

Changing times, shifting targets

Brands pivot to capture
new sources of growth

McKinsey 2015 Japan Luxury
Consumer Survey Report

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McKinsey 2015 Japan Luxury Consumer Survey overview

- Conducted April 2015 (McKinsey has conducted a Japan survey every April or May since 2009)
- 598 Japanese consumers purchasing luxury within the past 24 months
- 71% female, 29% male respondents
- Each respondent allocated to one of 4 categories (each including 122~142 respondents) within their purchased category
- Luxury users screened against 81 fashion brands, 57 leather goods brands, 46 watch/jewelry brands and 55 shoe brands
- Nationwide survey



Ways change with the territory.

Japanese proverb

Japan's luxury market of years past was akin to a dartboard with a red center nearly as large as the board itself: brands couldn't help but hit the bull's-eye. Their target, that homogenous shopper segment known as the middle-aged Japanese consumer, could be won with relative ease using a formulaic, straightforward, and reliable approach that involved little more than high-touch but undifferentiated services, and lookalike stores on seemingly every corner.

Today this market looks quite different. There are a bevy of targets, all of them moving, and brands must apply a far greater degree of marketing precision and anticipation. They must now attract new and unfamiliar markets and segments that will be key sources of growth going forward, including millennials, who are new to luxury, increasingly sophisticated digital models, and an influx of voracious tourist-shoppers, largely from the Asian mainland.

The challenge, in short, is to win in a vastly more complex and nuanced Japan luxury market. To adapt, luxury brands will need to rapidly target diverging segments by shifting and reshaping their in-store practices, marketing strategies, digital presence, and even approaches to online information gathering. Winners could well be rewarded with significant top line and margin growth.

In the wake of the hike

The April 2014 sales tax hike from five to eight percent saw government tax revenue in 2014 hit its highest point since 1993 (JPY 54 trillion, up nearly 15 percent year on year). A further planned jump from eight to ten percent has been pushed

back, most probably to 2017, to give consumers and businesses, alike, a little more breathing room.

For luxury brands, the increase in consumption tax certainly hurt sales in the short term, but results appear to have been generally within expectations. In a live voting survey at a luxury sector event in Japan hosted by McKinsey, over half of luxury brand executives indicated that their sales for summer, fall, and winter 2014 were either much better or somewhat better than expected.¹ Results were not uniform, however, as a full 20 percent indicated that they had taken a harder hit than they were expecting over the same period.

Consumer confidence has seesawed in the months since the tax hike, but has shown an overall recovery trend over the course of 2015. For consumer products overall, the tax increase has driven two strong trends: lower purchase frequency and increased trading up. For luxury brands, results are mixed. Consumers indicate that, as with general products, their luxury goods purchases are also less frequent, but whether they are trading up or not depends on the subcategory [Exhibit 1]. Experiential spend, for instance, held steady or even increased in areas such as travel, dining out, hobbies, and self-care services (e.g., spas). Luxury goods, by contrast, saw a decline both in frequency and price range across categories, with leather goods and watch/jewelry in particular seeing a significant drop [Exhibit 2]. Add to this a slight uptick in the percent of Japanese consumers who say they find conspicuous consumption to be in poor taste, and it seems as though some luxury categories in Japan could be facing at least a slight uphill climb.

