

Investing in SOUTH KOREA

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Free speech: farmers protest during talks on a trade deal this year. Agriculture is one of the sectors predicted to lose out as a result of agreements with the EU and the US

Reuters

Election set to dominate coming year

The republic's culture and tourism sectors are enjoying success, yet there is increasing disquiet about social inequalities, reports Daniel Tudor

W as this the year South Korea started to overcome its status as one of the global economy's whipping boys?

Jitteriness around the world usually leads to all the hot money flowing out of Korea, but while September's wobbles provoked the usual rush to exit the won, central bankers, backed by reserves of \$300bn, were able to head off the worst of it. The local bond market even experienced net inflows of \$319m that month.

The Organisation for Economic Co-operation and Development expects a 3.8 per cent increase in per capita gross domestic product for 2012, down from the 4.5 per cent estimated previously. Given the state of the world economy, this would be a creditable performance. Exports – still a critical driver of the South Korean economy – should grow by 11 per cent, according to the Samsung Economic Research Institute.

In the face of stagnation in Europe and the US, Korea's exporters are taking the opportunity to "increase their market share", according to Kwon Young-sun, senior Korea economist at Nomura. Highly competitive groups such as Hyundai Motor, on course to sell 100,000 more cars in the US this year than in 2010, will gain further through the strong yen and the two

huge free trade agreements signed by South Korea this year, he says.

But while "what's good for the *chaebol* (large family-owner enterprises) is good for Korea" may have been true once, such numbers mask a darker reality for smaller companies and indeed most citizens. The top four conglomerates alone earn 27 per cent of all profits, and the small and medium-sized firms that supply them complain of price squeezing.

SMEs employ 90 per cent of private sector workers and typically exist in a state of perpetual weakness. The lack of a solid successful middle class generating significant wealth should be a long-term cause for concern.

Daniel Shin, founder of social commerce firm TicketMonster, sees "the dominance of the conglomerates" as a hurdle for those wishing to start businesses. "[*Chaebol*] can easily assign huge resources and move into a market and dominate it," Mr Shin says.

As of this August, 6m Koreans – 34 per cent of the workforce – were stuck in temporary work, earning an average monthly salary of just Won1,348 (\$1,191). Headline inflation stands at 4.2 per cent, which critics see as partly the result of a pro-export, "weak won" policy, and has remained above the Bank of Korea's target range all year. This has disproportionately hit the poor: food prices, for instance, rose 9.5 per cent in the first half of the year. Furthermore, household debt jumped 12.7 per cent, and stands at 1.6 times disposable income.

The result of all this is an electorate increasingly concerned with income inequality. Parliamentary and presidential elections are due in April and December respectively; whoever wins the latter is certain to expand South

Korea's welfare state, currently one of the smallest among OECD nations.

The most popular figure in Korean politics today is technically not even a politician. Anti-virus software entrepreneur, professor and *chaebol* critic Ahn Chul-soo emerged as a potential candidate for the Seoul mayoral by-election in September, only to declare himself out of the running. He later backed independent Park Won-soon, who defeated the ruling Grand National party's candidate.

Though Mr Ahn has yet to declare any interest in becoming president, opinion polls put him ahead of the nearest rival, Park Geun-hye, the GNP's presumed candidate. Mr Ahn's rise reflects general dissatisfaction

About 34% of workers are in temporary jobs. The electorate is concerned with income inequality

not just with the government, but also the main opposition Democratic party. Some call Mr Ahn South Korea's great hope, others accuse him of being a *chaebol*-bashing populist.

It is impossible to guess what effect an Ahn presidency would have on the economy, but in 2012, Korea-watchers will also need to be Ahn watchers.

The South Korea-US free trade agreement (FTA) attracted huge attention because of a drawn-out struggle over ratification, but the FTA with the European Union, in effect since July, is no less important. The FTAs will permit "national champions" such as Samsung Electronics and LG Electronics to take business

away from tariff-hindered Japanese rivals in Korea's second- and third-largest export markets. This will help offset weak demand in the US and EU.

Long-suffering consumers, used to paying relatively high prices for both domestic and imported goods, should also benefit. Agriculture and fisheries are expected to lose about Won13tn of output in the next 15 years, because of the two new FTAs. The country's economic weak link, the service sector – which is only 40 per cent as productive as the manufacturing sector, and yet accounts for 60 per cent of GDP – will also face competitive threats.

For FTA critics, this all threatens further polarisation and smacks of aid for *chaebol* at the expense of everyone else.

Meanwhile, newer sectors are continuing to evolve. For example, the internet-crazy country has the world's biggest market for online games; this industry generated \$1.6bn in exports for the country in 2011, up from \$781m in 2007. Mr Shin talks of "an internet/mobile test bed that doesn't exist anywhere else", the result of cheap and fast bandwidth, and an urban population that loves smartphones and social networking.

