

McKinsey Consumer and Shopper Insights



Going (Back) for Gold

Japan's Cautious Luxury Resurgence

McKinsey 2014 Japan Luxury
Consumer Survey report
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McKinsey 2014 Japan Luxury Consumer Survey overview

- Conducted April 2014 (McKinsey has conducted the Japan Luxury Consumer Survey every April or May since 2009)
- Respondents: 544 current and lapsed¹ Japanese luxury consumers nationwide
 - Gender mix: 72% female, 28% male
 - Category mix: 420 current purchasers grouped into 4 categories (each including ~100 respondents) by purchase over the past 24 months
- Screening criteria include 76 fashion brands, 52 leather goods brands, 52 shoe brands, and 46 watch/jewelry brands¹

¹ The term “lapsed” refers to luxury buyers who have purchased luxury goods, but not over the past 24 months.

April in Japan brings sakura blossoms, changeable spring weather, and a new fiscal year. In 2014, it also brought a consumption-tax hike – the nation's first in nearly two decades. The shift from a five to eight percent sales tax was widely expected to drive last-minute binge buying, and also cause a dip in spending over the months that followed. In Japan's luxury category, the binge certainly took place. But the overall strength of the rebound in luxury following Japan's triple disasters of March 11, 2011 has been striking, and has more than cushioned the hit to post-hike luxury revenues. For most luxury CEOs in Japan, the luxury market is not merely back – it is among the world's healthiest.

The dangers of a sharper dip in spending still loom. After all, the last time the government raised the consumption tax (from three to five percent in 1997) it dealt a crippling blow to Japan's economy, which had been clawing its way back to recovery. The 1997 tax tipped consumer confidence and spending into free fall, recessionary woes returned with a vengeance – dealing a body blow to luxury sales in the process – and many associated with the tax hike, including then Prime Minister Ryutaro Hashimoto, soon left office.

Could 2014 be déjà vu all over again? The Abe administration, which has designs on a second tax increase from 8 to 10 percent in 2015, is taking no chances: only with annualized GDP growth of three percent or better in the third quarter of 2014 will they give the all clear signal and move to implement the sequel tax hike.

Some economists have, not surprisingly, predicted the grim scenario of a slide in GDP growth mirroring that of 1997. Others, such as Nicholas Smith of Credit Lyonnais Securities Asia, call such projections “cut and paste” thinking¹ that fails to acknowledge some key differences between then and now. The 1997 post-hike downturn, for instance, was exacerbated in no small part by the

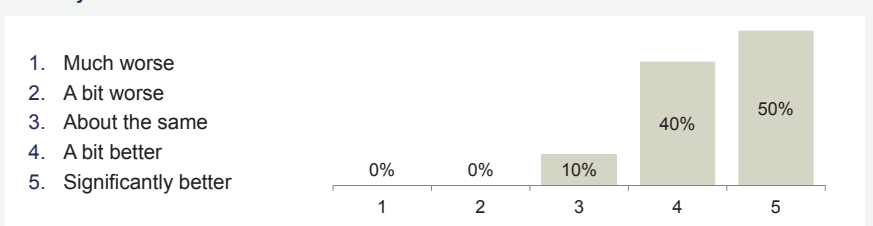
Asian financial crisis, which hit that same year. And consumer confidence in 2014 has, by some early measures, remained steadfast; according to a “Lifestyle Index Report” produced by the research arm of Japan's second-largest ad agency, Hakuhodo, consumer willingness to spend is already edging its way back to pre-hike levels following an initial dip in April, thanks in part to summer bonuses and seasonal consumption.²

The more optimistic and upbeat tone mirrors our findings in McKinsey's 2014 Japan Luxury Consumer Survey. While industry analysts and Japanese CEOs will be among the first to tell you it is too early to rest easy about the future, for luxury brands in Japan the signs are largely positive. Over 50 percent of luxury brand executives surveyed by McKinsey, for instance, described the effect of the tax increase on April and May

sales either as being “negative but not as much as expected,” having “no negative effect,” or being “actually positive.” These executives also uniformly agreed that the April tax increase was the primary driver for a jump in pre-April sales, with 75 percent of respondents saying that the tax hike had “significant positive impact.” Overall, consumer behavior in the first half of 2014 has spurred brand leaders' confidence in the future, with 90 percent of luxury executives declaring the 2014 sales outlook to be somewhat or significantly better than 2013 (Exhibit 1).