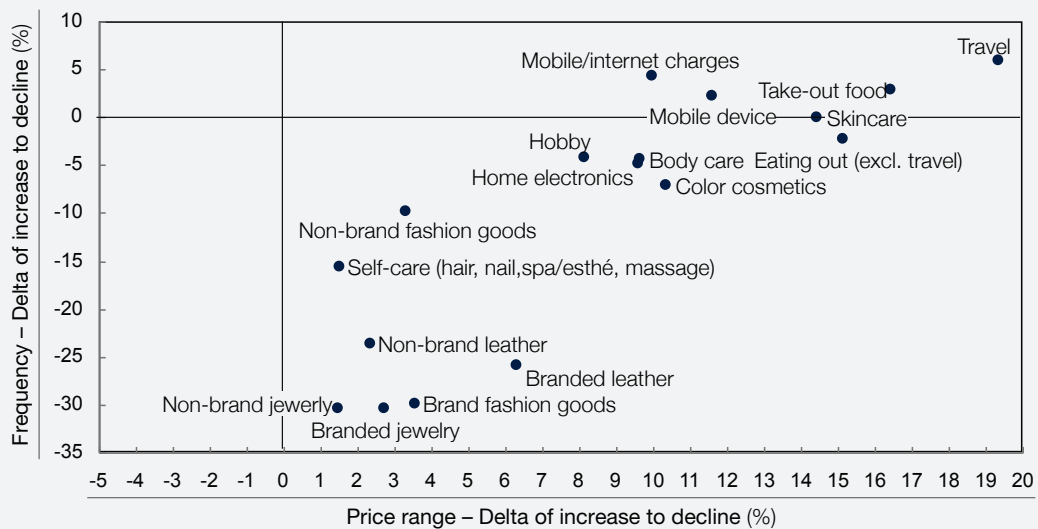
¹ McKinsey Luxury Goods Survey, 2015.

Exhibit 1

The April 2014 tax hike affected frequency, but with variable results on trading up and trading down

How did frequency/price of purchasing change before and after the 2014 tax increase?

Percent Delta between respondents who answered "increased"/"substantially increased" and "declined"/"substantially declined"; n=598



SOURCE: McKinsey Japan Luxury Consumer Survey 2015

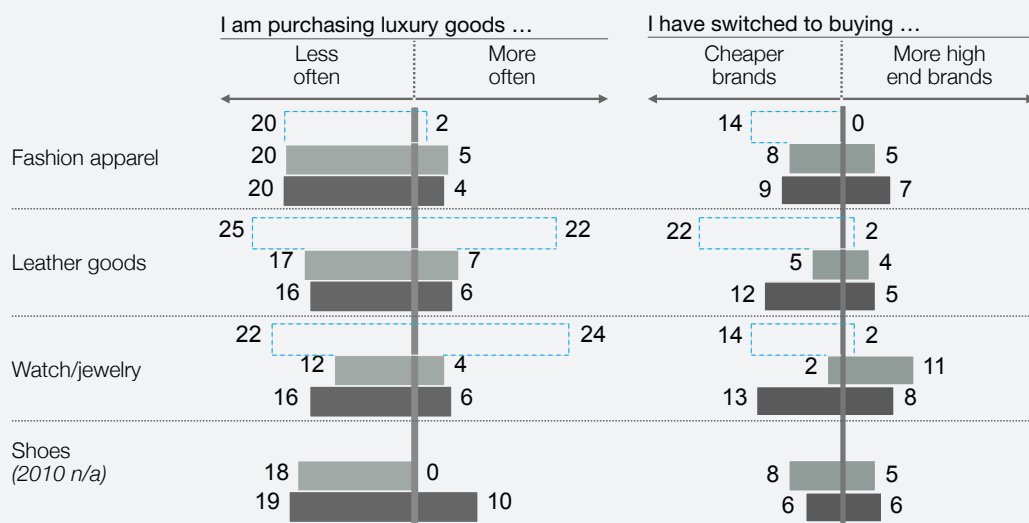
Exhibit 2

Trading up and trading down trends are bipolarizing across categories

How have your luxury shopping activities changed over past 24 months?

Percent who answered "Yes", current luxury purchasers by category¹; n = 418 (2014), 539 (2015)

2010 2014 2015



¹ Have purchased luxury goods in defined category within last 24 months

SOURCE: McKinsey Japan Luxury Consumer Survey 2014, 2015

The mystifying millennials

Amid these shifting trends, many luxury brand executives have started to cast their gaze toward Japan's millennials as a growth opportunity. To date, the young adult segment remains largely closed to luxury brands, and has been tricky to unlock [Exhibit 3]. In a market accustomed to clear differences across age segments, from high-saving, brand-affiliated retirees to credit-friendly, value-oriented thirty-somethings, the millennials present a bit of a conundrum, and luxury brand executives are keen to understand the way they think and consume.