This is driving a high-tech boom. Twenty-something Mr Shin is one of the new role models, having sold his company to US rival LivingSocial this year. His generation is overcoming Korea's traditional risk-aversion and freeing themselves from "the old conservative thinking" on entrepreneurship, he says.

Some also trumpet the power of *hal-lyu*, the growing international interest in Korean pop music and television. Direct revenues from "K-pop" are

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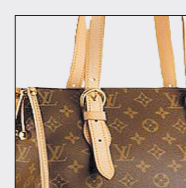
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small (top record company SM Entertainment's revenues were just Won86.4bn in 2010), but the trend is helping drive the booming tourist industry. South Korea is the top destination for Chinese holidaymakers. Meanwhile, more than 81,000 people

visited the country for medical tourism in 2010. The government wants this figure to reach 400,000 by 2015. Koreans themselves will soon be spending more per capita on medicine and healthcare too, because of the ageing population.

However, South Korea's overall attractiveness as a destination for foreign direct investment, according to Mr Kwon of Nomura, is declining in comparison with big, low-wage economies such as India and Indonesia.

However, "now is the time for Korea to invest abroad", he says. FDI outflow to countries based in the Association of Southeast Asian Nations region, for instance, jumped from \$1.4bn in 2009, to \$3.8bn in 2010.

The good news is that the operating environment for doing business in South Korea is much easier than before. The country's ranking on the World Bank's Doing Business survey is now eight, up from 15 last year, and the highest in Asia outside Hong Kong and Singapore.

The time taken to open a new business has been cut from an average of 14 to seven days in the past year. It is also much easier to import and export goods than at any time in the past.

South Korea is an increasingly open destination for business and it is looking like a rare example of a dynamic, yet developed economy.

But it is also a deeply divided place. Koreans are natural egalitarians, but their country's implicit social contract of shared growth looks fragile.

This will certainly affect next year's elections and future economic policy. Those who live here cannot take their eyes off the political scene; those who do business here should watch it too.

Real benefits of agreement are some way off

Trade pact

Europeans hope deal will aid them against China, says Sebastien Falletti

The unexpected happened last July. For the first time in a decade, the EU had a trade surplus with South Korea.

Only a month after the EU-Korea free trade agreement (FTA) came into force, the European bloc could claim a historic victory against the young, dynamic Asian powerhouse.

In a matter of weeks, exports of French wine, Belgian chocolates, German cars and pork jumped both in value and volume. On the surface, the EU's first FTA in Asia seemed to deliver quickly. Yet, European Commission officials were quick to play the figures down. It was "too early to talk of an FTA bounce", said EU trade commissioner Karel De Gucht.

There were two factors were behind this cautious Brussels tone.

First, the Commission was eager not to provoke a country obsessed with its export performance while many technical issues regarding implementation still need to be refined with Seoul's officials.

The country has embarked on an aggressive FTA strategy aimed at expanding its world market share and a sudden trade deficit did not fit well with the government's narrative that free trade promotes Korean interests globally.

Seoul cannot afford a trade deficit, as its export dependence is the highest among G20 countries, at 43 per cent of gross domestic product in 2010.

More importantly, the sudden EU trade surplus was short-lived. As early as August, the figures were back to normal, with a solid trade surplus worth \$130m. The unexpected surge of European exports in July was merely an illusion: many EU exporters had



Karel De Gucht: EU deal

simply postponed their spring shipment to Korea until July to benefit from the tariff reduction, creating an artificial export bubble.

Five months later, no bilateral trade revolution is in sight. While officials in Brussels and Seoul hope for a doubling of trade in the coming years, companies take a more cautious line.

"We will have to wait two years to start seeing the real benefits from the FTA," says Jean-Luc Valerio, president of the EU Chamber of Commerce in South Korea and head of aerospace and defence group EADS there.

For EU exporters there was no big bang on July 1. Instead, many were faced with increased pressure

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Day traders cry foul over warrants

Retail investments

Liquidity providers stand accused of aiding 'scalpers', writes Song Jung-a

Chung Jong-koo is one of the so-called "professional" day traders who trade stocks and derivatives. But the 38-year-old fumes that equity-linked warrants (ELWs) are "rubbish", because of their high risks and the market's unfair trading system.

After his internet venture went bankrupt three years ago, he has been going to a library-like "trading office" in downtown Seoul to trade stocks and ELWs through an advanced home-trading system each weekday, with some 20 other day traders.

"I felt like I could make quick bucks with ELWs," he recalls. "It looked so simple because you could make money even when the stock market fell."

Mr Chung invested about Won10m (\$8,841) in ELWs, an option contract that makes bets on stocks and stock indices. At first he made some money but it did not take long before he lost his investment. "Some-

times I made twice or three times as much money as my principal, but I soon found out it was a risky and unfair game that I could not win against liquidity providers," he says.

Thanks to tens of thousands of active retail investors like Mr Chung, South Korea's ELW market, which opened in 2005, has become the world's second largest behind Hong Kong in terms of turnover. The market's average daily turnover amounted to Won1,600bn last year, compared with Hong Kong's Won2,400bn.