There is little question that a pre-hike buying frenzy took place, with spend in 2014 well up from 2013 levels over the same period.³ More significantly though, sentiments are up: consumers are more excited about purchasing luxury goods than they have been in recent years. For the first time since the disastrous

Exhibit 1:
Asked of luxury brand CEOs in Japan
What is your overall sales outlook for 2014 versus 2013?



¹ “Groundhog day?” *The Economist*, www.economist.com, April 5, 2014.

² “Consumer Confidence Riding a Strong Tailwind of Bonuses and Seasonal Consumption,” *Lifestyle Index Report – Consumer Trends*, Hakuhodo Institute of Life and Living. <http://seikatsusoken.jp/index/consumption/> (accessed July 3, 2014).

³ McKinsey Japan Luxury Consumer Survey, 2014.

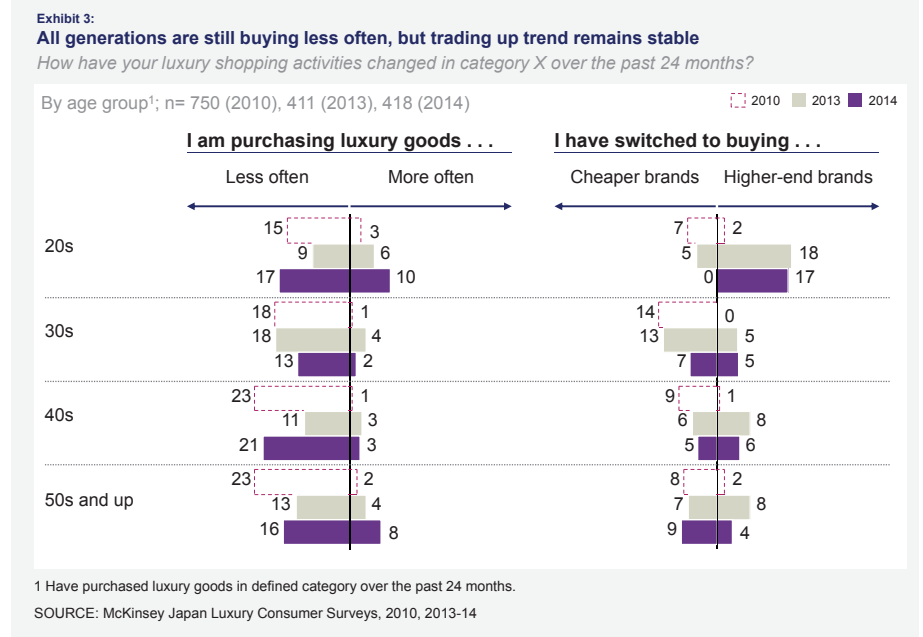
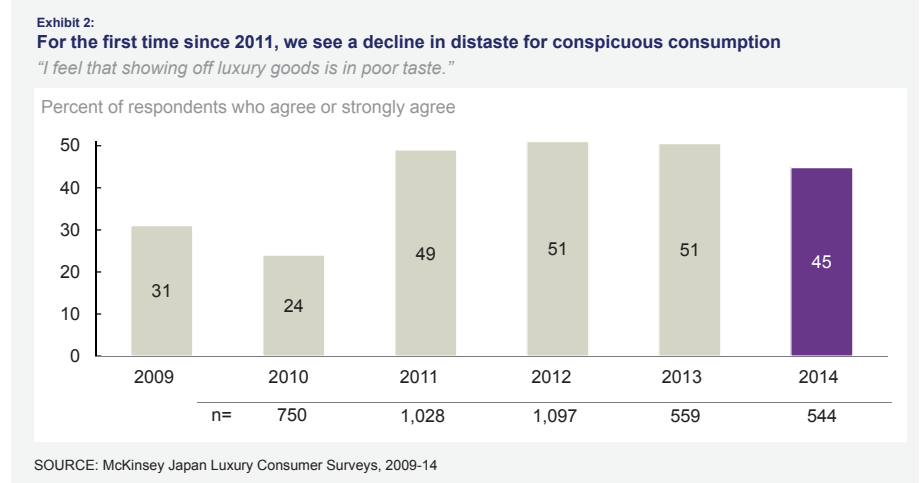
earthquake, tsunami, and nuclear accident of 2011, we have seen a decline in the percentage of respondents who feel that showing off luxury goods is “in poor taste” (Exhibit 2). And though our survey found that consumers of all ages are buying luxury goods less often than in the past and have maintained a strong value focus, the trend of trading up to higher-end, as well as to value, brands has largely remained stable (Exhibit 3).