Our research finds that those in their 20s

- disagree, more strongly than any other age group, that owning luxury goods “is not as special as it used to be”
- confirm, by nearly 60 percent, that they have particular brands they aspire to own
- are more willing than their seniors to stretch their budget to buy luxury items (even for

watches and jewelry, a category which we have just noted is seeing consumers shift to cheaper items) [Exhibit 4]

On the other hand, we found similarly firm responses that millennials

- feel guiltier than their seniors about spending money for luxury items [Exhibit 5]
- are vastly more pessimistic than other age groups regarding future opportunities to buy luxury [Exhibit 6]
- would not be willing to buy luxury items at full price

This apparent dichotomy of traits becomes even more puzzling when we consider that for many of the above attributes, the proportion of respondents holding the opposite view (i.e., the “minority” position) is not much smaller than the majority position.

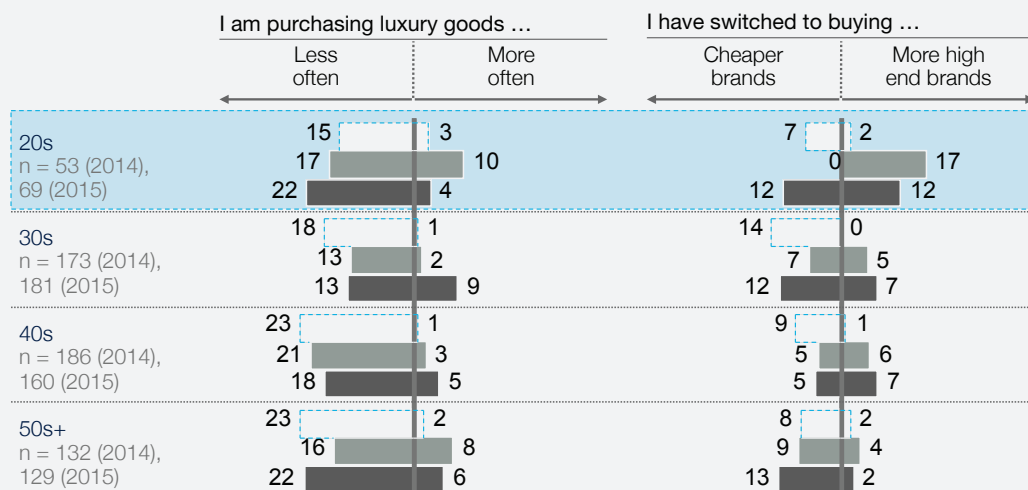
Exhibit 3

Millennials have largely been closed to luxury brands and remain a difficult segment to unlock

How have your luxury shopping activities changed in category X over the past 24 months?
– by age group

Percent who answered “Yes”, current category luxury purchasers by age group¹; n = 418 (2014), 539 (2015)

2010 2014 2015



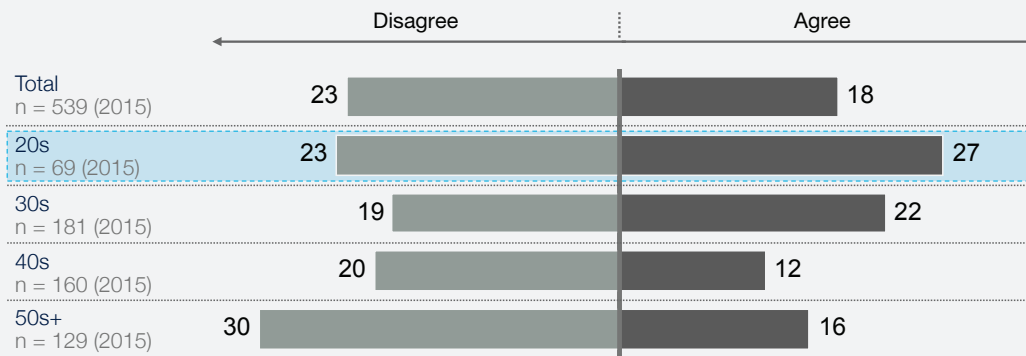
¹ Have purchased luxury good in defined category within last 24 months
SOURCE: McKinsey Japan Luxury Consumer Survey 2014, 2015

Exhibit 4

Millennials are more polarized than older generations on pushing their budgets for luxury

“I want to buy expensive watches/jewelry on special occasions even if it pushes my limits”

Percent of respondents who selected “agree”/“strongly agree” (top 2 on scale of 6) and “disagree”/“strongly disagree” (bottom 2 on scale of 6)



