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South Korea: Living it up in luxury

Special Report:
2010 Luxury Goods Survey
McKinsey & Company South Korea

South Korea: Living it up in luxury

South Korea is different.

Overall, the economy is booming, and even the financial crisis could not derail it. Korea weathered the 2008-09 global economic crisis surprisingly well, and although GDP took a substantial hit for two quarters, the market quickly regained momentum in mid-2009. Korea is now expected to be among the first countries to exit the recession, with a GDP growth rate forecast at 5.8 percent for 2010, according to a Korean Ministry of Strategy and Finance announcement in late June 2010.

The luxury market also surpassed expectations. Unlike in Japan, Europe, or the US, where the sale of luxury goods has either stagnated or shrunk, the market for high-end designer clothing and accessories is thriving in South Korea. Between 2008-09, sales rose 16.7 percent in department stores, the main channel for the sale of Korean luxury goods; after China, that was the fastest rate for any major market in the world.

Based on independent McKinsey research recently conducted on Korean luxury goods customers' purchasing behaviors and attitudes toward luxury goods, we expect Koreans' love for luxury to continue. And most lapsed customers (80-90 percent depending on the category) indicated that they intend to start buying luxury products again. With the economy showing signs of recovery, we expect the return of these buyers sooner rather than later.

That is the opportunity. The difficulty is that South Korea presents companies with unique challenges and the winners will be

those who understand the retail landscape and strategically manage their brands and businesses for the long-term.

The stakes are high. With four percent of global sales, South Korea has become a pillar of the international luxury industry. Luxury is a \$4 billion industry, accounting for more than 15 percent of all fashion spending. It is also becoming part of the fabric of Korean life.

For example, at Shinsegae, one of the primary department-store groups, the number of foreign luxury labels for sale has risen from fewer than 20 in the early 2000s to almost 300 by 2009. Greater variety has increased competition among brands, and driven changes in shopper behavior. [Exhibit 1]

Findings from our research suggest that the persistent strength in the South Korean

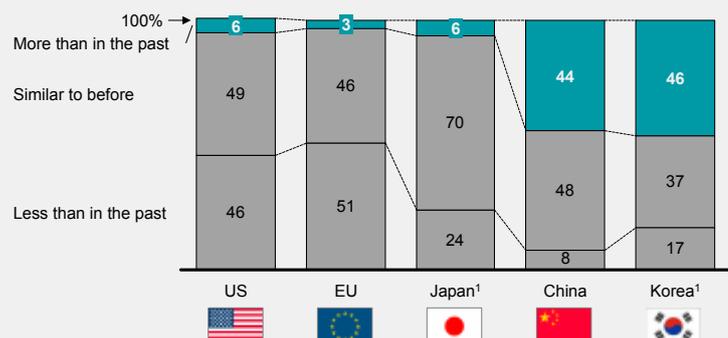
luxury market is driven by two important "soft" factors: a love of luxury and peer pressure.

Koreans are "luxury friendly" as few cultures are. For example, only 5 percent of Koreans say they feel guilty about how much they spend on high-end products, compared to 10-15 percent in other developed countries. Only five percent of respondents in Korea said that "I think buying luxury goods is a waste of money."

The pressure to conform, in the sense of keeping up with the neighbors, may also be more intense. Korean luxury consumers stay on top of trends, and showing off their latest luxury purchases seems to come naturally. While 45 percent of Japanese and 38 percent of Chinese believe that "showing off luxury goods is in bad taste," only 22 percent of Koreans do.

Exhibit 1
Korea is one of the few resilient luxury markets

How has your spending on luxury changed over the past 12 months?
Percentage of respondents



¹ Weighted average of three categories

SOURCE: McKinsey primary consumer research (Italy, France, UK, China, US, March 2010; Japan, Korea, May 2010)

In our survey, 60 to 70 percent of respondents mention finding enjoyment in “the functional or emotional value of wearing luxury items” as the leading reason for increasing purchases. The rising awareness of products and the improved convenience offered by distribution channels were the next most-cited reasons. [Exhibits 2, 3]

Our research identifies a number of interesting category, consumer, and channel trends that collectively point to a continued surge in luxury consumption in South Korea.

Not all categories behave the same

Sales of luxury bags and shoes grew significantly in 2009 (10 to 30 percent,

depending on the label). Watches and jewelry sales more than doubled. Fashion apparel, however, grew less than 5 percent. Some luxury players’ apparel sales even regressed from 2008 figures.