For the second year running, our Japan Luxury Consumer Survey specifically asked respondents which brands they were buying. Not surprisingly, the top brands in each category reveal a mix of traditional luxury names together with a rising contingent of what US and European industry experts call “casual luxury” – brands which fit into the luxury category, but with slightly lower value-based price points. Other noteworthy findings from McKinsey’s 2014 Japan Luxury Consumer Survey follow.

Generation gaps widening

While there are clear similarities in shopping behavior across age groups, the differences are stark. In terms of similarities, we observe that all age groups still peer into storefront windows before checking their smartphone, PC, or a magazine. All age groups, as noted above, have cut back on their buying frequency and display greater value orientation than they have in the years before 2011. At the same time, average annual spend is up and there is a greater willingness to pay full price for luxury items across age groups, with a similarly uniform drop in the ratio of those who feel that “owning luxury goods is not as special as it used to be” (Exhibit 4).

A closer look at each age cohort, however, reveals a distinct consumer “personality” and even role in the overall luxury market. Those in their 50s and up, for example,



represent the bubble generation. Trained to consume and excited to try new products such as smartphones and electric vehicles, this segment loves classic luxury brands and is also generally well off. To a large extent, the 50s+ set still drives consumption trends in Japan.

Those in their 20s – the sons and daughters of the bubble generation – are of particular interest to luxury brands as they have no direct experience with the economic downturn, having come to adulthood just

as the economy has recovered. As such, they are seeing more full-time employment opportunities and stable incomes, have a more global perspective, and are more optimistic. At the same time, they are also a more practical generation than their elders, with a stronger value orientation, and are less likely to purchase luxury brands purely for the label.

In sharp contrast to this youngest of generations surveyed, those in their 30s and 40s are much more conservative,

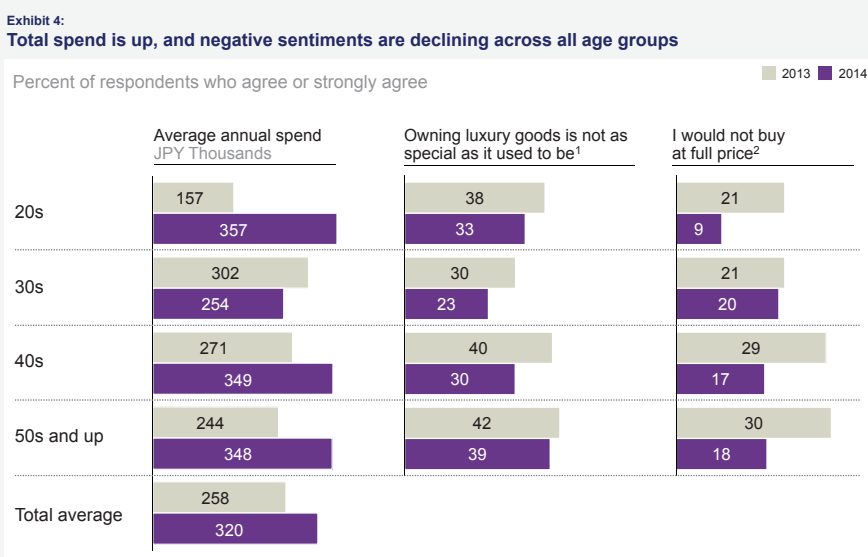
risk averse, and Japan-centric in their mindsets. Some executives we surveyed called this a “lost generation” for luxury, as they tend to have been traumatized by the economic downturn, are often in contract work situations, and on the whole have fewer assets than other segments.