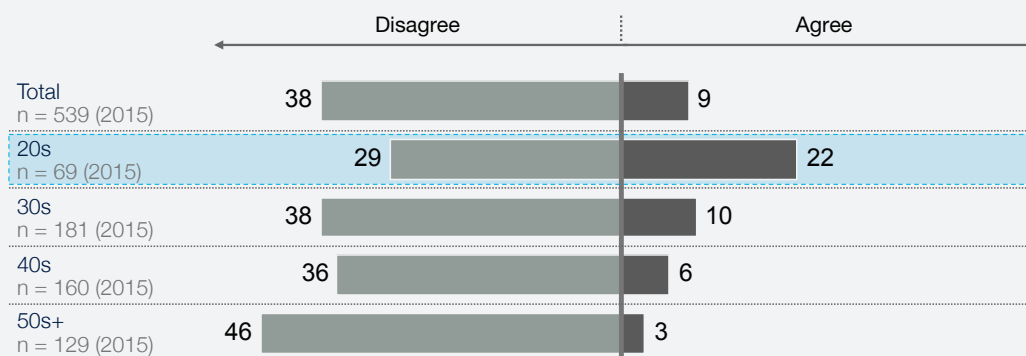
SOURCE: McKinsey Japan Luxury Consumer Survey 2015

Exhibit 5

Millennials, who came of age in the downturn, feel guilty about spending money on luxury goods

“I feel guilty about spending money for luxury goods”

Percent of respondents who selected “agree”/“strongly agree” (top 2 on scale of 6) and “disagree”/“strongly disagree” (bottom 2 on scale of 6)



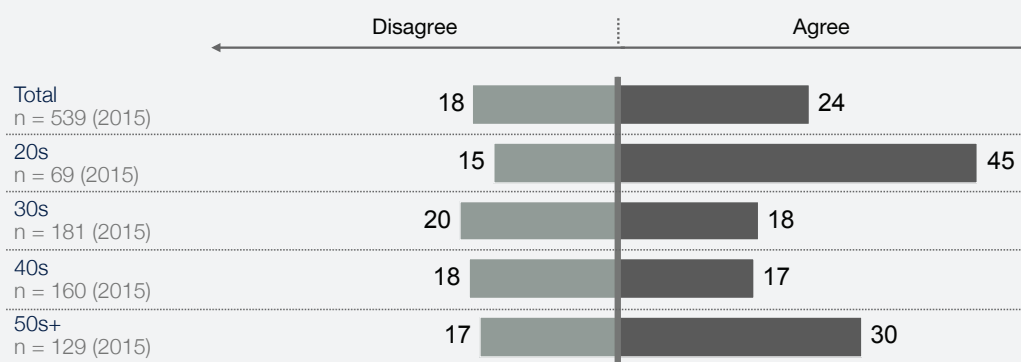
SOURCE: McKinsey Japan Luxury Consumer Survey 2015

Exhibit 6

Despite high aspirations, millennials are pessimistic about their own outlook for purchasing luxury in the future

"I think opportunities to buy luxury goods will decline for me in the future"

Percent of respondents who selected "agree"/"strongly agree" (top 2 on scale of 6) and "disagree"/"strongly disagree" (bottom 2 on scale of 6)



SOURCE: McKinsey Japan Luxury Consumer Survey 2015

Individual as they are, millennials do seem to share a few defining characteristics. By and large, they are already as practical about luxury spending as their seniors [Exhibit 7]. They agree in roughly the same proportion as older age groups that "functional" and "convenient" are more important buying factors for luxury items than

