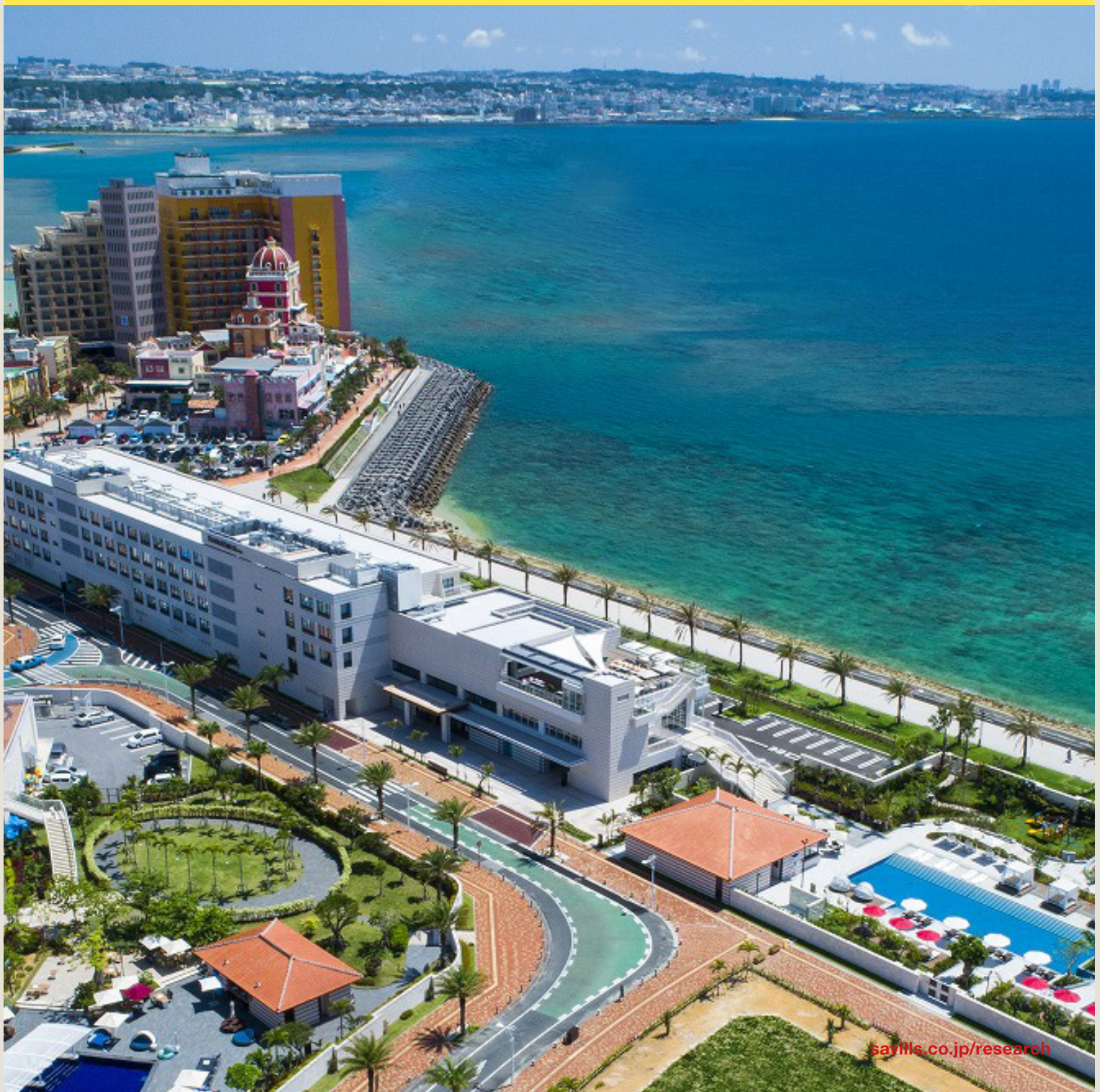




Spotlight **Japan inbound retail**

October 2018



Spotlight Japan inbound retail



“Japan is evolving as a global travel destination, and the retail market is benefiting from the explosive growth of inbound tourism. The impact is being felt across various retail sectors. If the country skilfully targets different tourist preferences, some of Japan’s retail market could continue to grow even faster than the rapidly expanding hospitality industry.”