Overall, consumer confidence and shopping behaviors have taken a positive tack. To that extent, high-end brands have good reason to feel upbeat about the Japanese luxury consumer, regardless of age. But there, resemblances between the 20 year-old, 35 year-old, and 50 year-old luxury consumer come to an abrupt halt. Brands taking a one-size-fits-all approach to luxury consumers risk alienating large swaths of their target customer base. Understanding not only a given segment's behaviors and preferred channels, but also its attitudes and values – that is to say, understanding the heart as well as the mind – is imperative for success.

Department stores: not down, definitely not out

As mentioned in last year's report, department stores are back as a destination, with sales for luxury items up for the first time in 16 years – hardly the expiring dinosaur many experts had forecast. Luxury buyer preferences, in terms of channel, have remained stable. Across categories, consumers turned to department stores for high-end purchases far more often than to any other channel, including brand shops, outlets, and duty free (Exhibit 5). In the watch/jewelry category alone, over 80 percent of shoppers visited department stores. In leather goods, department stores were a destination for nearly 70 percent of respondents, or 12 percent more than in 2013. In line with these findings, industry data reveals that total year-on-year department store sales are up for the first time in 16 years.⁴

4 Japan Department Store Association.



SOURCE: McKinsey Japan Luxury Consumer Surveys, 2013-14

Exhibit 5:
Department stores seem to be coming back in leather and watch/jewelry, while shoe sales may be shifting toward online
What channels did you use to buy luxury goods over the past 12 months?



SOURCE: McKinsey Japan Luxury Consumer Surveys, 2013-14

For luxury brands, a bit of backtracking may be in order. Just a year ago, over 60 percent of luxury brand executives saw the future of the department store as bleak, against just 3 percent who thought channel prospects were good. This year, those numbers are 40 percent and 15 percent, with a majority regarding the future of the department

store as good or neutral (Exhibit 6). Should brands be looking to department stores for growth? As you might expect, the answer depends largely on brand positioning and target segment. One thing is for certain: given their standing as a top shopping destination across categories, department stores will be a necessary, perhaps even a core, element

of most multi-channel strategies in the years to come.

Online comes of age

To be fair, online has been a mainstream information source in Japan for years now, though the storefront window remains the most popular source of information for luxury shoppers – hardly surprising in a country where department store is king (Exhibit 7). At the same time, we observe some new trends that suggest Japan's luxury buyers are growing more comfortable with the channel, and more astute about how to use it.

One new trend is the increased importance of word of mouth from online users. For shoppers under 50, online reviews and comments have surpassed direct mailings, online ads, and even TV commercials, in terms of their perceived helpfulness in making a buying decision. Even for those age 50 and up, online reviews and comments are still more relevant than online and TV ads.

Another interesting trend we found in comparing responses with the same questions asked in 2010 is that luxury shoppers today are less concerned about receiving a fake product or not being able to return a product when buying online. This greater confidence in shopping online is reiterated in a much lower ratio of those who would only buy online if they could get a lower price. At the same time, more luxury consumers agree that the online channel is useful for buying hard to find items (Exhibit 8).

In contrast with these trends, nearly a quarter of luxury brand executives we surveyed said that digital marketing was “not important” to their overall marketing effort in Japan (Exhibit 9). Further, 60 percent of these executives told us that

Exhibit 6:
Asked of luxury brand CEOs in Japan
What is the future of the department store in Japan?

1. Good
2. Neutral
3. Bleak

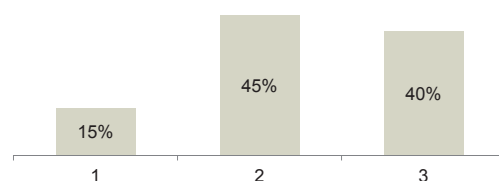


Exhibit 7:
Information sources largely remain the same, with storefronts and windows still key
How helpful are the below sources when buying luxury brand products?

