

Korean sales +30.9% to \$10.6bn as growth slows

South Korea's duty free industry saw total sales grow by +30.9% or \$2.5bn to a record-breaking \$10.6bn in 2016, although senior sources in Seoul tell *TRBusiness* that sales growth is expected to slow to between 10% to 15% in 2017 - resulting in incremental sales of between \$1bn to \$1.5bn.



These estimates nevertheless assume that foreign tourist numbers (*primarily Mainland Chinese*) continue to increase in 2017 as expected.

According to senior sources in Seoul, foreign visitors' duty free purchases amounted to US\$7.6bn in 2016, accounting for 72% of South Korea's total US\$10.6bn purchases last year. This sales result includes contributions from all airport, seaport and downtown shops (including internet) sales and 'domestic duty free' sales on Jeju Island, although it excludes inflight duty free sales.

BIG CHINESE TOURIST DEPENDENCY

Highlighting the dependence on foreign tourists for duty free growth, South Korean travellers' share of sales came in at \$2.9bn last year, which was equivalent to 28% of the national duty free revenue total.

"In 2015 we had a big impact from MERS on our duty free market from July to October, then the market recovered from November. It meant half of 2015 was impacted by MERS so we had a big 31% sales increase last year," said a senior industry duty free source in Seoul.

He told *TRBusiness*: "Sales to foreign tourists increased about 40% last year in value, about 80% of them are Chinese; but sales to South Korean travellers saw only a 9.7% increase."

Korean sales +30.9% to \$10.6bn as growth slows



A busy cosmetics counter at the Lotte World Tower duty free shop in Seoul.

Meanwhile, per capita duty free spending amongst foreign visitors grew last year, allaying fears among duty free operators that changes made to China's luxury goods import regulations in April might force a reduction in individual spending.

20.6M FOREIGNERS BOUGHT DUTY FREE

According to industry figures, a total of 20.6m foreign visitors bought duty free products in South Korea last year – a rise of 28% compared to those purchasing in 2015.

In addition, 27.9m South Koreans purchased duty free goods last year – an increase of 13.6% compared to 2015.

“Sales to foreign customers increased 40% in value and the number of foreign customers rose by 28%, so total per capita spending by foreign visitors increased last year,” said the source.

By contrast, South Korean per capita customer spending slowed slightly in 2016 as total South Korean duty free purchases rose by 9.8% in value, although this was less than the rise in the number of customers making purchases.

As expected, perfume and cosmetics continues to dominate as South Korea's largest duty free category accounting for more than 50% of duty free sales, with Lotte Duty Free – the country's leading operator – generating total sales of \$5.7bn, of which perfume and cosmetics sales accounted for almost \$3bn. These sales included all of Lotte's various downtown and airport stores.

Korean sales +30.9% to \$10.6bn as growth slows

HOTEL SHILLA SALES REACHED \$2.6BN

Hotel Shilla Duty Free was the next biggest operation with total sales registering \$2.6bn in 2016 (not including its HDC Shilla joint venture in Seoul) and once again, perfume and cosmetics accounted for a large share of revenue.

Other South Korean duty free operators – including new entrants to the industry – also registered good P&C sales, with many finding it easier to arrange supply deals with local cosmetics manufacturers rather than international brand suppliers.

“The numbers are incredible; cosmetics is the number one item for Chinese visitors,” said the senior source. “South Korean cosmetics brands are about 60% of the purchases and imported cosmetics are 40%. South Korean cosmetics are very good quality and the prices are reasonable.

SOUTH KOREAN COSMETICS GROWTH

“South Korean cosmetics companies are developing products to please East Asian customers, as their skin texture is different. They know what products Chinese visitors are looking for. South Korean face mask products are very famous with Chinese customers.



Enthusiastic Chinese customers wait for the lift in the basement area of the Lotte World Tower en-route to the duty free floors.

Korean sales +30.9% to \$10.6bn as growth slows

“The other thing is the price gap between the South Korean and Chinese markets. There are big perfume and cosmetics import tariffs in China; also, Chinese people do not trust products made in China, as there are many fake products.”

While duty free operators are obviously happy to see products fly off the shelves, a number of perfume and cosmetics brands and luxury goods brands have started to limit the volumes sold to individual customers, as suspicions grow amongst some suppliers that not all these purchases are for personal use.

SURROGATE SHOPPERS ARE A CONCERN

“Many people are saying that a significant ratio of purchases are by surrogate shoppers,” said the source. “As foreign brands begin to withdraw from China, so mainland tour companies are sending tourists here to buy luxury branded goods and pay them a commission for buying.

“The travel companies collect these products for re-sale in China, as there is a 30% to 40% price gap between South Korea and China because of the luxury goods tariffs. Chinese wholesalers organise these purchasing trips; they’re common now.”

Individual brand product purchasing limits also vary, with most international P&C brands – along with top South Korean brands – limiting the number of pieces sold to individual customers to five items. For luxury fashion goods and accessories, many international brands also limit purchases to one or two items per customer.