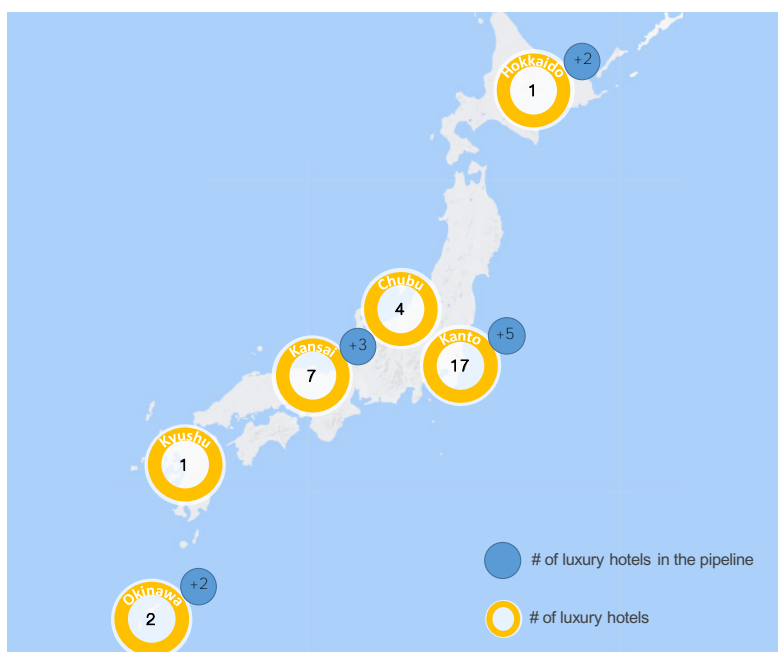
Introduction

Japan is an enormous retail market with annual retail sales of over JPY140 trillion, and most global retail brands have established client bases in the country. While domestic retail demand is stable, rapid expansion of tourism in recent years has jolted this mature market with new energy and is creating opportunities for a wide range of retailers who can swiftly adapt to new trends.

The number of inbound tourists has increased exponentially from 6.2 million in 2011 to 28.7 million in 2017, and total expenditures by overseas tourists amounted to JPY4.4 trillion. The government has set a goal of 40 million overseas visitors and JPY8 trillion of spending by 2020. It also aims to significantly increase Meeting, Incentive, Convention, and Exhibition (MICE) related expenditures from about JPY150 billion in 2016 to

MAP 1

Global luxury chain hotels* in Japan



Source: Smith Travel Research (STR), press releases., Savills Research & Consultancy
 * We have counted the number of hotels whose brands are categorised as luxury chains by STR in the 2018 STR Chain Scales list.

SUMMARY

- Shopping expenditure by overseas tourists reached JPY1.6 trillion in 2017, accounting for 37% of their total expenditure.
- Food and beverage, as well as entertainment spending has shown steady growth, exceeding JPY1.0 trillion in 2017.
- Convenience stores, drug stores, and department stores are frequently used for shopping by overseas tourists, and sales for these categories have been growing.
- Regional tourism should continue to grow to the benefit of retail shops and malls in those areas. Inbound tourism might be the last source of sustainable growth for some regional economies.
- Although resources are limited in regional markets, capital has started flowing as many large players now have 'skin in the game' via the hospitality industry.
- Experience is the essence of travel, and landlords should be able to benefit from mixing tenants who can provide unique and exciting offerings.

JPY800 billion in 2030. The Rugby World Cup 2019, the 2020 Tokyo Olympics, and integrated resort (IR) development could also be a boon for inbound tourism.

