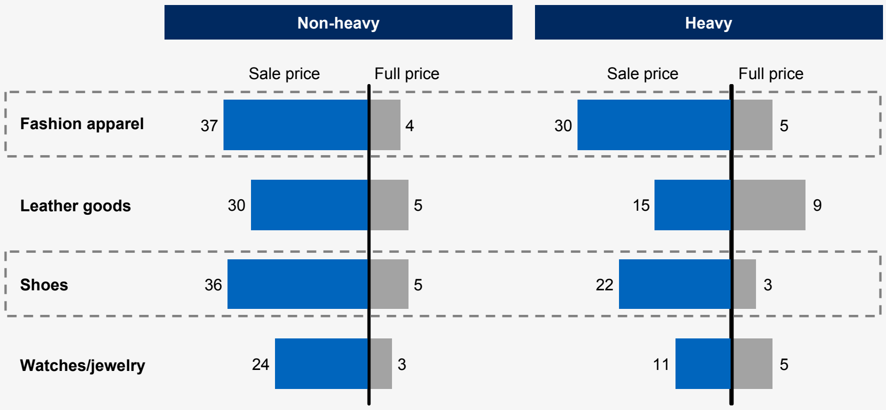
We have identified five priorities:

- **Innovate to create excitement:** For many consumers, particularly the young and fickle, a prestigious label is no longer enough to get them to open their wallets. To stay relevant, then, continuous innovation in the brand, products and promotions is key.
- **Clarify the brand:** As more brands enter the market, clutter becomes a problem. Consumers want a clear and convincing brand message; they are asking for reasons to buy. At the same time, it is important not to lose focus on what your brand stands for, whether it be heritage, craftsmanship or style.
- **Treat VIPs differently:** Heavy purchasers are more important than ever. Acknowledge and woo them through aspirational products, exclusive promotions and special services. Even among VIPs, there are distinctions to consider, in terms of how much is spent, and where, and how often. Knowing how to treat your heavy purchasers requires detailed customer data analysis. More importantly, it requires creativity and individual attention to build an emotional connection, such as luxury hotels providing bedding that is adapted to VIP guests with certain allergies.
- **Think of product and prices as a portfolio:** Customer segments are becoming more diverse, while brands still need to maintain a clear identity. That requires creating multiple tiers in products and pricing and building capabilities to cope with the ensuing complexity.

Exhibit 4:

Bargain hunters: Changes in luxury consumer behavior over the previous year

Percentage of category consumers who answered: I am buying more at…



SOURCE: 2011 McKinsey Korea Luxury Consumer Survey

- Invest in multiple channels: But be careful about it: Ensure that you are delivering the same message on- and off-line, and across borders as well

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