There are about 27,800 active ELW accounts held by retail investors, with an average balance of only Won4m-Won5m, according to regulators.

"There are not many leveraged products here that retail investors can invest in. So, private traders flock to ELWs, encouraged by easy access and high leverage," says Choi Chang-kyu, analyst at Woori Investment & Securities.

To meet surging retail demand, financial institutions rushed to issue ELWs. More than 8,500 ELW products are listed on the stock exchange, while 30 local and foreign financial firms serve as liquidity providers. But complaints from

investors such as Mr Chung have prompted prosecutors to look into liquidity providers and indict chief executives of 12 domestic brokerages on charges they provided some high-frequency traders, known as scalpers, with preferential treatment by allowing them to trade ELWs faster than other customers through dedicated high-speed lines.

One of the chief executives was found not guilty in the first verdict in such

"If you try to restrict trading behaviour, that will send the wrong message to investors"

cases, providing temporary relief to brokerages.

Regulators have adopted measures to cool the overheating market. From February, ELW investors have been required to take a one-hour training course, available online, before they can buy warrants. Investors are also required to make an initial deposit of Won15m before trading ELWs.

Regulations strengthened screening for new listings and added restrictions to

liquidity providers' activities.

"The market structure is unfavourable to retail investors, with liquidity providers having undue influence in setting prices and some scalpers having naked access to the trading system," says Choi Kye-myung, a director at the Financial Supervisory Service. "We need entry barriers to protect small investors."

According to the FSS, retail investors suffered a combined Won579bn of losses from ELW investments in 2009, while liquidity providers earned Won179bn and the scalpers made Won104bn.

The market remains highly speculative, dominated by day traders. Trading by the so-called scalpers, who make more than 100 trades a day, accounts for more than 90 per cent of daily turnover, while only about 3 per cent of trades are open interests – actual positions that are carried over at the end of each day.

Simon Yung, head of warrants sales at Standard Chartered, says Korean investors have high-risk preferences with extremely short-term investment horizons. "Korean investors are much more risky than people in Hong Kong. About

eight or nine years ago, Hong Kong investors were very much like Korean investors right now."

Mr Yung notes the average maturity of ELWs held by Koreans is two months while that of Hong Kong investors is five and a half months. Koreans invest in ELW products, which are leveraged 22.4 times their underlying assets on average, while people in Hong Kong invest in ELW products leveraged 10.2 times.

However, high entry barriers have sparked strong protests from retail investors, while liquidity providers complain that tougher regulations could dent market growth. Liquidity providers say regulators should take their hands off the market, as the country already has some of the toughest rules of any derivatives market, with strict disclosure rules for ELW products and a quarterly review of their business practices.

Mr Yung says. "If you try to restrict trading behaviour, that will send the wrong message to investors that they are protected by the restrictions. But in fact the best protection should be their knowledge. You should know what you are buying."

Investing in South Korea

Pharma chief has sights on 'biosimilar' market

Profile Seo Jung-jin

The former Daewoo Motor executive is making waves in the drug industry, writes Song Jung-a

Seo Jung-jin, the chief executive of Celltrion, South Korea's leading biopharmaceutical company, has made a strong career comeback. He lost his job in 1999 as a high-flying executive at the now-defunct Daewoo Motor when the Asian financial crisis toppled the automaker. However, things change, and Mr Seo is now a star of the country's biotechnology industry, running the most valuable company on the tech-heavy junior Kosdaq market. Celltrion, whose market value tops Won5,450bn

(\$4.8bn), recently held a big ceremony at its headquarters in Songdo business park, west of Seoul and built on land reclaimed from the Yellow Sea. It was celebrating the completion of its second plant, which will nearly triple production capacity. The company boasts the world's biggest manufacturing capacity in terms of antibody production, which makes it one of the few Asian groups with competitive technology and cutting-edge production facilities in the market. "The biotechnology industry's paradigm is shifting from research and development to manufacturing, as many significant drugs lose patent exclusivity in coming years," says Mr Seo. "Then, cost competitiveness will be the key, providing latecomers such as Korea with a good opportunity to lead the industry, which has been dominated by western groups."

Biosimilars – cheaper generic versions of complex biotechnology medicines – are nowadays one of the hottest topics in the global pharmaceutical industry, but no one in Korea understood the business when Mr Seo set up his venture in 2002. He was one of the few Korean businessmen to realise the market's potential, long before the country's big conglomerates such as Samsung and Hanwha entered it. With the government touting the industry as the economy's future growth driver, Samsung set up a biopharmaceutical joint venture with US biopharmaceutical company Quintiles this year, pledging to invest Won2,100bn in the sector. "For South Korea to become a richer nation, it needs a couple more new business areas apart from the IT industry. I believe biosimilars will become one of the economy's new pillars," says Mr Seo.