The general trend among shoppers in South Korea is to trade up rather than down. For leather goods/accessories and watches/jewelry, 18 and 19 percent of those surveyed said they had recently traded-up to pricier brands. Only 5 percent said they purchased cheaper brands. For fashion apparel, by contrast, nearly as many had traded down as up. As one industry expert told us, “Fashion apparel functions less as a status symbol than leather goods, watches, or jewelry, so customers are more willing to trade down.” Over half of consumers who spent less on high-end apparel agreed

that “affordable brands are good enough.” [Exhibit 4]

New luxury consumer segments are emerging

Wealthy women in their 40s to 60s have been the traditional core market for luxury brands. But with fewer financial responsibilities, increased openness to new ideas, and an eagerness to define themselves through how they dress, Koreans in their 20s and 30s have emerged as an exciting new demographic for retailers. At Lotte’s Avenue L, a high-end branch of the Lotte department store chain focused on luxury goods, 20- to 30-year-olds comprised 35 percent of shoppers in 2006, but 44 percent in 2009.¹ This

Exhibit 2
Compared to other countries, Korean customers are happier about how much they spend on luxury goods

“I feel guilty about how much I spent on luxury goods”
Percentage of respondents who selected agree and strongly agree (top 2 on scale of 6); 2010¹

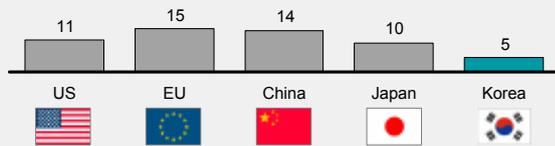
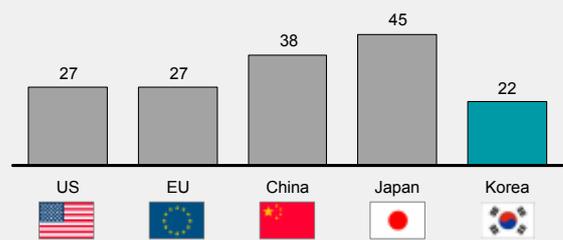


Exhibit 3
Korean customers feel less uncomfortable about showing off luxury goods to others

“I feel that showing off luxury goods is in bad taste”
Percentage of respondents who selected agree and strongly agree (top 2 on scale of 6); 2010¹



¹ Current and lapsed customers (customers who have not purchased in past 24 months for Korea; customers who have not purchased in past 12 and 24 months for Japan)
SOURCE: McKinsey primary consumer research (Italy, France, UK, China, U.S., March 2010; Japan, Korea, May 2010)

Exhibit 4
Although current customers have purchased more often for all categories, they are less willing to trade up or to purchase at full price for fashion apparel

How has your luxury shopping activities changed in category X over the last 12 months?
Percentage of customers who answered “yes”, “current” category luxury purchasers by category



SOURCE: 2010 Korea Luxury Survey

should be a particularly encouraging sign for retailers since, compared to older shoppers, younger ones tend to spend greater portions of their disposable income on high-end clothing and accessories. Our survey suggests that consumers aged 18-to-24 and 24-to-29 are the most enthusiastic about luxury goods, with 34 percent and 29 percent respectively declaring that “buying luxury goods is exhilarating,” compared to 20 percent or less for older consumers. Our research also reveals that awareness-building is important for both age groups. “I have a better understanding of luxury products” was a predominant reason for purchasing among this group, in addition to “I have come to enjoy the value of wearing luxury items.” Brands such as LVMH and Gucci have succeeded in capitalizing on the rise of this consuming class by introducing entry-level items such as \$1,000 dollar bags. More accessible brands like Coach benefited from the trend, too. [Exhibit 5]

Men are another emerging market. Shopping has become more common and accepted among Korean males, reinforced by pervasive messages on television, over the Internet, and in print media. While women remain the primary luxury market, a fashion industry magazine reported a 29 percent jump in male buyers, compared



to 12 percent among women. Savvy department stores have designated special enclaves to cater to the growing legions of men keen on shopping. Lotte department store, for example, expanded the space of its “Choix d’Adam” section, which is decorated to evoke masculinity and exclusivity, and stocked with goods for men. In fact, according to our research, men identified “better channel accessibility” as a key driver behind increased luxury purchases. In fashion apparel, for instance, 73 percent of men selected the statement: “It has become more convenient to purchase luxury goods” as the biggest reason for purchasing, compared with 43 percent for women.