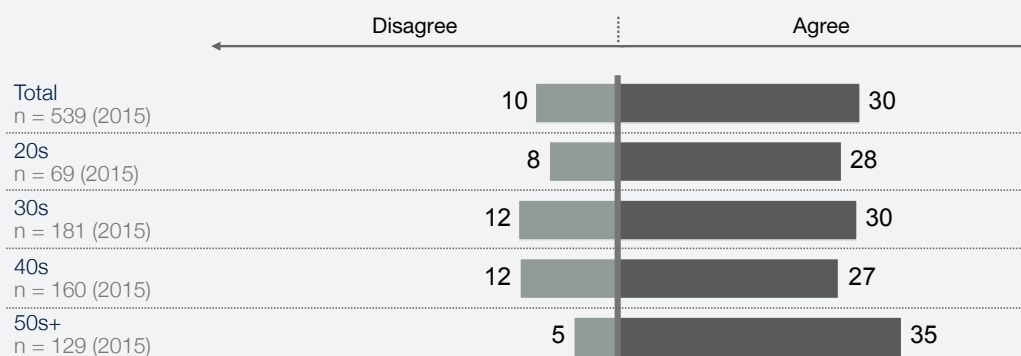
they were several years ago. At the same time, they clearly diverge from older consumers in that they are less likely to view affordable brands as an attractive alternative for pricier luxury brands; here too, however, millennials reveal something of a split personality, with only a slightly smaller group regarding affordable brands as attractive.

Exhibit 7

Japan's millennials are already as practical about luxury as their seniors

"Compared to a few years ago, it is more important for me that luxury goods are functional and/or convenient, compared to simply indulging my feelings"

Percent of respondents who selected "agree"/"strongly agree" (top 2 on scale of 6) and "disagree"/"strongly disagree" (bottom 2 on scale of 6)



SOURCE: McKinsey Japan Luxury Consumer Survey 2015

And while consumers across age segments are spending more on travel, dining and other experiences as opposed to brands, this behavior is strikingly more prevalent among millennials.

To capture this complex segment going forward, luxury brands may need to do even more in terms of millennial “upbringing,” and taking the brand experience beyond basic product ownership.

Not “going” digital... Gone digital

Not surprisingly, virtually all millennials responding to our survey had a smartphone, with 40 percent having used it for their last luxury purchase, and many in this age group value online consumer reviews and ratings as an important source of information.

We hasten to add, however, that this clear shift toward online research and purchase is no mere youth movement. Smartphone and tablet use for luxury shopping is climbing in all age segments, with those in their 30s being the most active

online shoppers [Exhibit 8]. This “new” reality has not gone unnoticed by Japan’s luxury players, with 87 percent of the executives we surveyed calling digital marketing either somewhat or very important to their overall marketing effort in Japan. Perhaps even more telling is that fully 60 percent of luxury brand executives estimate that the ratio of their marketing budget allocated to digital is between 10 and 50 percent. A year ago, far fewer luxury executives could make that claim; qualitatively speaking, CEO interest in increasing digital marketing spend was tepid at best until last year. Clearly, perceptions have changed.

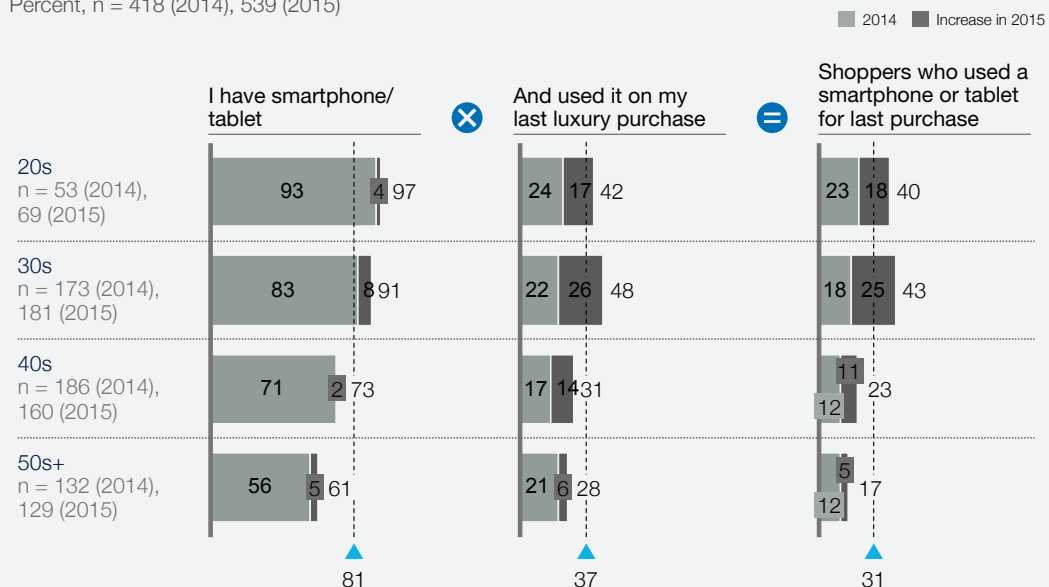
Key to “getting digital right” going forward will include meeting consumers’ online needs, such as the ability to check inventory stock of products before going to a physical store, and presenting a product from multiple angles and in different light settings to help consumers capture “true” product visualization. Put plainly, luxury players clearly realize the importance of mobile and digital. The