He predicts that biosimilars will create a huge market, citing the fact that patents on more than 30 branded biological drugs with sales of \$51bn are set to expire between this year and 2015, according to market researcher DataMonitor. It forecasts that the global market for biosimilars will grow from just \$243m in 2010 to \$3.7bn by 2015. Few companies have the manufacturing expertise and capacity needed to produce copies of complex biological drugs, although many global pharmaceutical groups are preparing to join the race for the next-generation business. Producing biosimilars is a complex process, because clinical trials are needed to prove their quality and efficacy, because biological drugs are impossible to replicate exactly – unlike drugs based on chemicals. "We are a frontrunner in biosimilars, with about four to five years of

technology gap over rivals. There will be no serious competitor by 2015, in which period the industry's capacity will be short of demand," says Mr Seo. Celltrion has become a stock market star, as it enjoys high profit margins with a 20 per cent return on earnings. It reported Won108.3bn of net profit in 2010 on sales



Seo Jung-jin: South Korea needs more new businesses apart from IT

of Won180.9bn. Its stock price has nearly doubled from less than Won20,000 in 2009 to 38,400 now. Foreign investors own 24 per cent of the company's equity, with Temasek, Singapore's sovereign wealth fund, being its second-largest shareholder with a 10 per cent stake. The company's success exemplifies the development of South

Korean business in many ways. After getting some technology and know-how advice from VaxGen, a California-based biopharmaceutical company, it started as a contract manufacturer for global pharmaceutical groups. The company reinvested the money generated from contract manufacturing – so far about Won1,000bn – in building production facilities and developing biosimilar products. It is now developing eight biosimilar products with the aim to launch them next year in emerging markets. Ultimately, the company wants to develop its own drugs to become a global biopharmaceutical leader. It has already developed a universal super-flu antibody capable of treating various influenza viruses. Celltrion has recently completed successful clinical trials for its generics of Herceptin, Genentech's anticancer

drug, and of Remicade, Johnson & Johnson's rheumatoid arthritis drug, to start selling them next year all over the world except in the US, China and Japan. The global market for the two products is estimated at more than Won30,000bn. The company is waiting for the US to unveil the guidelines for the development of biosimilars and plans to enter the crucial market in about 2015, as soon as patents of big blockbuster drugs expire there. Mr Seo forecasts the company will be able to post a net profit of about Won2,000bn in a couple of years on sales of some Won30,000bn. Mr Seo says: "So far, we have made snowballs, which are difficult. But it will be easy to make a snowman with them from now on. "With the profits made from biosimilars, we will prepare for our future and develop our own branded drugs."

Free trade benefits far off

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from their Korean partners, who asked for an immediate FTA discount. These requests were difficult for many European companies, since their products have to be registered as made in the EU in order to benefit from the tariff reductions included in the FTA. A lengthy registration process, in line with the complex EU rules of origin, has proved an unexpected hurdle, as several of the 27 EU nation's customs administrations, including Italy, were ill prepared for the FTA. More than three months after the FTA came into operation, fewer than half of EU exporters were registered, lagging far behind their Korean counterparts. Renault Samsung, the French-owned carmaker, which imports parts from Europe and Japan, predicts it will take a year to adjust its operations to the rules fully. This administrative burden could prove insurmountable for small and medium-sized enterprises, which are even more likely to miss the FTA train. Many European groups have not yet grasped the full implication of the 300-page trade treaty for their business strategy. "Companies are still examining the impact on

Union strife seen as a threat to business

Labour market

Companies face problems cutting staff, but workers feel their position is precarious, writes Song Jung-a

An 11-month protest at the top of a 35-metre crane by a lone female labour activist at Hanjin Heavy Industries & Construction has become a cause célèbre for South Korea's feisty labour unionists. Kim Jin-suk, a 51-year-old former welder, spent 309 days in a tiny cell 15 storeys above the ground at Hanjin's shipyard in Busan, a South Korean port city, protesting against the company's move to lay off 400 workers. Ms Kim was fired from the company in 1987 due to her union activities and is now the leader of the Busan district of the Korean Confederation of Trade Unions, a labour umbrella group. Her struggle against the layoffs had made the whole country

focus on the shipbuilder's trouble until she finally came down from the crane last month, extracting a compromise from the company to reinstate 94 dismissed workers within a year. Her saga highlights the difficulties companies face in shedding staff, no matter how bad business is. Hanjin Heavy had to lay off 400 workers last December as the company failed to get any orders for nearly three years after the 2008 global financial crisis. But the move sparked strong protests from the company's 700 unionised workers, who went on strike for more than six months. An agreement was reached at the end of June with 306 of the 400 workers accepting a special retirement package but the remaining 94 were still on strike, refusing to accept the deal. The company finally agreed to rehire the 94 workers last month, bowing to public pressure, but it now has to offer a paid leave to about 400 production workers because a drought of orders has left no work for them. In July, the company signed a letter of intent with an Asian shipper for a \$250m order to build four container ships, but the customer has refused to sign a final contract because of the protracted labour disputes. Hanjin's case has renewed fears among big groups about tackling labour strife, as they worry that the company's compromise will make restructuring more difficult. Labour unrest remains a thorny issue for corporate Korea, although the number of strikes and disputes has decreased sharply in recent years, with the conservative government cracking down on union activities and public support diminishing for industrial action and excessive wage demands. South Korea saw 86 labour disputes last year, almost 30 per cent down from 121 in 2009. Production days lost due to strikes fell 18.5 per cent to the lowest level in 12 years, according to the labour ministry. Hyundai Motor and its affiliate Kia Motors, which together rank