“The purchase limits are set by the brands, not the operators; the operators only think of profit. It’s the same around the world,” the source remarked.

Foreign visitors are the major customers in South Korea’s downtown duty free stores, spending \$6.4bn in downtown outlets in 2016, a huge figure which is five times the value of foreign traveller purchases worth \$1.1bn in airport duty free shops last year.



The HDC Shilla Duty Free store in Seoul.

AIRPORT SALES EQUALLY DIVIDED

Foreign and South Korean customers each accounted for half of the country’s total airport duty free sales that were worth \$2.4 billion in total in 2016, of which the major share was recorded at Incheon

Korean sales +30.9% to \$10.6bn as growth slows

International
Airport.

South Korean customer purchases were divided equally between downtown and airport shops, with spending reaching \$1.3bn in the country's downtown stores and \$1.2bn in international airport shops last year, plus almost \$500m was spent in Jeju Island's domestic airport and seaport duty free shops.

Foreign visitors accounted for 83% of all downtown store duty free purchases worth a total of \$7.7bn in 2016, according to industry figures. Outbound South Korean traveller purchases accounted for just 17% of downtown duty free stores' overall sales and included online and internet purchases estimated to account for 25% to 30% of total downtown revenue.

More than 80% of purchases in almost all downtown duty free stores in South Korea were made by foreign customers (*primarily Mainland Chinese*) with the exception of the Shinsegae Duty Free and Lotte Duty Free Busan downtown shops, where South Korean customers accounted for 48% and 34% of purchases respectively.

In addition, foreign visitors accounted for 71% of total sales in South Korea's various SME downtown duty free stores, which recorded combined total sales worth \$68m last year, a sales total equivalent to less than 1% of the nation's total duty free revenue.

Meanwhile, government policy to increase the number of duty free operator licenses in an effort to reduce large conglomerates' dominance of the domestic duty free market has led to increased competition.

LOUIS VUITTON STILL DELIVERS

"Last year there were 8m Chinese visitors to South Korea," said the source. "South Korea's duty free market is very concentrated and it's difficult to make money as travel agents



The large Louis Vuitton store located at Incheon International Airport continues to deliver dynamic sales.

Korean sales +30.9% to \$10.6bn as growth slows

dominate
an
important
share of
the
market. If
they do
not send
tourists
here there
will be no
group tour
sales, so
they
receive
huge a
commissio
n from
South
Korean
duty free
operators.

“Two to three years ago the maximum commission paid was 20% for group tour customers, but nowadays over 30% is being paid. It’s impacting on operator profits. Most small operators and new starters cannot expect a profit – it’s a severe and critical problem in this market.”

This follows the opening of new downtown stores in Seoul over the past 18 months by Shinsegae Duty Free, HDC Shilla, Doota (Doosan), Hanwha Galleria and SM Duty Free and another four downtown stores are also scheduled to open this year.

As reported, Lotte has only recently reopened its Lotte World Tower store after winning a new downtown license, while three completely new downtown stores are scheduled to open in the capital city.

DIPLOMATIC FALL OUT DUE TO MISSILE DEFENCE SYSTEM

Work is underway preparing the Shinsegae Kangnam and Hyundai CO-EX duty free stores that are scheduled to open in Seoul’s growing southern area by the end of 2017 – along with the SME Top City Sincheon (City Plus) store in the capital’s western region.

Meanwhile, one large dark cloud on the horizon is the deterioration in South Korea’s current diplomatic relations with China, which are causing serious concern for duty free operators.

Korean sales +30.9% to \$10.6bn as growth slows



An example of the Thaad missile system being tested by the US Army.

This follows Beijing's earlier protests to the Seoul administration that its proposed US-backed THAAD missile defence system infringes on China's security. [click here for more details:

<http://www.trbusiness.com/regional-news/asia-pacific/china-backlash-on-thaad-hits-arrivals-to-korea-badly/113668>].

This has resulted in a dramatic reduction of Chinese visitor arrivals in both November and December, according to the Korea Tourism Organization.

At the same time, South Korea's current domestic political crisis, after the National Assembly voted to impeach Park Geun Hye over corruption allegations, has left the country in a leaderless limbo with no major statesperson in place to handle the escalating dispute with China – until new presidential elections in the spring of this year.

GROUP TOUR NUMBERS ARE SUFFERING

Some operators say this dispute has already prompted Beijing to quietly reduce group tour numbers visiting South Korea in January, as a clear warning that it means business with its protest against Seoul installing the proposed Terminal High Altitude Area Defense (THAAD) defence system.

"South Korea's duty free market should be increasing this year by 10% to 15%, but already in January we are losing the group tour market. We have already felt impact from South Korea and China's tension," said the source.

"We will have presidential elections in April or May. Now there is no president as President Park is impeached and the South Korean government cannot react to China properly.

"For the first half of 2017 we will be impacted by the China group tours situation. Also, Chinese customers

Korean sales +30.9% to \$10.6bn as growth slows

are getting smarter and they are looking not only for luxury products, but reasonably-priced products and leveraging down their spend.”

TRB BUSINESS