Imported alcoholic beverages can be found much cheaper than the retail list prices thanks to parallel imports.

Discount Drinking

By Takashi Nagasaki

There is a revolution under way in the Japanese import liquor market as new companies–liquor discounters–are routinely offering even the most prestigious brands for far less than anyone might have thought possible only a few years ago.

It is estimated that there are now about 300 liquor discounters nationwide, and that they are selling the imported brands for about half of list price. A bottle of Hennessy XO that lists for ¥40,000 (about $280 at the rate of ¥140/$) at the corner retail outlet goes for ¥19,800 ($140) from the discounter. Nor is Hennessy an exception. Chivas Regal is ¥8,000 ($57) list and ¥3,980 ($28) discount, and I.W. Harper is ¥3,700 ($26) list and ¥1,980 ($14) discount.

How are these prices possible? Or maybe the real question is why the retail list prices are so high. Answering these questions takes us into the hazy world of Japan's import liquor market.

The normal practice is for an overseas distiller to focus its distribution through a single channel–either a local company licensed as an exclusive distributor or its own sales subsidiary in Japan. This is the same basic pattern that is also followed for other consumer imports such as automobiles, foodstuffs and the like, and it is a practice followed in non-Japanese markets as well. But in Japan, if not in other countries, this distribution structure has meant higher prices for imported liquor.

According to data released by the National Tax Administration Agency in November 1985, the markup added on by the exclusive distributor, sales subsidiary or whatnot accounts for a considerable percentage of the retail price of imported liquor. For standard-class whiskeys (those selling in the ¥4,000 range), this is about 8–21%. For premium whiskeys (the ¥10,000 range), it is 35–45%, and for brandy (retailing at around ¥12,000), it is 26–44% (Table 1).

Other markups are added on as the liquor goes from the importer to the retail outlet. There are usually at least one or two wholesalers involved in this process, and each of them tacks his expenses and profits onto the bill. Knowing this is going to happen, the importers set the suggested retail price to allow for everyone's markups, and the retailer sells the liquor at, or just slightly below, list price.

By contrast, the liquor discounters' markup is 12–15%. And because they put the stock out on the shelf without going through any wholesalers–bypassing much of the distribution chain and cutting their costs–they are able to sell at large discounts.

Frustrated distillers

There is only one snag: the overseas distillers prefer to work through their exclusive distributors or sales subsidiaries and do not want to supply the discounters. To get around this, the discounters do not buy their stock directly from the distillers but go to overseas distributors–taking pains not to be found out by the distillers or official importers. Hong Kong, Singapore and other Asian markets are prime sources for these discounters. Because these discount imports coexist side-by-side with the official distribution channels, they are called parallel imports. And the absence of any legal restrictions against these parallel imports makes them very frustrating for distillers and their officially authorized distributors.

The first big burst of liquor discounting was sparked by the yen's sharp appreciation in 1985. Although the official distributors did lower their prices somewhat to reflect the yen's enhanced buying power, they did not cut their prices enough to fully reflect the yen's appreciation. It was this price differential between Japanese and overseas retail prices that created the opening for the parallel importers.

At the same time, radical changes were also under way in consumer perceptions. The yen's appreciation made overseas travel much cheaper and more accessible for more people, and there was a sudden surge of Japanese tourists going abroad. Once there, these people were able to see for themselves how much more expensive liquor was in Japan than overseas. Having once assumed that Japanese prices were the norm everywhere, they were much more price-conscious when they got home.

As a manager at one of the major department stores put it, "It used to be that the famous international brands sold well even though they were much more expensive here than overseas. But a 30–40% markup is about the limit now. We get a lot of flack from customers if they are twice as expensive here as overseas." With both the supply and the demand sides more conscious of the disparity be-

Table 1. Price Structure for Import Liquors (%)

	Standard-class whiskey (approx. ¥4,000)	Premium-class whiskey (approx. ¥10,000)	Brandy (approx. ¥12,000)
CIF	10–12	7–9	8–10
Total tariffs and taxes	43	18–19	17–20
(Customs tariffs)	(5)	(3)	(2)
(Liquor tax)	(38)	(16–17)	(15–18)
Handling expenses	1–5	1–9	0–10
Importer's margin	8–21	35–45	26–44
Wholesalers' margins	5–6	7–8	4–16
Retailers' margins	20	20	20–31
Retail price	100	100	100

Note: This table is based on data released by the National Tax Administration Agency in November 1985, and liquor taxes are now substantially lower as a result of the tax reforms in April 1989.

tween Japanese and overseas prices, the parallel importers became more active.