With the expansion of inbound tourism, more investments are taking place in regional cities. This can be seen in the increased number of lodgings sprouting up around the country. More luxury hotel brands are also opening up in cities that used to be mainly for domestic tourists. In areas where lodgings are not sufficient, peer-to-peer accommodations (minpaku) may fill the void to accommodate regional tourism. Capital is also flowing as regional banks are actively lending money, and funds to promote tourism are being launched by both the public and the private sector. Investment should continue to increase as many

→ large players now have skin in the game via the hospitality industry, which previously catered mostly to Japanese tourists.

In the face of a dwindling population, inbound tourism could be the only immediate chance for retail shops and malls in some regional areas to reposition to a sustainable growth trajectory. For popular tourist destinations, this is likely to be a long-term growth driver. Osaka in particular is a clear beneficiary of tourism growth with drug stores and department stores performing exceptionally well. The news of an old family-run food stall in Osaka Castle Park earning over JPY500 million in three years also shows how wide the spillover effect is.

Since experience is the essence of travel, Japan's retail market should largely benefit from incorporating service elements into the shopping experience. Forays into the hospitality industry by luxury fashion brands such as Armani, Bulgari, and Versace illustrate the compatibility of retail and service. Although Japan is known for its service quality, a lack of basic amenities such as multilingual services and WiFi spots is leading to dissatisfaction. These are low hanging fruits that could potentially give some well-prepared retailers a competitive advantage.

Overview of inbound tourist spending

Although a rapid increase of Chinese tourist spending due to "bakugai" ("explosive buying") virtually ended in 2015, total expenditures by overseas tourists are steadily growing. In 2017, total shopping expenditures by overseas tourists reached JPY1.6 trillion, an increase of JPY214 billion or 15% YoY over 2016. Although Chinese tourists account for 25% of overseas visitors, they are responsible for over 50% of the spending. Expenditures by tourists from other countries also rapidly increased by JPY119 billion, to JPY762 billion, between 2016 and 2017. Furthermore, food and beverage, as well as entertainment services are contributing to tourists' total spending. Compared to shopping expenditures, growth of these categories appears more stable and should continue in line with increases in visitation.

Inbound tourists shop at a wide range of venues and contribute to sales in various retail sectors. The ubiquity of

convenience stores makes them the most frequented store types where tourists spend money. This is followed by airport duty-free stores, drugstores, department stores, and supermarkets, where one in two tourists choose to shop. Additionally, 15% to 17% of tourists shop at outlet malls, fashion speciality stores, and urban retail shops, which, although small as a percentage of the total, accounts for the equivalent of 4.3 to 4.9 million people. To highlight how inbound tourism is affecting Japan's retail market, we discuss three primary shopping venues: convenience stores, drugstores, and department stores. Although these are store types that have been significantly benefiting from inbound tourism, insights obtained from examining these sectors could present useful lessons for other store types as well.

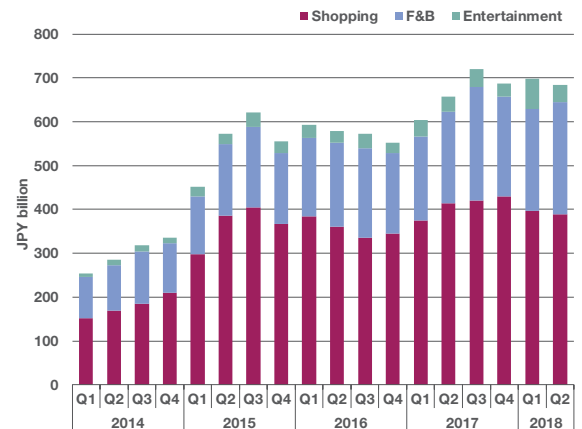
Convenience store sales

According to the Ministry of Economy, Trade and Industry (METI), convenience store sales increased from JPY8.1 trillion to JPY11.7 trillion between 2010 and 2017, an impressive 45% increase. While an increase in the number of stores largely contributed to overall sales, sales per store also grew in all regions between 2010 and 2017. In 2017, sales per store were the highest in Kanto at JPY221 million, followed by Kyushu/Okinawa, Kinki, and Tohoku, respectively.