as the world's fifth-largest automaker, avoided big strikes for a third consecutive year, though they had to offer big bonuses to appease disgruntled workers in 2011. Experts say union power is waning as the labour market undergoes structural changes, with the increasing number of contract workers and tougher regulations against payment for union leaders. Union members now account for only 10 per cent of the workforce, but the labour market remains rigid, with protection making it difficult to lose unwanted workers. Nam Yong-woo at the Korea Employers' Association says: "It is true that, overall, labour relations have improved but employment at big companies, to which 70 per cent of unionised workers belong, remains inflexible. "Even when companies are in a crisis, they find it difficult to restructure as they face unions' strong resistance against any lay-offs." The unions are still seen as one of the biggest threats to competitiveness, as they resort to strikes to back up their demands. Standard Chartered, a UK bank, had to suspend operations at 43 branches of its South Korean unit this year as its staff went on strike for about two months, the longest in the country's banking sector, protesting against the company's plan to introduce a performance-based pay system. A survey by the World Economic Forum (WEF) saw Korea drop two places to 24th in terms of global competitiveness in 2011-12, citing a rigid labour market as one area in need of reform. The World Bank estimates the average severance pay for dismissing an employee is equivalent to 91 weeks' worth of salary, placing Korea 114th on this indicator. "This leads companies to resort extensively to temporary employment, thus creating precarious working conditions and giving rise to tensions," said the WEF. About 26 per cent of



High-rise: Kim Jin-suk spent 309 days on top of a crane protesting over job cuts at a Busan shipyard Reuters

Korean workers are on temporary contracts – twice the average of Organisation for Economic Co-operation and Development countries – and with little

protection if they lose their jobs. Bae Kiu-sik, a researcher at the state-run Korea Labor Institute, argues that social welfare should be strengthened to

increase job market flexibility, as workers often resort to militant industrial action to be assured of their livelihoods because of the lack of a social safety net.

The bleak outlook in Europe and the US could further delay radical moves

their sector, they often have not made a strategic decision," says Yeojin Yii, an attorney at Kim & Chang, a Seoul law firm. Hence, British law firms are still pondering about whether to invest heavily in Korea in order to take advantage of the gradual opening up of the legal system. The bleak economic outlook in Europe and in the US only adds to the uncertainties and could further delay radical moves. For large European companies operating across Asia, the elimination of 98 per cent of duties on goods over the next seven years, or the gradual opening of several services sectors, are only one part of a bigger picture. Trade liberalisation is unlikely to radically change the operation of European companies already in the country, but it is likely to strengthen the position of European manufacturers in key sectors. Machinery makers from Germany will increase their dominance at the expense of Japanese rivals, who are seen as big losers in the EU-Korea FTA. Chemical exporters are also expected to be among the winners. "The FTA will only translate into a few percentage point gains, but that could be enough to make a difference in the price war against China," says André Nothern, representative of Solvay, a Belgian chemical group.

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Reforms needed to promote Seoul as finance centre

Guest Column KIM KI-HWAN

There are about 150 foreign financial institutions registered in Korea. Considering it ranks 13th globally in gross domestic product and has a total trade-to-GDP ratio approximating 100 per cent, this is surprisingly low. So, what should be done to encourage foreign financial institutions to increase their presence in the country?

There are many reasons why they should come here but I will concentrate on three. First, after nearly 40 years of dazzling performance, growth has decelerated in the past 10 years. However, its medium- to long-term prospects continue to be good, with a potential annual growth rate estimated at 3.5-5 per cent.

Accordingly, per capita GDP in 2030 will range from \$40,000-\$53,500 at today's rates, leading to the convergence of Korea's GDP per capita rate with that of countries such as Italy, the UK, and Japan.

Second, the South Korean economy is expected to undergo significant structural change. Currently, it is primarily a producer and exporter of high-tech products, such as flat-screen displays, sensors, semiconductors, and automobiles.

Thanks to the educational level of its workforce and growing competitiveness in a variety of technologies, as well as the global popularity of *hallyu*, the "Korean Wave", the country is set to become an important business and cultural centre, specialising in high

value-added services such as finance, medicine, research and development, product design, culture, and tourism.