Exhibit 8

Mobile usage in luxury shopping has roughly doubled across all age segments

Do you own a smartphone or tablet? Did you use it for your last luxury purchase?

Percent, n = 418 (2014), 539 (2015)



SOURCE: McKinsey Japan Luxury Consumer Survey 2015

question is whether, and to what extent, they are acting on what they already know.

The Chinese tourist factor

Another topic which was hot among luxury brand executives last year was the increased impact of tourism shopping in Japan. According to the Japan National Tourism Organization the country welcomed around 13.4 million tourists in 2014, the highest annual number on record. Of those, roughly 2.41 million, or about 18 percent, came from mainland China.² Amid their trips to famous landmarks and resorts, Chinese tourists in Japan are clearly visiting stores and shopping—often and at volume—for luxury items. The phenomenon even has its own sobriquet in Japanese media: *bakugai*, or “extreme shopping.” Indeed, nearly 60 percent of CEOs surveyed said that Chinese consumers represent more than 15 percent of their total Japan sales.

The rise of the middle class and growing affluence in China are certainly helping to drive this trend. Another part of the puzzle, though, is the weakened Japanese yen. Long gone are the days when Japanese shoppers would fly to Hong Kong for the sole purpose of picking up a few high-end suits or luxury designer outfits at rock-bottom prices. Today, the trend has actually reversed itself, with citizens from Hong Kong, whose currency is dollar-pegged, as well as those of mainland China, flying to Tokyo and Osaka in search of cheaper deals.

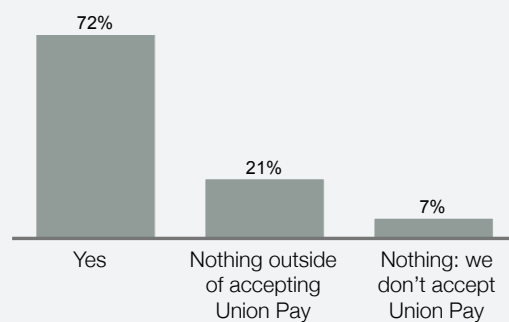
The relevance of the Chinese tourist contingent is even affecting luxury brand store operations. The ratio of luxury brands that have a specific store strategy in Japan targeting Chinese shoppers has soared to 73 percent this year, or nearly double last year’s 37 percent [Exhibit 9].

And despite ambivalence among luxury executives regarding the continued relevance of the department store format in Japan (over half are “neutral” regarding its future) its importance

2 JNTO press release dated Jan. 20, 2015 (http://www.jnto.go.jp/jpn/news/data_info_listing/pdf/150120_monthly.pdf)

Exhibit 9

Do you have a store operation strategy or approach specifically defined for Chinese tourists shopping in Japan?



for capturing Chinese luxury consumers is unquestioned. The Japan Department Store Association cited that its 2014 summer sales increase in luxury was supported in large part by Chinese tourists.³ Isetan Shinjuku, a major metropolitan store, also claimed that during the month of August 2014, Chinese consumers accounted for 10 percent of total store sales. And the tourist business bug has not only bitten department stores, but also general retailers such as drugstores and general merchandise stores, many of which are installing duty free services in-store to capture travel shoppers.