Although it is not easy to isolate the impact of inbound tourism on sales growth, its contribution is assumed to be significant in cities that are popular among tourists. According to Nikkei's 2017 retail survey, over 70% of surveyed convenience stores reported that inbound tourist customers increased compared to 2016. And, in the same survey, over 50% of respondents said that they were actively targeting overseas tourists.

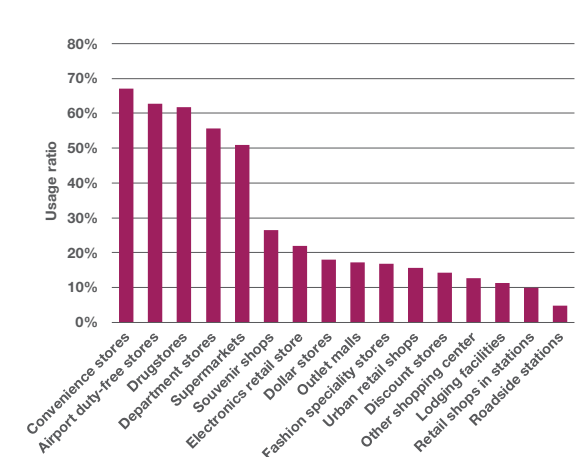
For example, FamilyMart announced that it would let Airbnb users pick up keys at stores. The company expects goods sales increases as Airbnb guests reportedly spent JPY800 on average at key pickup at its test stores. Lawson started accepting Alipay, an online payment platform popular in China, in January 2017. In January 2018, Alipay users reportedly paid JPY1,500 on average, almost triple the non-user average of JPY540 (as of December 2017). Other store types might also be able to increase sales by applying similar methods.

GRAPH 1 Overseas tourist retail/service expenditures, 2014 – Q2/2018



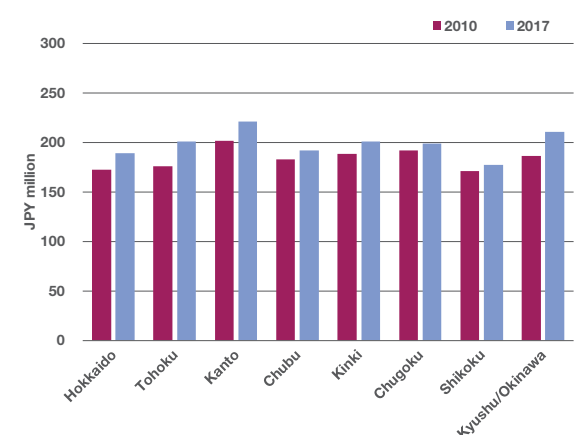
Source: Japan Tourism Agency, Savills Research & Consultancy

GRAPH 2 Overseas tourist shopping places, 2017



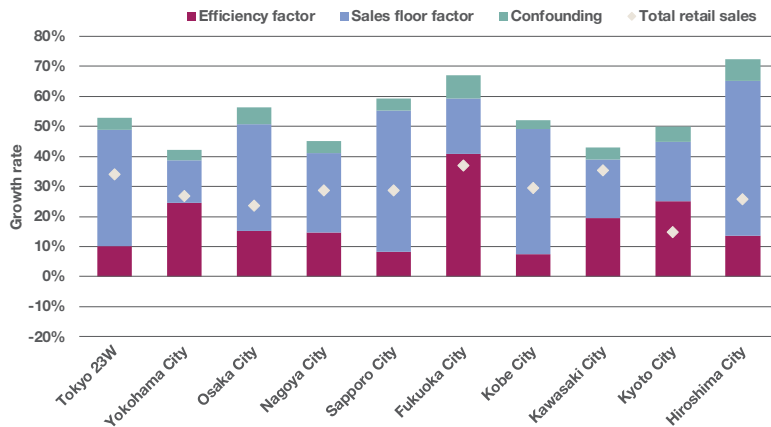
Source: Japan Tourism Agency, Savills Research & Consultancy

GRAPH 3 Convenience store sales per store by region, 2010 vs 2017



Source: METI, Savills Research & Consultancy

GRAPH 4
Breakdown of sales growth rate in the drug and toiletry sector by city, 2015 vs 2011