Weighted average on a 10 point scale
(10 = most informative, 1 = not informative at all); n = 544

	All ages	20s	30s	40s	50s and up
Storefront/windows	8.0	7.4	7.8	8.3	8.2
Word of mouth from friends and relatives	6.7	6.4	6.5	6.6	7.2
Magazine articles	6.6	6.4	6.5	6.9	6.6
Magazine ads	6.1	5.6	6.0	6.3	6.2
Word-of-mouth from online reviews/comments	5.7	5.4	6.0	5.8	5.5
Direct mailings	5.3	4.3	5.2	5.4	5.8
Online ads	5.3	4.3	5.4	5.4	5.3
TV ads	4.9	4.2	4.9	4.9	5.2
Direct e-mail to PC	4.7	3.6	4.6	4.7	5.1
Direct e-mail to mobile	3.8	3.1	4.0	3.7	3.8

SOURCE: McKinsey Japan Luxury Consumer Survey, 2014

Exhibit 8:
Coming of (digital) age: online is increasingly viewed as a source for locating hard-to-finds as 2010 concerns about fraud and after-sales wane
How strongly do you agree with the below comments?

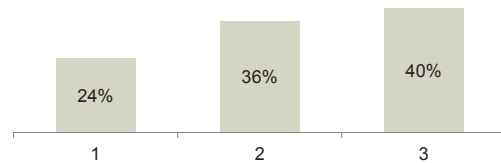
Percent of respondents who agree or strongly agree; n = 750 (2010), 544 (2014)

	2010	2014
I worry that some products may not fit me (e.g., apparel, shoes)	65	67
I'm uncomfortable buying high-end luxury items online without seeing and handling them first	58	56
I worry that I'll end up buying a fake product if I purchase online	60	52
I'm concerned about after-sales service for items purchased online (e.g., return policy)	53	45
Online is a good channel to buy hard-to-find luxury goods (e.g., not available in Japan)	30	39
I'm uncomfortable buying any type of product online	28	29
I would buy luxury goods online only if the price were at least slightly lower than in other channels	34	27
The upscale service that I receive in physical stores when I purchase a luxury product is important to me	24	25
The benefits (point cards, discounts, gifts) that I receive when buying luxury products in physical stores are too valuable to give up	25	22
Online is a convenient channel for people like me to buy luxury products	16	15
My perception of shopping for luxury items online has improved over the past 12 months	9	7

SOURCE: McKinsey Japan Luxury Consumer Surveys, 2010 and 2014

Exhibit 9:
 Asked of luxury brand CEOs in Japan
 Relative to your overall marketing effort in Japan, how important is digital marketing?

1. Unimportant
2. Somewhat important
3. Very important



the percentage of their marketing budget allocated to digital marketing was 10 percent or less. To some extent, these responses likely reflect realities on the ground today – more than three quarters of executives surveyed said that online sales account for five percent or less of total Japan sales – rather than where the market is headed.

For luxury brands, the importance of generating positive word of mouth is growing fast. They need to move quickly to identify and sample key opinion leaders well in advance of product launch to ensure online reviews and product comparisons are ready when the product goes to market. This may mean brands will need to take a hard look at their current marketing budget allocation to ensure they have the resources to capture share of customers who get their information online.

Get smart

Closely related to the growing affinity with online resources and online buying is the digitization of the shopping experience. Digital is now an inevitable part of the consumer journey – this is true in luxury, true across age groups, and the numbers are growing fast. In 2013, 84 percent of those in their 20s had a smartphone or PC and used it for their most recent luxury purchase. In 2014, the figure is now 93 percent.

Without question, brands targeting younger consumers simply must have a robust online presence optimized for smartphones, tablets, and other mobile devices.

Luxury brands today doubtless face a difficult challenge in knowing how to fully leverage digital and mobile. Potential solutions are numerous, but brands that take a reactive stance risk quickly falling behind in this rapidly shifting shopper landscape.



Clearly, the longer term implications of the 2014 tax hike are the stuff of mere conjecture at this point. Projections on consumer confidence and the economy as a whole run the gamut from doom and gloom to roses and daffodils. And even if, as early signs suggest, Japan emerges from the increase unscathed, 2015 could rehash these same concerns as taxes go up yet again.

The early results, however, suggest that Japan's luxury consumer is resilient, and that the market is at last rebounding from the impact of 2011. Luxury brands attuned to their customers' preferences, in terms of where and how they shop, are likely to meet with success.

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