They got a further boost from the April 1989 liquor tax reforms that focused renewed attention on how inexpensive the parallel imports really were. The main feature of the liquor tax reforms was to lower the taxes on whiskey, brandy and other high-priced beverages. But the overseas distillers and their authorized importers did not bring prices down enough to fully reflect the tax savings.

There are three major groups acting as official importers. One is the Japanese sales and marketing subsidiary of the Guinness United Distillers Group (UDG) that owns such household-name Scotches as Old Parr, Johnnie Walker and I.W. Harper. And the other two are the importers set up by Suntory and by Kirin-Seagram. Each of the three handles a long list of import brands.

All three were decidedly unenthusiastic about cutting their suggested retail prices as much as the tax reforms would have warranted. While UDG did slash Johnnie Walker Black Label to ¥6,000 from ¥8,500, it held back on cutting the prices for its other leading brands. Old Parr, for example, was repriced at ¥8,000 (from ¥8,500), White Horse at ¥3,600 (from ¥4,150) and I.W. Harper at ¥3,800 (from ¥4,300). Suntory and Kirin-Seagram followed suit. Suntory-handled Ballentine's Finest was repriced at ¥3,600 (from ¥4,000) and Kirin-Seagram-distributed Chivas Regal at ¥8,000 (from ¥8,500).

Not only were consumers scornful, the Tax Agency was not amused either. In fact, the tax office complained to the distributors that they should be able to cut their prices more in light of the tax savings—and told them to do just that.

After having been badgered for years by Britain complaining that Scotch was not selling as well as it should in Japan because the liquor tax made it so expensive, and after having sharply cut the liquor tax at least partly in response to this argument, the tax people were determined to have prices come down at least as much as the tax bill had. Even today, after another round of price-cutting for most of the suggested retail prices, sources in the Tax Agency contend there is still room for further reductions.

There are reasons why the overseas distillers and their authorized distributors want to hold the line on prices. One, of course, is that it puts more money in their pockets. But that is not the whole story. They also make the argument that advertising and marketing is very expensive in Japan—and that they need to have money to invest in building a position in the Japanese market.

In effect, they want to use the money they save on the liquor tax to build up their marketing organizations. But the discounters do not incur these costs. Instead, as a Suntory official put it, "The discounters get all the benefits of our advertising without incurring any of the costs. They're riding on our coattails."

Price prestige

But the biggest reason for wanting to hold the line on prices is that Japanese consumers are very price-conscious and the more expensive brands have considerable appeal precisely because they are so expensive. Even though consumers are sensitive to price differentials and shop around for the lowest prices on everyday purchases, there are some products that are immune to this. In fact, there are some products for which price competition means costing more.

This is particularly pronounced among the prestige brands that are bought not for personal use but as gifts. Old Parr, Chivas Regal and the other leading gift items have gift value precisely because everyone knows how expensive they are. How can you impress someone with a bottle of cheap booze? For many of these imports, pricing is an integral part of the brand image.

As a result, the distillers and authorized importers have been screaming mad at the inroads made by the discounters and the fact that they are flooding the market with cheap parallel imports—many of the importers complaining that the prevalence of discounting has seriously eroded their products' market prestige.

It is war, and the official importers are out to get the discounters. They are watching closely to identify which Asian distributors are selling to the Japanese discounters, and the battle is taking its toll. As one discounter confided, "The big British and other distillers are warning their Asian distributors not to sell to Japanese discounters. And they're backing this up. It used to be that a distributor caught selling to a Japanese discounter was let off with a slap on the wrist. But now they're cutting their hands off."

There has been a special effort to shut the parallel importers down as part of the drive to enforce the new pricing strategies following the liquor tax reforms. "It used to be we could import 800 cases of Old Parr in a single shipment,"says one discounter, "but now we're lucky to get 50 or 100."

Nevertheless, it is impossible for the distillers to maintain an iron grip on distribution. Their distribution networks are too far-flung and their products too widely available for that. A major discounter shrugged it off with the comment, "Sure they're cracking down hard on brands like Old Parr, Chivas Regal and Hennessy where the Japanese market is a major percentage of their worldwide sales, but the void is being filled by other liquors that are just as good. Just look at the sales figures if you don't believe me. The parallel importers have sold twice as much in 1989 as they did in 1988." In short, the authorized distributors are losing their grip on the Japanese market.

Complaining that there is too much rigidity in Japanese price formation mechanisms and that this is fostered by a tightly controlled distribution system, the United States has made this a major issue in the Structural Impediments Initiative talks started with Japan this fall.

Yet the market for import whiskeys demonstrates that the Japanese market is able to adapt and change. Significantly, however, the government was not the primary force behind these changes. Instead, it was a revolution led by discounters and price-conscious consumers.

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