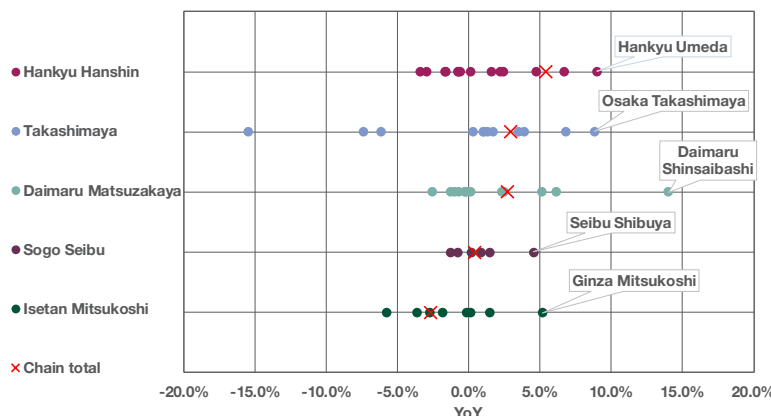
Source: METI, Savills Research & Consultancy

GRAPH 5
Duty-free sales, Jan 2017 – May 2018



Source: JDSA, Savills Research & Consultancy

GRAPH 6
Comparison of store sales growth of major department store chains, FY2017 vs FY2016



Source: Company disclosures, Savills Research & Consultancy

Drugs and toiletries sales

The popularity of Japanese drugs and cosmetics among overseas tourists is widely publicised. METI's data shows that drug store sales increased from JPY4.9 trillion to JPY6.0 trillion between 2014 and 2017. At the city level, sales growth in the drug and toiletry sector outpaced that of overall retail sales in a majority of markets between 2011 and 2015. Most notably, in the Chuo Ward of Osaka, where Shinsaibashi is located, drug and toiletry sales grew over 150% during the same period due to explosive increases of overseas shoppers in the area.

Drugs and toiletries were added to the duty-free item list in 2014, which appears to have helped sales growth in this sector. According to the Japan Department Store Association (JDSA), cosmetics are typically the most popular duty-free category among overseas tourists, followed by high-end brand goods. New rules will simplify the process of claiming duty-free items by allowing general and expendable goods to be claimed together. Digitisation of purchase records will eliminate the hassle of carrying around passports thickened with receipts.

Unlike the short-lived electronics and luxury item shopping sprees, the popularity of daily necessities is likely to last longer. Drug, toiletry, and cosmetic products are popular among not only Chinese, but also Taiwanese and South Korean tourists, which should also contribute to stable demand for these items. However, one caveat is that sales growth in this sector was primarily driven by increases in sales floor areas rather than improvement in sales efficiency in many cities. If total demand shrinks, competition for larger shares will intensify.

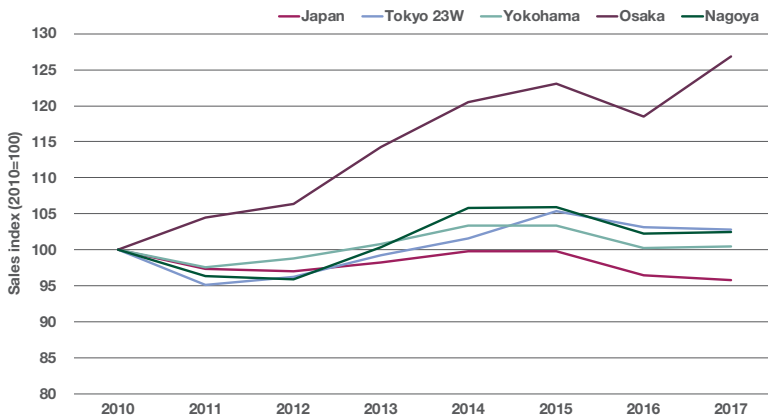
Department store sales

Department stores are another beneficiary of inbound tourism. As discussed in our "Japan Retail May 2018" report, inbound tourist demand is propelling sales at department stores in popular destinations. Such properties in Osaka in particular have been outperforming others.