Third, significant progress has already been made in becoming a global financial centre. The latest issue of The Global Financial Centre Index shows Seoul's ranking has improved. While it was



53rd of 62 cities in March 2009, this year it is 11th out of 75. Seoul will continue to improve its standing. With the Korea-EU free-trade agreement operational, and the Korea-US FTA soon coming into effect, the government will have to improve the nation's financial regulatory environment by enhancing transparency in the rulemaking and enforcement processes, speeding approval for new products, ensuring a level playing field for all participants and adopting global best practices.

As a result, there is no doubt that opportunities for foreign financial institutions will grow. It is critical, however, to undertake more reforms to ensure its successful emergence as a premier global financial centre. First, it must resume its efforts to achieve full convertibility of the won. The government announced in 2003 that it would achieve full convertibility by 2011. Over the past few years, however, it has been backpedalling on this policy. Increased fluctuations in the flow of foreign capital brought by the global financial crisis led to policy concerns with liquidity reserves and an increase in the volatility of the value of the won vis-à-vis big reserve currencies. As a solution, the government imposed a series of restrictions on the flow of short-term capital. Rather than having a stabilising effect, they have

probably aggravated the volatility of the won by further reducing both the breadth and depth of the domestic foreign exchange market. It is time to end these restrictions.

Another step to address the same problem is to lift the ban on the use of the Korean won offshore. This has prevented the full integration of Korea's domestic and international financial markets, thus preventing any progress towards full convertibility, the absence of which amounts to Korea's "original sin".

As long as Korea does not grow out of the "original sin", the domestic foreign exchange market will remain narrow and shallow, the structural cause of high volatility. High volatility in turn increases exchange risks to the detriment of all businesses and households

engaging in cross-border transactions. Finally, the Lone Star episode is coming to an end. The US private equity fund bought Korea Exchange Bank in 2003 but was deterred by regulators when it tried to sell the bank for a big profit in 2006 and 2008 for two reasons. A controversy over the legality of the purchase was in progress and a number of suits filed by entities including the national legislature and a citizen group were pending in court. At last, thanks to a high court decision, Lone Star's majority stake is to be bought by Hana Financial Group.

The episode should not have happened, and the damage to Korea's reputation is incalculable and perhaps long lasting. It is critical Korea's leaders reflect on its causes and act to prevent a

similar recurrence.

It is also critical for labour leaders to stop strikes similar to the one at the Standard Chartered Bank in Seoul last summer. Strikers set out to block the introduction of a salary and bonus system designed to enhance productivity. While it ended quickly and failed in its objectives, it damaged foreign perception of the labour scene. This is a pity, since over the past three years labour relations have improved.

For this and other reasons, it is now up to Korean leaders to make full use of the country's potential and turn it into an even better host for all international financial institutions.

The writer is chairman of the Seoul Financial Forum and former ambassador-at-large for economic affairs

State and big business decide to foster entrepreneurship

Small businesses

Political concerns over economic polarisation are bringing change, writes **Daniel Tudor**

For many, the term South Korean business is synonymous with *chaebol*, family-controlled conglomerates that dominate this former Tiger economy. Headlines in the business pages typically refer to the likes of Hyundai, LG, or Samsung – of which the latter alone accounts for 20 per cent of Korean exports.

Since the 1960s, when Park Chung-hee, the president, encouraged *chaebol* to enter certain additional markets, the largest business groups have

taken advantage of economies of scale by diversifying. Lotte, for instance, makes chocolate, sells insurance, builds apartments, and owns a baseball team.

In April, the country's top 30 business groups had a total of 1,069 affiliates between them.

That the *chaebol* have made large contributions to South Korea's economic development is beyond doubt. However, one unfortunate consequence of their size and diversification has been the discouragement of entrepreneurship and the hindrance of small- and medium-sized businesses.

Because of Korea's risk-averse culture and the power of the *chaebol*, the usual choices of bright graduates have been to join the civil service, one of the professions, or a *chaebol*.

Times are changing, however, and the country is experiencing

a start-up boom. In January, there were 24,800 registered venture companies, up from 19,100 a year earlier. This is far greater than the number in existence even during the late-1990s internet boom, which threw up such current Korean tech stalwarts as NHN, and NCSOFT.

This is partly the result of government intervention, just as *chaebol* growth was in the 1960s. Political concerns over economic polarisation are forcing both the state and the *chaebol* to invest in start-ups.

Hanwha, for example, recently announced that it would pull out of seven markets in which it competed with small companies, and invest Won200bn in a venture fund. Hyundai is also to spend Won500bn on its Asan Sharing Foundation, which partly exists to support young entrepreneurs.

However, pure venture capital is also growing. The 95 per cent broadband penetration, the world's second-highest level of enrolment in higher education, and its well-known mania for any form of new technology

The status of start-up entrepreneurs was, until recently, 'below that of peasant farmer'

should make this country fertile ground for internet and tech investment.