New luxury channels are coming of age

While department stores remain by far the most important channel for luxury in

Korea, new channels, such as premium outlets and online shops, are generating traffic. Perhaps not surprisingly, it is South Korea’s major department store chains—Lotte, Shinsegae, and Hyundai, which together account for three quarters of all luxury sales—that are helping to develop these newer channels and thus extending their influence through diversification.

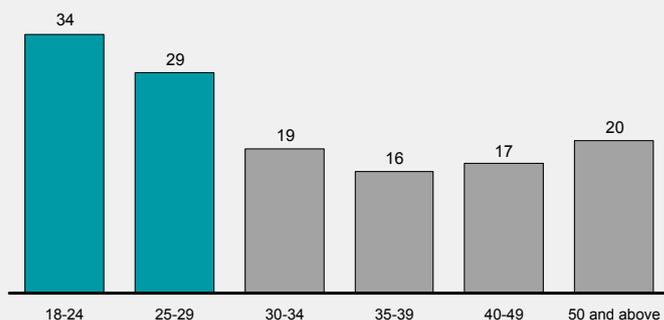
- **Department stores** remain the premier sales channel, thanks to strong relationships with shoppers, discounts and special offers, and non-monetary incentives provided through loyalty-club memberships. These programs offer benefits ranging from cash rebates and special gifts to free parking and VIP lounge access. In 2009, more than 70 percent of respondents bought luxury goods at department stores, which are omnipresent, with strategically located, self-contained structures. Luxury players recognize their importance. For instance, 60 percent of Bulgari watch sales were through department stores in 2009²

- **Brand boutiques** are a staple of many luxury brands. While offering visibility, our data suggests that visits, purchases, and conversion rates tend to be three-to-seven percent lower, depending on the category, than for department stores “Our brand shops do not actually make money due to the large retail space and high labor costs; it is there more for symbolic reasons,” according to one luxury company executive. That said, our research suggests that, done right, a small number of brand boutiques can

Exhibit 5
More excitement in purchasing luxury goods expressed among young customers

“Buying luxury goods is exhilarating”

Percentage of respondents who selected agree and strongly agree (top 2 on scale of 1 to 6) by age group; 2010¹



¹ Current and lapsed customers (customers who have not purchased in past 24 months)
SOURCE: 2010 Korea Luxury Survey

serve as powerful communications and marketing tools. Maison Hermès, which opened in 2006 at Seoul's Dosan Park, is a 10-story building with just two floors of retail, and the remainder occupied by restaurants, an atelier, and an art gallery, all intended to provide a unique Hermès experience

- Premium outlets** are another, relatively new, sales channel. These are shops located away from city centers that specialize in bargain-priced, off-season goods. Department stores, which also own the outlets, have succeeded in launching the format by encouraging the brands that they act as agents or partners for. Though only about 10 percent of Korean consumers in our survey said they had visited premium outlets for a luxury goods purchase in the past 12 months, revenue growth has been impressive. Kimhae Outlet, opened by Lotte in 2008, last year declared a 155 percent increase in sales. Shinsegae will open its second location, in Paju this year, and a third planned for Busan

- E-commerce** is emerging as a useful marketing, communications, and e-commerce platform. Online shopping is hardly new in South Korea, which is one of the most wired countries on the planet. In fact, more than 40 percent of our online survey respondents have visited an online channel at least once for a luxury goods purchase. Also, 35-45 percent of current customers mentioned they were purchasing more online than in the past. At the moment, however, it is primarily the less expensive items that are moving, with an average purchase of about \$50 per item, compared with over \$100 per item, offline. Many Koreans resist making big purchases online because of concerns about authenticity, sizes, after-sales service, and the need to see and touch the product before buying [Exhibit 6]



Compared to China or Japan, South Korea's luxury goods market looks small. But its growth and diversification should give luxury-goods makers pause. Investing an appropriate amount of management time on the following considerations could prove highly profitable:

Exert tighter control of the brand image:

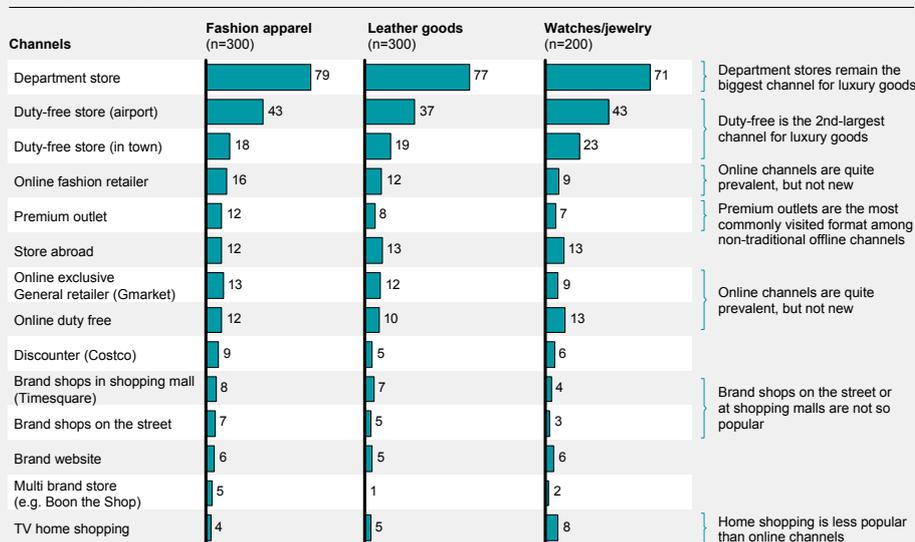
Given the need to target emerging luxury consumer segments with "entry level" product lines, the most effective luxury narratives in South Korea will need to emphasize the brand story and protect the prestige associated with it. "Affordable luxury" items have become an important strategic element in the product-mix for capturing a wider consumer market, but a brand needs to guard against making the label feel too accessible or common. Koreans, remember, are more often looking to trade up than down. There are multiple approaches for addressing this issue. Armani, one of the most popular luxury apparel brands in Korea, captures customers in its most accessible tier and preserves their loyalty as they move up from Emporio Armani to Armani Collezioni, and finally to Giorgio Armani Black Label. Hermès has enjoyed much success with under-\$500 bracelets, which are accessible to younger customers with thinner wallets yet allow the company to maintain its price point and brand prestige.

Invest in CRM:

Given the dominant position of Korean department stores, most customer transactions—and in many cases the transaction data—are owned by retailers. Over the long-term, luxury brands will need to build and maintain relationships directly with their consumers to learn from them. An important start is to gather proprietary customer data. As membership programs proliferate, however, customers are less inclined to undertake the often cumbersome enrollment process. Overcoming the barrier will require creativity and persistence. For example, luxury cosmetics brands such as Estée

Exhibit 6
While department store and duty-free outlets remain the two major channels for luxury goods, online is also emerging as format visited often

Sales channel visited by current customers in the past 12 months
Percentage of category respondents



SOURCE: 2010 Korea Luxury Survey

Lauder and Fresh have succeeded in making the process easier for customers by affixing small stickers to the backs of credit cards with membership bar codes. Some high-end fashion brands, such as DKNY in Korea, have made membership more appealing by holding invitation-only functions, such as parties and limited-edition sales events.

Ensure consistent multichannel management:

Following the lead of department stores, luxury labels also need the capability to coordinate a variety of sales channels, from operating proprietary boutiques (including new premium outlet locations) to selling online. For the latter, investing in a good Korean language-friendly website is imperative, but not sufficient. Especially in the luxury sector, looks and details matter—photos must be of excellent quality and the product descriptions need to be well-written. The website is increasingly becoming the first place shoppers look to get more information about products and brands, so the same degree of thought and precision that goes into developing magazine advertisements

or flagship stores must go into the digital channel. Elle Atzine, an online community site launched last November by fashion magazine Elle Korea, is emerging as the “go-to” place for consumers to check out luxury products before visiting land-based stores. Elle Atzine provides a shopping environment for potential customers that approximates the in-store experience by offering a 3D showroom. Leading luxury brands such as Gucci, Burberry, and Chaumet—26 as of this writing—have opened virtual stores within Elle Atzine, and over 100 fashion and cosmetics brands are planning to enter

and promote products with site visitors, whose numbers had already hit 0.3 million subscribers by month five after launch. Elle Atzine has also launched “Atzine mobile,” an application for Android-based smartphones, such as Samsung’s Galaxy.

Korea’s robust economy provides a different set of challenges than luxury players are accustomed to in many advanced markets. By addressing the needs of Korea’s new luxury consumers and adapting to the new channel realities, the potential rewards awaiting astute luxury players are rich, indeed.



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1 “Women in their 20s and 30s are the main contributors for growth in the luxury market.” Hankyung Economy, Oct. 23, 2009.
2 Industry executive interview.