

Lotte, Shilla and Incheon count the cost of MERS

Incheon International Airport and its two largest operators, Lotte Duty Free and Shilla Duty Free, are naturally hoping that the current MERS scare will disappear as quickly as it arrived in South Korea, but there is little sign of that just yet. Hopes that the number of Chinese tourists to South Korea will surpass 8m compared to 6.1m last year are also now in doubt.



As reported, Chinese bookings for trips to South Korea are being cancelled by the thousand at present, as the country's highest spending tourist nationality cautiously avoids the destination, following adverse publicity surrounding the MERS outbreak, which has accounted for nine deaths to date in South Korea.

The financial cost to the country is also huge, as Chinese cancel bookings, Hong Kong and Macau issue travel advisories against visiting South Korea and foreign airlines such as Taiwan's Eva Air and China Airlines cut the total number of weekly flights by more than 30 between them [see <http://www.trbusiness.com/regional-news/asia-pacific/president-vows-to-fight-mers-as-tourists-fall-away/77004>].

The potential losses from any sustained absence of Chinese tourists are also huge for the country's duty free industry. For example, Lotte has a \$5bn sales target this year, which actually represents a 25% rise on its 2014 sales. This follows Lotte revising its original \$4.7bn forecast up after witnessing the huge success of the January and February sales – mostly driven by Chinese tourist spending.

This was revealed exclusively *TRBusiness* by Lee Seung Kook, Lotte Duty Free's Managing Director of Merchandising 1 Division only last May. He pointed out that in 2013 Chinese customers accounted for around 46% of customer spending, but in 2014 this has grown to almost 60% as Japanese spending dropped back and Chinese spending grew by 58%.



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Lotte Duty Free will be looking at Chinese arrivals numbers carefully with the new concession awards at Incheon International Airport very much in mind.

Any drop in Chinese spending will obviously be a blow for Lotte and all other downtown (and airport) duty free retailers in Seoul, Busan and Jeju – especially considering that South Korean customer spending dropped by 7% last year. This was due to slow economic local growth and numbers only began to show signs of between 3-5% growth again in the early months of this year.

The blow to Chinese numbers also comes as the number of Japanese tourists has continued to fall. These visitors to South Korea in January and February fell by 8% year-on-year, while the number of Chinese arrivals in January and February – including the key Chinese New Year holiday period – rose by 25% yoy.

Any significant Chinese downturn will deal a big blow to Lotte considering its 2014 record sales performance saw almost every one of its seven South Korean duty free stores achieve a double-digit increase in income last year.

One of the biggest and fastest growing contributors to those sales has been Lotte's Chinese language website which grew by a whopping 60% in 2014 to reach \$450m according to Lee. Until now, online sales were expected to grow by at least 30% this year to around \$600m, with around 65% of sales predictably in the cosmetics and perfume categories.

Last May, Lee said that earlier this year and on average, Chinese spending per person reached around \$700 per person in Lotte's downtown shops – about the same as last year – while it was considerably less at around \$200 per person at Incheon Airport – but still a number most other airports would love to have.



Lotte Duty Free's hugely successful Seoul Sogong downtown duty free shop.

By contrast, online Chinese customers' average spends were about \$200. Meanwhile, the average per

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capita spend by South Korean customers visiting a Lotte Duty Free shop is \$400. These customers, purchasing through Lotte's online service, spend \$150 per transaction on average and usually choose cosmetics.

Shilla Duty Free also has substantial business with Chinese customers, both at the airport and downtown, with Jason Cha, Senior Executive, Vice President & Head of Duty Free Business reporting a very healthy 27% increase in domestic duty free sales to \$2.4bn last year.

He confirmed to TRBusiness last May that the major portion of Shilla's business continues to come from group tours as the share of Chinese customers visiting Shilla's flagship store in Seoul has now soared to 82%, with just 8% accounted for by South Koreans.



Shilla Duty Free dominated the cosmetics and perfume business under the previous round of tenders at Incheon, but this has now changed.

However, Cha added that the number South Koreans and Chinese customers using its Incheon Airport shops was more equally balanced, with Koreans accounting for 42% of purchases last year, while Chinese 41%.

With no visa restrictions on Chinese tourists, Shilla's Jeju downtown store has also been booming with a sales growth of 38% last year – the same growth rate also seen at Shilla's Seoul downtown shop. Here, the average spend per Chinese customer has been around the \$650 level until recently, while average South Korean spend has also been very high at around \$500.



Shilla Duty Free's successful downtown duty free shop in Seoul.

Meanwhile – and as reported – total duty free revenue hit US\$2bn in 2014 at Incheon Airport, registering an increase of slightly more than 10% compared with total sales of \$1.78bn the previous year.

Airport management told *TRBusiness* earlier this year that it was originally hoping for a 10% increase in sales – some \$200m – this year based on the growth of Chinese passengers, although this forecast may need revising if the current MERS virus concerns continue for a sustained period.

[This article was written and researched jointly by David Hayes and Doug Newhouse].