Masayoshi Son, Japan's richest man – and an ethnic Korean – has invested \$200m in 120 small Korean businesses. Foreign multinationals such as Qualcomm, and BASF – which

announced plans in August to invest between €1m-€5m each in a series of start-ups – are also getting involved.

The interest of foreign investors, as well as Korean-Americans such as David Lee, a former Google executive now a partner at Silicon Valley-based venture capital firm XG Ventures, is having other effects.

Start-up investments in Korea typically came with a double contract, in which the founder had to guarantee the investor's capital in the event of the company failing. Better options from abroad are encouraging Korean venture capitalists to remove such stipulations, according to Mr Lee.

One beneficiary of this is Richard Choi, a 27-year-old entrepreneur, who received funding for his company Spoga without having to sign his life

away. Spoga operates a social-networking loyalty point system. When users visit a participating shop or restaurant, they can recommend it to their friends via a smartphone app. If that recommendation leads another person to make a purchase, both will receive points, which can later be redeemed at other establishments.

He aims to create a "win-win" for buyer and seller, in contrast to what he sees as the flawed social commerce model of companies such as Groupon, which has been criticised for providing little benefit to participating businesses.

According to Nielsen Korea, 58 per cent of the population now use smartphones. It is unsurprising then that there are already 1,000 companies developing apps for the Apple and Android operating systems. The

majority of app-focused start-ups will fail, but there have been some notable successes. Chief among these is Kakao, the creator of KakaoTalk, a free mobile messaging app that has virtually replaced traditional SMS in the country.

Pyo Chul-min, another 27-year-old, whose company Wizard Works provides the "widgets" that provide enhanced features on most Korean blogs, says his parents were disappointed when he started his first business. He jokes that the status of a start-up entrepreneur was "less than that of a peasant farmer". Today, he is a regular guest lecturer at universities, and is cited as a role model for young people.

For a country in which most brilliant young minds have typically elected to play it safe, this has to be a welcome change.

Luxury groups have their eye on trendy Seoul

Luxury goods

Fashion brands are increasing their presence, reports **Sebastien Falletti**

If you are looking for a challenger to Tokyo's title of Asia's capital of luxury, forget other contenders and think of Seoul.

And if you want your brand to be cool on Shanghai's Bund or in Hong Kong's Central district, just invest in fancy flagship stores in Chungdam or Apgujeong-dong, affluent districts of the South Korean capital. This is the latest strategy of French luxury giants in Korea with an eye on the entire Asia-Pacific region.

Louis Vuitton, Hermès and Christian Dior – all wholly or part-owned by LVMH, the French luxury goods group – are stepping up their presence. These iconic brands are having a second look at Asia's fourth-largest economy, which has become much more than a juicy market that gobbles \$4.5bn of luxury items a year.

It is now a strategic place in which to invest in order to strengthen luxury brands across the region. "If your brand is understood in Korea, it will boost your sales all over the region," says the representative of an famous Parisian brand in Seoul who requested anonymity.

Louis Vuitton is already the most popular brand in the country and is continuing aggressively to raise its profile. In September, the most successful luxury brand in the world opened a spectacular 500 square

'Korean women have become the model for all Asian women'

metre shop in the heart of Incheon international airport, the gateway to Seoul. For the first time, LVMH's president Bernard Arnault agreed to open a shop in an airport duty-free area. Its local partner Bluebell, a leader in Asia's duty-free business, was keen on the arrangement.

This shift reflects the strategic importance of

South Korea as a luxury hub in Asia. The country is already the largest duty-free market in the world, but is now attracting a growing number of Asian tourists, especially Chinese who transit through Incheon and prefer to do their luxury shopping in Korea by fear of counterfeiting at home.

"Incheon will become an Asian hub and attract a growing number of Chinese and Japanese consumers," predicts Doreen Kim, a representative of Louis Vuitton Korea.

Another jewel of Mr Arnault's empire, the haute couture brand Christian Dior, is also launching a fresh offensive in Korea. Dior will soon build its largest flagship store on Chungdam Avenue, dubbed the Ginza of Seoul, after the fashionable shopping district of Tokyo.

The building will occupy an entire block and is set to open in 2013 with the aim of asserting the "hyper luxe" positioning of the brand.

The purpose of this large investment is to catch up with other European competitors, which have aggressively invested in the market over the past few years. Dior is following in the



Louis Vuitton is the most popular brand in the country and is aggressively raising its profile

Alamy

footsteps of another French legend, Hermès – the owners of which are resisting a takeover by LVMH, which has a 21.4 per cent stake in the company.

The brand was the first to open a flagship store in Seoul, near Dosan park, in the trendy Apgujeong-dong district. The place is more than a shop and was conceived by Hermès Korea's managing director H.S. Jun, in order to inspire visitors. Flagship stores are not meant to make a profit but to assert the power of a brand.

Although Seoul is not as multicultural as Hong Kong or Shanghai, it can boast a key asset: South Korea resonates in the heart of young generations across Asia.