Unlike convenience stores and drugstores, however, overall sales at department stores have been stagnant in Japan, save for Osaka¹. The demise

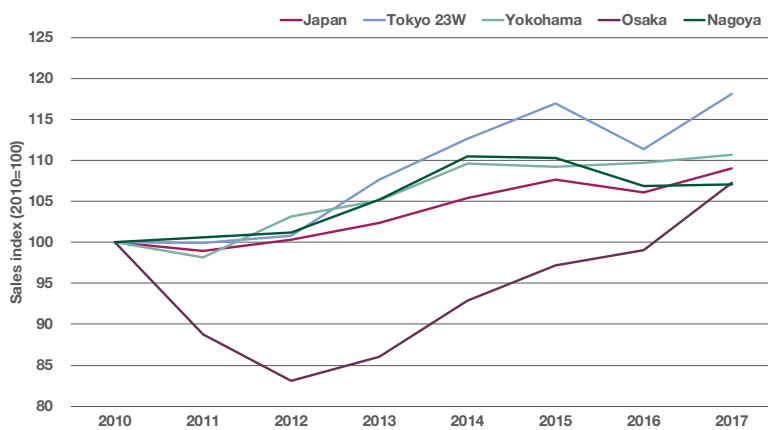
¹ Osaka appears to be a positive outlier among cities. The underlying cause for this divergence is likely the "Osaka 2011 Problem" where a series of expansions and openings of new stores abruptly increased department store supply.

GRAPH 7
Department store sales in Japan and major submarkets, 2010 – 2017



Source: METI, Savills Research & Consultancy

GRAPH 8
Department store sales per sq m of sales floor in major submarkets, 2010 – 2017



Source: METI, Savills Research & Consultancy

of department stores is a global phenomenon, and it is hard to imagine that the trend will reverse without the entire industry going through a massive transformation. Having said that, sales per sq m of sales floor area showed stable growth in major markets in recent years. Specifically, Tokyo's 23 wards improved the figure by 18% between 2010 and 2017. A likely cause for improving performance is reduced competition following a series of closures of underperforming stores. In addition to inbound tourism demand, surviving department stores appear to have absorbed displaced demand from closed stores.

What is happening in the department store sector could be applicable to other retail categories. Graph 9 indicates that supply of new retail

space has been declining since 2005. Retailers who can leverage growing tourism may survive competition and improve profits by increasing market share.

Regional tourism

In Japan, total room nights stayed by overseas tourists more than quadrupled from 17 million to 72 million between 2011 and 2017. During this period, while Kanto shrank its share from 46% to 37%, Kinki and Okinawa increased their shares by 4 percentage points (ppts) and 3ppts, respectively, indicating increasing popularity of regional cities outside Greater Tokyo. As the number of repeat tourists increases, more people are likely to explore regional destinations. Increases in regular routes of low cost carriers (LCCs) to regional airports

should also energise regional tourism (cover photo: DoubleTree by Hilton Okinawa Chatan Resort).

In the face of depopulation, regional stakeholders have acknowledged that tourism could be the key to the revitalisation of local economies and are ramping up their efforts to attract visitors. For some regional areas where local economies are rapidly shrinking, it may be the last clear and immediate chance to escape from the downward spiral of decreases in population and investment. To effectively promote regional tourism, the government aims to create 100 registered Destination Marketing/Management Organisations (DMOs) by 2020, and 86 DMOs have been registered as of July 2018.