Some luxury CEOs we spoke with have expressed foreboding over the rising influence of Chinese travel consumers, the shift in store strategy to address their needs, and how these changes may affect the behaviors and appetites of local Japanese consumers. This is a story that has yet to play out, but the concern is not wholly unwarranted. Some, for instance, have commented that they are torn when it comes to balancing resources and customer experience between, on the one hand, the Chinese consumers who flood their stores, and on the other, local Japanese customers who

3 Japan Department Store Association, 平成 26 年 8 月百貨店売上高概況 http://www.depart.or.jp/common_press_release/list/0?page=2

are traditionally the foundation of their business. Expectations around language requirements, especially in areas with heavy tourist foot traffic, are already shaping brand sales planning; getting staff allocation right in terms of Chinese-speaking staff versus local staff, is a key discussion.

Still others have pointed to a subtler, hard-to-quantify difference between the *bakugai* shopping style, which calls for a more efficient and fun experience involving vast product selections, and the more personalized, considered approach typical of Japanese luxury shoppers, who tend to view the buying experience as an important, even solemn, event [Exhibit 10]. Striking a balance between two such polar opposite shopping preferences is likely to be no small task.

Making the transition

Far from being a market past its prime, Japan holds much potential for top line and margin growth going forward. For proof, look no further than the luxury executives we surveyed, who

remain staunchly positive about the future. In fact, fewer than 10 percent expected somewhat lower sales in 2015 compared with a year prior.

The many changes occurring in the Japan market, taken altogether, point to a clear, actionable path for winning. Japan should no longer be painted as a simple, homogenous market where brands can expect to succeed with a one-size-fits-all approach. Going forward, luxury players will need to serve highly differentiated consumers from varied cultures and interests—simultaneously. They will need to provide seamless, omni-channel experiences, customized and segmented across channels, and even within each channel. That includes digital, of course, but also diversity of customer experience in physical stores.

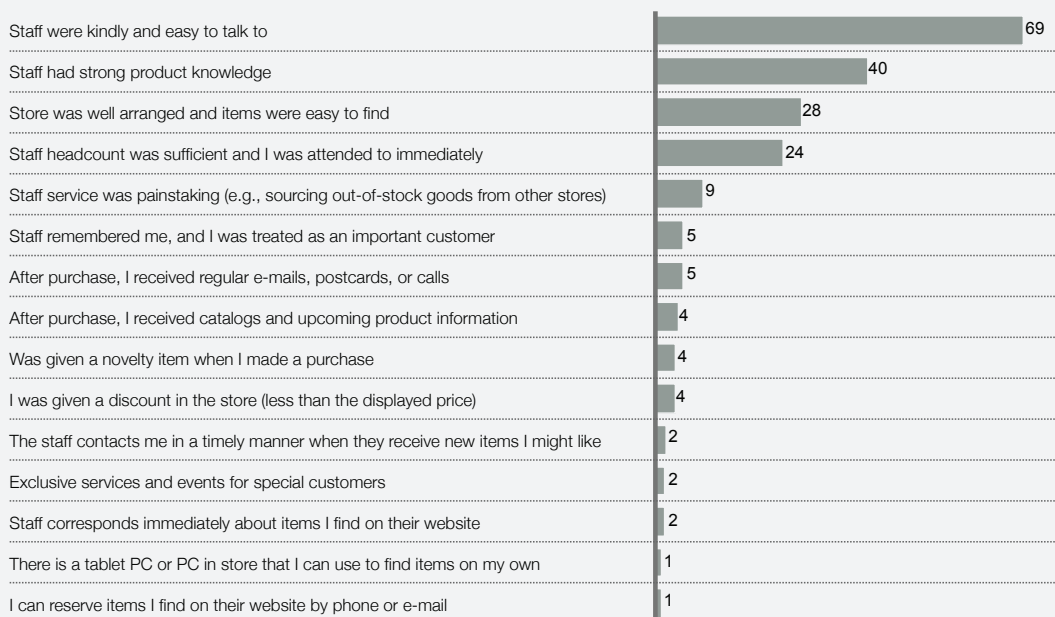
Most essential, brands must put forth more demanding and sophisticated business and talent development models. The winning brands will not merely navigate, but adapt to and ultimately shape, Japan's nascent luxury channels and segments.

Exhibit 10

Japanese luxury consumers expect attentive, knowledgeable service

What kind of service did you appreciate most in the luxury brand store you feel has the best service?

Percent; all respondents (n=598); multiple answer (maximum 3)



SOURCE: McKinsey Japan Luxury Consumer Survey 2015