Over the past few years, it has emerged as Asia's trendsetter in the fashion, movie and beauty industries. Television dramas, singers and actresses have revamped the country's image into a glamorous destination. Started in China

during the early 2000s, the so-called *hallyu* or "Korean Wave" has swept across the region, inspiring young and newly affluent consumers in Bangkok, Beijing and Jakarta.

"Our artists symbolise the dreams of young Asian people, they are handsome, wealthy and successful," says Choi Eun-a, of SM

Entertainment, the agency that manages Girls Generation, the most popular band in Asia, which dominates the charts across the region and was dubbed as the "new Samsung" by the Nikkei, Japan's leading business newspaper.

European luxury brands see this new trend as an opportunity to lure addi-

tional customers across the region through more investments in Seoul.

"The Korean woman is beautiful, sophisticated, and trendy. She has become a model for all women across Asia," says a representative from a French haute-couture brand.

Hence, when Dior opened its flagship store in Hong

Kong, it drafted in several actresses and celebrities from Seoul to attend its grand opening.

No wonder a recent report from McKinsey on the luxury sector described Korea as a very "promising" destination, despite a decade of double-digit growth already having passed.

Next year will be tough, but the economy will make progress

Guest Column

BAHK JAEWAN

Having successfully overcome the economic crises of 1997 and 2008, South Korea is now wrestling with another creeping from Europe. Its economy cannot evade the fallout of the 2008 crisis and the current European sovereign debt turmoil because of its dependence on the global economy.

However, it has been described as making a "textbook recovery" by some international media. It has returned to \$20,000 of gross domestic product per capita, and its credit ratings have risen, while those of the leading economies have fallen. Employment and fiscal soundness have rapidly improved, and its annual trade volume reached \$1tn, the world's ninth biggest, in 2011.

Next year's forecast for the global economy is not bright, with advanced nations likely to have a sluggish recovery. Financial markets will probably remain volatile due to the eurozone crisis. Against this backdrop, the government presented the country's 2012 economic policies aimed at revitalising the economy and consolidating inclusive growth through stabilising the livelihoods of the middle- and low-income classes.

The policies prioritise stimulating the real economy's vitality. As to the global economy, the government will keep alert to any changes through internal response systems such as the ministerial meeting on economic emergencies, the crisis management meeting, and contingency plans for each possible situation. About 60 per cent of fiscal expenditure will be executed during the first half, and budgets for large projects will be set before the start of the fiscal year. Meanwhile, in order to achieve a fiscal balance as planned in 2013, the

government will control the total fiscal expenditure more strictly.

Household debt is to be controlled so as not to exceed the economy's capacity, and transfer of existing loans to long-term repayments and fixed-interest rates is encouraged.

Financial institutions will be under tighter supervision. Furthermore, there will be tax incentives for corporate restructuring and increased financial support for viable and promising companies through credit and technology funding systems.

As specified in the 2012 economic policies, South Korea continues to enhance its economic competence in investment, exports, future growth and inclusive growth. There will be incentives and support to stimulate investment and domestic demand, and plans to further support free economic zones will come out in the first half of 2012. Tax incentives given to start-up, small- and medium-sized enterprises (SMEs) and tax deductions for investments in energy-saving facilities will increase, while companies moving business back to the country will receive corporate and income tax exemption for an extended period.

The 2012 policies will continue to shore up service industries and aid their development. There will be programmes for potential growth areas, such as tourism, and tax and labour incentives are planned to help establish supporting infrastructure.

The nation is looking to expand its trade links. In addition to seven existing free-trade agreements in effect, it enacted the Korea-European Union FTA and ratified the South Korea-US FTA this year. A number of discussions for trade agreements with countries in Asia, Europe, Oceania and North and South America are also under way. Along with existing FTAs covering more than 60 per cent of the globe, the

government will focus on emerging economies as trading partners, with plans to facilitate the construction of logistics centres in those countries. It will also raise the volume of trade credit insurance for exports to African and Latin American countries.

Nurturing future technologies is an important policy goal. South Korea is one of the emerging economies leading the way in planning and implementing green growth policies and it aims to secure a firm base in this area. More than half of the country's research and development budget, for example, will go on basic science research and fundamental technology development.

On its path to becoming a developed economy, it faces the difficult challenges of a low birth rate and an ageing population, and the government is preparing to provide more maternity and childcare support, as well as to respond to the challenge of many people living to 100. The government intends to improve welfare services by encouraging workfare – whereby adults need to work to receive aid – and reducing disenfranchisement through improved implementation.

The global economic crisis has yet to be overcome, and it may worsen. However, South Koreans have learnt to make a crisis an opportunity. Once a poor country receiving aid, it joined the Development Assistance Committee of the Organisation for Economic Co-operation and Development last year, and is making global contributions as a member of the G20 group of leading nations. While 2012 will be tough, the South Korean economy will not only survive the difficult year but also make progress.

The writer is the Republic of Korea's Minister of Strategy and Finance



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