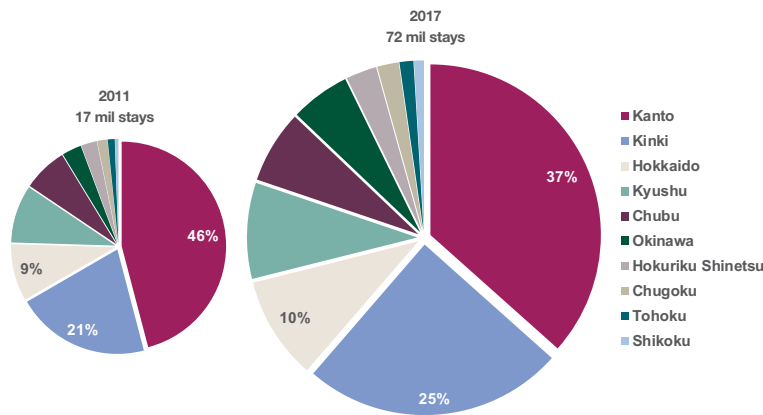
These organisations are consortiums of local stakeholders; it is expected that they can implement coherent strategies, which are essential for long-term growth, through effective consensus building. DMOs are also responsible for collecting data on tourists. Consumer behaviour and preferences of tourists widely differ based on their nationalities and can abruptly change, as with the Chinese tourist "bakugai". Timely data accumulated by DMOs should assist retailers in capturing emerging trends. Given that tourists' dissatisfaction comes from basic information needs such as a lack of WiFi spots or multilingual services, there still seems to be huge untapped potential for sales improvements. Furthermore, the Japan Tourism Agency (JTA) is sharing detailed survey results on tourist preferences and behaviour

GRAPH 9
New supply of large-scale retail facilities in major cities*, 2005-2017



Source: METI, Savills Research & Consultancy
 * Retail facilities of over 1,000 sq m of store area in 20 cities designated by ordinance plus Tokyo's 23 wards.

GRAPH 10 Total room nights by overseas tourists, 2017 vs 2011



Source: JTA, Savills Research & Consultancy

→ by nationality, which should assist formation of effective strategies.

Capital is also flowing into various regional cities. The Regional Economy Vitalization Corporation of Japan, established in 2009, has been setting up funds for revitalisation of regional economies, and tourism is one of their major focuses. Furthermore, All-Japan Kanko Rikkoku Fund, a JPY25 billion fund, was established in April 2018 by a consortium of 60 companies such as MUFG Bank, Sekisui House, JAL, and regional banks. Combined with bank loans, the fund is expected to provide a total of JPY100 billion in financing for regional tourism projects. Organisations like the aforementioned DMOs should also be able to help effective allocation of capital.

Overall, the inflow of tourists and capital to regions should have a positive impact on regional retail markets. Some cities may also be able to utilise new resources to attract Japanese tourists, who are still by far the largest source of tourism demand. Considering that depopulation is severe in some areas, however, consolidation of stores is likely to proceed, which, as with department stores, should create opportunities for surviving stores. Consolidation of ownership could also progress if J-REITs pick up underperforming properties as high-yield assets.

Experiential retail

The importance of in-store experience has been widely discussed in the context of the looming threat of e-commerce to brick-and-mortar shops. Examples of Amazon Go, LINE FRIENDS stores, and the pop-up Mercari Café indicate that even online

retailers acknowledge the importance of physical stores. Incorporating experience in retail is especially essential to attract tourists as many visit Japan for unique and authentic experiences.

Enjoying local cuisine and drinks is a popular activity for most tourists. Total food and beverage spending by overseas tourists was JPY886 billion in 2017, accounting for 20% of their total expenditures. In 2017, tourists from Hong Kong spent the most on food and beverage per person per day, followed by Singapore and South Korea. According to the Japan Foodservice Association, restaurant sales² in Japan have grown concurrently with tourism since 2011 and recorded about JPY19 trillion in 2016. The story of the Osaka food stall mentioned in the introduction also shows the huge potential of this category.

Additionally, entertainment service expenditures by inbound tourists amounted to JPY144 billion in 2017 with western tourists in particular spending more per person than the average. Among Asian tourists, going to a Japanese hair salon, for instance, is a popular experience as beauty standards in Japan are widely admired in other parts of Asia.

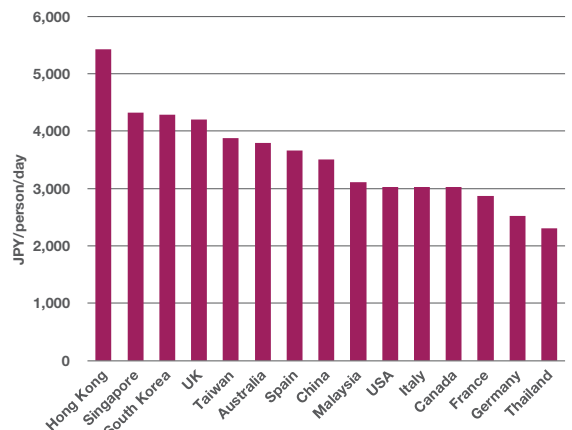
Moreover, these experience elements are used for brand marketing. For instance, Lexus Meets... Hibiya opened in Tokyo Midtown Hibiya in March 2018 as a brand experience facility; customers are able to experience the Lexus brand through

² Restaurants include various food and beverage functions such as cafes and bars.

dining, boutique shopping, and a driving simulation. In 2017, Asics, a Japanese footwear and sports equipment producer, opened Asics Connection Tokyo along the Sumida River. The facility features cafes and fitness studios and aims to promote active lifestyles to locals, as well as domestic and overseas tourists.

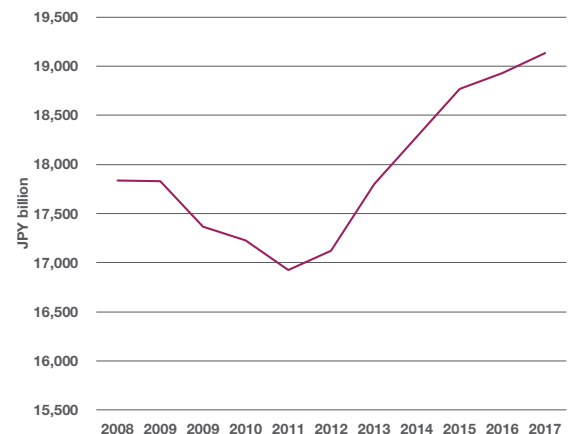
Currently, a shortage of multilingual services in Japan is a major source of frustration for overseas tourists. Since interaction is usually a key element of experience-based products, retailers may be able to significantly improve customer satisfaction with better language services. Advancements in translation technology, as well as increases in the number of foreign residents in Japan could help address the problem. ■

GRAPH 11 Daily food and beverage spending per person by country in 2017



Source: Japan Tourism Agency, Savills Research & Consultancy

GRAPH 12 Restaurant sales in Japan between 2008 and 2017



Source: Japan Foodservice Association, Savills Research & Consultancy

OUTLOOK

The prospects for the market

Overall, the momentum of inbound tourism should continue, further bolstered in the medium-term by the Rugby World Cup 2019, the 2020 Tokyo Olympics, and IR development. Japan's retail market should continue to be a beneficiary of this trend, although shifts in the shopping behavior of overseas tourists could cause some volatility in performance.

As Japan's hospitality industry grows larger, it will be increasingly important to have long-term strategies to capture the growing demand and diversified preferences of different nationalities. For some regional cities, inbound tourism might be the last clear and immediate chance to break the negative cycle of population outflows and declines in economic activity. The government has

acknowledged the importance of tourism for revitalisation of local economies, facilitating the formation of DMOs and providing risk capital. Tourism is now a major concern for many entities as it has attracted players from various industries, which could accelerate further investment as exemplified by All-Japan Kanko Rikkoku Fund.

Considering trends in tourist demand for leisure activities, it is becoming increasingly important for retail stores to offer experiences. Landlords are likely to benefit from mixing specialty restaurants and service-oriented tenants for added excitement. Having local flairs should also add to the uniqueness and authenticity that travellers seek. JTA's vast and detailed disclosures should be helpful for the formation of effective marketing strategies.

However, Japan's heavy reliance on tourists from Asia could pose a risk. As illustrated by the impact from China's boycott of travels to South Korea, inbound tourism is susceptible to various external factors including political tensions. Natural disasters are also an inherent risk in the tourism industry. A potential retreat of the global economy might also put a temporary break on travel volumes in Asia. To mitigate the risk, it is essential for the country to diversify source regions of tourists. Some cities might be able to use resources accumulated through inbound tourism to attract domestic tourists for stable demand.

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